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

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

Elizabeth S. Miller

I. Introduction

This paper summarizes recent Texas cases involving issues of partnership and limited liability company law. Summaries of cases involving general and limited partnerships are provided for the current calendar year and the previous three calendar years. Because limited liability companies and limited liability partnerships are a relatively recent innovation in the law and the body of case law is more limited, summaries of cases involving these types of entities are provided from the inception of the case law on these entities in Texas.

II. Recent Texas Cases Involving General Partnerships

A. Existence of Partnership


Box, a licensed real estate broker, worked with the Dallas Mexican Consulate General (“Consulate”) in its search for a new location in Dallas. Box found a building for the Consulate to purchase, but the building was part of a three-building complex that the owner refused to subdivide. Box alleged that Consulate officials agreed to enter into a joint venture arrangement with Box whereby Box and possibly a third-party investor would buy the complex, subdivide it, and sell the building to the Consulate. Ultimately, the Consulate purchased the building from a third party. Box sued the Consulate contending that the Consulate breached the parties’ joint venture agreement. The Consulate argued that it was immune from suit, but Box relied on the commercial activity exception to sovereign immunity. Subject matter jurisdiction based on the commercial activity exception depended on the existence of the joint venture, and the court analyzed whether a joint venture between Box and the Consulate existed. The court applied Texas law to the issue of whether a joint venture was formed and set forth the common-law elements of a joint venture as well as the factors in the Texas Business Organizations Code that indicate the existence of a partnership. The court stated that a joint venture must be based on an express or implied agreement and is a question of law for the court. In addition to the intention of the parties, the court identified the elements of a joint venture as: (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 enterprise. The court stated that joint ventures are normally indistinguishable from partnerships on the question of formation, and both are governed by the rules applicable to partnerships. The Texas Business Organizations Code sets forth the following five factors indicating the existence of a partnership: (1) receipt or right to receive a share of profits of the business; (2) expression of 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 court stated that the “most important factors” are the sharing of profits and control over the business. The court also noted that courts must examine the totality of the circumstances, that no single factor is determinative, and that the evidence in support of the factors is to be considered on a “continuum.” The court discussed Box’s affidavit and concluded that it was not clear whether Box formed a joint venture with the third-party investor or the Consulate or both. The court stated that the party seeking to prove the existence of a joint venture bears the burden of proof and must present evidence that both parties expressed an intent to be partners. Box did not show any expression by the Consulate of an intent to enter into a joint venture with Box. The court acknowledged that the absence of this factor was not determinative, but the court found Box failed to present evidence on the remaining factors as well. Because a joint venture between Box and the Consulate was never formed, the formation of the joint venture was not commercial activity that would except this claim from the general statutory sovereign immunity enjoyed by the Consulate, and the court was required to dismiss the claim.


The plaintiff sought to hold Tripplehorn and Aspen Development Company, LLC (“Aspen”) liable on a contract executed by Rollings on the basis that Rollings and Tripplehorn, on behalf of Aspen, formed a joint venture. The court
concluded that the evidence supported the jury’s finding that the parties formed a joint venture under the judicial four-element definition of a joint venture: (1) a community of interest; (2) an agreement to share profits; (3) an agreement to share losses; and (4) a mutual right of control or management of the enterprise. The evidence showed a community of interest because Rollings and Tripplehorn agreed that each of them would pay half the purchase price of a rig that Rollings would refurbish and to which Tripplehorn would hold title. Then the parties would find a purchaser, and Tripplehorn would convey title to the purchaser. The evidence showed an express agreement to share all profits and losses, and a sharing of control was shown by Rollings’ control of the refurbishment and responsibility for purchasing and selling the equipment while Tripplehorn held title and thus controlled whether to enter into a transaction for the sale of the equipment. Although the evidence supported the finding of the existence of a joint venture, an improper judgment was not caused by the trial court’s disregard of the finding because the contract entered into by Rollings was only an obligation of Rollings and not an obligation of the joint venture.

MetroplexCore, L.L.C. v. Parsons Transportation, Incorporated, 743 F.3d 964 (5th Cir. 2014).

In this contracting dispute, MetroplexCore LLC (“MetroplexCore”), a Texas environmental engineering firm, sued Parsons Transportation Group, Inc. (“Parsons”), an Illinois general contracting firm that contracted with Harris County to design, build, and operate a Houston-area transit system. In an initial bid, Parsons included MetroplexCore as a “team member.” Parsons did not win the bid, but several years later, after the initial contractor was unable to proceed, Harris County awarded Parsons (who had a new set of subcontractors) the contract for the remainder of the projects. After a few months, MetroplexCore notified Parsons that MetroplexCore believed it was entitled to a share of the profits. Parsons denied that it had an agreement with MetroplexCore, and MetroplexCore filed suit. In this appeal, MetroplexCore argued that the district court erred in granting Parsons’ motion for summary judgment on the issue of the formation and existence of an enforceable joint venture. The court of appeals first set forth the common-law elements of a joint venture: (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 enterprise. The court cited Texas case law and the definition of a partnership in Section 152.051(b) of the Texas Business Organizations Code as authority for the common-law elements of a joint venture and the proposition that a joint venture is governed by the rules applicable to a partnership. The court next set forth the five statutory factors for determining whether a partnership has been created: (1) receipt or right to receive a share of profits of the business, (2) expression of 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 court noted that the statute provides that an agreement to share losses is not necessary to create a partnership and that simply showing the right to share or sharing in gross returns or revenue is not enough by itself to show a partnership. Tex. Bus. Orgs. Code § 152.052(b)(3), (c). The court stated that the right to share profits and control of the business are generally considered the most important factors in establishing the existence of a partnership. The court acknowledged that MetroplexCore produced evidence of a “community of interest,” as defined by Texas courts, but the court stated that this factor alone was insufficient to create a partnership or joint venture. With respect to profit sharing, MetroplexCore argued that there was an agreement to share the profits in 90% and 10% shares based on a letter stating that MetroplexCore would “participate in the contract to a minimum 10% level,” but the court stated that the evidence did not make it clear whether MetroplexCore was entitled to 10% of the profits or 10% of some of other feature, such as workload or management responsibility. Further, Parsons produced evidence that it had profit-sharing joint-venture agreements with other collaborators and did not have a similar contract with MetroplexCore. Even if there were a fact question on the profit-sharing element, more evidence was needed to establish the existence of a joint venture, and the court stated that MetroplexCore did not meet either of the remaining common-law elements of a joint venture and did not argue or present evidence of the other statutory factors listed in Section 152.052(a). Finally, even if the evidence could support a finding of the existence of a joint venture with respect to the first phase of the project, it did not create a genuine issue of fact as to the second phase of the project. MetroplexCore’s joint venture claim was entirely premised on the second phase of the project, and the district court thus correctly granted summary judgment on the claim.


Jarrah and Reservoir, Inc. opened a bar named “Rebels Honky Tonk” in Houston. After Jarrah leased the space for the bar, he enlisted the help of others, including Truesdell, to create and operate the bar. Jarrah and Truesdell worked together during the summer of 2009. Jarrah invested approximately $400,000, and Truesdell contributed no funds but was actively involved in developing the country-western theme for the bar. Truesdell arranged for a designer and an artist to design and paint a logo and a mural. The relationship between Jarrah and Truesdell soured when Truesdell sought a
written partnership agreement and Jarrah declined the terms requested by Truesdell. Truesdell ceased working on the Houston bar and subsequently opened Rebels Honky Tonk bars in Austin and Oak Ridge (near Houston). Truesdell filed an application with the United States Patent and Trademark Office to register the Rebels Honky Tonk marks, and Jarrah filed this action to protect his common law rights in the marks. The first issue addressed by the court in this opinion was whether Truesdell proved that he entered into a partnership with either Jarrah or Reservoir, Inc. The court relied on the Texas Revised Partnership Act, noting in a footnote that the Texas Revised Partnership Act (TRPA) went into effect January 1, 1994, and expired January 1, 2010. [The court apparently overlooked the fact that the Texas Business Organizations Code, which went into effect January 1, 2006, governs a partnership formed on or after that date. After January 1, 2006, TRPA continued to be in effect until January 1, 2010, but only with respect to partnerships formed before January 1, 2006. In any event, there was no substantive change in the provisions relied on by the court.] The court set forth the five factors identified in TRPA as indicating a partnership: (1) receipt or right to receive a share of profits of the business; (2) expression of intent to be partners in the business; (3) participation or right to participate in control of the business; (4) sharing or agreeing to share losses of the business or liability for claims by third parties against the business; and (5) contributing or agreeing to contribute money or property to the business. Each factor is not necessary to the creation of a partnership, and Texas courts apply a “totality-of-the-circumstances” test. The party asserting the existence of a partnership bears the burden to prove a partnership was created. The court concluded that Truesdell failed to prove that he entered into a partnership with Jarrah or Reservoir, Inc., let alone a partnership permitting Truesdell to use the Rebel Honky Tonk marks. While Truesdell wanted and may have offered to enter into a partnership with Jarrah, Jarrah did not agree to the terms demanded. Truesdell offered no evidence addressing the other TRPA factors. Truesdell admitted that he did not contribute any funds or property to the Houston bar and did not agree to share losses. Thus, the court concluded that neither Jarrah nor Reservoir, Inc. formed any partnership with Truesdell or any of his entities.

Fleming & Associates, L.L.P. v. Barton, 425 S.W.3d 560 (Tex. App.–Houston [14th Dist.] 2014, pet. filed). In 2002, Johnson-Barton Joint Venture (“J&B”), a joint venture formed by lawyers Nick Johnson and Dan Barton, entered into a referral agreement with Fleming & Associates, L.L.P. (“F&A”) regarding the referral of Fen-Phen cases by J&B to R&A. The letter agreement had two parts, the first addressing 224 existing cases already in J&B’s offices to be forwarded to F&A, and the second addressing future Fen-Phen cases to be referred by J&B to F&A. Each part provided for the division of fees between the parties on a 50-50 basis and addressed the handling of expenses. In 2006, after F&A had favorably resolved most of the original 224 cases and an additional 1,500 cases referred to it by J&B, F&A paid J&B for most of the cases and sent a letter with a “distribution statement” explaining deductions for certain “client non-reimbursable expenses.” J&B contended that these deductions were improper because the referral agreement provided that F&A would be responsible for all litigation costs on cases referred to F&A. In 2007, a subsequent dispute developed with regard to expense reimbursements and fees on cases settled after the first distribution. In 2009, Barton, his law firm, and J&B filed suit against Fleming and F&A alleging breach of the referral agreement. The trial court granted J&B summary judgment on its breach of contract claim. F&A’s argument that it was entitled to judgment as a matter of law with respect to the J&B’s claim under the referral agreement hinged on F&A’s argument that its agreement with J&B was a joint venture in which F&A and J&B must share profits and losses equally under Texas joint venture law. F&A also argued that the referral agreement, taken as a whole, reflected the parties’ intent to share expenses equally as joint venturers. F&A relied on Section 152.202(c) of the Texas Business Organizations Code (which provides that each partner is credited with an equal share of the partnership’s profits and is chargeable with a share of the partnership’s losses in proportion to the partner’s share of the profits) as well as common law and the predecessor partnership statute for the proposition that an agreement to share losses equally is implied from an agreement to share profits equally. The court of appeals pointed out that the referral agreement only characterized the second part of the agreement (which dealt with future referrals after the initial cases referred under part one of the agreement) as a joint venture. In addition, the court stated that a joint venture is governed by the same rules as a partnership, and the partnership agreement governs the relationship of the partners with respect to most matters. The Texas Revised Partnership Act, which was in effect when the parties entered into the referral agreement, provided that an agreement to share losses was not necessary to create a partnership. Thus, the court rejected F&A’s argument that J&B’s interpretation placing responsibility for all litigation expenses on F&A under the terms of the agreement was “at odds with Texas statutory and common law on joint venture.” Furthermore, the court said that F&A never established that the expenses deducted were attributable to the clients that J&B referred to F&A as opposed to the thousands of other clients referred to F&A from other sources. After reviewing the plain language of the contract and the description of expenses, the court of appeals concluded that the trial court properly granted summary judgment in favor J&B with respect to liability on the referral agreement.
The plaintiff brought suit in federal court to collect on a delinquent note acquired from the FDIC as receiver of a failed bank. The defendant argued that diversity jurisdiction was lacking based on an alleged partnership between the FDIC and the plaintiff. Applying the statutory five-factor test for determining the existence of a partnership, the court concluded that the agreements entered into between the FDIC and the plaintiff’s parent company resulted in a partnership between the FDIC and the plaintiff. Because the FDIC is a federally chartered corporation whose presence in a suit destroys diversity, its partnership with the plaintiff destroyed diversity in this case, and the court dismissed the suit.

When Colonial Bank failed, Branch Banking & Trust Company (“BB&T”) acquired certain assets and liabilities of Colonial Bank from the FDIC as receiver pursuant to a purchase and assumption agreement (“PAA”) and loss-sharing agreement (“LSA”). Included in the assets acquired by BB&T were secured notes owed by the defendants to Colonial Bank. BB&T transferred the notes and related loan documents to the plaintiff, a wholly owned subsidiary of BB&T. After the notes became delinquent, the plaintiff foreclosed on the collateral and filed this suit to collect the deficiency amounts allegedly owed on the notes. The plaintiff relied on diversity jurisdiction, and the defendants sought dismissal based on an alleged partnership between the plaintiff and the FDIC, a federally chartered corporation whose presence would destroy diversity. The defendants argued that the terms of the PAA and LSA between BB&T and the FDIC created a partnership between those parties, and the court agreed.

The court cited the definition of a partnership in the Texas Business Organizations Code (BOC) 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; or...the association is called a ‘partnership,’ ‘joint venture,’ or other name,” and the court set forth the five factors enumerated in the BOC that indicate persons have created a partnership. The five factors are: (1) receipt or right to receive a share of profits of the business; (2) expression of 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. The court noted that the most important factors are the sharing of profits and control over the business. The court also noted that courts must examine the totality of the circumstances and that no single factor is determinative.

The court next examined the relationship of BB&T and the FDIC with respect to each of the five statutory factors. Although the LSA imposed certain reimbursement requirements on the parties with respect to losses and recoveries by BB&T on the assets, the court stated that these reimbursements were not profits and there was no evidence that BB&T and the FDIC agreed to share profits. Thus, the first factor weighed against finding that a partnership existed. The court also concluded that the evidence did not show an expression of intent to be partners. The defendants argued that an FDIC press release referring to its “loss-share partners” expressed an intent to be partners, but the court found no evidence that the FDIC was attempting to attach legal significance to the statement. Furthermore, the defendants presented no evidence that BB&T expressed an intent to be partners. Thus, this factor did not weigh in favor of finding a partnership. The court next analyzed control of the business. After reviewing the provisions of the PAA and LSA, the court found that the FDIC had the right to participate in the control of the business. The court pointed to provisions that gave the FDIC rights with respect to the books and records related to the transferred assets and provisions imposing standards on BB&T similar to a partner’s statutory duties of loyalty and care. The LSA required BB&T to obtain the FDIC’s approval for transactions with affiliates and prohibited BB&T from taking action with respect to related loans to the detriment of the transferred assets. The LSA also required BB&T to exercise its best business judgment and use its best efforts to maximize collections. These standards evidenced the exercise of control by the FDIC according to the court. Additionally, the court pointed to provisions of the PAA and LSA that gave the FDIC the right to exercise authority over BB&T’s administration, management, and collection of the transferred assets. The court concluded that the FDIC’s rights amounted to the right to make “executive decisions” as opposed to mere “input” into the operation of the business. Thus, the control factor weighed in favor of finding a partnership. The plaintiff did not challenge the defendant’s contention that the purpose of the agreements between BB&T and the FDIC was to share losses associated with assets of Colonial Bank; therefore, the loss-sharing factor favored a finding of a partnership. Finally, the court concluded that the FDIC did not contribute or agree to contribute property to the business. Although only two factors weighed in favor of finding a partnership, the court concluded that the FDIC’s right to participate in the control of the business and the agreement to share losses established that the parties created a partnership.

Having found that the agreements between the FDIC and BB&T created a partnership, the court proceeded to analyze whether the plaintiff, a wholly owned subsidiary of BB&T, was a partner. After acquiring assets of Colonial Bank by entering into the PAA and LSA with the FDIC, BB&T transferred all of its rights in the assets to the plaintiff, and the plaintiff assumed all of the duties and obligations of BB&T. The court noted that a person may become a partner
only with consent of all partners. Neither party asserted that the FDIC, the sole remaining partner, consented to the plaintiff becoming a partner, and the court stated that the partnership between BB&T and the FDIC terminated when BB&T transferred its rights and interests to the plaintiff. Because the PAA and LSA contained provisions making the agreements binding on successors and requiring the FDIC’s consent to the transfer of assets to the plaintiff, the court stated that the agreements suggested that the FDIC consented to the transfer and that the plaintiff was now subject to the terms of the agreements and responsible for the performance of the duties imposed. Thus, the court concluded that a partnership existed between the plaintiff and the FDIC. Because the FDIC is a federally chartered corporation and thus a stateless entity whose presence in the suit (by virtue of its partnership with the plaintiff) destroyed diversity of citizenship in the suit, the court granted the defendants’ motion to dismiss.


Chapman Custom Homes, Inc. (“Chapman Homes”), a general contractor and home builder, entered into a contract with Dallas Plumbing Company (“Dallas Plumbing”) to install plumbing in a home that Chapman Homes was building. The property was owned by Michael Duncan, as trustee of the M.B. Duncan Trust (“Duncan trustee”). After a leak was discovered, Chapman Homes and Duncan trustee sued Dallas Plumbing for breach of contract and breach of warranty. Dallas Plumbing argued that Chapman Homes could not prevail on these claims because it was not the owner of the house, and Duncan trustee could not recover for breach of contract because it had not entered into a contract with Dallas Plumbing. Chapman Homes and Duncan trustee argued that they had a joint venture that included the house in this case and that Chapman Homes contracted with Dallas Plumbing on behalf of the joint venture. They further alleged that the rights at issue belonged to the joint venture and that they had standing to sue to enforce the rights of the joint venture. The court of appeals examined whether the trial court properly granted summary judgment in favor of Dallas Plumbing and concluded it did. Chapman Homes and Duncan trustee relied primarily on the provisions of a Construction Contract for Speculative Single Family Residence (“Construction Contract”) as evidence of their joint venture. The parties to that contract were Chapman Homes and MB Duncan, Inc., which was not a party to the suit but which the parties claimed was acting as a nominee or agent for Duncan trustee. The court analyzed the contract in light of the statutory factors indicating creation of a partnership. The court stated that the common-law test for a joint venture contained four necessary elements: (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 enterprise. The court stated that “[t]he Business Organizations Code takes a less formalistic approach in determining whether a joint venture partnership has been created...” and “considers the above four factors as well as expression of intent to become partners, agreements to share liability of claims by third parties, and agreements to contribute money or property to the business.” Considering these factors, the court said that the terms of the Construction Contract tended to negate the existence of a partnership. The contract obligated Chapman Homes to construct the house, gave it full control over construction, and paid it a contractor’s fee for doing so. All losses were to be borne by MB Duncan, Inc. The contract did provide for equal division of the profit (after payment of Chapman Homes’ contractor fee) between Duncan Limited Partnership (nothing in the record explained the identity of this entity or its relationship to any of the parties) and Chapman Homes, but the contract stated that the distribution of this profit was part of the contractor’s fee. The court pointed out that the Business Organizations Code provides that an independent contractor’s right to receive a share of the profits as compensation does not by itself indicate a person is a partner. Tex. Bus. Orgs Code § 152.052(b)(1)(B). Even assuming a joint venture existed, the court concluded that summary judgment was still proper because the basis for the motion was that the claim for damages to real property belonged to the owner. Dallas Plumbing presented sufficient evidence to conclusively show that Duncan trustee was the owner of the house. Chapman Homes and Duncan trustee relied on affidavits that stated there was an agreement that Duncan trustee held the house on behalf of the joint venture, but the court concluded that these statements were not any evidence that the joint venture was the actual owner of the house. The court reviewed the provisions of Section 152.102 of the Business Organizations Code regarding partnership property and pointed out that property acquired in the name of a partner is presumed to be the property of that partner, even though the property is used for partnership purposes, if the property is not acquired with partnership property and the instrument transferring title does not indicate the person’s capacity as a partner or the existence of the partnership. Tex. Bus. Orgs. Code § 152.102(c). It was undisputed that the property was acquired with funds owned by Duncan trustee and that the property was shown in the appraisal records as property of Duncan trustee. Viewed in the context of the Construction Contract, the court said the evidence reflected an intent that Duncan trustee would retain ownership of the property even though the parties agreed to share profits from the property when it was sold. Because the mere fact of use of property for partnership purposes is not evidence that it is partnership property, the court held that Chapman Homes and Duncan
trustee failed to raise a fact issue controverting Dallas Plumbing’s evidence that Duncan trustee owned the property, and summary judgment was proper.


Matthew Minnis and Cullen 130, LLC (the “Minnis Parties”) and Jacob Citrin and Citrin Holdings, LLC (the “Citrin Parties”) went into business to acquire and develop industrial properties near airports and seaports. Citrin, Minnis, and their attorneys spent several months negotiating the terms of an operating agreement for an existing LLC (“Cargo Ventures New York”) of Citrin’s. Under this operating agreement, Cullen 130, LLC (“Cullen 130”) was admitted as an additional member with a 45% interest, and Citrin Holdings, LLC (“Citrin Holdings”) held a 55% interest. Citrin was the manager of Cargo Ventures New York. A bank was to lend most of the money to purchase and develop the properties, and Millennium Partners, a company owned by Citrin’s father-in-law, provided the rest of the money. A single-purpose entity would hold title to each property. The members of the single-purpose entities were to be Cargo Investors, LLC (an entity created by Citrin Holdings and Cullen 130) and a Millenium entity. Citrin Holdings and Cullen 130 later formed another entity, Cargo Investors II, LLC, for the purpose of investing in a particular project. The Minnis Parties sued the Citrin Parties after their relationship deteriorated, claiming that the Citrin Parties excluded them from the business and alleging causes of action for breach of fiduciary duty, breach of contract, fraud, minority oppression, conspiracy to breach fiduciary duties, and aiding and abetting breach of fiduciary duties. Minnis alleged that before signing off on the Cargo Ventures New York operating agreement, he and Citrin entered into an oral agreement creating an “overarching” partnership agreement. Minnis claimed that a piece of paper signed by Minnis and Citrin stating that they were 45%-55% partners confirmed the creation of the overarching partnership under which Cargo Ventures New York, Cargo Investors, and Cargo Investors II (the “Cargo entities”) would be created. Citrin denied that he and Minnis had a partnership distinct from their relationship in the Cargo entities and argued that the “partnership” was subsumed into the Cargo Ventures New York operating agreement. The case was tried to a jury, which found for Minnis, Cullen 130, or both on each cause of action. The jury findings included a finding that Citrin and Minnis agreed to form a partnership. A judgment holding Citrin and Citrin Holdings liable to Cullen 130 for over $28,000,000 in actual damages for breach of fiduciary duty was entered, but the judgment stated that, should the recovery for breach of fiduciary duty become less favorable, the plaintiffs may recover on any one of the other theories found by the jury. On appeal, the court of appeals found that the Minnis Parties’ damage expert’s testimony was unreliable and should have been excluded, and the Minnis Parties were unable to show any other reliable evidence on which their $28,000,000 damage award could be sustained. The damage model for all of the Minnis Parties’ theories of liability was based on the expert’s testimony, so neither Cullen 130 nor Minnis could recover the damages awarded on any of their claims in the trial court’s alternative judgment. The trial court also awarded out-of-pocket damages of $1,000,000 on the alternative claim for fraud and/or fraudulent inducement based on claims that Citrin fraudulently induced Minnis into entering an oral partnership agreement with Citrin.

The parties urged competing theories of analysis with respect to whether there was a binding partnership between the parties. The Citrin Parties advanced a contract-based analysis and contended that the alleged oral partnership was too indefinite to be enforceable. The Minnis Parties countered that contract principles do not apply when determining whether a partnership has been formed and that the courts instead must consider the statutory factors found in the Texas Revised Partnership Act (TRPA). The court explained in a footnote the transition from TRPA to the Business Organizations Code and that the rules for determining the formation of a partnership are substantially the same under the two statutes. The court concluded that it need not determine which of the parties’ theories was more appropriate because the Minnis/Citrin partnership did not survive either analysis.

Examining the alleged partnership first under the contract-based analysis, the court pointed out that Minnis could not identify when the partnership was orally created. Subsequent to the purported oral agreement, Minnis and Citrin signed a piece of paper that said: “We are partners. Jake Citrin, Matt Minnis, 45% and 55%.” Minnis explained that they would split “any dollar that came in the door” 55/45 and that the piece of paper described the only terms Minnis needed. According to Minnis, this overarching partnership “gave birth” to the Cargo entities’ operating agreements. Minnis testified that the different entities were necessary because it was important to be specific. There was nothing about the overarching partnership in any tax returns because it was a handshake deal and an agreement on what the terms were going to be. No books and records were kept for a separate partnership between Citrin and Minnis. Based on this evidence, the court of appeals concluded the oral overarching partnership was not definite enough to be enforced.

Next the court of appeals examined the evidence relating to the five factors set forth in TRPA as indicating the creation of a partnership. The five factors that indicate the creation of a partnership are: (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 in or right
to participate in control of the business; (4) sharing or agreeing to share losses or liabilities; and (5) contributing or agreeing to contribute money or property to the business. Proof of all factors is not required, and the existence of a partnership is determined by looking at the “totality of the circumstances” considering all the evidence bearing on the factors. Absence of any evidence of the factors will preclude recognition of a partnership, and conclusive evidence of only one factor will ordinarily be insufficient to establish the existence of a partnership. There was some evidence of an agreement to share profits because Minnis testified that they were going to split profits 55/45 of every dollar. The court concluded that there was some evidence of an expression of an intent to be partners based on the piece of paper signed by Minnis and Citrin, emails in which Citrin and Minnis referred to each other as partners, and testimony that Citrin referred to Minnis as his partner. Citrin testified that he used the term “partner” loosely and that they only discussed the LLC structure and he intended to have a formal relationship with Minnis, which occurred when they signed the Cargo Ventures New York operating agreement. There was no evidence of who had the right to control the overarching partnership. While Minnis was president of Cargo Ventures New York, there was no such evidence as to titles or roles in the overarching partnership. Although Minnis testified that he figured he and Citrin would be responsible for whatever their shares of the losses were, there was no evidence of any agreement to share losses. Cullen 130 made a capital contribution to Cargo Ventures New York, but there was no evidence that there was an agreement to contribute money or property to the partnership or that Minnis or Citrin actually contributed money or property to the partnership. Thus, there was some evidence of only two of five factors, i.e., sharing of profits and expression of an intent to be partners. Based on the totality of the circumstances, the court of appeals concluded as a matter of law that Minnis and Citrin did not create an overarching partnership, oral or otherwise. Because there was no partnership, the claim for fraudulent inducement to enter into a partnership agreement failed.

Strickland Group, Inc. v. Pathfinder Exploration, LLC

Over the course of several months Strickland Group, Inc. (“Strickland”) had discussions with Pathfinder Exploration, LLC (“Pathfinder”) that led to a Letter of Understanding (“LOU”). Ultimately, Strickland sued Pathfinder, alleging that it had formed a partnership with Pathfinder and was entitled to half the proceeds from the sale by Pathfinder of Pathfinder’s interest in a project in the Fayetteville Shale. The jury found that Pathfinder did not breach the LOU and that no partnership was formed, and Strickland appealed. The court of appeals held that the evidence supported the jury’s verdict.

Strickland was a consulting services firm that wanted to become involved in the management and ownership of oil and gas projects. Pathfinder put together oil and gas projects and managed them. Strickland’s vice-president, Purvis, first spoke with Pathfinder’s managing member and sole owner, Wilson, in August 2005 about shale projects on which Pathfinder was working and for which Pathfinder needed significant capital funding, including the Fayetteville Shale. Wilson told Purvis that Pathfinder was already part of a joint venture relating to the Fayetteville Shale and that Pathfinder needed money to fund its share of the venture. Purvis told Wilson that Strickland was a consulting company that had helped other companies raise capital. Strickland entered into a confidentiality agreement with Pathfinder, and Pathfinder disclosed production data, maps, and geologic data. Strickland used information received from Pathfinder to prepare presentations to financing companies. Wilson and Purvis testified regarding an understanding that was reached to share equally in Pathfinder’s interest in the Fayetteville Shale if Strickland connected Pathfinder to a financing company that agreed to certain financing terms. Strickland eventually made financial presentations to five financing companies, including Constellation Energy (“Constellation”). Constellation informed Strickland that it was interested in continuing to discuss the possibility of funding Pathfinder’s operations, and Purvis called Wilson to suggest that they enter into a written agreement regarding their business relationship before continuing discussions with Constellation. Wilson’s attorney drafted a Letter of Understanding (“LOU”) in November 2005 that described what kind of financing was anticipated and recited an intention to negotiate and execute a definitive agreement including certain terms if Strickland secured financing. Pathfinder and Strickland signed the letter although Strickland had some concerns about it. In April 2006, Pathfinder entered into a financing agreement with Constellation. Constellation’s representative testified that Strickland did not play a critical role in structuring the deal with Pathfinder. Strickland did not learn of Pathfinder’s agreement with Constellation until October 2006. In January 2009, Strickland learned that Constellation and Pathfinder had sold most of their interests in the Fayetteville Shale. Strickland later discovered that Pathfinder had made approximately $4.5 million from the sale. Strickland sued Pathfinder and Wilson. The jury found that Strickland and Pathfinder had intended to bind themselves to an agreement that, if Strickland obtained financing for 100% of the financial obligations related to Pathfinder’s oil and gas projects, and if Pathfinder retained a carried working interest in those projects, the parties would further negotiate and sign an agreement to jointly manage the projects and would share equally in any revenue generated by the projects. But the jury found that Strickland did not identify a financing source
2007 to purchase feed for the cattle at the dairy. Whalen fell into arrears, and the unpaid amount on the account was over

protocol) was a supplier of cattle feed. Protocol asserted that Whalen opened a line of credit with Protocol in May

agreement for JW Grand Canyon Dairy to lease the dairy prior to completing the purchase. Protocol Technologies, Inc.

Grand Canyon Dairy, LLC" for several months. J.B. and Whalen/JW Grand Canyon Dairy also executed a lease

Whalen ("Whalen"). Before completing the conveyance, Whalen assumed control of the dairy and operated it as "JW

that had assumed 100% of Pathfinder’s financial obligations or that allowed Pathfinder to retain a carried working

interest; therefore, the jury determined that Pathfinder did not breach its agreement with Strickland. The jury also found

that Pathfinder and Strickland had not entered a partnership.

The trial court instructed the jury that a partnership is an association of two or more persons to carry on a

business for profit and that factors indicating creation of a partnership include: (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 the control of the business; (4) sharing or agreeing to share 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. These are the

factors listed in Tex. Bus. Orgs. Code § 152.052(a). Strickland argued that the evidence established the first factor

because the parties agreed to share the profits related to the Fayetteville Shale project 50/50 and agreed to work together

in a sweat-equity deal in which Strickland would receive equity for its work. But the court of appeals identified numerous

statements by Purvis in which Purvis expressed his understanding that Strickland would earn its interest only if it was

successful in bringing a financing source that would cover all of Pathfinder’s expenses and that Strickland got nothing

if it did not bring financing. Purvis recognized that he did not ask for the LOU to mention anything about a partnership

or joint venture and that he had in the past used formal written partnership agreements when he had formed partnerships.

Based on the evidence, the court of appeals concluded the jury could have reasonably found that Pathfinder and

Strickland did not agree to share profits but instead agreed to enter into another agreement regarding the creation of a

partnership only upon Strickland’s fulfillment of certain conditions that it did not fulfill. With regard to the second and

third factors, the evidence showed that the parties held themselves out as joint managers of the Fayetteville Shale project

to Constellation and that the parties agreed to jointly manage the project, but Purvis testified that he told Constellation

that Strickland “expected to earn” an interest in the project and that Wilson had the authority to decide whether to make

a deal with Constellation. With respect to the fourth factor, Purvis testified that he did not recall ever explicitly discussing

with Wilson the sharing of losses. Dr. Strickland, the CEO of Strickland, testified at one point that he did not believe

Strickland and Pathfinder had formed a partnership in the legal sense but believed they were “headed” in that direction

after signing the LOU. Dr. Strickland also testified that Wilson never specifically said that there was an agreement to

share losses. In view of all of this evidence, the court of appeals held that the evidence was sufficient to support the jury’s

verdict that there was no partnership.


The lessor under a commercial lease agreement with the Williamson County Charitable Bingo Association

(“WCCBA”) sued a lodge that was a member of WCCBA, alleging that the lodge was liable for the breach of the lease.

WCCBA’s restated articles of organization recited that WCCBA was an unincorporated nonprofit association with up

to six members, who must also be nonprofit organizations. The articles stated that the purpose of the association was to

conduct a shared charitable bingo operation. The plaintiff asserted that WCCBA was a general partnership governed by

Chapter 152 of the Texas Business Organizations Code (BOC) rather than an unincorporated nonprofit association

governed by Chapter 252 of the BOC as determined by the trial court by summary judgment. The plaintiff argued that

WCCBA had many of the characteristics that would indicate the formation of a partnership and that there was thus a fact

question about whether WCCBA was a partnership. The court of appeals stated that unincorporated nonprofit

associations commonly exhibit some characteristics of a partnership. The summary judgment evidence established that

WCCBA operated for a common, nonprofit purpose and thus was an unincorporated nonprofit association as defined by

Chapter 252 of the BOC. The argument that WCCBA has many characteristics of a partnership and could also be

classified as a partnership was without merit insofar as establishing liability under Chapter 152. Because WCCBA

qualified as an unincorporated nonprofit association, it was governed solely by Chapter 252. The court went on to

conclude that Chapter 252 abrogated common law such that a member of an unincorporated nonprofit association is not

liable for the association’s contract merely because the member assented to or ratified the contract.


In 2007, J.B. Grand Canyon Dairy, LP (“J.B.”) entered into a written agreement to convey a dairy to Jeff

Whalen ("Whalen"). Before completing the conveyance, Whalen assumed control of the dairy and operated it as “JW

Grand Canyon Dairy, LLC” for several months. J.B. and Whalen/JW Grand Canyon Dairy also executed a lease

agreement for JW Grand Canyon Dairy to lease the dairy prior to completing the purchase. Protocol Technologies, Inc.

(“Protocol”) was a supplier of cattle feed. Protocol asserted that Whalen opened a line of credit with Protocol in May

2007 to purchase feed for the cattle at the dairy. Whalen fell into arrears, and the unpaid amount on the account was over


$20,000 by the time Whalen filed for bankruptcy. Protocol filed suit against J.B. for the unpaid balance on the account. Asserting numerous causes of action (both equitable and others), Protocol alleged J.B. was liable for the unpaid debt because its actions made Whalen the agent of J.B. if not a de facto joint venturer or partner of J.B. in the dairy business. Specifically, the plaintiff claimed that J.B. charged Whalen with the responsibility of the daily operations of the business, J.B. permitted Whalen to use the business name of “JW Grand Canyon Dairy, LLC,” J.B. allowed Whalen to refer to himself as the owner of the dairy without disclosing the contemplated conveyance of ownership, and J.B. retained ownership of the dairy during the period of Whalen’s operation. Protocol and J.B. filed motions for summary judgment. J.B.’s motion for summary judgment sought to negate all of Protocol’s claims. The trial court granted J.B.’s motion for summary judgment in all respects, finding that a partnership did not exist between J.B. and Whalen and that J.B. was not liable for the unpaid debt owing to Protocol.

Protocol contended on appeal that the trial court erred in finding that Whalen was not an agent of J.B. and in finding that J.B. and Whalen were not in a partnership. J.B. argued that an agency relationship did not exist between it and Whalen because J.B. did not hold Whalen out as having authority to act on its behalf and Whalen had no express authority to act on its behalf. J.B. also maintained that it had no partnership or joint venture agreement with Whalen. Protocol argued that there was evidence of a de facto partnership or joint venture relationship between J.B. and Whalen because of the nature of the detailed agreements between J.B. and Whalen relating to the operation of the dairy during the contemplated sale period. The agreements between J.B. and Whalen specifically provided that their relationship was “an ordinary commercial relationship” and that they did not intend to create a principal-agent relationship, partnership, or joint venture. The court stated that the contracts thus negated the existence of an agency relationship by actual or express authority. Protocol based its allegations of apparent authority solely on its dealings with Whalen. The court of appeals concluded that the trial court correctly determined no agency relationship existed between J.B. and Whalen because apparent authority must be based on the acts of the principal rather than simply declarations of the alleged agent, and Protocol did not assert any reliance on dealings directly between it and J.B. As to the existence of a partnership, the court of appeals relied on the Texas Supreme Court’s discussion of the factors relating to establishment of a partnership in *Ingram v. Deere*. There are five factors that indicate the creation of a partnership: (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 in or right to participate in control of the business; (4) sharing or agreeing to share losses or liabilities; and (5) contributing or agreeing to contribute money or property to the business. All of the factors should be considered in determining whether a partnership exists, but proof of all factors is not required, and no one factor is determinative. Here, the agreements executed by J.B. and Whalen expressly disclaimed the existence of a partnership. In addition, evidence showed that J.B. had no control of the dairy operations while Whalen had control of the dairy, Whalen received all profits from the dairy during this period, and Whalen was responsible for all expenses incurred at the dairy during this period. Thus, the evidence offered by J.B. conclusively established that it and Whalen did not have a partnership, and Protocol failed to raise a genuine issue of material fact on its de facto partnership argument.


Duarte and Rojas grew up together, and Duarte considered Rojas his mentor. Rojas would help Duarte find work. At one job, Duarte learned how to repair, maintain, and program ATMs. Duarte bought an ATM and approached Rojas about acquiring, selling, and operating ATMs together. At trial, Duarte testified that Rojas assented to the proposal and they agreed to be partners in the fall of 2002, splitting profits and liabilities equally and reinvesting profits into the business. Rojas testified that he and Duarte were not partners, but that Duarte was a contract laborer who helped him operate the ATM business that he began previously with his wife. The ATM business grew, but by May 2005 the relationship between Duarte and Rojas had soured and they agreed to part ways. Duarte testified he and Rojas agreed to divide the partnership’s assets and property equally, however a division never occurred. According to Duarte, Rojas told him he was keeping all the ATMs and would give Duarte $1,000 a month until Duarte was paid out. Duarte received $2,500. Duarte (and his wife) sued Rojas (and his wife) and various entities through which the business operated, alleging that he and Rojas verbally formed a partnership for the purpose of acquiring and operating ATMs. The jury found that a partnership existed, but Duarte voluntarily withdrew from the partnership, and that the value of Duarte’s one-half interest in the partnership was $119,000 as of May 31, 2005. The trial court entered a judgment in accordance with the verdict in favor of Duarte.

On appeal, Rojas argued that the trial court erred because the evidence was legally insufficient to support the jury’s finding of a partnership and the award of damages. Both parties agreed that the question of the existence of a partnership was governed by the Texas Revised Partnership Act (TRPA) as construed by the Texas Supreme Court in *Ingram v. Deere*. Under TRPA, an association of two or more persons to carry on a business for profit as owners creates a partnership. TRPA sets forth five factors that indicate the creation of a partnership: (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 in or right to participate in control of the business; (4) sharing or agreeing to share losses or liabilities; and (5) contributing or agreeing to contribute money or property to the business. Evidence of the five factors is considered under a totality-of-the-circumstances test. The court of appeals considered the evidence relating to each of the five statutory factors to determine whether the evidence was legally sufficient to support the jury’s finding that Duarte and Rojas were partners. The receipt or right to receive a share of profits of the business, along with the right to control, has traditionally been the most important factor in determining whether a partnership existed. Rojas argued Duarte was paid as an independent contractor and never received any profits and that at one point he prepared financial paperwork to entice Duarte into becoming a shareholder in a corporation he owned. Duarte testified that he and Rojas agreed to split profits equally and to reinvest profits back into the business to support its growth. The financial paperwork allocated the net profits to Rojas and Duarte equally, and nothing indicated the paperwork was prepared to entice Duarte into buying stock in one of Rojas’ corporations. The court determined that although there was no evidence Duarte actually received a share of profits, there was evidence in the record of Duarte’s right to share profits. The second factor of an expression of intent to be partners was supported by testimony of three witnesses that both Duarte and Rojas introduced themselves as partners in various business settings. Despite Rojas’ testimony that he did not want Duarte to be a partner, the testimony of the three witnesses was some evidence that both parties expressed an intent to be partners. The third factor of control or right of control of the business is one of the key factors in determining the existence of a partnership. The right to control a business is the right to make executive decisions about the business such as the right to exercise authority over the business’s operation, the right to write checks on the business’s checking account, control over and access to the business’s books, and the receipt and management of the business’s assets and money. The court found that Rojas was in charge of the business’s accounting and that he compiled the financial information to which Duarte had access; however, there was evidence that Duarte had the right to and did make executive decisions about the business. Specifically, evidence showed Duarte exercised authority over some of the business’s operations and monitored the ATMs, made business decisions collaboratively with Rojas, and had complete access to the business’s checking account and the right to write checks from the account. Also, Duarte testified he had daily unrestricted access to the business’s books and records, which were kept at Rojas’ home to which Duarte had a key. The fourth factor of sharing or agreeing to share losses or liabilities was also supported by the evidence. Although the court agreed with Rojas that there was no evidence that the business ever lost money, the relevant test was whether the parties shared or agreed to share losses or liabilities. Here, the record showed Duarte agreed to and did share liabilities in that when ATMs were purchased back from customers the purchases were characterized as expenses on the financial documents provided by Rojas. The documents subtracted expenses, and Duarte and Rojas shared equally in the profits. When viewed in the light most favorable to the jury’s verdict, the court found this was more than a scintilla of evidence that Duarte and Rojas agreed to share, and did share, liabilities as well as profits. Finally, the fifth factor of whether the alleged partners contributed or agreed to contribute money or property to the business was supported by Duarte’s testimony that he contributed money to the business and reinvested his profits back into the business. In addition, Duarte argued he contributed several ATMs to the business. The court concluded that the record contained legally sufficient evidence in support of each of the five TRPA factors to be used to determine whether a partnership existed and thus supported the jury’s finding of a partnership. The court concluded that the award of $119,000 of damages to Duarte was erroneous because there was no evidence in the record to provide the jury with a rational basis to calculate damages on May 31, 2005. The court remanded to allow Duarte an opportunity to prove the amount of his damages with reasonable certainty.


The Government sought to forfeit a car used in connection with a counterfeiting conspiracy, and the claimant argued she had standing as an innocent owner to challenge the forfeiture based on an in rem interest in the car arising from a joint venture between the claimant and her son, the legal owner of the car. The claimant’s son purchased the car in Texas, and the claimant argued that the existence of the joint venture should be determined under Texas law. The Government argued that existence of the joint venture should be determined under Pennsylvania law. The claimant relied on the four-element test of a joint venture set forth in Texas case law before the Texas Revised Partnership Act, but the court pointed out that Texas law does not currently recognize a separate “joint venture” form of business outside the category of partnerships and that under **Ingram v. Deere**, 288 S.W.3d 886 (Tex. 2009) and the Texas Business Organizations Code, there are five factors, some combination of which must be shown, to consider when determining the existence of a partnership. The court stated that Pennsylvania law still recognizes a “joint venture” as distinct from a partnership and that the selection of Pennsylvania law rather than Texas law might be determinative of the claimant’s claim because of the difference in analyzing the existence of a joint venture under Pennsylvania law. In this case, all the facts giving rise to the alleged “joint venture” occurred before the claimant came to Texas in that the discussion of and
negotiation of the terms of the joint venture took place in Pennsylvania. Given that Pennsylvania was the situs of the formation, the court stated that Pennsylvania law created the rights that gave the claimant her legal interest. The court set forth the four requirements of a joint venture under Pennsylvania law and held that the claimant could not show the existence of a joint venture because she could not show that she and her son had a joint proprietary interest and right of control over the car. Proprietary control of the car was vested solely in the claimant’s son because he was the legal owner of the car. This fact precluded formation of a joint venture according to the court.


Three entities sued a chemist, Joseph Hanafin, for breach of contract, breach of fiduciary duties, and tortious interference with a prospective contract. One of the plaintiffs was Intumescents Associates Group (IAG), a partnership allegedly formed by Hanafin, Hugh Scott, and Craig Scott to market any future technology Hanafin might develop. The district court ruled that the IAG partnership was never formalized and lacked the legal capacity to bring this suit. The court of appeals noted that the Texas Business Organizations Code provides that an association of two or more persons to carry on a business for profit as owners creates a partnership regardless of whether the persons intend to create a partnership or whether the association is called a “partnership,” “joint venture,” or other name. The court also noted that the Texas Business and Commerce Code prohibits persons doing business under an assumed name from maintaining in a Texas court an action arising out of a contract or act in which an assumed name was used until an assumed name certificate has been filed as required by the statute. IAG did not file an assumed name certificate until two weeks prior to the scheduled trial date. The certificate identified IAG as a partnership owned by Craig and Hugh Scott, and the district court recognized that it is possible for a partnership to cure lack of capacity by belatedly filing a certificate. However, the district court ruled that IAG could not cure the defect because it did not exist as a partnership at that time or when the complaint was filed. The court of appeals concluded that the district court erred in ruling there was no issue of material fact with respect to the existence of IAG as a partnership. The court of appeals relied on the five statutory factors considered in determining the existence of a partnership: (1) the receipt or right to receive a share of profits of the business; (2) the expression of an intent to be partners in the business; (3) participation or the right to participate in control of the business; (4) an agreement to share or sharing in the losses of the business or liability for claims by third parties against the business; and (5) an agreement to contribute or contributing money or property to the business. With respect to the first factor, Hugh Scott testified in a deposition that Hanafin had a 25% interest in the IAG partnership, indicating that Hanafin had a right to receive a share of the profits. With respect to the second factor, Hanafin testified in his deposition that he, Hugh Scott, and Craig Scott “formed a partnership, IAG.” He also testified that he did work on behalf of IAG under a nondisclosure agreement and signed a confidentiality agreement as IAG’s Director of Technology Development. Regarding the third factor, Hanafin dealt directly with other companies on behalf of IAG in that he had authority to sign agreements on IAG’s behalf. Although there was no apparent agreement that Hanafin was required to share in IAG’s losses, the court noted that the statute expressly provides that an agreement by the owners of a business to share losses is not required to create a partnership. As for the fifth factor, Hanafin’s creation of formulas and product would constitute a contribution of property to the business. Since four of the five factors indicated the creation of a partnership, the court concluded that the district court erred in ruling that there was no issue of material fact as to the existence of IAG as a partnership.


The plaintiff sued Jerry Edwards and Jens Lorenz in their individual capacities and doing business as Jesco Disaster Services. Lorenz filed a general denial, but Edwards did not answer. In an amended petition, the plaintiff added John Shavers and alleged that Lorenz, Edwards, and Shavers participated in a partnership of Jesco Disaster Services. Shavers filed a general denial, and Lorenz did not amend his initial general denial. The trial court rendered a judgment in favor of the plaintiff after a bench trial. On appeal, Lorenz complained that the trial court erred in finding Lorenz and Shavers participated in a partnership. Because the Texas Rules of Civil Procedure require that the denial of a partnership must be raised by a verified denial, the court of appeals held that the existence of the partnership could not be controverted at trial. Lorenz argued that he sufficiently denied the partnership status in his verified special appearance, but the court of appeals stated that the denial of a partnership in a special appearance does not satisfy the requirement of Rule 93(5). Finally, the court rejected Lorenz’s argument that the existence of the partnership was tried by consent. The president of the plaintiff testified that Lorenz represented to him that Lorenz and Shavers were partners with Shavers in Jesco Disaster Services. When Lorenz cross examined the plaintiff’s president on the partnership issue, the plaintiff objected to testimony or attempts to establish there was no partnership and called the court’s attention to the absence of
a sworn denial of partnership. The trial court overruled the objection, and the plaintiff obtained a running objection. The court of appeals held that the issue was not tried by consent and found that the evidence was sufficient to support the trial court’s finding that Lorenz and Shavers participated in a partnership.

Gary Burt sued Asphalt Cowboys and its alleged partners Richard Reek and Larry Harwell in connection with work on a driveway that Burt hired Asphalt Cowboys to do. Harwell filed a verified denial swearing that he did not contract with Burt, had never done business as Asphalt Cowboys, and was not in a partnership with any of the defendants. Harwell filed a no-evidence summary judgment motion, and the trial court granted the motion. On appeal, Burt argued that he raised a fact issue as to the existence of a partnership. The court of appeals concluded that Burt failed to raise a fact issue on partnership because his response referred only generally to an appendix containing affidavits and discovery and did not direct the trial court to any specific summary judgment evidence to establish a partnership. Additionally, the only evidence Burt cited on appeal consisted of exhibits attached to Richard Reek’s motion for summary judgment. Reek’s response did not reference and did not purport to reference any evidence showing Harwell was a partner, and the court of appeals thus declined to consider evidence attached to that response.

Firdosh Patel sued Edward Malone alleging that Malone reneged on their agreement to form a partnership for a consulting business called Prescendo Consulting, LP (“Prescendo”) in which they and Meng Choo would be equal partners. Patel emigrated from India in 1994 and earned an MBA from Rice. He worked for many years in the energy sector while seeking permanent residency, which he obtained in December 2004. His immigration status was cited as a reason why the parties’ disputed business relationship was not documented in writing earlier. In December 2003, Patel signed a letter accepting a low salary as an at-will employee of Prescendo with the possibility of a merit-based bonus dependent on Prescendo’s overall performance. According to Patel, Malone told him that his ownership could not be documented in writing until his green card was finalized. Patel testified that he understood that he was an employee but that the agreement he had with Malone was to own one-third of Prescendo with Malone and Choo. Several documents introduced at trial reflected Malone as 100% owner of Prescendo. The three agreed to hire an employee and split up the start-up and ongoing responsibilities at Prescendo. In 2004, the three agreed to raise Patel’s salary, and in December Patel received his green card. Over the next year and a half Patel and Choo asked Malone about putting their partnership agreement in writing, but no writing was ever produced. In September 2006, the dispute over ownership of Prescendo that led to the litigation occurred. Patel reminded Malone about reducing their agreement to writing, and Malone responded that they needed to create a spreadsheet to determine what percentage of ownership he, Patel, and Choo would own. Patel demanded to know why a spreadsheet was needed when the three had always agreed that each owned a one-third interest in Prescendo. Malone informed Patel and Choo that he considered them at-will employees and not partners. Malone made a proposal regarding dividing past retained earnings and considering future ownership; however, the relationship deteriorated and Patel resigned from Prescendo in November 2006. At trial, Patel argued that he and Malone had agreed since its inception to be equal partners in Prescendo but that Malone had represented that until Patel secured a green card they could not put their agreement in writing because Patel was prohibited from owning equity. Malone contended that an agreement to be equal partners never existed and that Patel was an at-will employee who had been told he may be granted some ownership in the business in the future. The jury found that Patel and Malone had agreed that they would be equal partners in Prescendo together with Choo and awarded Patel $495,000 as damages for the amount of money Patel would have received as an equal partner in Prescendo less the value of what he was paid. The trial court entered judgment on the jury finding that the parties had formed a partnership and awarded Patel damages.

On appeal, Malone argued that the evidence was legally and factually insufficient to prove that Malone and Patel were partners. Instead, Malone asserted that the trial court’s judgment should be reversed because the evidence conclusively showed that Patel was an at-will employee, not a partner. The court of appeals considered the evidence presented at trial to determine whether it sufficiently supported the jury’s verdict. The court determined sufficiency based on the evidence as to whether Patel and Malone had an agreement that they would be equal partners, as the jury was instructed to decide. The court noted that its sufficiency review was not the same as the Texas Supreme Court’s analysis of the Texas Revised Partnership Act (TRPA) factors indicating the existence of a partnership in *Ingram v. Deere*, 288 S.W.3d 886 (Tex. 2009). The analysis instead was confined to whether there was sufficient evidence of the parties’ agreement to be equal partners in Prescendo considering the totality of the circumstances.

Malone used the five TRPA factors in his argument that a partnership never existed. The five factors are: (1) the receipt or right to receive a share of profits of the business; (2) the expression of an intent to be partners in the business; (3) participation or the right to participate in control of the business; (4) an agreement to share or sharing in
the losses of the business or liability for claims by third parties against the business; and (5) an agreement to contribute or contributing money or property to the business. The appellate court stated that four witnesses testified with varying degrees of specificity that Malone expressed an intent to be partners with Patel and Choo. Malone emphasized the lack of a partnership agreement in writing, but the law recognizes oral agreements, and the lack of a written agreement did not conclusively establish that an oral agreement did not exist. Thus, there was some evidence that Malone agreed to be equal partners with Patel and Choo. Next, Malone maintained there was no evidence of sharing or the right to share profits and losses of the business, but instead Patel received a salary and yearly bonuses. The court found there was no evidence that Patel actually received a share of Prescendo’s profits other than the bonuses; however, there was evidence of Patel’s right to share profits and losses to support the jury’s findings of an agreement to be equal partners. There was testimony that the parties had agreed to share profits and losses of the company equally, that the parties agreed to hire an employee and sponsor his green card which was a risk that may have caused loss to the company, and that Patel accepted a nominal salary and bonuses with the understanding that profits in Prescendo’s early years would be invested back in the company so as to increase the value of his ownership despite other lucrative job opportunities. Malone next contended there was no evidence of Patel’s participation or right to participate in control of the business in that there was no evidence that Patel made any executive decisions on behalf of Prescendo. The court disagreed and found there was evidence that Patel had the right to exercise and did exercise some control of executive decisions of Prescendo (e.g., hiring employees, salaries, and bonuses), which supported the jury’s finding of an agreement to be equal partners. Finally, Malone argued the evidence showed Patel used personal items for the business but that Patel did not contribute money or property to Prescendo such as was indicative of a partnership interest. Again, the court found some evidence of contribution based on Patel’s unremunerated start-up labor and bringing in clients, which was some evidence of an agreement to be equal partners. Furthermore, a number of emails sent by Patel and Choo referenced the partnership agreement, which Malone never questioned and to which he replied with, “All good.” In sum, the court concluded that the evidence presented at trial supported the jury’s decision that the parties had an agreement to be equal partners in Prescendo.

Malone also argued there were documents showing Patel as an at-will employee and Malone as wholly owning Prescendo, which prevented Patel’s claim that he was a partner in a partnership. Although such documents existed, Patel’s status as an at-will employee did not conclusively establish that there was legally insufficient evidence to support the jury’s finding of the existence of an agreement to be equal partners. The court stated that an at-will employee can own an equity interest in an employer’s business, and status as an employee and a partner were not mutually exclusive. Malone further asserted that Patel’s execution or acquiescence in preparing the documents at issue negated the existence of an agreement that the parties were equal owners in Prescendo. The court noted that the documents were relevant to the jury’s consideration, but the jury heard and accepted an explanation for why the documents said what they did. The jury evaluated the testimony and was free to believe that Patel relied on Malone’s instructions to complete the documents as they did because Malone told him it was necessary the documents identify Malone as the owner since Patel’s ownership could not be documented in writing until he obtained his green card. The jury determined the parties’ intent considering their words and actions in light of the surrounding circumstances. The court held that the verdict that the parties agreed to be equal partners was supported by sufficient evidence, and the evidence supporting the jury’s finding was not so contrary to the overwhelming weight of the evidence as to be clearly wrong or unjust. Therefore, the appellate court affirmed the trial court’s judgment.


Steven Bowman, as Personal Representative of the Estate of William Bowman (“Bowman”), brought suit against Richard Sewing in relation to the development of townhomes in Houston. Bowman and Sewing met in the early 1950s, and between 2003 and 2005 Bowman transferred money to Sewing in excess of $200,000 for the purpose of developing, renting, and selling townhomes in Houston. Sewing owned the two properties at issue, and together they were valued at approximately $600,000. Sewing testified at a deposition that the parties’ agreement required Bowman to pay Sewing $300,000 to acquire a half interest in the properties. Bowman alleged that he and Sewing formed a partnership to carry on the development business, and when Bowman died in 2005 he became a withdrawn partner entitled to buyout rights and remedies. Sewing testified at trial that the partnership had never formed and that Bowman never agreed to buy the land to become a partner. The jury found that Bowman and Sewing had bound themselves to a contract but that neither had failed to comply with the contract. The jury also found that Sewing and Bowman had formed a partnership regarding the properties at issue and that the value of Bowman’s partnership interest at the time of his death was $231,743.61. The trial court entered judgment on the jury verdict in favor of Bowman. On appeal, Sewing asserted error by the trial court and maintained, among other points, that the statute of frauds precluded Bowman’s claim for recovery for redemption of a partnership interest, that the evidence was insufficient to support the
jury’s finding that the parties formed a partnership, and that the evidence was insufficient to support the jury’s award of redemption of partnership interest. After rejecting Sewing’s argument that the statute of frauds applied to the alleged partnership between Sewing and Bowman, the court addressed Sewing’s argument that the evidence was insufficient to establish the existence of a partnership. Specifically, Sewing claimed there was insufficient evidence to establish an enforceable agreement or contract between the parties. In deciding whether the parties had formed a partnership, the court relied upon Ingram v. Deere, 288 S.W.3d 886 (Tex. 2009), in which the Texas Supreme Court looked to the totality of the circumstances and the elements of partnership formation based on the statutory factors indicating the formation of a partnership. The court stated that proof of each element required for formation of contract was not required to establish the existence of a partnership. The court analyzed whether the evidence was sufficient to support the jury finding that a partnership existed by considering the evidence as to each factor indicating partnership formation under the Texas Revised Partnership Act (TRPA). The five factors used to determine the existence of a partnership are: (1) the receipt or right to receive a share of profits of the business; (2) the expression of an intent to be partners in the business; (3) participation or the right to participate in control of the business; (4) an agreement to share or sharing in the losses of the business or liability for claims by third parties against the business; and (5) an agreement to contribute or contributing money or property to the business. Sewing testified that he and Bowman were to share profits in regard to the development of the properties, which was some evidence of the right to receive a share of the profits. Sewing’s testimony also indicated that the parties expressed an intent to be partners in that once Bowman paid Sewing $300,000 they would be equal partners, and the parties had agreed to share losses if they had occurred. There was also evidence from which the jury could have reasonably concluded that Bowman contributed money to form a partnership with Sewing and that he made payments to Sewing over the course of several years to pay down on his partnership contribution. Bowman presented no evidence that he had control over the business or had the right to control the business. Although Sewing argued that Bowman had to pay the entire $300,000 as a prerequisite to the formation of the partnership, the jury was not required to believe such a condition existed. The court found that Bowman presented sufficient evidence on four of the five TRPA factors indicating the existence of a partnership agreement, and viewing the evidence in the light most favorable to the verdict, a reasonable and fair-minded fact finder could have found the existence of a partnership. The evidence supporting the jury’s finding of a partnership was not so weak as to make the finding clearly wrong and manifestly unjust. Thus, the court held that the evidence was legally and factually sufficient to support the jury’s finding of the existence of a partnership between Bowman and Sewing.


Jim Sandt, a CPA employed by Enron as vice president of its tax group, became interested in buying Enron assets that had substantial value when he became aware that many Enron assets were being sold in Enron’s bankruptcy. Sandt and his wife became friends with Tim Nesler and his wife, and Jim and Tim began working on a business plan for the purchase and management of an Enron business. Four other individuals joined the group, and eventually formed an LLC for the purpose of acquiring the interest of Enron in a limited partnership. Jim invested in the LLC and later sued for fraud and breach of contract when he learned that his original 18% interest had been substantially reduced without his knowledge by an amendment to the LLC agreement and the issuance of additional units shortly after the LLC was organized and he made his capital contribution. The jury found for Jim on his statutory fraud claim, and part of the defendants’ argument on appeal regarding the sufficiency of the evidence related to Jim’s assertion that an oral partnership existed. The jury found that Jim failed to prove an oral partnership, and there was no evidence of any written partnership agreement. In this context, the defendants argued that Jim’s testimony referring to a “partnership” should not be considered evidence in his statutory fraud claim regarding his purchase of 75 units in an LLC. The court said that there were instances where Jim in his testimony referred to an “oral partnership,” but most of the time he referred to a partnership, he used the term “partnership.” He referred to his units in the LLC as “partnership interests,” and he referred to the LLC agreement as the “partnership agreement.” Based on his review of financial statements of the LLC, he testified that he issuance of additional units had reduced his “interest in the partnership.” The court noted that the LLC was a partnership for tax purposes and that people involved in business sometimes use the word “partnership” to refer to entities that are actually corporations or other entities. Thus, the jury could reasonably have understood Jim’s references to the “partnership” as references to the LLC.


Patricia Garcia alleged that she and Bernardo Lucero were partners in a general partnership for the purpose of acquiring and operating businesses. Garcia sought a declaration that they were equal partners in the partnership and that an electronics service business and an apartment complex acquired during their relationship were partnership
property owned equally by them. The trial court granted a no-evidence summary judgment motion filed by Lucero. Lucero’s motion asserted that Garcia could not present sufficient evidence to raise a genuine issue of material fact with respect to the existence of any partnership agreement or any ownership interest in any of the alleged partnership property. Lucero’s motion characterized these matters as fundamental elements of her cause of action. On appeal, the court pointed out that the Business Organizations Code sets forth five factors to be considered in determining the existence of a partnership: (1) the receipt or right to receive a share of profits of the business; (2) the expression of an intent to be partners in the business; (3) participation or the right to participate in control of the business; (4) an agreement to share or sharing in the losses of the business or liability for claims by third parties against the business; and (5) an agreement to contribute or contributing money or property to the business. Lucero did not dispute that the five-factor test applied but asserted that the summary judgment motion challenged a specific element by stating that there was no evidence of a partnership agreement. The court noted that the existence of a formal partnership agreement is not one of the five statutory factors and pointed out that the Business Organizations Code provides that the statute applies to the extent that the partnership agreement does not provide otherwise and that an association of two or more persons to carry on a business for profit creates a partnership regardless of whether they intended to form a partnership or referred to the relationship as a “partnership.” Thus, the court concluded that the existence of a formal partnership agreement is not an element that must be proved to establish a partnership. Lucero also argued that his motion challenged a specific element of Garcia’s claim by stating that there was no evidence that Garcia had any ownership interest in any of the alleged partnership property. However, the court noted that partnership property is not property of the partners, and direct ownership of partnership property is not an element that must be proved to establish a partnership. Thus, any allegations by Garcia suggesting direct ownership of property were mere surplusage. Because Lucero’s motion did not specifically challenge the essential elements of a partnership, the trial court’s summary judgment in favor of Lucero was reversed.


In 2004, R. Scott Brown and Allan Keel discussed forming a private equity fund with a focus on oil and gas investments. After an unsuccessful trip to New York together to meet with potential investors, Brown contacted Keel about an investment opportunity involving a Houston-based oil and gas company called GulfWest Energy (“GulfWest”) that needed investors to remedy a cash-flow problem. Brown and Keel entered into a confidentiality agreement with GulfWest to obtain information necessary to perform due diligence on a potential investment in GulfWest. The two men formed a limited liability company as an investment vehicle for purchasing GulfWest’s shares, and Keel then contacted Oaktree Capital Management (“Oaktree”), a private investment fund in California, to finance the purchase of GulfWest. During discussions with Oaktree about the GulfWest investment, Keel and Brown sent Oaktree a term sheet in which they were identified as “Management,” each would provide some initial funding, they would be retained in an employment contract, and they would receive a transaction fee at closing and equity options in the new entity. Oaktree countered with different terms. Brown led the negotiations with Oaktree, but Oaktree’s representative disliked Brown’s negotiation style and expressed concern that Brown had never served as CFO of a publicly traded company. Oaktree’s representative began communicating primarily with Keel, and Oaktree concluded it would not hire Brown as CFO. Although aware of Oaktree’s intentions, Keel did not tell Brown, and Brown and Keel thereafter loaned GulfWest money to cover the necessary due diligence costs to move forward with the transaction. Keel’s position in discussions with Oaktree about Brown was that he could not see Brown as anything other than CFO of the new company. When Brown was informed he would not be hired in any role at the new company, he argued that his employer Southwest Securities (“Southwest”) was entitled to an investment banking fee based on Brown’s work on the transaction and that he should have been compensated individually for bringing the opportunity to Oaktree. Brown refused to sign a waiver in exchange for compensation releasing Oaktree from any liability before Oaktree closed on the GulfWest transaction. Oaktree informed Southwest that Brown had attempted to arrange additional individual compensation. Southwest accepted an investment banking fee from Oaktree and fired Brown after he refused to sign the release. The GulfWest transaction then closed.

Brown sued Keel for breach of partnership duties. At trial, the jury found that Brown and Keel had entered into a partnership to identify and invest in oil and gas companies, Keel breached his duty of loyalty to Brown, and Keel’s breach proximately caused Brown damages based on the value of the stock options Brown would have received but for the breach. The jury did not find that Brown ratified Keel’s conduct. Brown and Keel both moved for judgment notwithstanding the verdict. The trial court granted Keel’s motion for JNOV, holding that the damages amount was in error, Keel’s conduct did not cause Brown’s damages, and there was no evidence that a partnership existed between Brown and Keel. The trial court entered a take-nothing judgment in favor of Keel.
On appeal, Brown argued that the trial court erred in entering a JNOV on the ground that there was no evidence as to the existence of a partnership between the parties. The parties agreed that the determination of whether a partnership existed was to be made based on consideration of the five statutory factors identified in *Ingram v. Deere*, 288 S.W.3d 886 (Tex. 2009). The five factors are: (1) the receipt or right to receive a share of profits of the business; (2) the expression of intent to be partners in the business; (3) participation or the right to participate in control of the business; (4) an agreement to share or sharing in the losses of the business or liability for claims by third parties against the business; and (5) an agreement to contribute or contributing money or property to the business. See Tex. Rev. Civ. Stat. Ann. art. 6132b-2.03 (expired Jan. 1, 2010); Tex. Bus. Orgs. Code Ann. § 152.052. The evidence relating to the factors must be considered under a totality-of-the-circumstances test, but the court noted that shared rights to profits and to control the business are generally considered the most important factors. Brown testified at trial that he and Keel had agreed to equally share profits and losses under their investment proposal, and Brown testified broadly as to sharing profits from investment management fees earned by the partnership entity and increases in the value of their investment, not merely compensation which was not indicative of a partnership interest. The jury was the sole judge of witness credibility and was free to credit Brown’s testimony as to the agreement with Keel to share profits. Keel offered no evidence tending to disprove such an agreement. Thus, the profit-sharing factor supported the jury’s finding that a partnership existed. Next the court analyzed the evidence of whether the parties expressed an intent to be partners. Brown’s conclusion and testimony that he believed the parties had formed a partnership was not competent evidence as to this factor; however, the jury could have reasonably inferred from Brown’s testimony that he and Keel expressed their mutual intent to be partners, “shook hands” on it before going to New York to seek potential investors, and made mutual statements to each other that they were partners. Although Keel denied making such statements, the jury was allowed to credit Brown’s testimony and discredit Keel’s contradictory testimony. The third factor was whether the alleged partners shared control of the business, i.e., the right to make executive decisions. Both parties testified that Brown and Keel worked together on the material presented to Oaktree, and Keel testified that Brown took the lead in negotiations with Oaktree on behalf of both of them. Brown also testified that he and Keel would both be a part of the management team and participate in the control of the business. This evidence constituted some evidence that Brown participated in the decision-making process of the venture with Keel, and there was no contrary evidence that decision-making authority was vested in Keel alone. The only evidence regarding the fourth factor of an agreement to share losses or liabilities was Brown’s testimony that he and Keel agreed to share losses and risks equally. Since the jury was free to credit Brown’s testimony, the testimony was some evidence as to this factor and provided support for the jury’s finding. Finally, Brown presented evidence of the fifth factor that he contributed money to the partnership when he made an $80,000 loan on behalf of the partnership to GulfWest to help cover the necessary due diligence costs in order for the proposed transaction with Oaktree to move forward. Brown also testified that he and Keel had agreed to contribute to closing costs as needed. Considering the totality of the circumstances, there was some evidence as to each of the five factors, and the court of appeals concluded that the evidence was legally sufficient to support the jury finding that Brown and Keel were partners. Thus, court of appeals held that the trial court erred in granting a JNOV on the ground that there was no evidence of a partnership.

Despite the evidence supporting the existence of a partnership, the court of appeals found that the trial court properly granted Keel’s motion for JNOV on the ground that there was no evidence that Keel caused Brown’s actual damages. At trial, Brown alleged that Keel’s breach of his duty of loyalty to Brown proximately caused Brown actual damages in the form of lost stock options. Keel asserted there was no evidence that his actions proximately caused Brown not to receive stock options in the new company because Oaktree would not go forward with the investment if hiring Brown as the CFO was a requirement. The court of appeals held that the jury had no basis to conclude that but for Keel’s conduct Brown would have received the stock options that were the basis of the jury’s award for actual damages, and the trial court did not err in granting Keel’s motion for JNOV on the ground that there was no evidence of causation. Therefore, the court affirmed the trial court’s take-nothing judgment in favor of Keel.

In a concurring and dissenting opinion, one justice maintained that the trial court’s grant of JNOV on the ground that there was no evidence of a partnership was error; however, the justice disagreed as to the majority’s causation holding and would have held there was evidence to support the jury’s finding that Keel’s breach of a partnership duty of loyalty caused Brown’s damages. The dissent pointed to evidence that Oaktree was open to hiring Brown in a role other than CFO and allowing him to receive the compensation he had negotiated until Keel resisted such a move. The dissent argued that a reasonable jury could infer that Keel’s actions were a substantial factor in having brought about Brown’s loss and that the trial court thus erred in disregarding the jury’s finding of causation and rendering a JNOV on this ground.
that Westside, Corporate Auto, Skafi, and Cannon created a partnership to conduct the SAFEClear business and that declaratory judgment that Westside was never a partner with Skafi and Cannon. After trial, the jury found, inter alia, among other causes of action, breach of fiduciary duties. Westside denied the claims, countersued, and sought a terminated Skafi and Cannon from services on Westside’s SAFEClear segments. Skafi and Cannon brought suit alleging, Disputes arose between the parties regarding the performance of the SAFEClear contracts. Westside eventually terminated Skafi and Cannon from services on Westside’s SAFEClear segments. Skafi and Cannon brought suit alleging, among other causes of action, breach of fiduciary duties. Westside denied the claims, countersued, and sought a declaratory judgment that Westside was never a partner with Skafi and Cannon. After trial, the jury found, inter alia, that Westside, Corporate Auto, Skafi, and Cannon created a partnership to conduct the SAFEClear business and that
Westside breached its fiduciary duties to Skafi and Cannon. The trial court disregarded the jury’s finding on the existence of a partnership and breach of fiduciary duties and held that the evidence was legally insufficient to support such findings. Skafi and Cannon appealed the judgment notwithstanding the verdict, and Westside raised a legal sufficiency challenge to the jury’s findings relating to the existence of a partnership.

The appellate court reviewed the evidence to determine whether the evidence was legally sufficient to support the jury’s finding that a partnership existed so as to support a breach of fiduciary duties claim. Skafi and Cannon urged the appellate court to find that the jury’s partnership finding was supported by legally sufficient evidence of the parties’ conduct in conformance with the requirements of the Texas Revised Partnership Act (TRPA), which governed the dispute although the statute expired January 1, 2010. The court noted that both TRPA and the Texas Business Organizations Code identify the same five factors for determining whether parties formed a partnership. These factors are: (1) the receipt or right to receive a share of profits of the business; (2) the expression of an intent to be partners in the business; (3) participation or the right to participate in control of the business; (4) an agreement to share or sharing in the losses of the business or liability for claims by third parties against the business; and (5) an agreement to contribute or contributing money or property to the business. The Texas Supreme Court held in *Ingram v. Deere*, 288 S.W.3d 886 (Tex. 2009), that, unlike the four-factor common law test, TRPA does not require proof of each element to establish the existence of a partnership. Instead, all factors should be considered in a totality-of-the-circumstances test, and no single factor is determinative. Conclusive evidence of only one factor normally will not be sufficient to establish the existence of a partnership, however conclusive evidence of all five factors will establish a partnership as a matter of law. The statute also lists circumstances that alone do not indicate that a person is a partner in a business.

The court of appeals considered the evidence related to each of the five factors courts use to determine the existence of a partnership and concluded that there was insufficient evidence to support the jury’s finding of a partnership. The court first noted that sharing profits is one of the most important factors in establishing the existence of a partnership. The evidence was undisputed that the parties did not share or account for the profits from their individual SAFEClear operations or share all of the expenses for their SAFEClear-related operations. The parties did not pool their profits and divide them among themselves, and they were not entitled to an accounting regarding each other’s profits. The parties shared in an opportunity but not in profits, so the first factor suggested the absence of a partnership. Next, the court considered whether the parties expressed an intent to be partners by looking at the parties’ speech, writings, and conduct. There was no evidence that all parties (i.e., Westside as well as Skafi and Cannon) expressed their intent to be partners. In fact, King was emphatic that Westside had no intention of being partners with anyone and did not want a partnership. King rejected a draft partnership agreement, and in the proposed partnership agreement Skafi’s and Cannon’s companies were included as subcontractors rather than partners. Cannon’s conclusory testimony that the parties had formed a partnership was legally competent evidence of his own understanding of an agreement but was not evidence of the other parties’ understanding. Furthermore, evidence as to the parties’ discussions of shared expenses, participation, and responsibility was relevant to show whether the parties shared expenses or control but not whether the parties expressed an intent to be partners. Reference to another as “partner” in a situation where the recipient would not expect the declarant to make a statement of legal significance was not enough to show an intent to create a partnership. None of the four towing companies changed their name to reference each other, registered an assumed name, shared a bank account or had signatory authority on each other’s bank account, filed a partnership tax return, or maintained insurance together. The second factor also suggested that the parties did not form a partnership. The third factor of sharing control of the business is another factor given particular importance in analyzing the existence of a partnership. The trial testimony of all four alleged partners was that each ran its own business and operated as four different companies. None of the four parties had any ability to act on behalf of or bind the others. The four owners of the towing companies did hire an individual to serve as their SAFEClear manager, and each paid an equal share of his salary. This individual handled numerous administrative tasks that were for the benefit of all four tow companies with respect to the SAFEClear contract, but a shared employee is not the same as shared control. The evidence indicated that the parties attempted to work together as separate business entities seeking to share in a mutually beneficial business opportunity, but they did not work together to exercise shared control over a single, united partnership entity or over each others’ individual business entities. The third factor thus suggested an absence of a partnership. The appellate court considered evidence related to the fourth factor and found that the evidence did not demonstrate that the parties shared losses or liabilities. Each party maintained its own separate liability insurance, and no party testified that it had an agreement such that it would share liability for the others’ drivers or debts. Although the parties shared certain expenses, sharing specific expenses is not evidence of sharing losses or liabilities. Therefore, the fourth factor did not support the existence of a partnership. Finally, the court determined there was some evidence of a partnership under the fifth factor of contributing money or property to the business. Skafi and Cannon shared expenses related to the SAFEClear contract, but sharing expenses does not necessarily constitute contributing money or property to a partnership. It was equally
consistent with the possibility that the four towing companies agreed to share the cost of obtaining a particular business opportunity in which all would participate equally but as individual companies. The SAFEClear bids listed all four towing companies’ assets, which, like the shared expenses, was equally consistent with the possibility that four separate companies were working together to obtain a business opportunity in which they each would participate. There was no evidence that the parties transferred ownership or any interest in their individual assets to a partnership entity or that any of the four towing companies had a right to possess or use assets belonging to one of the others. The only evidence as to the existence of a partnership was that Skafi and Cannon contributed money to the alleged partnership by issuing payments of SAFEClear fees purportedly made on behalf of the partnership. The towing companies owned by Skafi and Cannon made checks to Westside and Corporate Auto, not an alleged partnership entity, but the checks expressly noted that they were issued “as partner in City of Houston Major Freeway Tow Agreement.” Thus, under the fifth factor alone, there was some evidence of the existence of a partnership.

TRPA defines a partnership as “an association of two or more persons to carry on a business for profit as owners.” The court of appeals determined that the parties did not associate for the purpose of carrying on a single business in which they each held an ownership interest. Instead, the four separate businesses agreed to work together for their mutual, but individually realized, benefit. Such coordinated business efforts alone do not create a partnership under Texas law. The parties did not share profits, losses, or liabilities. Although the parties did share an employee, each party maintained exclusive control over his or her own business operations. There was no evidence that King or any other representative of Westside ever expressed an intent to be partners with Skafi and Cannon. In fact, uncontested evidence existed that King told the other parties that Westside would not form a partnership with anyone. There was, however, some evidence that Skafi and Cannon contributed money to the alleged partnership. In sum, there was no evidence of four of the five TRPA factors and only weak evidence of the fifth factor. Thus, considering the evidence in its totality, the evidence was not legally sufficient to support the jury’s findings that a partnership existed, and there was no predicate for Skafi’s and Cannon’s claim of breach of fiduciary duties. Therefore, the trial court properly disregarded the jury’s findings and did not err in entering a judgment notwithstanding the verdict in favor of Westside.


Lentz Engineering, L.C. (“Lentz”) sued Alden Brown for breach of contract and quantum meruit alleging that Brown was liable as a partner in a general partnership with William Wilkins, who contracted for Lentz’s services in June 2005. In 2004 and 2005 (before the contract with Lentz), Wilkins and Brown discussed acquiring and developing a piece of property, Wilkins contracted to purchase the property, Brown and Wilkins met with an attorney and agreed to form an LLC, Brown supplied funds for the purchase, and Wilkins acquired title to the property. In April 2005, one day after the property was acquired by Wilkins, the attorney filed the articles of organization for the LLC. The articles of organization identified Brown and Wilkins as managers. Brown and Wilkins also established a bank account for the LLC. Brown later became suspicious of Wilkins’s conduct and attempted to recover his money and obtain title to the property. Meanwhile, Wilkins contracted with Lentz to provide engineering services on the property. Lentz was never paid and sued Brown and Wilkins. Wilkins defaulted, and after a bench trial, the trial court made findings of fact and conclusions of law that included the following: (1) Brown and Wilkins agreed to establish the LLC for the purpose of owning and developing the property; (2) Brown and Wilkins were never general partners; and (3) Brown could not be personally liable for the contract between Lentz and Wilkins. Lentz appealed.

On appeal, Lentz argued that the trial court erred in finding that there was no general partnership between Brown and Wilkins because Brown judicially admitted in a motion for summary judgment that a partnership existed between Brown and Wilkins. The court examined the statements made in the motion for summary judgment and concluded that they were not clear, deliberate, and unequivocal as required to be considered a judicial admission. Furthermore, the court concluded that Lentz waived this argument by failing to object to the admission of evidence contrary to the alleged judicial admission. The court next looked at the sufficiency of the evidence with regard to the trial court’s conclusion that there was no partnership between Brown and Wilkins at the time of the contract with Lentz. The court recited the statutory definition 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 or whether the association is actually called a “partnership.” The court noted that an association or organization is not a partnership if it was created under the statute governing the formation of an LLC. The court also noted that partners in a general partnership may be held personally liable for debts and obligations of the partnership while managers or members of an LLC may not generally be held personally liable for the debts and obligations of the LLC. The court set forth the five factors identified by statute as indicating a partnership: (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 the right to participate in control of the business; (4) agreement to share
or sharing in the 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. The court discussed the guidance provided in Ingram v. Deere, 288 S.W.3d 886 (Tex. 2009), in which the Texas Supreme Court set forth a totality-of-circumstances test for applying the factors.

Lentz had the burden to establish the existence of a partnership, and the court examined the evidence relating to the statutory factors. The court found that there was some uncontroverted evidence weighing against the trial court’s finding, i.e., evidence that Brown and Wilkins agreed to split profits equally and that they participated or had the right to participate in the control of the business. However, there was also some uncontroverted evidence weighing in favor of the trial court’s finding, i.e., only Brown contributed money or property to the business. Additionally, there was controverted evidence weighing both for and against the trial court’s finding. There was evidence of Brown’s expression of intent to be partners, but this evidence was controverted by Brown’s testimony at trial and the formation of the LLC. The court discussed Lentz’s argument that the formation of an LLC does not displace a preexisting partnership, but the court concluded that the mere fact that promoters of a company engage in conduct to further the company’s formation and business does not per se establish a partnership under the Business Organizations Code so that partner-like liability of promoters may extend beyond the date of the company’s formation. Finally, there was no evidence that the parties agreed to share losses of the business or liability for claims by third parties. Thus, the court of appeals held that the trial court’s finding was not against the great weight and preponderance of the evidence given the totality of the circumstances.


Betty Domingo and Brenda Mitchell had been friends and co-workers for 30 years, and they began to play the Texas lottery in 2004 by pooling their money and splitting winnings equally. In March of 2006, Cindy Skidmore emailed a group of people, including Mitchell, and asked if they wanted to form a lottery group. According to Domingo, Mitchell invited Domingo and another co-worker to participate in the lottery group for April 2006. Six individuals referred to as the “LGroup” agreed to enter seventeen dollars for seventeen unique (i.e., not Quick Picks) lottery tickets. The group included Mitchell, Skidmore, and four other individuals. Mitchell paid her share and submitted her numbers, but she did not mention Domingo to the group or contribute money and numbers for Domingo to participate in the April drawings. In a later deposition, Mitchell testified that she told Domingo she did not pay Domingo’s part because she did not have enough money. At no time did Mitchell tell Domingo that she was not invited to play in April despite this being a defensive theory. One of the April tickets won and was worth almost $21 million. When Domingo was excluded from a share of the winnings, she filed suit for breach of contract against Mitchell arguing that but for Mitchell’s broken promise, she would have been entitled to a share of the winnings. Domingo sought joint and several liability against the six members of the LGroup as well as the LGroup, a Texas general partnership, contending that Mitchell acted with full authority of the LGroup under the Texas Revised Partnership Act. Following summary judgment motions by Mitchell, the appellate court found that a genuine issue of material fact existed as to whether Domingo and Mitchell had entered a valid oral contract and whether Mitchell had breached that contract. The case went to jury trial, and the jury found in favor of the six individuals and the LGroup in deciding that Domingo and Mitchell did not intend to bind themselves to an agreement with specific terms that were listed in the jury question (e.g., whether Domingo would participate in the LGroup for April 2006 and whether Mitchell would advance Domingo’s share of the ticket cost). The trial court signed the defendants’ motion for judgment on the verdict, denied Domingo’s judgment notwithstanding the verdict, and ordered Domingo take nothing. Domingo appealed.

On appeal, Domingo argued, among other issues, that the trial court erred by failing to grant her motion for directed verdict and judgment on the evidence as to whether a partnership existed. Domingo argued that the evidence conclusively established the existence of a partnership as a matter of law. The defendants maintained that a directed verdict was improper because evidence raised an issue of fact on the question. Domingo claimed that despite Mitchell’s denial that she entered into an oral contract with Domingo, Mitchell had the authority to do so under a general partnership. The court analyzed the evidence in light of the five statutory factors used to determine the existence of a partnership under the Texas Business Organizations Code: (1) the receipt or right to receive a share of profits of the business, (2) the expression of an intent to be partners in the business, (3) participation or the right to participate in control of the business, (4) an agreement to share or sharing in the losses of the business or liability for claims by third parties against the business, and (5) an agreement to contribute or contributing money or property to the business. Skidmore and Mitchell were the only members of the LGroup to testify at trial. Skidmore testified that the LGroup was a trust and that after the defendants won the lottery in April 2006 an attorney set up the LGroup Managed Trust. Mitchell offered no testimony regarding the LGroup as a partnership. In addition, no evidence was presented that all of the
defendants expressed an intent to be partners, participate in control of the LGroup, or be liable for claims by third parties. In discussing how many factors are required to form a partnership, the Texas Supreme Court In *Ingram v. Deere* determined that courts should apply a totality of the circumstances test. Under this test, if conclusive evidence establishes all five factors, a partnership exists as a matter of law. In this case, the court of appeals determined that there was not conclusive evidence establishing any of the factors. Thus, a partnership was not established as a matter of law. The court of appeals held that the trial court did not err in refusing to grant a directed verdict on the issue of the existence of a partnership and affirmed the trial court’s judgment.


Thomas Flores and his brother Senovio Flores entered into an alleged agreement to acquire, develop, and sell several tracts of real property together. The parties agreed Thomas would provide the working capital and that his engineering company would furnish engineering services to enhance the properties’ marketability. Senovio was responsible for holding the properties in his name, marketing the properties, and ensuring that all taxes on the properties were paid. When the properties’ tax obligations were not fulfilled, liens were placed on the properties and various taxing entities initiated foreclosure proceedings. Thomas filed suit against Senovio seeking to establish the existence and assets of a partnership and the rights of the parties. Thomas alleged that Senovio owed Thomas a fiduciary duty based on their partnership agreement and that Senoio breached his fiduciary duty to Thomas by jeopardizing ownership of the properties by failing to pay the property taxes owed. Thomas also sought to impose a constructive trust on the properties acquired in Senovio’s name for the benefit of the partnership. The trial court entered a post-answer default judgment in favor of Thomas.

In a restricted appeal Senovio argued, among other issues, that the evidence was insufficient to support the trial court’s default judgment in favor of Thomas. Senovio contended that the evidence was insufficient to support the trial court’s finding because Thomas failed to establish the existence of a partnership. The appellate court stated that Senovio waived his contention because he did not support it in the appeal with legal analysis. The court went on to explain that even if Senovio had not waived this contention, the record did contain evidence to support the existence of a partnership between Senovio and Thomas, relying on the definition of a partnership and statutory factors set forth in the Texas Business Organizations Code and the Texas Supreme Court’s guidance in *Ingram v. Deere*. Texas law defines a partnership as “an association of two or more persons to carry on a business for profit as owners.” Tex. Bus. Orgs. Code Ann. § 152.051(b). There are five statutory factors courts consider when determining whether a partnership was formed: (1) the receipt or right to receive a share of profits; (2) the expression of an intent to be partners; (3) the right to participate in control of the business; (4) an agreement to share losses or liabilities; and (5) an agreement to contribute money or property to the business. Courts applying these factors are to use a totality of the circumstances test. No one factor is dispositive. Under this test, conclusive evidence as to all five factors establishes the existence of a partnership as a matter of law, and the absence of all five factors precludes the recognition of a partnership as a matter of law. Typically, conclusive evidence of only one factor is insufficient to establish the existence of a partnership. According to the court of appeals, the record supported the existence of a partnership between Senovio and Thomas because Thomas controlled the engineering aspects of the partnership, contributed significant amounts of money to the partnership, and had the right to an equal share of the profits from the sale of the partnership’s investment properties. Based on the trial court’s finding that Senovio had breached his fiduciary duty to Thomas in relation to the partnership, the court of appeals held there was a sufficient basis for the trial court to impose a constructive trust on the investment properties held in Senovio’s name.


The plaintiff, a software company, sued Accenture, LLP, a global consulting company, alleging breach of fiduciary duty and various other claims. The court applied the old four-factor test of a joint venture, i.e., (1) mutual right of control, (2) community interest, (3) sharing of profits as principals, and (4) sharing of losses, costs, or expenses, and concluded that the various agreements between the plaintiff and Accenture did not create a joint venture such that there was a formal fiduciary relationship. The court briefly described the purpose of each agreement and noted that several of the agreements provided that each party would bear its own costs. The plaintiff also alleged that Accenture aided and abetted a breach of fiduciary duty by a third party with whom the plaintiff had contracted. The third party was a global business accounting software company, and the court likewise concluded that the plaintiff’s relationship with this company did not amount to a joint venture that would give rise to a formal fiduciary relationship because the agreement expressly disclaimed the creation of a partnership or joint venture and provided that each party would bear its own costs on the project.
Alardin sued Hoss alleging that he and Hoss orally formed a partnership and that Hoss breached his fiduciary duty arising from that partnership. The jury found that a partnership existed and that Hoss breached his fiduciary duty. The alleged partnership arose out of Hoss’s contribution of $25,000 and some equipment to Alardin’s SiteWatch project (a surveillance technology project). Consistent with the Texas Revised Partnership Act (“TRPA”) the jury was instructed that “an association of two or more persons to carry on a business for profit creates a partnership, regardless of whether: (1) the persons intend to create a partnership or (2) the association is called a ‘partnership’, ‘joint venture’, or other name.” The instruction also set forth the following five factors that indicate the existence of a partnership: (1) receipt or right to receive a share of profits of the business; (2) expression of intent to be partners in the business; (3) participation or right to participate in control of the business; (4) sharing or agreeing to share losses and liabilities of the business; and (5) contributing or agreeing to contribute money or property to the business. The recitation of these factors tracked the statute except for a minor variation with regard to the way the fourth factor was stated, as further explained below. The court noted that Ingram v. Deere characterized the five-factor test as a “totality-of-the-circumstances test.” The court also noted the guidelines provided by the supreme court in Ingram, i.e., that no evidence of any of the factors will preclude recognition of a partnership under TRPA, that conclusive evidence of only one factor is normally insufficient, and that conclusive evidence of all five factors will establish the existence of a partnership as a matter of law. Between these extremes, the challenge of applying the totality-of-the-circumstances test is presented. The court noted that the commentary to TRPA states that the sharing of profits and control have traditionally been regarded as the most important factors and will probably continue to be the most important factors under the statute. The court also noted that TRPA specifically provides that an agreement to share losses is not a required element of a partnership. The court then examined the evidence pertaining to each of the five statutory factors.

First, the court looked at the profit sharing factor. An agreement to share gross revenues alone is insufficient to satisfy this element. Alardin offered no evidence that the venture generated any profits, and Hoss testified that it never made a profit. Alardin’s primary evidence of an agreement to share profits was his own personal testimony. The court found this testimony to be some evidence of an agreement to share profits but characterized the evidence as “weak and self-contradictory.”

Second, the court looked at the expression of intent factor. Merely referring to another person as “partner” in a situation where the recipient of the message would not expect the declarant to make a statement of legal significance is not enough. Further, there must be evidence that both parties expressed their intent to be partners. Alardin again relied on his own testimony in attempting to satisfy this element. He also pointed to Hoss’s trial testimony that he was “partnering with [Alardin] to try to get him into a business where he could be successful.” The court stressed that the terms used by the parties do not control and that the context of the statements is most important in determining whether they evidence a legal partnership. Business people often use the words “partner” and “partnership” to mean any sort of close business relationship and not strictly to mean a legal partnership. Further, legal conclusions by a lay witness do not prove the existence of a partnership. Thus, the court found that no evidence supported the argument that Hoss expressed any intent to form a legal partnership with Alardin.

Third, the court looked at the factor of participation in or right to participate in control. The focus of this element is the right to make executive decisions. Relevant factors for control include exercising authority over the business’s operations, the right to write checks on the business’s checking account, control over and access to the business’s books, and receiving and managing all of the business’s assets and monies. The court found that Alardin offered no evidence showing that he exercised control over the business’s operations or made any executive decisions. At most, Alardin directed Hoss’s employees that Hoss assigned to Alardin’s SiteWatch project.

Fourth, the court looked at the factor regarding sharing of losses or liabilities. The court noted that the jury instruction stated the factor as whether the parties shared or agreed to share the “losses and liabilities of the business” rather than precisely tracking the language of TRPA, which refers to losses or liabilities of the business. Because there was no objection to the instruction, the court evaluated the evidence under the instruction given. The court noted that an agreement to share losses is not necessary to create a partnership under TRPA, but the existence of such an agreement supports the existence of a partnership. Again, Alardin relied only on his own testimony. In response to a question at trial as to whether he and Hoss agreed to share liabilities, Alardin answered “Yes.” The court found that this statement alone was insufficient evidence to support an agreement to share losses and that there was thus no evidence of the fourth factor as submitted to the jury.

Fifth, the court looked at the fact regarding contribution of money or property. TRPA defines “property” as “all property, real, personal, or mixed, tangible or intangible, or an interest in that property.” Hoss argued that certain loans he made were not contributions to a partnership and that there was no other evidence that he contributed money
or property to the alleged partnership. The court stated that loans of money can constitute contributions to the business under TRPA although TRPA provides that the right to repayment of a debt by itself does not indicate a partnership relationship. Alardin argued that Hoss agreed to contribute financing, business management, credit, mentoring, and resources of Hoss’s own business. Alardin testified that Hoss contributed a piece of equipment to the project, agreed to help Alardin with the credit situation, and allowed Alardin to use facilities and personnel of Hoss’s business. The court stated that helping someone obtain credit from a third party is not a contribution of money or property and that evidence of contributions by Hoss’s business was no evidence of contributions by Hoss individually. Further, even though there was evidence that Hoss made loans toward the project and contributed a piece of equipment used as part of the project, there was no evidence that Alardin himself contributed or agreed to contribute money or property to the project. Therefore, the court found no evidence to support this factor.

Having concluded that there was no evidence of four of the five factors and that the evidence of an agreement to share profits was weak and self-contradictory, the court also noted other evidence that pointed away from the existence of the partnership. Despite Alardin’s allegation that the partnership existed for several years, the alleged partnership never filed a federal or state partnership tax return. It never applied for its own federal tax identification number or issued K-1 tax forms to its partners. Further, the alleged partnership did not have a name. There was also no evidence that anyone, including Alardin, ever treated the alleged partnership as a distinct entity independent of the people and companies that participated in the SiteWatch project. Finally, in his own pre-litigation documentation, Alardin did not refer to the partnership at all. Based on this analysis, the court concluded that the evidence was legally insufficient to support the jury’s finding of a partnership between Hoss and Alardin. Because no partnership existed, Hoss could not have breached a fiduciary duty arising out of the alleged partnership.

_Carpenter v. Phelps_, 391 S.W.3d 143 (Tex. App.—Houston [1st Dist.] 2011, no pet.).

The court reviewed the factors indicating a partnership and the circumstances that by themselves do not indicate a partnership under the Texas Revised Partnership Act and noted the Texas Supreme Court’s explanation in _Ingram v. Deere_ that the issue of a partnership’s existence should be decided based upon a totality-of-the-circumstances test. The court also noted that the supreme court stated that an absence of any evidence of the factors precludes recognition of a partnership under Texas law. The court concluded that there was no evidence in this case of any of the statutory factors apart from an alleged agreement regarding the acquisition of an oil and gas lease, and that agreement was unenforceable under the statute of frauds. Thus, the trial court erred in concluding that the parties were partners in the oil and gas lease in issue.


The plaintiff claimed that it entered into a joint venture with the defendant and that the defendant breached a fiduciary duty owed to the plaintiff by virtue of the joint venture relationship. The defendant sought summary judgment on the basis that there was no evidence of a joint venture, and the court analyzed whether there was a fact issue as to the existence of a joint venture between the parties. Noting that the Texas Supreme Court has stated that there is no reason to distinguish a joint venture from a partnership, the court cited the statutory definition of a partnership as “an association of two or more persons to carry on a business for profit as owners,” and the court listed the five factors set forth in the Business Organizations Code indicating the existence of a partnership: (1) the receipt or right to receive a share of profits, (2) the expression of an intent to be partners, (3) the right to participate in control of the business, (4) an agreement to share losses or liabilities, and (5) an agreement to contribute money or property to the business. The court noted the guiding principles provided by the Texas Supreme Court in _Ingram v. Deere_, i.e., that no one factor is dispositive, that conclusive proof of all five establishes a partnership as a matter of law, and that conclusive proof of only one is typically insufficient. The plaintiff pointed to three categories of evidence to support its claim that a joint venture existed: (1) a deposition of the plaintiff’s founder and sole shareholder in which he testified that he and the defendant’s founder “agreed to have a partnership” and that they “talked about what our partnership and what our agreement as partners would be;” (2) a fee-splitting agreement concerning television advertising; and (3) the contribution of property to the venture by the plaintiff in the form of the plaintiff’s reputation. The court noted that the plaintiff offered no evidence regarding the third and fourth factors, i.e., the right to participate in the control of the business or the sharing of losses or liabilities. As to the first factor, the court noted that the plaintiff argued that profit sharing was not essential to establish a joint venture and did not argue that the fee-splitting agreement involved the sharing of profits as opposed to sharing of revenue or income. As to the fifth factor, the plaintiff presented only argument, but no summary judgment evidence, that it had a good reputation that could be considered capital for the joint venture. That left the expression of intent as the only remaining factor, and the court found that the first category of evidence alone would not lead a
reasonable jury applying Texas law to conclude the parties entered a joint venture. The court determined that the mere fact that the parties used the terms “partners” and “partnership” was non-controlling and constituted conclusory testimony of the type that the Texas Supreme Court characterized as insufficient in *Ingram v. Deere*. In context, the deposition testimony relied upon was confusing and ambiguous and was insufficient to give rise to a fact issue regarding the creation of a joint venture given the absence of any evidence of any of the other four factors. Thus, the court granted the summary judgment motion of the defendant on the breach of fiduciary duty claim.


The plaintiff sought to impose liability on a lender for its borrower’s obligation based on a de facto partnership theory. The court cited the old four-factor test for the existence of a de facto partnership, i.e., (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 business. The court dismissed the claim because the complaint contained only conclusory allegations and lacked the factual allegations necessary for a de facto partnership.

**B. Partner’s Personal Liability**


The plaintiff sought to hold Tripplehorn and Aspen Development Company, LLC (“Aspen”) liable on a contract executed by Rollings on the basis that Rollings and Tripplehorn, on behalf of Aspen, formed a joint venture. The court concluded that the evidence supported the jury’s finding that the parties formed a joint venture, but an improper judgment was not caused by the trial court’s disregard of the finding because the contract entered into by Rollings was not an obligation of the joint venture. The court acknowledged that a joint venturer, like a partner in a partnership, is jointly and severally liable for joint venture debts and obligations, citing Section 152.304 of the Texas Business Organizations Code, but the court cited Section 152.302 and case law for the proposition that a joint venturer may only be held liable on obligations made on behalf of the joint venture. The contract did not give any indication that any individual or entity other than Rollings was a party or obligated under the contract. Further, the party who contracted with Rollings did not know of the existence of the joint venture or Tripplehorn or Aspen when the contract was executed. Because the contract was not a debt or obligation of the joint venture, as opposed to Rollings, it was not an obligation for which Tripplehorn could be held liable.


American Star Energy and Minerals Corporation (“American”) obtained a judgment against S & J Investments, a Texas general partnership. When the judgment could not be satisfied through the assets of the partnership, American sued the individual partners of the partnership. It was undisputed that the cause of action on which the judgment against the partnership was based accrued more than four years before the partners were sued individually, but American argued that its suit against the partners was timely because it sued the partners within four years of the date of the judgment. The partners argued that they had to be sued within the same limitations period applicable to the suit against the partnership, and the court of appeals agreed. The court based its conclusion on Sections 152.304-152.306 of the Texas Business Organizations Code, which provide that partners are jointly and severally liable for the obligations of the partnership, that an action may be brought against a partnership and any or all of its partners in the same or separate actions, and that, although a judgment against a partnership is not by itself a judgment against a partner, a judgment may be entered against a partner who has been served with process in a suit against the partnership. The court stated that these provisions recognize both the existence of a chose in action against the individual partners and its accrual at the same time the claim accrues against the partnership. American argued that it sued on the judgment against the partnership rather than the claim on which the judgment was founded, relying on *In re Jones*, 161 B.R. 180 (Bankr. N.D. Tex. 1993) and *Evanston Insurance Co. v. Dillard Department Stores, Inc.*, 602 F.3d 610 (5th Cir. 2010). The court rejected the reasoning in those cases because the courts in those cases did not address the applicable provisions of the Texas Business Organizations Code.

A concurring justice wrote to address two points. First, the concurring justice stated that the Texas Supreme Court’s opinion in *In re Allocat Claims Service, L.P.*, 356 S.W.3d 455 (Tex. 2011) did not require a different conclusion. In that case, the supreme court held that the Texas Revised Partnership Act unequivocally embraced the entity theory of partnership. However, the legislature retained the joint and several liability of partners as a feature of partnership law,
and the concurring justice did not see any intention by the legislature to distinguish between the cause of action against the partnership and the cause of action against the partners. Second, the concurring justice stated that Fifth Circuit precedent contradicted the bankruptcy court’s conclusion in In re Jones that under the entity theory a partner logically has no liability until the partnership has liability.

The lengthiest opinion in this case was the dissenting opinion. The dissenting opinion describes in more detail the protracted history of American’s judgment against the partnership, which included two appeals that concluded with the Texas Supreme Court’s denial of a petition for review in each instance. When American finally proceeded to collect the judgment, the partnership asserted its assets were insufficient to satisfy it. The dissenting justice then discussed at length the rationale that the cause of action asserted against the partners was not a breach-of-contract cause of action but rather an action based on the statutory liability of the partners for the partnership’s obligation on the contract. The dissenting justice pointed out that the Texas Business Organizations Code generally does not permit a partnership creditor from pursuing a partner’s assets unless the creditor has obtained an unsatisfied judgment against the partnership as well as a judgment against the partner, either in the same suit or in separate actions. The dissenting justice did not interpret American’s ability to sue the partners and the partnership in the same action to mean that the cause of action against the partners was based on breach of contract since American did not contract with the partners and was required to obtain a judgment against the partnership before pursuing the partners’ property. The dissenting justice likened the situation to that in which a third-party claim for indemnification may be asserted against a party who may be liable for all or part of a plaintiff’s claims. Further, the dissenting justice argued that the policies underlying statutes of limitations were not implicated here because American timely pursued its claim against the partnership, and American’s claim against the partners did not arise until a judgment against the partnership meeting the requirements of Section 152.306(b) was obtained. Thus, the dissenting justice would have held that American’s claim against the partners did not arise until a final judgment was entered against the partnership that remained unsatisfied for ninety days after it was entered.

C. Power of Partner to Bind Partnership


Partners in a real estate partnership sought to hold a law firm liable for breach of fiduciary duty and knowing participation in breach of fiduciary duty in connection with transfers of real estate involving Maynard, a partner in the real estate partnership who was also a partner in the law firm, and Judy Maynard, Maynard’s wife and trustee for the partnership. The law firm sought and obtained summary judgment, and the plaintiffs appealed. The court of appeals concluded that there was no summary judgment evidence of an attorney-client relationship between the law firm and the real estate partnership, and the summary judgment record also did not contain any evidence that the law firm knowingly participated in a breach of fiduciary duty by Judy Maynard.

To recover for breach of fiduciary duty, a plaintiff must show that the defendant owed a fiduciary duty. Thus, the court analyzed whether there was evidence of an attorney-client relationship between the real estate partnership and the law firm. The plaintiffs conceded that the parties did not expressly reach an agreement to provide legal services, but they contended that they raised facts to allow an agreement to be implied. The plaintiffs pointed to several pieces of correspondence from Maynard to other partners of the real estate partnership or third parties regarding the real estate partnership’s affairs. Some of the letters were on letterhead that showed Maynard’s name and the law firm address but did not mention the firm’s name, and some were on law firm letterhead. The transmittal letter for a deed prepared by Maynard for the partnership instructed the clerk to return the deed to Maynard in care of the law firm at the firm’s address, and the partnership bank account had the law firm’s address. Given Maynard’s concurrent status as a partner in the real estate partnership, the court said his status as a partner in the law firm, standing alone, was insufficient to raise a fact issue that his actions constituted legal services within the scope of the law firm’s business. The court cited Tex. Bus. Orgs. Code Ann. § 152.301, which provides that each partner is an agent of the partnership for the purpose of the partnership. The letters that showed Maynard’s name and the law firm address without naming the law firm complied with the law firm’s policy that attorneys use personal letterhead, on which they may list the law firm’s address, for non-firm matters. Maynard’s use of law firm letterhead in the real estate partnership’s affairs on two occasions over a four-year period did not raise a fact issue as to whether the law firm agreed to provide legal services. The court distinguished other cases relied on by the plaintiffs and stated that the plaintiffs did not identify any evidence that Maynard or the law firm undertook any action leading anyone in the real estate partnership to believe the firm represented the partnership. The court stated that the plaintiffs’ unstated perceptions of Maynard’s role as a partner in their partnership business did not raise a fact issue concerning the existence of an attorney-client relationship between the firm and the partnership where none was communicated by either party.
The court next addressed the trial court’s summary judgment in favor of the law firm on the plaintiffs’ claim that the law firm knowingly participated in an alleged breach of fiduciary duty by Judy Maynard (Maynard’s wife and trustee of the partnership). To establish that a defendant knowingly participated in another’s breach of fiduciary duty, a plaintiff must prove that the defendant (1) knew of the fiduciary’s breach of duty to the plaintiffs and (2) was aware that it was participating in the breach of duty. The law firm’s affidavit negated the first element because the executive director of the firm stated that he was unaware that Judy Maynard was trustee of the real estate partnership. The court rejected the argument that the law firm had imputed knowledge of Maynard’s services to the partnership based on Maynard’s status as a named partner in the firm and that he knowingly participated in his wife’s breach of fiduciary duty. The court stated that none of the summary judgment evidence supported a finding that Maynard acted as a law firm partner rather than a partner of the real estate partnership that he was. The court stated that the law firm could be held liable only for the wrongdoings of its agents committed in the scope of their duties for the firm and imputed knowledge was insufficient to find knowing participation in a breach of fiduciary duty.


In 2007, Dr. Martinez performed gall bladder surgery on Amanda Jones at the Brazoria County Surgery Center, which was the d/b/a name for Foundation Surgery Affiliates of Brazoria County, LLP, a general partnership registered as a limited liability partnership. Martinez became a partner in the partnership in November 2006. Jones filed suit against the partnership and Martinez following the surgery, alleging that Martinez committed egregious surgical errors causing catastrophic injury to Jones and that the partnership was vicariously liable for the medical negligence of Martinez since he was a partner in the partnership.

The partnership was formed in 2003 under the Texas Revised Partnership Act (TRPA) to perform the business or professional service of conducting outpatient surgery. The partnership owned and operated a multi-specialty outpatient surgery center in Brazoria County. In 2006, Martinez purchased a partnership interest and became a partner under the subscription agreement. The agreement contained risk factors such as the requirement that all of the investors (i.e., partners) be physicians in different specialties or hospitals, that the partners had limited rights in the management or control of the partnership business, and that the partnership had limited control over the actions of physicians who may treat their patients at the partnership. The summary judgment evidence included deposition testimony from Cardenas, the surgery center’s vice president of operations. Cardenas testified that the business of the partnership was to provide a facility (the surgery center) – as well as nursing staff, technical staff, scrub techs, supplies, equipment, and a business staff – where its partners could perform their surgeries, and at the time of Jones’s surgery Martinez was one of ten of the partnership’s partner-surgeons. The partnership billed the patients and insurance carriers for services performed, and resulting profits were periodically distributed to the partners on a pro rata ownership basis. Under the partnership agreement, each partner-surgeon was obligated to perform one-third of his or her outpatient cases and derive one-third of his or her income at the partnership’s surgery center. Failure to meet these requirements would result in revocation of the partnership interest. The trial court granted the partnership’s motion for summary judgment, finding that the partnership was not vicariously liable for the actions of its partner Martinez.

On appeal, the court of appeals first addressed which law governed the suit. Although the parties agreed that TRPA controlled because the partnership was formed in 2003 and governed at the time of Jones’s surgery, the court of appeals applied the Texas Business Organizations Code (BOC) because the TRPA expired on January 1, 2010, and was replaced by the TBOC. The court noted that the TRPA provisions relied on by the parties were substantially the same as the provisions of the TBOC.

Next, the court of appeals addressed the central issue. Jones argued that the trial court erred in granting the partnership’s motion for summary judgment because Jones presented more than a scintilla of evidence that Martinez was acting as a partner in the ordinary course of the partnership’s business when Jones was injured. Jones argued that the partnership was vicariously liable for the acts of Martinez because he was a partner in the partnership at the time of his actions, and partnerships are liable for the actionable conduct of their partners in the ordinary course of business. Martinez was not a party to the appeal. Specifically, Jones alleged that the business purpose of the partnership was to operate an outpatient surgical facility where its partner-surgeons would perform a portion of their surgeries. As a partner, Martinez was obligated to perform a minimum percentage of his outpatient surgeries at the partnership’s surgery center. Thus, according to Jones, Martinez was acting in the ordinary course of the partnership’s business in furtherance of the partnership’s goals when he negligently performed the outpatient surgery on Jones at the surgery center, and the partnership was liable for damages caused by one of its partners. In contrast, the partnership contended that Jones did not and could not provide any evidence that Martinez was acting in the ordinary course of the partnership’s business when Jones was injured. The partnership claimed it was impossible for Martinez to have been acting in the ordinary
course of the partnership’s business when he operated on Jones because Martinez was practicing medicine when he injured Jones, and the partnership was prohibited by statute from practicing medicine (i.e., the Texas Occupations Code states that only a “person” may be licensed to practice medicine in Texas). Following the partnership’s reasoning, the practice of medicine could not be its ordinary course of business. The court considered the BOC, which provides that each partner is an agent of the partnership for the purpose of its business. Tex. Bus. Orgs. Code §152.301. In addition, the actions of a partner in a partnership bind the partnership if the act is apparently for carrying on in the ordinary course the partnership business or the business of the kind carried on by the partnership. Tex. Bus. Orgs. Code § 152.302(a).

However, an act of a partner that is outside the scope of the partnership business binds the partnership only if authorized by the other partners. Tex. Bus. Orgs. Code § 152.302(b). Finally, under the BOC, a partnership is liable for injuries resulting from a wrongful act or omission or other actionable conduct of a partner acting in the ordinary course of business of the partnership or with the authority of the partnership. Tex. Bus. Orgs. Code § 152.303. The uncontested summary judgment evidence of the partnership’s filings with the Secretary of State as a registered LLP, the partnership subscription agreement, and the testimony of Cardenas showed that Martinez was a partner in the partnership at the time he performed the outpatient surgery on Jones at the surgery center. The filings also showed that the partnership’s purpose was to own and operate a multi-specialty outpatient surgery center in Texas. The court held there was more than a scintilla of evidence to show that Martinez was acting in the ordinary course of the partnership’s business when he performed surgery on Jones, and that Jones had raised a material fact issue as to whether the partnership was vicariously liable for any loss or injury incurred as a result of a wrongful act or omission or other actionable conduct of Martinez in performing the surgery. The court addressed the partnership’s contention that its ordinary course of business could not be the practice of medicine because a partnership cannot be licensed to practice medicine. The partnership cited the testimony by Cardenas that the partnership business was merely to provide a facility, staff, and equipment where its partner-surgeons could perform their surgeries. According to the partnership, utilizing the facilities and its resources was not equivalent to providing that facility and its resources, so there was no evidence Martinez was acting in the ordinary course of the partnership’s business when he performed the surgery on Jones. The court disagreed and explained that the partnership’s contention ignored its own filings with the Texas Secretary of State and the plain language of its subscription agreement, which stated that its business was outpatient ambulatory surgery. Thus, the trial court erred in granting summary judgment to the partnership on its claim that Martinez was not acting in the ordinary course of the business of the partnership when he operated on Jones such that the partnership could not be held vicariously liable for the wrongful conduct of Martinez.

The court of appeals next addressed Jones’s second point of error, under which Jones claimed that there was evidence that the partnership authorized Martinez’s actions. Since the court of appeals had already held that the allegedly wrongful conduct of Martinez occurred in the ordinary course of business, the court stated that it was unnecessary to reach this second argument because a partnership must be shown to have authorized the acts of a partner for liability to attach only if the wrongful conduct at issue was not within the ordinary course of business. However, the court chose to explain why it found the partnership’s arguments that it did not authorize or ratify Martinez’s surgery to be contradicted by the law and summary judgment evidence. The partnership argued that it was prohibited from authorizing Martinez’s treatment and care of Jones because (1) the partnership was prevented by law from controlling the treatment decisions made by Martinez, and (2) the summary judgment evidence showed that the partnership authorized only medical treatment within the scope of reasonable care, whereas Martinez’s acts were outside the scope of reasonable care. The partnership also maintained that it did not ratify Martinez’s unauthorized acts, and thus the partnership could not be vicariously liable for the negligent treatment provided by Martinez. The court rejected these arguments. The BOC allows doctors to form partnerships that are jointly owned by the practitioners to perform a professional service that falls within the scope of practice of those practitioners. Tex. Bus. Orgs. Code § 152.055. The partnership’s conclusion that it did not authorize Martinez to conduct surgery at the surgery center was contradicted by the evidence, such as the subscription agreement acknowledging that the partnership had control of Martinez’s authorization to provide professional services by performing outpatient surgery within his specialty at the surgery center as a partner in the partnership. The evidence also showed the partnership expressly authorized Martinez to perform surgery on Jones at the surgery center, the partnership accepted his investment in and services to the partnership, and the partnership accepted remuneration from Martinez’s share of the partnership’s profits. The court stated that evidence that the partnership did not control Martinez’s treatment decisions with respect to the performance of the operation was not evidence that Martinez’s surgery on Jones was not authorized by the partnership, as it was plainly authorized. The partnership’s argument that it only authorized surgeries within a reasonable standard of care and thus was not liable for wrongful conduct of a partner would allow partnerships to never be held liable for wrongful acts of any partner in providing the professional services it was organized to perform. The partnership granted Martinez permission to perform outpatient surgery in his specialty at the surgery center in the ordinary course of partnership business and thus was potentially liable
for the manner in which that surgery was performed through its responsibility to operate a health-care facility that met the professional standard of care for the practice of medicine within each partner’s specialty. There was more than a scintilla of evidence that the partnership authorized Martinez to perform the surgery on Jones and that any wrongful act or omission or other actionable conduct that Martinez committed with respect to that surgery was committed with the partnership’s authority. Therefore, the trial court erred in granting the partnership’s motion for summary judgment on the ground that the partnership did not authorize Martinez’s conduct.

D. Partner’s Fiduciary Duty

[Note: The Texas Uniform Partnership Act (in effect in Texas from 1962 through 1999) addressed only certain aspects of the fiduciary duties of partners. In fleshing out the fiduciary duties of partners, courts have often spoken in broad, sweeping terms. At times, courts have even referred to partners as trustees. Section 4.04 of the Texas Revised Partnership Act (“TRPA”) (which went into effect January 1, 1994, and expired January 1, 2010) included a more specific and comprehensive description of partner duties than the Texas Uniform Partnership Act but eschewed some of the broader language found in some cases. The BOC recodified and carries forward the provisions of Section 4.04 of TRPA. See Tex. Bus. Orgs. Code §§ 152.204-152.206. TRPA and the BOC certainly describe the core of what has traditionally been referred to by the courts as partner fiduciary duties, but the Bar Committee comments to TRPA reflect the Committee’s hope that the statutorily described duties will not be expanded by loose use of “fiduciary” concepts from other contexts or by the broad rhetoric from some prior cases. See Tex. Rev. Civ. Stat. Ann. art. 6132b-4.04 (expired), Comment of Bar Committee--1993. In fact, the drafters of TRPA quite deliberately refrained from using the term “fiduciary,” and TRPA and the BOC explicitly provide that a partner is not a trustee and is not to be held to such a standard. On the other hand, the statutes leave the courts some flexibility because the duties are not listed or described in exclusive terms, and the statute states that a partner is an agent, which is a status that has been held to be of a fiduciary nature under Texas case law. Thus far, there is relatively little case law addressing these provisions of TRPA or the BOC. The Texas Supreme Court addressed Section 4.04 of TRPA in one case and indicated that the law as it applied in that case was not changed by TRPA; however, the case was actually governed by TUPA. See M.R. Champion, Inc. v. Mizell, 904 S.W.2d 617 (Tex. 1995). In Johnson v. Brewer & Pritchard, P.C., 73 S.W.3d 193 (Tex. 2002), the Texas Supreme Court noted that it had historically held that partners owe one another certain fiduciary duties, but stated: “We need not consider here the impact of the provisions of the Texas Revised Partnership Act [Section 4.04] on duties partners owe one another.” A Fifth Circuit Court of Appeals case pointed out that TRPA “significantly amended” partnership law in 1994 to “refine the nature and scope of partners’ duties to each other.” See In re Gupta, 394 F.3d 347 (5th Cir. 2004). In Ingram v. Deere, 288 S.W.3d 886, 892 n.1 (Tex. 2009), the Texas Supreme Court noted that Section 4.04 of TRPA recognizes “the unwaviable duties of care and loyalty and the obligation of good faith” and referred to Bohatch v. Butler & Binion, 977 S.W.2d 543, 545 (Tex. 1998) as recognizing that the relationship between partners is fiduciary in character as a matter of common law. Cases dealing with limited partnerships have cited Section 4.04 of TRPA along with case law in characterizing the duties of partners as traditional fiduciary duties. In In re Jones, 445 B.R. 677 (Bankr. N.D. Tex. 2011), the court discussed the statutory developments and concluded that the changes in Texas statutory partnership law in recent years expunged the concept of a partner as a per se fiduciary but did not eliminate the fiduciary status of a managing general partner because of the control exercised by such a partner. In re Jones and other fiduciary duty cases arising in the limited partnership context are summarized in Section III of this paper.]


The trial court erred in sanctioning the plaintiff in this case with respect to the plaintiff’s breach of fiduciary duty claim. The petition, “[w]hile not a model of clarity,” sued the defendant as a “conspiring defendant” with parties who were allegedly in a fiduciary relationship with the plaintiff by virtue of a joint venture with the plaintiff. The court stated that partners in a partnership may owe particular duties to one another as determined by the partnership agreement based on Tex. Bus. Orgs. Code § 152.002, which provides that the partnership agreement governs the relations of the partners. The court also cited Tex. Bus. Orgs. Code §§ 152.205, 152.206, 152.204(b), which define the duties of loyalty and care owed by partners and provide for an obligation of good faith. The court also stated that some case authority exists in Texas to support the proposition that a party who knowingly participates in another’s breach of fiduciary duty may be liable for the breach as a joint tortfeasor. Because there was some basis to assert the application of existing law to the alleged facts, the plaintiff’s claim, even if without merit, was a nonfrivolous argument for the extension,
modification, or reversal of existing law or the establishment of new law, and the trial court erred in sanctioning the plaintiff for filing the breach of fiduciary duty claim.


Naples and Gurav sued Lesher for breach of their partnership agreement and breach of fiduciary duty, among other claims. The trial court granted summary judgment on some of the claims, including the claim for breach of fiduciary duty. The trial court granted summary judgment on the breach of fiduciary duty claim on the basis that “there was no duty created by the GLN Partnership Agreement.” On appeal, the plaintiffs argued that the trial court erred because the partnership agreement created fiduciary duties between the partners. The court of appeals stated that it is well-settled that partners owe each other a fiduciary-like duty in the conduct of the partnership business and that liability flows from the breach of that duty. The parties did not dispute that they entered into a partnership agreement as equal partners, and the court stated that the parties thus owed each other and the partnership a fiduciary duty in the conduct of the business. The court sustained the point of error and reversed and remanded the breach of fiduciary duty claim.


Lemon, an attorney, sued his former partner, Shaw, in a dispute over their fee-sharing agreement. On appeal, Lemon complained of the trial court’s failure to submit a jury question on Lemon’s claims for breach of fiduciary duty, conversion, and theft. Lemon pointed to evidence that the parties established a partnership/joint venture and that Shaw was the senior partner responsible for finances and failed to pay Lemon his share of fees collected by the partnership. The court of appeals stated that it was unable to determine whether the evidence cited by Lemon supported submission of jury questions on the claims that were not submitted because Lemon did not identify the elements he was required to prove or argue how the evidence supported those elements.


Partners in a real estate partnership sought to hold a law firm liable for breach of fiduciary duty and knowing participation in breach of fiduciary duty in connection with transfers of real estate involving Maynard, a partner in the real estate partnership who was also a partner in the law firm, and Judy Maynard, Maynard’s wife and trustee for the partnership. The law firm sought and obtained summary judgment, and the plaintiffs appealed. The court of appeals concluded that there was no summary judgment evidence of an attorney-client relationship between the law firm and the real estate partnership, and the summary judgment record also did not contain any evidence that the law firm knowingly participated in a breach of fiduciary duty by Judy Maynard.

To recover for breach of fiduciary duty, a plaintiff must show that the defendant owed a fiduciary duty. Thus, the court analyzed whether there was evidence of an attorney-client relationship between the real estate partnership and the law firm. The plaintiffs conceded that the parties did not expressly reach an agreement to provide legal services, but they contended that they raised facts to allow an agreement to be implied. The plaintiffs pointed to several pieces of correspondence from Maynard to other partners of the real estate partnership or third parties regarding the real estate partnership’s affairs. Some of the letters were on letterhead that showed Maynard’s name and the law firm address but did not mention the firm’s name, and some were on law firm letterhead. The transmittal letter for a deed prepared by Maynard for the partnership instructed the clerk to return the deed to Maynard in care of the law firm at the firm’s address, and the partnership bank account had the law firm’s address. Given Maynard’s concurrent status as a partner in the real estate partnership, the court said his status as a partner in the law firm, standing alone, was insufficient to raise a fact issue that his actions constituted legal services within the scope of the law firm’s business. The court cited Tex. Bus. Orgs. Code Ann. § 152.301, which provides that each partner is an agent of the partnership for the purpose of its business. The letters that showed Maynard’s name and the firm address without naming the law firm complied with the firm’s policy that attorneys use personal letterhead, on which they may list the law firm’s address, for non-firm matters. Maynard’s use of law firm letterhead in the real estate partnership’s affairs on two occasions over a four-year period did not raise a fact issue as to whether the law firm agreed to provide legal services. The court distinguished other cases relied on by the plaintiffs and stated that the plaintiffs did not identify any evidence that Maynard or the law firm undertook any action leading anyone in the real estate partnership to believe the firm represented the partnership. The court stated that the plaintiffs’ unstated perceptions of Maynard’s role as a partner in their partnership business did not raise a fact issue concerning the existence of an attorney-client relationship between the firm and the partnership where none was communicated by either party.
The court next addressed the trial court’s summary judgment in favor of the law firm on the plaintiffs’ claim that the law firm knowingly participated in an alleged breach of fiduciary duty by Judy Maynard (Maynard’s wife and trustee of the partnership). To establish that a defendant knowingly participated in another’s breach of fiduciary duty, a plaintiff must prove that the defendant (1) knew of the fiduciary’s breach of duty to the plaintiffs and (2) was aware that it was participating in the breach of duty. The law firm’s affidavit negated the first element because the executive director of the firm stated that he was unaware that Judy Maynard was trustee of the real estate partnership. The court rejected the argument that the law firm had imputed knowledge of Maynard’s services to the partnership based on Maynard’s status as a named partner in the firm and that he knowingly participated in his wife’s breach of fiduciary duty. The court stated that none of the summary judgment evidence supported a finding that Maynard acted as a law firm partner rather than a partner of the real estate partnership that he was. The court stated that the law firm could be held liable only for the wrongdoings of its agents committed in the scope of their duties for the firm and imputed knowledge was insufficient to find knowing participation in a breach of fiduciary duty.


Sharon Booher sued Victory Park Mobile Home Park (“Victory”), a general partnership of which she and her two sisters were partners, to recover amounts she alleged were due under an oral partnership agreement. Victory counterclaimed for breach of contract and breach of fiduciary duty. The trial court granted a directed verdict against Victory on its breach of fiduciary duty claim and rendered judgment based on the jury’s verdict on the breach of contract claims. On appeal, the court of appeals affirmed the directed verdict against Victory on its breach of fiduciary duty claim against Booher because the economic loss rule, which bars recovery in tort for economic losses resulting from a breach of contract, barred recovery by Victory for damages for breach of fiduciary duty.

Booher and her two sisters formed Victory for the purpose of operating a mobile home park and orally agreed that each of them would receive a monthly payment from the partnership for managing and running the park. By the time of the suit, the amount of the monthly payment was $3,000 each. The partners also agreed that each partner would be entitled to rent-free use of ten mobile home lots. Each partner could allow a friend or family member to use their ten allotted lots rent-free, or the partner could collect and keep the rent on the their ten lots. Booher collected rent on seven lots in addition to the ten lots allotted to her and remitted the rent on the seven additional lots for a period of time. After January 1, 2009, Booher did not remit the rent on the extra lots to the partnership because she believed she was not obligated to do so. Victory stopped making monthly payments to Booher in July 2010. One of the partners testified that the reason Victory stopped paying Booher the monthly management payment was that Booher was not remitting the rent on the additional lots. Booher brought suit for the monthly payments she alleged were owed to her, and Victory counterclaimed for the rent it alleged was owed on the additional lots. The trial court ruled before trial that all of Victory’s breach of contract claims on or after January 1, 2009 were barred by the statute of frauds. At the conclusion of the trial, the trial court directed a verdict in favor of Booher on the breach of fiduciary duty claim and submitted breach of contract questions to the jury. The jury found that Booher breached her agreement with Victory and that Victory failed to comply with its agreement to make the monthly payments to Booher. The jury found damages of $60,000 for Booher and damages of $100 for Victory. The trial court rendered judgment for Booher in the amount of $59,900.

On appeal, Victory argued that the trial court erred in granting a directed verdict against Victory on its breach of fiduciary duty claim. The elements of a breach of fiduciary duty claim are the existence of a fiduciary relationship, breach of the duty, and injury to the plaintiff or benefit to the defendant as a result of the breach. Booher argued that the directed verdict was proper because the economic loss rule barred Victory’s claim. The economic loss rule precludes recovery in tort for economic loss resulting from a party’s failure to perform a contract. Victory argued that the economic loss rule did not apply because Booher’s fiduciary duty existed independent of any contract. The court concluded that if the cases relied on by Victory were distinguishable because the plaintiffs in those cases did not complain of any failure on the part of the defendant to perform a contract. The court stated that the breach of fiduciary duty alleged in this case was Booher’s failure to pay amounts allegedly required under the partnership agreement. There was no allegation or evidence regarding any conduct on the part of Booher constituting a breach of fiduciary duty other than her alleged failure to remit rent collected for the additional lots. Victory argued that the statute of frauds is not a defense to a claim for breach of fiduciary duty and that the economic loss rule did not bar its claims for breach of fiduciary duty arising after January 1, 2009 (the date after which the trial court had ruled that Victory’s breach of contract claims were barred by the statute of frauds). The court stated that Victory did not cite any authority for the proposition that a breach of fiduciary duty claim may be asserted to recover sums allegedly due under an unenforceable partnership agreement. Thus, the court held that the economic loss rule barred recovery for Victory’s breach of fiduciary duty claim.
O’Neal v. State, 426 S.W.3d 242 (Tex. App.–Texarkana 2013, no pet.).

O’Neal, a physician, pled guilty to the first degree felony offense of misapplication of fiduciary property in excess of $200,000 and was placed on ten years’ deferred adjudication with supervision. One of the requirements of his supervision was to make restitution, and a hearing was held to determine the amount. The trial court ordered O’Neal to pay $817,675 to the victim, a medical clinic. O’Neal appealed the restitution order, and one of his arguments on appeal was that his status as a 25% partner in the clinic entitled him to a 25% credit in the restitution amount. (Although the name of the clinic as set forth in a footnote of the opinion suggests that the clinic was a professional association, the clinic was described in the footnote as a partnership of four physicians, each owning a 25% interest in the partnership, and was referred to throughout the opinion as a partnership of which O’Neal served as managing partner.) The court stated that one fallacy in O’Neal’s argument was the entity nature of partnerships pursuant to which partners do not own any of the income or profit while it is still in the partnership and has not been distributed. Further, the court did not believe the issue was as clear as O’Neal contended even if the court were to ignore the entity theory. The court stated that it was unclear how such funds would be divided among the clinic owners because physician payments were based on a collections...
formula. The court concluded that the clinic was the sole victim and was solely entitled to restitution. According to the court, any dispute regarding the proper allocation of the restitution amongst the clinic’s partners should be resolved in a civil proceeding.


In 2004, R. Scott Brown and Allan Keel discussed forming a private equity fund with a focus on oil and gas investments. After an unsuccessful trip to New York together to meet with potential investors, Brown contacted Keel about an investment opportunity involving a Houston-based oil and gas company called GulfWest Energy (“GulfWest”) that needed investors to remedy a cash-flow problem. Brown and Keel entered into a confidentiality agreement with GulfWest to obtain information necessary to perform due diligence on a potential investment in GulfWest. The two men formed a limited liability company as an investment vehicle for purchasing GulfWest’s shares, and Keel then contacted Oaktree Capital Management (“Oaktree”), a private investment fund in California, to finance the purchase of GulfWest. During discussions with Oaktree about the GulfWest investment, Keel and Brown sent Oaktree a term sheet in which they were identified as “Management,” each would provide some initial funding, they would be retained in an employment contract, and they would receive a transaction fee at closing and equity options in the new entity. Oaktree countered with different terms. Brown led the negotiations with Oaktree, but Oaktree’s representative disliked Brown’s negotiation style and expressed concern that Brown had never served as CFO of a publicly traded company. Oaktree’s representative began communicating primarily with Keel, and Oaktree concluded it would not hire Brown as CFO. Although aware of Oaktree’s intentions, Keel did not tell Brown, and Brown and Keel thereafter loaned GulfWest money to cover the necessary due diligence costs to move forward with the transaction. Keel’s position in discussions with Oaktree about Brown was that he could not see Brown as anything other than CFO of the new company. When Brown was informed he would not be hired in any role at the new company, he argued that his employer Southwest Securities (“Southwest”) was entitled to an investment banking fee based on Brown’s work on the transaction and that he should have been compensated individually for bringing the opportunity to Oaktree. Brown refused to sign a waiver in exchange for compensation releasing Oaktree from any liability before Oaktree closed on the GulfWest transaction. Oaktree informed Southwest that Brown had attempted to arrange additional individual compensation. Southwest accepted an investment banking fee from Oaktree and fired Brown after he refused to sign the release. The GulfWest transaction then closed.

Brown sued Keel for breach of partnership duties. At trial, the jury found that Brown and Keel had entered into a partnership to identify and invest in oil and gas companies, Keel breached his duty of loyalty to Brown, and Keel’s breach proximately caused Brown damages based on the value of the stock options Brown would have received but for the breach. The jury did not find that Brown ratified Keel’s conduct. Brown and Keel both moved for judgment notwithstanding the verdict. The trial court granted Keel’s motion for JNOV holding that the damages amount was in error, Keel’s conduct did not cause Brown’s damages, and there was no evidence that a partnership existed between Brown and Keel. The trial court entered a take-nothing judgment in favor of Keel.

On appeal, Brown argued that the trial court erred in entering a JNOV on the ground that there was no evidence as to the existence of a partnership between the parties. The parties agreed that the determination of whether a partnership existed was to be made based on consideration of the five statutory factors identified in Ingram v. Deere, 288 S.W.3d 886 (Tex. 2009), and the court of appeals concluded that the trial court erred in granting a JNOV on the ground that there was no evidence of a partnership. Despite the evidence supporting the existence of a partnership, the court of appeals found that the trial court properly granted Keel’s motion for JNOV on the ground that there was no evidence that Keel caused Brown’s actual damages. At trial, Brown alleged that Keel’s breach of his duty of loyalty to Brown proximately caused Brown actual damages in the form of lost stock options. Keel asserted there was no evidence that his actions proximately caused Brown not to receive stock options in the new company because Oaktree would not go forward with the investment if hiring Brown as the CFO was a requirement. The court of appeals explained that the damages question decided by the jury was based on lost stock options, and there was no evidence that Keel’s resistance to hiring Brown in a position other than CFO caused Brown not to receive the stock options because only as the CFO would Brown have received stock options anyway. Oaktree made it clear that it would not hire Brown as CFO, and Brown offered no evidence that Oaktree would have considered him for any other positions absent Keel’s resistance or that such positions would have come with stock options. Oaktree expressly refused a request for shares by Brown because it would not give Brown an employee stock package when he was not going to be an employee. The court of appeals held that the jury had no basis to conclude that but for Keel’s conduct Brown would have received the stock options that were the basis of the jury’s award for actual damages, and the trial court did not err in granting Keel’s motion for JNOV on the ground
that there was no evidence of causation. Therefore, the court affirmed the trial court’s take-nothing judgment in favor of Keel.

In a concurring and dissenting opinion, one justice maintained that the trial court’s grant of JNOV on the ground that there was no evidence of a partnership was error; however, the justice disagreed as to the majority’s causation holding and would have held there was evidence to support the jury’s finding that Keel’s breach of a partnership duty of loyalty caused Brown’s damages. The dissent pointed to evidence that Oaktree was open to hiring Brown in a role other than CFO and allowing him to receive the compensation he had negotiated until Keel resisted such a move. The dissent argued that a reasonable jury could infer that Keel’s actions were a substantial factor in having brought about Brown’s loss and that the trial court thus erred in disregarding the jury’s finding of causation and rendering a JNOV on this ground.


Texas Legislative Service (“TLS”) was a legislative tracking service that provided subscribers with information about the activities of the Texas Legislature. TLS became a family partnership in 1953, and the original partnership agreement was amended periodically thereafter. The disputes at issue here involved the TLS partnership agreement executed in 1979, which remained in effect subject to certain amendments not applicable to this suit. The partnership included members of the Fish family. The parties in this case were three brothers who were partners in TLS: Russell, Andrew, and John Fish. Due to various transactions over the years, Andrew and John held a majority interest in the partnership since 1994 when they purchased equal shares of their mother’s interest in the partnership. The parties distinguished “working partners” who work in the TLS business and “non-working partners” who did not work in the business. Andrew and John were the only working partners when the action was filed, and that had been the case since 1994 when their mother retired. Russell was never a working partner. Andrew was elected manager of TLS in the late 1980s and continued in that position to the present. During Andrew’s tenure as manager, Andrew and John set their compensation without notice or the express consent of any non-working partners, including their brother Russell, as was the custom when their uncle and father acted as manager before them. As specified in the partnership agreement, salaries paid to working partners were deducted from TLS revenue before residual profits were distributed to the partners on a pro rata basis. Compensation paid to working partners therefore directly impacted the proceeds available for distribution to all partners. Following their mother’s death, Russell filed suit individually and on behalf of TLS against his brothers Andrew and John. Russell alleged that over the course of 20 or more years, Andrew and John engaged in various activities that violated the provisions of the partnership agreement and misappropriated TLS’s trade secrets and copyrights in connection with legislative tracking businesses Andrew owned separately in other states. Russell further alleged that Andrew and John breached their fiduciary duties to TLS and the partners by engaging in these activities. Andrew and John asserted a number of defenses and also challenged the allegations on substantive grounds.

One issue Russell contested was the payment of compensation to Andrew and John without unanimous partner approval. Under the Texas Business Organizations Code, partners are not entitled to compensation for services performed on behalf of the partnership except for services rendered in winding up the partnership business. However, if partners have executed an agreement authorizing compensation, as they did here, then the terms of that agreement would control. At the heart of this dispute was the proper interpretation and application of Section 2.5 of the TLS partnership agreement, which stated: “For each fiscal year, the partners shall receive such monthly salaries as the partners mutually agree shall be paid.” Russell argued that Section 2.5 was unambiguous and did not authorize a working partner to receive any compensation absent the unanimous consent of all partners. Furthermore, Russell argued that the agreement did not authorize salaries to be paid more frequently than monthly and did not allow the payment of bonuses or any other special compensation. Andrew and John maintained that Section 2.5 unambiguously authorized them to set their own compensation both as majority interest holders and as a majority of the working partners. In addition, they maintained that the bonuses and other special payments were deferred compensation payable if and when the cash flow allowed because the nature of TLS’s business resulted in an irregular cash flow. The court of appeals attempted to ascertain the true intent of the parties as expressed in the partnership agreement by conducting a construction analysis. The court concluded that Andrew and John’s interpretation of Section 2.5 of the partnership agreement was incorrect and that the partnership agreement unambiguously required consent of all the partners in order for a partner to be compensated for working at TLS. However, the court held that Andrew and John conclusively established a statute of limitations bar to any damages for breach of Section 2.5 that accrued more than four years before the lawsuit was filed, which was the limitations period applicable to breach of contract claims. The limitations period was not tolled either by the discovery rule or fraudulent concealment, as urged by Russell who waited nearly 30 years to complain about compensation paid without unanimous consent. The court also stated that there was a fact issue as to other damages
issues and whether Russell waived his right to enforce Section 2.5. Thus, summary judgment was precluded, and remand on this issue was the proper relief. The court, in sum, affirmed in part the trial court’s take-nothing summary judgment on Russell’s breach of contract claim related to Section 2.5 of the partnership agreement and reversed and remanded in part for further proceedings as to the damages not precluded by the statute of limitations.

Russell also contended that Andrew and John breached Section 1.5 of the partnership agreement by repeatedly denying him access to TLS’s books and records. The court found there was no evidence to support this claim, and in fact the record affirmatively established that neither Andrew nor John ever denied Russell such access. There was no evidence that the partnership’s books or records were not maintained at TLS’s principal place of business or were not made available for partner access at all times per the partnership agreement. The trial court properly granted summary judgment in favor of Andrew and John as to this claim and any breach of fiduciary duty claims predicated on the same allegations.

Russell also contended that Andrew violated the covenant not to compete in Section 7.41 of the partnership agreement by owning, operating, or conducting business with similar legislative tracking services in other states for his own benefit and not in furtherance of TLS’s interests. Russell further alleged that in establishing the businesses in other states Andrew misappropriated TLS’s trade secrets and infringed on TLS’s copyright in the proprietary software systems TLS allegedly owned and used in its business. It was undisputed that Andrew owned and operated legislative tracking services in other states that offered the same basic services that TLS provided in relation to the Texas legislature, that the software systems used by the businesses were the same or substantially similar to that used by TLS, and that Andrew retained the monetary benefits of these transactions for himself. The court determined there was no evidence that John competed with TLS or misappropriated any of its trade secrets, so the trial court properly granted summary judgment in favor of John as to these claims against him. Regarding the claims against Andrew, the trial court also properly granted summary judgment in Andrew’s favor. The noncompete provision in the partnership agreement applied to former employees of TLS, and Andrew was still a TLS partner and employee. Also, there was no evidence that any of Andrew’s out-of-state businesses competed with TLS in Texas or elsewhere. There was no evidence that Andrew disclosed any confidential information in violation of the confidentiality agreement implicitly embedded in the partnership agreement. As for the misappropriating trade secrets and copyright infringement claims, an essential element of both claims is that the complainant owned the trade secret or copyright. Here, there was no evidence that TLS owned the software at issue and no evidence to contradict Andrew’s assertion that he owned the software. Thus, the trial court properly granted summary judgment in favor of Andrew on Russell’s claims for misappropriated trade secrets and copyright infringement.

Finally, Russell’s suit included claims against Andrew and John for breach of fiduciary duties to TLS and its partners. Generally, Russell contended that Andrew and John breached their fiduciary duties by refusing to give an accounting for TLS, self-dealing, competing with the partnership by opening similar companies in other states, paying themselves excessive compensation and bonuses, funding self interests with partnership profits, failing to disclose raises or bonuses, failing to act in good faith in discharging the partner’s duties, using the partnership’s proprietary and trade secrets, and failing to disclose competitors and other companies in which Andrew had an interest. The claims were based on the same factual predicates discussed above in the claims for breach of contract, misappropriation of trade secrets, and copyright infringement. As a result, to the extent the court affirmed summary judgment on those claims, the court likewise affirmed summary judgment on the related claims for breach of fiduciary duties. There was no evidence that Andrew and John refused to give an accounting for TLS, and Russell did not challenge the trial court’s ruling on this claim, thus waiving any error in the trial court’s judgment. The court affirmed the trial court’s summary judgment as to that claim. Regarding the breach of fiduciary duty claims arising from Andrew’s and John’s payment of compensation other than as authorized by Section 2.5 of the partnership agreement, the court determined that the related breach of contract claims were partially time-barred by the statute of limitations and that a fact issue existed as to waiver. The analysis was equally applicable to fiduciary duties claims predicated on the same conduct, and four years was the limitations period for breach of fiduciary duties. To the extent the breach of fiduciary duties was not time-barred, Andrew and John sought summary judgment on the ground that the claims were barred by the economic loss rule. The court held that the economic loss rule applied because the alleged damages arose only from the nonperformance of duties governed by the partnership agreement and neither Andrew nor John made false statements or representations about their compensation. The nature of the injury in this case emanated from nonperformance of the partnership agreement itself and was more appropriately characterized as a breach of contract claim. Therefore, the court affirmed the trial court’s summary judgment on each of Russell’s breach of fiduciary duty claims.

Thomas Flores and his brother Senovio Flores entered into an alleged agreement to acquire, develop, and sell several tracts of real property together. The parties agreed Thomas would provide the working capital and that his engineering company would furnish engineering services to enhance the properties’ marketability. Senovio was responsible for holding the properties in his name, marketing the properties, and ensuring that all taxes on the properties were paid. When the properties’ tax obligations were not fulfilled, liens were placed on the properties and various taxing entities initiated foreclosure proceedings. Thomas filed suit against Senovio seeking to establish the existence and assets of a partnership and the rights of the parties. Thomas alleged that Senovio owed Thomas a fiduciary duty based on their partnership agreement and that Senovio breached his fiduciary duty to Thomas by jeopardizing ownership of the properties by failing to pay the property taxes owed. Thomas also sought to impose a constructive trust on the properties acquired in Senovio’s name for the benefit of the partnership. The trial court entered a post-answer default judgment in favor of Thomas. In a restricted appeal Senovio argued, among other issues, that the evidence was insufficient to support the trial court’s default judgment in favor of Thomas. The court of appeals concluded that the record supported the existence of a partnership between Senovio and Thomas because Thomas controlled the engineering aspects of the partnership, contributed significant amounts of money to the partnership, and had the right to an equal share of the profits from the sale of the partnership’s investment properties. In addition to challenging the sufficiency of the evidence to support the existence of a partnership, Senovio argued that the evidence was insufficient to support the trial court’s default judgment because there was no basis to support imposing a constructive trust on the partnership’s investment properties. A constructive trust is an equitable remedy that is often imposed when there is constructive fraud based on the breach of a fiduciary duty or actual fraud. A constructive trust is used when a person holding title to property would profit by a wrong or would be unjustly enriched if allowed to keep the property. The court stated that a fiduciary duty arises from formal relationships such as partnerships. The court of appeals held that the trial court had a sufficient basis to impose a constructive trust on the investment properties held in Senovio’s name based on the trial court’s finding that Senovio had breached his fiduciary duty to Thomas in relation to their partnership.


Gregan was the sole owner of a law firm, and Kelly was employed by the law firm as a “profit-sharing partner (non-owner)” of the firm. After Gregan terminated Kelly, Kelly sued for breach of contract, statutory fraud, and breach of fiduciary duty. Kelly asserted a claim for breach of partnership agreement in his pleadings, but the claim was not submitted to the jury and was thus waived. For purposes of the appeal, there was thus no partnership on which to base a formal fiduciary relationship. However, the court discussed the duties of partners in an at-will partnership in response to Kelly’s argument that there is a duty not to expel partners in a partnership in bad faith and, by extension, a similar duty that can exist in an informal fiduciary relationship. Kelly argued that the court of appeals in Bohatch v Butler Binion established such a duty in the partnership context and that the holding stands because the Texas Supreme Court in Bohatch held that there is no duty to remain partners in an at-will partnership. The court here said that an at-will relationship and a duty not to terminate in bad faith are antithetical because the very idea of an at-will relationship is that it can be terminated for good cause, bad cause, or no cause at all. The court thus concluded that the Texas Supreme Court’s ruling in Bohatch necessarily overruled the holding of the court of appeals in Bohatch that a fiduciary duty existed not to fire fellow partners in a partnership in bad faith. The court stated that the supreme court affirmed the court of appeals in Bohatch because the two opinions reached the same result, not because all the holdings in the two cases were consistent. The court held that Kelly failed to show that Gregan had a fiduciary duty to Kelly that limited the manner in which she could terminate Kelly’s employment, stating that there was no evidence of a fiduciary relationship in a transaction between two lawyers where their contract did not suggest such a relationship, their relationship as lawyers practicing in a firm did not suggest such a relationship, and there was no evidence Kelly justifiably relied on Gregan to put Kelly’s interests above the firm’s.


The plaintiff, a software company, sued Accenture, LLP, a global consulting company, alleging breach of fiduciary duty and various other claims. The court applied the old four-factor test of a joint venture and concluded that the various agreements between the plaintiff and Accenture did not create a joint venture such that there was a formal fiduciary relationship. The plaintiff also alleged that Accenture aided and abetted a breach of fiduciary duty by a third party with whom the plaintiff had contracted. The court likewise concluded that the plaintiff’s relationship with this company did not amount to a joint venture that would give rise to a formal fiduciary relationship.
**Hoss v. Alardin**, 338 S.W.3d 635 (Tex. App.—Dallas 2011, no pet.).

Alardin sued Hoss alleging that he and Hoss orally formed a partnership and that Hoss breached his fiduciary duty arising from that partnership. The jury found that a partnership existed and that Hoss breached his fiduciary duty. The court analyzed the evidence at length in light of the statutory factors used to determine the existence of a partnership. Based on this analysis, the court concluded that the evidence was legally insufficient to support the jury’s finding of a partnership between Hoss and Alardin. Because no partnership existed, Hoss could not have breached a fiduciary duty arising out of the alleged partnership.


The plaintiff claimed that the defendant breached its fiduciary duty to the plaintiff in connection with a joint venture between the two. The court stated that the elements of a breach of fiduciary duty under Texas law are (1) the existence of a fiduciary relationship between the plaintiff and the defendant, (2) the defendant’s breach of the fiduciary duty owed the plaintiff, and (3) injury to the plaintiff or benefit to the defendant caused by the breach. The court then stated that partners in a partnership or joint venture owe one another and the partnership or joint venture a fiduciary duty. However, after analyzing the evidence in light of the factors indicating the creation of a partnership or joint venture, the court concluded that there was no evidence that the parties formed a joint venture and thus no evidence that the defendant owed the plaintiff a fiduciary duty.

**E. Fraudulent Inducement to Form and Continue Partnership**


In 2002, J.R. O’Brien (“J.R.”) decided to leave his law firm to form a firm with Dan Daboval. (Although the parties and the court consistently referred to the firm formed by the two men as a partnership, the opinion identifies the firm as Daboval & Brien, PLLC, so it thus appears that it was actually a professional limited liability company.) J.R.’s wife, Shelly, was involved in the start up of the firm and worked for the firm as a bookkeeper. After forming and operating the firm for a period of time, Daboval, along with his wife and the firm of Daboval & O’Brien, PLLC (which had wound up and terminated by the time of trial and whose claims the trial court concluded belonged to Daboval as successor in interest) sued J.R. and Shelly for fraudulently inducing Daboval to enter into a partnership with J.R., establish a line of credit, fund a firm account from which the O’Briens took excessive draws, and post a personal bank account as collateral. The Dabovals claimed that the O’Briens failed to disclose that they were in dire financial straits and made affirmative misrepresentations regarding the status of J.R.’s practice and financial situation. The Dabovals sought damages in an amount that included the negative capital account of Daboval and the loss of the personal bank account. After J.R. filed bankruptcy, the Dabovals pursued their fraud case against Shelly. After a bench trial, the trial court found, among other things, that Shelly fraudulently induced Daboval to form a partnership with J.R. and fund the firm account so that Shelly could pay off other obligations, that J.R. took excessive draws from the account with Shelly’s knowledge, and that the Dabovals suffered damages as a result of their reliance on Shelly’s misrepresentations and concealment of material facts. The trial court also calculated the amount of J.R.’s capital account. The trial court entered a judgment in favor of the Dabovals, and Shelly made several arguments on appeal. First, Shelly argued that the affirmative misrepresentations found by the trial court were merely expressions of opinion and not actionable as common law fraud. The court of appeals discussed the misrepresentations found by the trial court and held that the record supported the trial court’s findings that Shelly made material, false representations that legally supported a fraud claim. Shelly next argued that the evidence conclusively established that Daboval’s purported reliance on the O’Briens’ financial statement and lifestyle was unjustifiable as a matter of law. The court discussed this contention and concluded that, even setting aside the fact finding regarding the O’Briens’ lifestyle, the court could not say the evidence was insufficient to support the trial court’s finding that Daboval justifiably relied on the financial statement and Shelly’s representations, which occurred throughout the parties’ relationship. Next Shelly argued that the evidence conclusively established that Daboval was responsible for most of the damages because he made a conscious decision in 2003 and 2004 to continue the firm and allow J.R. to take draws while the firm was “in the hole” and “under water.” As part of this argument, Shelly argued that the judgment could not be affirmed on the ground that Daboval was fraudulently induced into continuing to operate the firm. The court held that the evidence did not establish that Daboval was responsible for most of the damages because the trial court found that Shelly intended to induce Daboval to form and capitalize the partnership so she could pay off other obligations, that Shelly feared if she disclosed material facts to Daboval he would have restricted her access to the firm account (indicating that Shelly’s fraudulent conduct resulted not only in Daboval’s formation and capitalization of the firm, but its continued operation), that Shelly was the firm’s
bookkeeper through spring of 2004, that she failed to disclose J.R.’s excessive withdrawals, that she failed to disclose J.R.’s true financial situation during the partnership, and that the Dabovals suffered damages in reliance on Shelly’s misrepresentations and failures to disclose. The court stated that the record demonstrated that the exact amount of Daboval’s damages was not necessarily subject to precise calculation because he was induced into forming, capitalizing, and continuing to operate the firm. The court said the matter of damages was thus a matter well-suited to the fact finder. Although the trial court’s finding did not directly tie the Dabovals’ damages to a specific factual theory, the findings indicated that the trial court may have sought to limit the damages to those sustained through some time in 2004. The findings suggested that the trial court determined that the Dabovals were entitled to recover an amount generally consistent with J.R.’s negative capital account through that time period. Whether Daboval’s continued reliance through 2004 remained justifiable was also a fact issue well-suited to resolution by the trial court. Based upon the evidence, the court of appeals could not say that the trial court’s award of damages in an amount generally consistent with J.R.’s negative capital account through 2004 was an excessive award lacking in evidentiary support.

F. Partnership Property


In 2002, Johnson-Barton Joint Venture (“J&B”), a joint venture formed by lawyers Nick Johnson and Dan Barton, entered into a referral agreement with Fleming & Associates, L.L.P. (“F&A”) regarding the referral of Fen-Phen cases by J&B to R&A. The letter agreement had two parts, the first addressing 224 existing cases already in J&B’s offices to be forwarded to F&A, and the second addressing future Fen-Phen cases to be referred by J&B to F&A. Each part provided for the division of fees between the parties on a 50-50 basis and addressed the handling of expenses. In 2006, after F&A had favorably resolved most of the original 224 cases and an additional 1,500 cases referred to it by J&B, F&A paid J&B for most of the cases and sent a letter with a “distribution statement” explaining deductions for certain “client non-reimbursable expenses.” J&B contended that these deductions were improper because the referral agreement provided that F&A would be responsible for all litigation costs on cases referred to F&A. In 2007, a subsequent dispute developed with regard to expense reimbursements and fees on cases settled after the first distribution. In 2008, without Barton’s knowledge, Johnson, individually and on behalf of his law firm, and Fleming, individually and on behalf of F&A, entered into a Profits Interest Transfer Agreement (“PITA”) under which Johnson sold to Fleming and F&A “the entirety of Johnson’s right, title and interest in and to any profits, income, revenues, distributions or compensation associated with or flowing from Johnson’s 45% interest in The Johnson Barton Joint Venture” for $500,000. The PITA stated that it did not constitute a conveyance to Fleming and F&A of Johnson’s equity interest in J&B or make Fleming or F&A a partner or venturer in J&B. About six months after signing the PITA, Johnson withdrew from J&B, stating that he was relinquishing “any legal, beneficial, or other rights, title, or interests in any way related to J&B and/or the ownership of J&B.” In 2009, Barton, his law firm, and J&B filed suit against Fleming and F&A alleging breach of the referral agreement. The trial court granted J&B summary judgment on its breach of contract claim against F&A but granted summary judgment in favor of Fleming on J&B’s claim that Fleming was personally liable. On appeal F&A argued that the trial court erred in granting J&B’s motion for summary judgment and denying summary judgment in favor of F&A. F&A also argued that the trial court erred in refusing to reduce the damage award against F&A based on the PITA. F&A’s argument that it was entitled to judgment as a matter of law with respect to the J&B’s claim under the referral agreement hinged on F&A’s argument that its agreement with J&B was a joint venture in which F&A and J&B must share profits and losses equally under Texas joint venture law. F&A also argued that the referral agreement, taken as a whole, reflected the parties’ intent to share expenses equally as joint venturers. After reviewing the plain language of the agreement and the description of expenses, the court of appeals concluded that the trial court properly granted summary judgment in favor J&B with respect to liability on the referral agreement. The court next addressed F&A’s contention that the trial court should have offset or reduced F&A’s damages by 45% based on the PITA under which Johnson transferred his right to receive profits, revenues, distributions, or compensation from J&B. The court of appeals concluded that F&A did not establish that it was entitled to an offset or extinguishment of 45% of its liability based on the PITA. The court pointed out that a partnership is an entity distinct from its partners and that partnership property is not property of the partners. Tex. Bus. Orgs. Code §§ 152.056, 152.101. A partner’s partnership interest includes the partner’s share of profits and losses and right to distributions, but does not include the partner’s right to participate in management. Tex. Bus. Orgs. Code § 1.002(68). A partner may transfer all or part of his partnership interest, and a transferee is entitled to receive, to the extent transferred, distributions to which the transferor otherwise would be entitled. Tex. Bus. Orgs. Code §§ 152.401, 152.404(a). The court stated that it did not appear Johnson transferred his partnership interest as F&A claimed. The court stated that it was reasonable to interpret the PITA to entitle Johnson to receive disbursements from J&B during his tenure as a partner and during winding up and to require Johnson to then convey
consideration as a result of irregularities in the sale. The jury found that the property was partnership property and that LPP for wrongful foreclosure on the grounds that the property was their homestead and that it sold for grossly inadequate on the note under the plan of reorganization, and LPP foreclosed on the property in August 2001. The Sillers then sued bankruptcy, the SBA assigned the note to LPP Mortgage Ltd. (“LPP”). The Sillers defaulted on the first payment due to retain its lien and for payment of the SBA’s note by the partnership over a ten-year period. Following the partnership’s left the partnership around 1983. In the 1990s, the partnership had difficulty making the payments on the SBA loan, and . The Sillers then sued LPP for wrongful foreclosure on the grounds that the property was their homestead and that it sold for grossly inadequate consideration as a result of irregularities in the sale. The jury found that the property was partnership property and that those disbursements to F&A. At the time the suit was filed, Johnson had withdrawn from J&B and stated that he no longer owned any interest in J&B. F&A did not address the impact of Johnson’s withdrawal on its rights to any distributions. The court agreed with J&B that any recovery it was entitled to in this breach of contract action was partnership property owned by J&B and not its partners. Partnership property could not be transferred in whole or in part to F&A by Johnson. The PITA, as an agreement between Johnson and F&A, gave F&A rights against Johnson but not against J&B. Thus, F&A was not entitled to a 45% reduction in the damages it owed J&B.

Chapman Custom Homes, Inc. v. Dallas Plumbing Company, No. 05-12-00132-CV, 2013 WL 4478187 (Tex. App.—Dallas Aug. 2013, pet. filed) (mem. op.). Chapman Custom Homes, Inc. (“Chapman Homes”), a general contractor and home builder, entered into a contract with Dallas Plumbing Company (“Dallas Plumbing”) to install plumbing in a home that Chapman Homes was building. The property was owned by Michael Duncan, as trustee of the M.B. Duncan Trust (“Duncan trustee”). After a leak was discovered, Chapman Homes and Duncan trustee sued Dallas Plumbing for breach of contract and breach of warranty. Dallas Plumbing argued that Chapman Homes could not prevail on these claims because it was not the owner of the house, and Duncan trustee could not recover for breach of contract because it had not entered into a contract with Dallas Plumbing. Chapman Homes and Duncan trustee argued that they had a joint venture that included the house in this case and that Chapman Homes contracted with Dallas Plumbing on behalf of the joint venture. They further alleged that the rights at issue belonged to the joint venture and that they had standing to sue to enforce the rights of the joint venture. The court of appeals examined whether the trial court properly granted summary judgment in favor of Dallas Plumbing and concluded it did. Chapman Homes and Duncan trustee relied primarily on the provisions of a Construction Contract for Speculative Single Family Residence (“Construction Contract”) as evidence of their joint venture. Considering the statutory factors indicating the creation of a partnership, the court said that the terms of the Construction Contract tended to negate the existence of a partnership, but even assuming a joint venture existed, the court concluded that summary judgment was proper because the basis for the motion was that the claim for damages to real property belonged to the owner of the property. Dallas Plumbing presented sufficient evidence to conclusively show that Duncan trustee was the owner of the house. Chapman Homes and Duncan trustee relied on affidavits that stated there was an agreement that Duncan trustee held the house on behalf of the joint venture, but the court concluded that these statements were not any evidence that the joint venture was the actual owner of the house. The court reviewed the provisions of Section 152.102 of the Business Organizations Code regarding partnership property and pointed out that property acquired in the name of a partner is presumed to be the property of that partner, even though the property is used for partnership purposes, if the property is not acquired with partnership property and the instrument transferring title does not indicate the person’s capacity as a partner or the existence of the partnership. Tex. Bus. Orgs. Code § 152.102(c). It was undisputed that the property was acquired with funds owned by Duncan trustee and that the property was shown in the appraisal records as property of Duncan trustee. Viewed in the context of the Construction Contract, the court said the evidence reflected an intent that Duncan trustee would retain ownership of the property even though the parties agreed to share profits from the property when it was sold. Because the mere fact of use of property for partnership purposes is not evidence that it is partnership property, the court held that Chapman Homes and Duncan trustee failed to raise a fact issue controverting Dallas Plumbing’s evidence that Duncan trustee owned the property, and summary judgment was proper.

Siller v. LPP Mortgage Ltd., No. 04-11-00132-CV, 2013 WL 4478187 (Tex. App.—San Antonio Apr. 10, 2013, pet. denied) (mem. op.). In 1967, a 520-acre tract of land was conveyed to Abel Siller, Santiago Siller, Mario Siller, and Jose M. Siller, Jr. The four brothers used the land for farming, but they and their wives also lived on the property (Abel and his wife continuously and the others off and on) and claimed a homestead interest in the property. In the early 1980s, Abel, Mario, and Santiago sought a loan from the SBA. The note was signed by the three brothers and their wives. The three brothers also signed the deed of trust. The partnership continued to operate its farming and ranching business, but Jose left the partnership around 1983. In the 1990s, the partnership had difficulty making the payments on the SBA loan, and the partnership filed bankruptcy in 1999 to prevent foreclosure on the property. The Chapter 11 petition listed the property as an asset of the partnership, and the partnership later filed a plan of reorganization that provided for the SBA to retain its lien and for payment of the SBA’s note by the partnership over a ten-year period. Following the partnership’s bankruptcy, the SBA assigned the note to LPP Mortgage Ltd. (“LPP”). The Sillers defaulted on the first payment due on the note under the plan of reorganization, and LPP foreclosed on the property in August 2001. The Sillers then sued LPP for wrongful foreclosure on the grounds that the property was their homestead and that it sold for grossly inadequate consideration as a result of irregularities in the sale. The jury found that the property was partnership property and that
In the divorce proceeding of Danette Pappas (“Danette”) and William Michael Pappas (“Michael”), both parties requested an equal division of the community estate. Following a bench trial, the trial court granted the parties’ petitions for divorce and awarded each real and personal property valued at almost an equal amount. On appeal, Danette asserted that the trial court abused its discretion by making numerous errors when valuing the property in the community estate, which she alleged resulted in a division of the estate that was so disproportionate as to be manifestly unjust. Among other issues, Danette contended that the trial court erred in valuing the community interest in the real property on which Michael co-owned and operated a business for carpet cleaning known as “Best Way Carpet” in a partnership with a friend.

LPP did not wrongfully foreclose, and the trial court entered a judgment in favor of LPP, but the judgment was reversed on appeal due to a disqualified juror. At the second trial, the jury found that the property was not partnership property and that it was the homestead of Abel and his wife. The jury also found that the notice of foreclosure was not posted at least 21 days before the foreclosure sale. The trial court granted a JNOV in favor of LPP on the basis that the Sillers were precluded by the doctrines of judicial estoppel and res judicata from asserting that the property was not owned by the partnership and that the undisputed evidence established the foreclosure notice was posted at least 21 days before the sale. The Sillers appealed, and the court of appeals affirmed the trial court’s judgment.

On appeal, the court first discussed the doctrine of judicial estoppel. LPP argued that the Sillers were judicially estopped from asserting in this lawsuit that the property was not owned by the partnership because they asserted in the prior bankruptcy proceeding that the property was an asset of the partnership. The parties disagreed as to whether federal or Texas law regarding judicial estoppel applied, and the court concluded federal law applied because a majority of Texas courts have applied federal judicial estoppel law when the prior proceeding was in bankruptcy court. Furthermore, under the similar doctrine of res judicata, the Texas Supreme Court has held that federal law determines the preclusive effect of a prior judgment. Since the primary purpose of judicial estoppel is to preserve the integrity of a prior judicial proceeding, and the prior proceeding in this case was a bankruptcy proceeding, applying federal law regarding judicial estoppel served to protect the integrity of a prior federal proceeding. The Sillers argued that the trial court erred in applying judicial estoppel because they were not parties to the bankruptcy proceeding, but the court stated that federal courts have held that those in privity with a prior judgment are barred by judicial estoppel in a subsequent action. The court concluded that the Sillers were in privity with the partnership based on their control over the bankruptcy. The court also rejected the argument that the trial court erred in applying judicial estoppel to Abel’s wife. Any homestead rights she had to the property were derivative of her spouse, and neither a partner nor a partner’s spouse has an interest in partnership property. Because the doctrine of judicial estoppel may extend to a spouse, because her rights were derivative of her husband’s, and because she was in privity with her husband, the trial court did not abuse its discretion in applying judicial estoppel to Abel’s wife. The court of appeals pointed out various statements made by the Sillers to the bankruptcy court representing and affirming that the property was partnership property. After filing for bankruptcy and preventing foreclosure of the property, the Sillers took the opposite position in this lawsuit regarding ownership of the property. The court of appeals thus found that the trial court did not abuse its discretion in applying the doctrine of judicial estoppel. The court of appeals went on to conclude that the undisputed evidence showed that the foreclosure notice was posted for the required period of time.

O’Neal v. State, 426 S.W.3d 242 (Tex. App.–Texarkana 2013, no pet.).

O’Neal, a physician, pled guilty to the first degree felony offense of misapplication of fiduciary property in excess of $200,000 and was placed on ten years’ deferred adjudication with supervision. One of the requirements of his supervision was to make restitution, and a hearing was held to determine the amount. The trial court ordered O’Neal to pay $817,675 to the victim, a medical clinic. O’Neal appealed the restitution order, and one of his arguments on appeal was that his status as a 25% partner in the clinic entitled him to a 25% credit in the restitution amount. (Although the name of the clinic as set forth in a footnote of the opinion suggests that the clinic was a professional association, the clinic was described in the footnote as a partnership of four physicians, each owning a 25% interest in the partnership, and was referred to throughout the opinion as a partnership of which O’Neal served as managing partner.) The court stated that one fallacy in O’Neal’s argument was the entity nature of partnerships pursuant to which partners do not own any of the income or profit while it is still in the partnership and has not been distributed. The court concluded that the clinic was the sole victim and was solely entitled to restitution. According to the court, any dispute regarding the proper allocation of the restitution amongst the clinic’s partners should be resolved in a civil proceeding.


In the divorce proceeding of Danette Pappas (“Danette”) and William Michael Pappas (“Michael”), both parties requested an equal division of the community estate. Following a bench trial, the trial court granted the parties’ petitions for divorce and awarded each real and personal property valued at almost an equal amount. On appeal, Danette asserted that the trial court abused its discretion by making numerous errors when valuing the property in the community estate, which she alleged resulted in a division of the estate that was so disproportionate as to be manifestly unjust. Among other issues, Danette contended that the trial court erred in valuing the community interest in a rental-storage business known as “Northwest Hills” that Michael co-owned and operated in a partnership with his father and that the trial court failed to dispose of a community interest in the real property on which Michael co-owned and operated a business for carpet cleaning known as “Best Way Carpet” in a partnership with a friend.
Danette alleged on appeal that the trial court erred in determining the value of the community estate related to real property used by Northwest Hills, a partnership owned by Michael and his father. Northwest Hills was a rental-storage business that operated on several lots in three blocks in a development. The blocks (i.e., Blocks 1, 7, and 8) were acquired and improved at different times over an extended period of years both before and during Danette and Michael’s marriage. It was undisputed that Michael acquired an interest in the Northwest Hills partnership in 1989 before he married Danette. The parties disputed the extent of Michael’s ownership interest in the partnership and whether some of the real property used in the business should be characterized as partnership, separate, or community property. The partnership agreement specified that the two partners had equal ownership interests, however Michael and his father testified that Michael held a 49% ownership interest. Danette argued that the trial court significantly undervalued the community’s interest in Blocks 1 and 7. The issues in relation to these blocks at trial were whether the lots were community property or partnership property, the extent of Michael’s ownership interest in the partnership, and the value of the property and the business. The lots in Block 1 were purchased in 1998 by Michael, Danette, and Micheal’s parents, and buildings were constructed on those lots with funds borrowed by the same four people. Michael’s father provided uncontroverted testimony that the lots in Block 1 were acquired for use by the partnership, the funds used to buy the property came from the income retained by the partnership, the construction loans were paid by the partnership from income retained by the partnership, and the property was used by the partnership exclusively and treated as partnership property on tax returns. As for the lots in Block 7, Michael’s father purchased the lots before forming the partnership with Michael. In 2003, Michael purchased a 49% interest in the Block 7 property with a $150,000 seller-financed note payable to his father in order to bring the property into the partnership and consolidate the accounting books. Each month, the partnership distributed $1,500 to Michael, which he used to pay down the note to his father. At the time of trial, approximately $58,000 remained unpaid on the note. The experts for both Michael and Danette valued the Northwest Hills partnership at $2.22 million and $2.23 million respectively using an income-capitalization method. Using a cost approach to valuation, both parties’ experts valued the business at approximately $1.9 million. Essentially, the experts agreed on the overall value of the business. The dispute between the experts involved the applicability and extent of discounts to be applied to Michael’s interest in the business. That is, the question was whether Michael held an interest in Northwest Hills that was properly characterized as “non-controlling.” Michael and his father testified that Michael held a 49% interest in the partnership, which was confirmed by other documents admitted at trial and the transaction involving Michael’s purchase of a 49% interest in Block 7. The partnership agreement, however, listed the two men as equal owners. Danette’s expert testified that the value of the partnership should not be discounted because of the equal ownership. Michael’s expert disagreed and testified that discounts applied due to the lack of control and lack of marketability/liquidity either way because even a 50% ownership interest was properly characterized as a non-controlling interest. In the final divorce decree, the trial court awarded Michael the business known as Northwest Hills, including all community interest in the three Blocks, and the court found that Block 8 was Michael’s separate property. To the extent the trial court concluded that the property used in the storage business was either community or separate property, the appellate court noted that the trial court implicitly determined that it was not partnership property because partnership property is neither community property nor separate property in nature. Although the trial court did not expressly make findings resolving the disputes about Michael’s ownership percentage or the applicable discounts, the court’s valuation of the community’s interest in Northwest Hills was consistent with the application of a non-controlling interest discount and a finding that Michael owned a 49% interest in the partnership. On appeal, Danette contended that the trial court undervalued the value of Northwest Hills and the community’s interest in the partnership, and the court of appeals agreed. Although the trial court did not explain its methodology in valuing Northwest Hills, the appellate court stated that it appeared as though the trial court followed Michael’s reasoning that all Blocks were partnership property. In addition, the only block with a community property interest was Block 7, which Michael purchased after marriage and paid for with profits distributed to him by the partnership. The trial court also allowed the discount based on Michael’s non-controlling interest and further reduced it by the outstanding debt owed to his father. The trial court found the community interest in the Northwest Hills partnership to be $82,125. Even given deference to the trial court’s determination regarding applicable discounts, the appellate court found that there were errors in the trial court’s valuation of the business (e.g., failure to attribute any value to the miscellaneous improvements on the property and, more importantly, failing to assign any value to Block 1 as having a community interest) that so significantly undervalued the community’s interest in Northwest Hills as awarded by the court that a new division of the marital estate was required. The court of appeal s sustained Danette’s point of error holding that the trial court’s valuation of the community interest in the Northwest Hills partnership was so disproportionate as to constitute an abuse of discretion requiring the appellate court to remand the cause for a new just and right division of the community estate.

Danette next argued that the trial court abused its discretion by not valuing and disposing of the community’s interest in two lots upon which Best Way Carpet (“Best Way”) operated. Michael formed Best Way, a carpet cleaning
business, as a partnership with a friend after his marriage to Danette. It was undisputed that Michael’s interest in the partnership was community property and that he held an equal ownership interest. The trial court awarded Michael the interest in Best Way based on Michael’s expert witness testimony, which applied discounts for lack of control and marketability/liquidity. Danette did not dispute the trial court’s valuation of the business or application of the discounts, but she did argue that the trial court failed to dispose of the community’s 50% interest in the real property of the business – the lots upon which it operated. There was no dispute as to the value of the lots themselves, so the only issue was whether the trial court disposed of the property in the final divorce decree. The court of appeals stated that the trial court did not specifically mention or designate the Best Way lots or real property in valuing and awarding Best Way to Michael. However, by adopting the valuation of the business proposed by Michael’s expert, the trial court appeared to account for the value of the lots as a major component of the business’s value and thus valued and disposed of this property in its award to Michael of an undivided one-half interest in Best Way. The court of appeals overruled Danette’s point of error complaining about the disposition of the lots used by Best Way. The court of appeals did note that the trial court awarded a separate lot not in dispute differently than it did the two lots questioned by Danette. Since the appellate court reversed the trial court and remanded the entire community estate for a new just and right division due to the trial court’s error in valuing and dividing the community’s interest in the Northwest Hills rental-storage business in the final divorce decree, the court of appeals remarked that the trial court would have the opportunity to revisit its valuation and disposition of the three lots owned by Best Way.


In an insurance dispute, the insurer asserted that Zertuche had no insurable interest in the property in question because he did not hold title. The test for an insurable interest is not legal title but whether the insured derives a pecuniary benefit or advantage by the preservation and continued existence of the property or would sustain pecuniary loss from its destruction. The court noted that legal ownership of property that is intended to be a partnership asset is not determined by legal title, but instead by the intention of the parties as reflected in the evidence. Here, the evidence suggested that the property was owned either by Zertuche’s mother or by Zertuche Enterprises, but in either case for use and benefit of the Zertuche Enterprises partnership. Zertuche testified that the policy was in his name, that the other partners consented to imposition of a lien on their partnership interests in order to secure a mortgage note on the property in his name and his mother’s name, and that the partnership documents reflected this consent. As stakeholder and managing partner of the partnership, Zertuche would derive pecuniary benefit from the property’s preservation and suffer pecuniary loss from its destruction. Thus, there was at least a fact issue as to whether Zertuche had an insurable interest in the property, and the court denied the insurer’s motion for summary judgment on the insurable interest question.

G. Interpretation and Enforcement of Partnership Agreement

1. Fiduciary Duties


Texas Legislative Service (“TLS”) was a legislative tracking service that provided subscribers with information about the activities of the Texas Legislature. TLS became a family partnership in 1953, and the original partnership agreement was amended periodically thereafter. The disputes at issue here involved the TLS partnership agreement executed in 1979, which remained in effect subject to certain amendments not applicable to this suit. The partnership included members of the Fish family. The parties in this case were three brothers who were partners in TLS: Russell, Andrew, and John Fish. Due to various transactions over the years, Andrew and John held a majority interest in the partnership since 1994 when they purchased equal shares of their mother’s interest in the partnership. The parties distinguished “working partners” who work in the TLS business and “non-working partners” who did not work in the business. Andrew and John were the only working partners when the action was filed, and that had been the case since 1994 when their mother retired. Russell was never a working partner. Andrew was elected manager of TLS in the late 1980s and continued in that position to the present. During Andrew’s tenure as manager, Andrew and John set their compensation without notice or the express consent of any non-working partners, including their brother Russell, as was the custom when their uncle and father acted as manager before them. As specified in the partnership agreement, salaries paid to working partners were deducted from TLS revenue before residual profits were distributed to the partners on a pro rata basis. Compensation paid to working partners therefore directly impacted the proceeds available for distribution to all partners. Following their mother’s death, Russell filed suit individually and on behalf of TLS against his brothers Andrew and John. Russell alleged that over the course of 20 or more years, Andrew and John engaged in various
activities that violated the provisions of the partnership agreement and misappropriated TLS’s trade secrets and copyrights in connection with legislative tracking businesses Andrew owned separately in other states. Russell further alleged that Andrew and John breached their fiduciary duties to TLS and the partners by engaging in these activities. Andrew and John asserted a number of defenses and also challenged the allegations on substantive grounds.

One issue Russell contested was the payment of compensation to Andrew and John without unanimous partner approval. Under the Texas Business Organizations Code, partners are not entitled to compensation for services performed on behalf of the partnership except for services rendered in winding up the partnership business. However, if partners have executed an agreement authorizing compensation, as they did here, then the terms of that agreement would control. At the heart of this dispute was the proper interpretation and application of Section 2.5 of the TLS partnership agreement, which stated: “For each fiscal year, the partners shall receive such monthly salaries as the partners mutually agree shall be paid.” Russell argued that Section 2.5 was unambiguous and did not authorize a working partner to receive any compensation absent the unanimous consent of all partners. Furthermore, Russell argued that the agreement did not authorize salaries to be paid more frequently than monthly and did not allow the payment of bonuses or any other special compensation. Andrew and John maintained that Section 2.5 unambiguously authorized them to set their own compensation both as majority interest holders and as a majority of the working partners. In addition, they maintained that the bonuses and other special payments were deferred compensation payable if and when the cash flow allowed because the nature of TLS’s business resulted in an irregular cash flow. The court determined there was no evidence that Andrew and John misappropriated TLS’s trade secrets and infringed on TLS’s copyright in the proprietary software systems which was the limitations period applicable to breach of contract claims. The limitations period was not tolled either by the discovery rule or fraudulent concealment, as urged by Russell who waited nearly 30 years to complain about compensation paid without unanimous consent. The court also stated that there was a fact issue as to other damages issues and whether Russell waived his right to enforce Section 2.5. Thus, summary judgment was precluded, and remand on this issue was the proper relief. The court, in sum, affirmed in part the trial court’s take-nothing summary judgment on Russell’s breach of contract claim related to Section 2.5 of the partnership agreement and reversed and remanded in part for further proceedings as to the damages not precluded by the statute of limitations.

Russell also contended that Andrew and John breached Section 1.5 of the partnership agreement by repeatedly denying him access to TLS’s books and records. The court found there was no evidence to support this claim, and in fact the record affirmatively established that neither Andrew nor John ever denied Russell such access. There was no evidence that the partnership’s books or records were not maintained at TLS’s principal place of business or were not made available for partner access at all times per the partnership agreement. The trial court properly granted summary judgment in favor of Andrew and John as to this claim and any breach of fiduciary duty claims predicated on the same allegations.

Russell also contended that Andrew violated the covenant not to compete in Section 7.41 of the partnership agreement by owning, operating, or conducting business with similar legislative tracking services in other states for his own benefit and not in furtherance of TLS’s interests. Russell further alleged that in establishing the businesses in other states Andrew misappropriated TLS’s trade secrets and infringed on TLS’s copyright in the proprietary software systems TLS allegedly owned and used in its business. It was undisputed that Andrew owned and operated legislative tracking services in other states that offered the same basic services that TLS provided in relation to the Texas legislature, that the software systems used by the businesses were the same or substantially similar to that used by TLS, and that Andrew retained the monetary benefits of these transactions for himself. The court determined there was no evidence that John competed with TLS or misappropriated any of its trade secrets, so the trial court properly granted summary judgment in favor of John as to these claims against him. Regarding the claims against Andrew, the trial court also properly granted summary judgment in Andrew’s favor. The noncompete provision in the partnership agreement applied to former employees of TLS, and Andrew was still a TLS partner and employee. Also, there was no evidence that any of Andrew’s out-of-state businesses competed with TLS in Texas or elsewhere. There was no evidence that Andrew disclosed any confidential information in violation of the confidentiality agreement implicitly embedded in the partnership agreement. As for the misappropriating trade secrets and copyright infringement claims, an essential element of both claims is that the complainant owned the trade secret or copyright. Here, there was no evidence that TLS owned the software at issue and no evidence to contradict Andrew’s assertion that he owned the software. Thus, the trial court properly granted summary judgment in favor of Andrew on Russell’s claims for misappropriated trade secrets and copyright infringement.
Finally, Russell’s suit included claims against Andrew and John for breach of fiduciary duties to TLS and its partners. Generally, Russell contended that Andrew and John breached their fiduciary duties by refusing to give an accounting for TLS, self-dealing, competing with the partnership by opening similar companies in other states, paying themselves excessive compensation and bonuses, funding self-interests with partnership profits, failing to disclose raises or bonuses, failing to act in good faith in discharging the partner’s duties, using the partnership’s proprietary and trade secrets, and failing to disclose competitors and other companies in which Andrew had an interest. The claims were based on the same factual predicates discussed above in the claims for breach of contract, misappropriation of trade secrets, and copyright infringement. As a result, to the extent the court affirmed summary judgment on those claims, the court likewise affirmed summary judgment on the related claims for breach of fiduciary duties. There was no evidence that Andrew and John refused to give an accounting for TLS, and Russell did not challenge the trial court’s ruling on this claim, thus waiving any error in the trial court’s judgment. The court affirmed the trial court’s summary judgment as to that claim. Regarding the breach of fiduciary duty claims arising from Andrew’s and John’s payment of compensation other than as authorized by Section 2.5 of the partnership agreement, the court determined that the related breach of contract claims were partially time-barred by the statute of limitations and that a fact issue existed as to waiver. The analysis was equally applicable to fiduciary duties claims predicated on the same conduct, and four years was the limitations period for breach of fiduciary duties. To the extent the breach of fiduciary duties was not time-barred, Andrew and John sought summary judgment on the ground that the claims were barred by the economic loss rule. The court held that the economic loss rule applied because the alleged damages arose only from the nonperformance of duties governed by the partnership agreement and neither Andrew nor John made false statements or representations about their compensation. The nature of the injury in this case emanated from nonperformance of the partnership agreement itself and was more appropriately characterized as a breach of contract claim. Therefore, the court affirmed the trial court’s summary judgment on each of Russell’s breach of fiduciary duty claims.

2. Financial Rights


Naples and Gurav sued Lesher for breach of their partnership agreement and breach of fiduciary duty, among other causes of action. The claims for breach of the partnership agreement were based on allegations that Lesher sold the timber on their jointly owned property and that Lesher kept more than his share of the proceeds generated from the property’s mineral income. The trial court granted summary judgment on a number of claims, including the claims for breach of the partnership agreement. On appeal, the court analyzed whether the claims for breach of the partnership agreement were barred by the four-year statute of limitations. The plaintiffs relied on the discovery rule, and the court analyzed the summary judgment evidence and determined when the plaintiffs discovered or in the exercise of reasonable diligence could have discovered Lesher’s cutting of the timber and Lesher’s failure to pay the other partners their share of oil and gas royalty payments. As a result of this analysis, the court held that the timber claims were barred by the statute of limitations, and some of the mineral royalty claims were barred.


In 2002, Johnson-Barton Joint Venture (“J&B”), a joint venture formed by lawyers Nick Johnson and Dan Barton, entered into a referral agreement with Fleming & Associates, L.L.P. (“F&A”) regarding the referral of Fen-Phen cases by J&B to R&A. The letter agreement had two parts, the first addressing 224 existing cases already in J&B’s offices to be forwarded to F&A, and the second addressing future Fen-Phen cases to be referred by J&B to F&A. Each part provided for the division of fees between the parties on a 50-50 basis and addressed the handling of expenses. In 2006, after F&A had favorably resolved most of the original 224 cases and an additional 1,500 cases referred to it by J&B, F&A paid J&B for most of the cases and sent a letter with a “distribution statement” explaining deductions for certain “client non-reimbursable expenses.” J&B contended that these deductions were improper because the referral agreement provided that F&A would be responsible for all litigation costs on cases referred to F&A. In 2007, a subsequent dispute developed with regard to expense reimbursements and fees on cases settled after the first distribution. In 2008, without Barton’s knowledge, Johnson, individually and on behalf of his law firm, and Fleming, individually and on behalf of F&A, entered into a Profits Interest Transfer Agreement (“PITA”) under which Johnson sold to Fleming and F&A “the entirety of Johnson’s right, title and interest in and to any profits, income, revenues, distributions or compensation associated with or flowing from Johnson’s 45% interest in The Johnson Barton Joint Venture” for $500,000. The PITA stated that it did not constitute a conveyance to Fleming and F&A of Johnson’s equity interest in J&B or make Fleming or F&A a partner or venturer in J&B. About six months after signing the PITA, Johnson withdrew from J&B,
that Fleming established as a matter of law that he was not personally liable under the referral agreement. The court stated that the other parties were aware that Fleming was acting as an agent for F&A, and the court saw nothing as Johnson and Barton. An addendum was written on letterhead labeled “Johnson Law Firm * Barton Law Firm.” Both the referral agreement, which was in the form of a letter written on F&A letterhead and was signed by Fleming as well referral agreement without indicating his representative capacity and was thus individually liable. The court examined J&B. Thus, F&A was not entitled to a 45% reduction in the damages it owed not be transferred in whole or in part to F&A by Johnson. The PITA, as an agreement between Johnson and F&A, gave in this breach of contract action was partnership property owned by J&B and not its partners. Partnership property could winding up and to require Johnson to then convey those disbursements to F&A. At the time the suit was filed, Johnson not appear Johnson transferred his partnership interest as F&A claimed. The court stated that it was reasonable to F&A or part of his partnership interest, and a transferee is entitled to receive, to the extent transferred, distributions to which the transferor otherwise would be entitled. Tex. Bus. Orgs. Code §§ 152.401, 152.404(a). The court stated that it did not appear Johnson transferred his partnership interest as F&A claimed. The court stated that it was reasonable to interpret the PITA to entitle Johnson to receive disbursements from J&B during his tenure as a partner and during winding up and to require Johnson to then convey those disbursements to F&A. At the time the suit was filed, Johnson had withdrawn from J&B and stated that he no longer owned any interest in J&B. F&A did not address the impact of Johnson’s withdrawal on its rights to any distributions. The court agreed with J&B that any recovery it was entitled to in this breach of contract action was partnership property owned by J&B and not its partners. Partnership property could not be transferred in whole or in part to F&A by Johnson. The PITA, as an agreement between Johnson and F&A, gave F&A rights against Johnson but not against J&B. Thus, F&A was not entitled to a 45% reduction in the damages it owed J&B.

Next the court addressed F&A’s contention that the trial court should have offset or reduced F&A’s damages by 45% based on the PITA under which Johnson transferred his right to receive profits, revenues, distributions, or compensation from J&B. The court of appeals concluded that F&A did not establish that it was entitled to an offset or extinguishment of 45% of its liability based on the PITA. The court pointed out that a partnership is an entity distinct from its partners and that partnership property is not property of the partners. Tex. Bus. Orgs. Code §§ 152.056, 152.101. A partner’s partnership interest includes the partner’s share of profits and losses and right to distributions, but does not include the partner’s right to participate in management. Tex. Bus. Orgs. Code § 1.002(68). A partner may transfer all or part of his partnership interest, and a transferee is entitled to receive, to the extent transferred, distributions to which the transferor otherwise would be entitled. Tex. Bus. Orgs. Code §§ 152.401, 152.404(a). The court stated that it did not appear Johnson transferred his partnership interest as F&A claimed. The court stated that it was reasonable to interpret the PITA to entitle Johnson to receive disbursements from J&B during his tenure as a partner and during J&B.

Next the court of appeals addressed J&B’s argument that it was entitled to hold Fleming individually liable on the referral agreement. The only ground for this argument that J&B preserved for appeal was that Fleming signed the referral agreement without indicating his representative capacity and was thus individually liable. The court examined the referral agreement, which was in the form of a letter written on F&A letterhead and was signed by Fleming as well as Johnson and Barton. An addendum was written on letterhead labeled “Johnson Law Firm * Barton Law Firm.” Both Barton and Johnson signed the addendum, and Fleming signed on a line below their signatures to the left of the page. The court stated that the other parties were aware that Fleming was acting as an agent for F&A, and the court saw nothing in the addendum that would alter the fact that Fleming was acting as agent for a disclosed principal. The court concluded that Fleming established as a matter of law that he was not personally liable under the referral agreement.
The final issue addressed by the court was F&A’s liability for attorney’s fees under Section 38.001(8) of the Texas Civil Practice and Remedies Code. The court of appeals concluded that the plain language of Section 38.001(8) does not permit a person to recover attorney’s fees against a partnership, and the trial court erred in awarding attorney’s fees against F&A.

**Leighton v. Rebeles**, 399 S.W. 3d 721 (Tex. App.–Dallas 2013, no pet.).

Leighton and Rebeles moved to Dallas, began living together, filed joint tax returns, purchased property as husband and wife, and operated a sand and gravel business together. They purchased two properties that they operated as Paul’s Pit Sand and Gravel and Hutchins Sand & Gravel. After 12 years together, believing she had entered into a common law marriage, Rebeles filed for divorce, but she later learned that there was no record of her divorce from a previous husband, so she and Leighton decided to non-suit the divorce case. To facilitate their separation, they signed an agreement on August 26, 2006, in which Rebeles, for $150,000, agreed “to relinquish all past present, and future interest in Paul’s Pit Sand and Gravel, and in Hutchins Sand & Gravel and any dealings by Paul M. Leighton.” Shortly after signing this agreement, Leighton and Rebeles entered into an oral agreement under which Leighton would sell sand, gravel, and other materials from properties he leased mixed with one of the properties he owned with Rebeles. Rebeles agreed to perform administrative and clerical work through her separate company in exchange for a share of the profits from the sales. Rebeles sued Leighton alleging that she and Leighton had formed a partnership during the time they lived together and requesting the trial court to supervise a winding up and divide the partnership assets. Leighton responded that Rebeles had released any claim to the alleged partnership assets and that Rebeles had breached her oral contract with Leighton regarding the sale of sand and gravel through her company. The jury found that Leighton and Rebeles formed a partnership in 1984 and that an event requiring winding up occurred in 2006. The jury found that Rebeles did not release her claim to the partnership assets but did breach her oral contract with Leighton regarding the sale of materials through her company and was liable for damages. In protracted post-verdict proceedings, the trial court wound up the partnership and divided the assets. The trial court concluded the case by entering a final judgment incorporating its rulings on the verdict and post-verdict winding up of the partnership. In the final judgment, the trial court disregarded the jury’s finding on Leighton’s breach of contract claim. Leighton did not challenge the finding of a partnership on appeal, but he contended that Rebeles unambiguously released any claim she had to the partnership assets in the agreement she signed on August 26, 2006. The court of appeals reviewed testimony of Leighton and Rebeles regarding the release agreement. The court of appeals concluded the agreement was ambiguous and that the evidence was sufficient to support the jury’s finding that the contract was not intended as a release of Rebeles’ claim to her interest in the partnership itself or her share of the partnership assets. The court noted that the agreement referred only to the businesses being operated by the partnership and not the partnership itself. Leighton conceded that neither he nor Rebeles believed the agreement had any effect on Rebeles’ interest in the land they owned jointly and on which they operated the partnership businesses named in the release. The testimony indicated the agreement was a means of distancing themselves in their business activities after the deterioration of their personal relationship. They both testified that it was intended to provide Rebeles with the funds to start her own business. Leighton viewed the payment as a “severance package” that terminated her employment, and Rebeles testified that she understood that she was relinquishing her involvement in Paul’s Pit and Hutchins Sand & Gravel, that she would have a separate bank account, and that she would no longer receive income from the businesses operated by Leighton. Rebeles testified that the $150,000 represented only a portion of their attempt to separate their business activities and that she requested some other partnership assets. Based on the testimony, the court concluded the jury could have reasonably interpreted the agreement as merely the first step in the separation of the partners’ business dealings as Rebeles testified. Leighton’s other contention on appeal was that the trial court erred in disregarding the jury’s finding that Rebeles breached their oral agreement regarding the billing of materials through Rebeles’ separate business. Rebeles argued that the activity was part of the partnership business and was subsumed by and irreconcilable with the jury’s findings on partnership. Leighton argued that the jury could have concluded the agreement was outside the partnership. The court of appeals agreed with Leighton. According to the court, the jury could have concluded that Leighton and Rebeles were not acting as agents of the partnership when they entered into the agreement but were representing their own independent interests. Thus, the court of appeals rendered judgment that Leighton recover damages in the amount found by the jury on his breach of contract claim against Rebeles.


The Johnsons and Graze Out Cattle Co. (“Graze Out”), a closely held corporation, formed a partnership to purchase and operate a catering and special event business in 2005. The Johnsons agreed to be the partnership’s day-to-day operators, i.e., to provide the labor and make the decisions using their knowledge of the food industry, and Graze
Out agreed to secure the financing and provide accounting services. The parties did not sign a written partnership agreement but agreed to a 50-50 split of profits and losses. In 2007, the partnership was under water, and Mr. Johnson called Graze Out’s president and told him the partnership would have to be dissolved because it was not making enough money to pay its expenses and could not afford a rent increase that went into effect in 2007. At that time, all the partnership’s vendors had been paid. Graze Out had the partnership’s equipment picked up, and the business was closed. In 2008, Graze Out filed a petition for dissolution and an accounting. Following a bench trial, the trial court issued a judgment dissolving the partnership, ordering the Johnsons to pay $28,479 to Graze Out, and requiring Graze Out to auction the equipment in its possession and retain the proceeds. The judgment against the Johnsons would then be reduced by 50% of the sales proceeds. The trial court also awarded Graze Out attorney’s fees and costs. The Johnsons appealed, arguing the evidence was insufficient to establish Graze Out’s liability and damage claim and that there was no basis to award Graze Out attorney’s fees. On appeal, the court of appeals first addressed whether a $70,000 note that provided the funds to purchase the catering business and pay initial operating expenses was a partnership obligation. The note was signed by the president of Graze Out on Graze Out’s behalf, and the guarantors signed in their individual capacities. Neither the note nor any other loan documentation made mention of the partnership, and the note was paid off by the children of Graze Out’s president after the partnership ceased operation, further indicating that the note was not a partnership obligation. Thus, there was no basis for the trial court to presume that the note was a partnership obligation. Next the court of appeals examined the evidence to determine whether the trial court’s judgment reflected the correct calculation of the capital accounts pursuant to the Business Organizations Code (BOC). The court noted that the parties had relied on the Texas Revised Partnership Act (TRPA), which expired January 1, 2010. (Although the court noted that the BOC applies to all partnerships after January 1, 2010, it appears the parties were correct to rely on TRPA since the partnership at issue was formed before the effective date of the BOC and the events in question all occurred before January 1, 2010, but there is no substantive difference between the BOC provisions relied on by the court and the analogous TRPA provisions.) The court explained that a “capital account” is computed by adding a partner’s cash contributions, the agreed value of other property contributed by the partner, and allocations of partnership profits, and subtracting the amount of distributions to the partner and the partner’s share of partnership losses. The court also noted the definition of a “distribution” as a transfer of property, including cash, from a partnership to a partner in the partner’s capacity as a partner. On winding up, capital accounts having a positive balance are a debt of the partnership unless the partners have agreed otherwise. The court then proceeded to walk through the calculation of the partners’ capital accounts. Graze Out’s capital account started out with the proceeds of the note in the amount of $70,000 executed by Graze Out. The evidence showed the Johnsons contributed $10,000 from a personal account, $12,000 worth of equipment, and $1,350 paid for accounting fees, for a total of $23,350. The court considered and rejected the Johnsons’ contention that they should be credited for the contribution of their reputations and goodwill to the partnership. The court acknowledged reputation is a type of goodwill that may be valuable intangible property, but the court found no evidence that distinguished between any intangible value the Johnsons brought to the business and their worth as employees or for services rendered. There was no evidence that clients came to the partnership because of the Johnsons, that the business was marketed using the Johnsons’ names, or that there was a change in the value after it was purchased by the partnership and operated by the Johnsons. The court then addressed the distributions received by each partner. During the operation of the partnership, $27,074 was paid on the Graze Out note, so that amount constituted a distribution to Graze Out. The Johnsons received a $30,000 distribution for living expenses. The court commented that the $30,000 withdrawn by the Johnsons should not be considered compensation (which would be an expense charged to the partners’ capital accounts 50-50) as opposed to a “distribution” (which would be subtracted from the capital account of the partner receiving the distribution) because the BOC provides that absent an agreement to the contrary, a partner is not entitled to receive compensation for services performed for the partnership other than reasonable compensation for services rendered in winding up the partnership business. Because the partners agreed to split profits and losses 50-50, and all other expenses had been paid, the court credited each partner with half of the amounts distributed to each partner and then subtracted the distribution of $30,000 from the Johnsons’ capital account and the distribution of $27,074 from Graze Out’s capital account. Because the partnership lacked the funds to cover the amounts in the capital accounts, there was a capital loss that had to be allocated. Allocating the loss 50-50 per the partners’ agreement resulted in a negative balance in the Johnsons’ capital account in the amount of $24,787, and a positive balance in Graze Out’s capital account in a like amount. Thus, the court of appeals modified the trial court’s judgment against the Johnsons by reducing the amount in the trial court’s judgment from $28,479 to $27,787. Finally, the court calculated the pre-judgment interest owed Graze Out and addressed the award of attorney’s fees to Graze Out. The court concluded that Graze Out was entitled to recover attorney’s fees because Section 38.001(8) of the Civil Practice and Remedies Code allows a party to recover reasonable attorney’s fees in a suit based on breach of an oral or written contract, and a partnership agreement is a contract.
Texas Legislative Service (“TLS”) was a legislative tracking service that provided subscribers with information about the activities of the Texas Legislature. TLS became a family partnership in 1953, and the original partnership agreement was amended periodically thereafter. The disputes at issue here involved the TLS partnership agreement executed in 1979, which remained in effect subject to certain amendments not applicable to this suit. The partnership included members of the Fish family. The parties in this case were three brothers who were partners in TLS: Russell, Andrew, and John Fish. Due to various transactions over the years, Andrew and John held a majority interest in the partnership since 1994 when they purchased equal shares of their mother’s interest in the partnership. The parties distinguished “working partners” who work in the TLS business and “non-working partners” who did not work in the business. Andrew and John were the only working partners when the action was filed, and that had been the case since 1994 when their mother retired. Russell was never a working partner. Andrew was elected manager of TLS in the late 1980s and continued in that position to the present. During Andrew’s tenure as manager, Andrew and John set their compensation without notice or the express consent of any non-working partners, including their brother Russell, as was the custom when their uncle and father acted as manager before them. As specified in the partnership agreement, salaries paid to working partners were deducted from TLS revenue before residual profits were distributed to the partners on a pro rata basis. Compensation paid to working partners therefore directly impacted the proceeds available for distribution to all partners. Following their mother’s death, Russell filed suit individually and on behalf of TLS against his brothers Andrew and John, alleging various claims for breach of the partnership agreement and breach of fiduciary duties. The trial court rendered final judgment in favor of Andrew and John on all claims without stating the grounds on which it relied. Russell appealed arguing that the trial court erred in denying his motion for summary judgment and granting Andrew and John’s motion for summary judgment.

One issue Russell contested was the payment of compensation to Andrew and John without unanimous partner approval. Under the Texas Business Organizations Code, partners are not entitled to compensation for services performed on behalf of the partnership except for services rendered in winding up the partnership business. However, if partners have executed an agreement authorizing compensation, as they did here, then the terms of that agreement would control. At the heart of this dispute was the proper interpretation and application of Section 2.5 of the TLS partnership agreement, which stated: “For each fiscal year, the partners shall receive such monthly salaries as the partners mutually agree shall be paid.” Russell argued that Section 2.5 was unambiguous and did not authorize a working partner to receive any compensation absent the unanimous consent of all partners. Furthermore, Russell argued that the agreement did not authorize salaries to be paid more frequently than monthly and did not allow the payment of bonuses or any other special compensation. Andrew and John maintained that Section 2.5 unambiguously authorized them to set their own compensation both as majority interest holders and as a majority of the working partners. In addition, they maintained that the bonuses and other special payments were deferred compensation payable if and when the cash flow allowed because the nature of TLS’s business resulted in an irregular cash flow. The court of appeals attempted to ascertain the true intent of the parties as expressed in the partnership agreement by conducting a construction analysis. The court interpreted “partners” to mean all interest holders, not just the majority interest holders or working partners as suggested by Andrew and John. The phrase “mutually agree” as used in Section 2.5 meant unanimous agreement of the partners, not a majority in interest. Importantly, the term “majority in interest” was specifically defined in Section 3.11 of the partnership agreement. Certain provisions detailed with particularity what actions could be carried out with less than unanimity of assent, and Section 2.5 was not one of them. The court concluded that Andrew and John’s interpretation of Section 2.5 of the partnership agreement was incorrect and that the partnership agreement unambiguously required consent of all the partners in order for a partner to be compensated for working at TLS. However, the court held that Andrew and John conclusively established a statute of limitations bar to any damages for breach of Section 2.5 that accrued more than four years before the lawsuit was filed, which was the limitations period applicable to breach of contract claims. The limitations period was not tolled either by the discovery rule or fraudulent concealment, as urged by Russell who waited nearly 30 years to complain about compensation paid without unanimous consent. The court also stated that there was a fact issue as to other damages issues and whether Russell waived his right to enforce Section 2.5. Thus, summary judgment was precluded, and remand on this issue was the proper relief. The court, in sum, affirmed in part the trial court’s take-nothing summary judgment on Russell’s breach of contract claim related to Section 2.5 of the partnership agreement and reversed and remanded in part for further proceedings as to the damages not precluded by the statute of limitations.

Russell’s suit included claims against Andrew and John for breach of fiduciary duties to TLS and its partners in various respects, including paying themselves excessive compensation and bonuses, funding self interests with partnership profits, and failing to disclose raises or bonuses. Regarding the breach of fiduciary duties claims arising from
Andrew’s and John’s payment of compensation other than as authorized by Section 2.5 of the partnership agreement, the court determined that the related breach of contract claims were partially time-barred by the statute of limitations and that a fact existed as to waiver. The analysis was equally applicable to fiduciary duty claims predicated on the same conduct, and four years was the limitations period for breach of fiduciary duties. To the extent the breach of fiduciary duties was not time-barred, Andrew and John sought summary judgment on the ground that the claims were barred by the economic loss rule. The court held that the economic loss rule applied because the alleged damages arose only from the nonperformance of duties governed by the partnership agreement and neither Andrew nor John made false statements or representations about their compensation. The nature of the injury in this case emanated from nonperformance of the partnership agreement itself and was more appropriately characterized as a breach of contract claim.

In a separate opinion by Justice Henson, she concurred with the majority decision to affirm the trial court’s summary judgment in part and reverse as to the noncompliance with Section 2.5 of the partnership agreement relating to the partners’ compensation. Justice Henson agreed that the court must remand the breach of contract claim for potential damages that were not barred by the statute of limitations and that a fact issue existed as to Russell’s possible waiver of these damages. However, she dissented from the majority’s conclusion that the clause in the partnership agreement addressing the approval of partners’ salaries was unambiguous and required unanimous consent of the partners. After considering the agreement in its entirety and the surrounding objective circumstances, she concluded that the provision was ambiguous and would remand to the trial court for the fact finder to determine the intended meaning of the clause after consideration of the relevant extrinsic evidence. Section 2.5 provided that “the partners shall receive such monthly salaries as the partners mutually agree shall be paid.” The majority interpreted the provision to require unanimous consent of the partners. Justice Henson maintained that the phrase did not unambiguously mandate unanimous consent among all partners each of whom owned varying percentages of interest in the partnership. The partnership agreement was inconsistent in the terms used in it, and it did not define the phrase “mutually agree.” Justice Henson argued that one interpretation of the phrase was such that each partner would agree or disagree on partner salaries in proportion to his or her share in the partnership. A partner with a minority interest would be unable to veto an agreement reached by a majority in interest of the partners. These varying interpretations indicated that ambiguity existed. Furthermore, even if the majority’s interpretation of the phrase was correct, the court must look beyond the plain meaning of the words if it appeared that the plain meaning would defeat the parties’ intent as evidenced by the entire agreement. Justice Henson explained that harmonizing all provisions so that none were rendered meaningless and considering the contract as a whole in light of the circumstances present when the contract was entered into (e.g., the partnership’s historical practice), it was apparent that Section 2.5 was susceptible of more than one legal meaning or construction. The phrase “mutually agree” in relation to partner salaries could be interpreted as requiring unanimous consent or agreement of a majority in interest of the partners. Consequently, the partnership agreement did not clearly disclose the parties’ intentions and was ambiguous. Justice Henson would remand the breach of contract claim to the trial court for the fact finder to determine the parties’ true intent as to the provision at issue. As to the remainder of the majority’s disposition, Justice Henson concurred.


When a family partnership ended in 2006, a dispute among the three brothers who were the partners arose as to the rights to a five-acre tract of land owned by the partnership. The tract had been sold to the partnership in 1983 by the son of another brother who had died. Although the deed named the grantees as the three surviving brothers, the parties did not dispute that the tract was conveyed to the partnership. One of the brothers, Roberto, asserted that there was an oral partnership agreement providing for equal division of profits and that he was entitled to the entire five-acre tract based on an oral agreement stemming from an earlier unequal partition of family lands. The other two brothers testified that they never agreed that Roberto was to receive the five-acre tract, and the court held that there was no evidence of an agreement that Roberto was to receive the five-acre tract. Further, the court stated that there was no evidence that Roberto had personally taken possession of the property or made permanent and valuable improvements to the property with the partnership’s consent, necessary factors for an oral contract for the transfer of real property. Thus, the trial court erred in awarding Roberto the five-acre tract.
3. Voting Rights


Physician partners in a hospital limited liability partnership sought preliminary injunctive relief against the partnership and its corporate managing partner in their suit alleging various causes of action. The plaintiffs were Class A unit holders, and the corporate general partner was a Class B unit holder in the partnership. Under the original partnership agreement, Class A units (which were reserved for physicians) always represented 49% of the “Percentage Interest,” and Class B Units (which were reserved for the managing partner) always represented 51%, regardless of the number of outstanding units of either class. An amendment of the partnership agreement in connection with a second offering of Class A units eliminated this provision and specified that a partner’s “Percentage Interest” was based on the total number of units outstanding at the time, regardless of class. Also, the managing partner had the right to acquire additional Class B units whenever additional Class A units were issued in order to maintain the proportionate ownership of the classes. Thus, the managing partner acquired additional Class B units when the additional Class A units were issued in connection with the second offering. The amended agreement, like the original agreement, established a governing board to manage several aspects of the partnership. The board consisted of 15 members, 8 to be chosen by the managing partner, and the remaining 7 members (“Physician Representatives”) to be chosen by the Class A unit holders. Under the amended agreement, decisions of the governing board generally required the affirmative vote of board members controlling more than 50% of the voting interest of all board members (the “Voting Interest”), and the agreement provided that the Physician Representatives, whether one or more, collectively controlled 49% of the Voting Interest. The agreement specified that several types of major decisions, including a capital call, required the affirmative vote of 75% of the Voting Interest. The affirmative vote of 75% of the Partnership Interest was required to approve several types of major decisions, including amendment of the agreement. After this lawsuit was brought, the partnership initiated a rescission offer, and most of the Class A owners accepted the offer. The trial court initially granted temporary injunctive relief, but that order was later dissolved, and the partnership proceeded with the rescission of Class A units of the partners who had accepted the offer. The partnership informed the current and former Class A unit owners that less than 15% of the partnership’s total Percentage Interest was represented by Class A unit owners as a result of the rescission. The same communication also announced the adoption of an amendment regarding the composition of the governing board. Under this amendment, the managing partner retained the right to elect 8 members of the governing board, but the Class A unit owners had the right to elect only one member for each 7% of the Percentage Interest owned by all Class A unit owners. A subsequent notice of meeting was sent to Class A unit holders informing them that they could elect one member of the governing board. At this point, the original plaintiffs sought a TRO and temporary injunction, which was denied. After the denial of the second temporary injunction application, the partnership sent notice of a capital call (purportedly effectuated by the managing member with its Percentage Interest in excess of 75%) to the four remaining Class A partners. The notice of capital call warned that failure to satisfy the capital call would subject the partners’ interests to termination. The two remaining Class A partners who were not then plaintiffs in this lawsuit joined the suit, and these four partners filed an amended petition and a third request for temporary injunctive relief. The trial court denied this request, and two of the plaintiffs pursued this interlocutory appeal. On appeal, the plaintiffs argued that the capital call and termination of their interests in the partnership were not authorized. Alternatively, they argued that the legal effect of a rescission of Class A units of the partnership was to reduce the number of Class B units because rescissions restore parties to their relative positions before the transaction.

In addressing the irreparable injury requirement that generally must be met for injunctive relief, the court considered whether the Texas Business Organizations Code (BOC) authorizes injunctive relief in the partnership context without a showing of irreparable injury. The plaintiffs argued that they did not need to show irreparable injury because Section 152.211 of the BOC authorizes “equitable” relief to enforce a partner’s rights. Alternatively, the plaintiffs argued that they met the irreparable injury requirement if they were required to do so. The court analyzed the statutory provision and concluded it did not contain the kind of express language required to supersede the common law’s irreparable injury requirement for injunctive relief. However, the court agreed with the plaintiffs that they had satisfied the requisite showing of irreparable injury. Although the court stated that termination of their partnership interests alone would not demonstrate that damages would be an inadequate remedy, termination of their interests in this case would involve the loss of several management rights, including the right to participate in selecting a governing board representative who wielded 49% of the Voting Interest and could block several major decisions. Money damages would not provide adequate compensation for the loss of these management rights because the rights could not be measured by a pecuniary standard and were unique and irreplaceable.
The court of appeals next concluded that the plaintiffs demonstrated a probable right to relief on the merits. Under the partnership agreement, “Percentage Interest” and “Voting Interest” were not synonymous terms. Although the language of the partnership agreement had been amended to reduce the number of Physician Representatives on the governing board to one, the plain and unamended terms of another paragraph provided that “Physician Representatives [on the Governing Board] whether one or more, shall collectively control forty-nine percent (49%) of the Voting Interest, which shall be allocated among the Physician Representatives in attendance at the meeting (whether in person or by proxy) on a per capita basis.” This paragraph further required the affirmative vote of 75% of the Voting Interest for a capital call. It was undisputed that no Physician Representative approved the capital call, and the court held that the plaintiffs had thus shown a probable right to injunctive relief. The court did not reach the issue of whether the legal effect of the rescission of Class A units was to reduce the number of Class B units, since it was not necessary to the disposition of the appeal.

4. Transfer Restrictions and Buyout Provisions


Texas Legislative Service (“TLS”) was a legislative tracking service that provided subscribers with information about the activities of the Texas Legislature. TLS became a family partnership in 1953, and the original partnership agreement was amended periodically thereafter. The disputes at issue here involved the TLS partnership agreement executed in 1979, which remained in effect subject to certain amendments not applicable to this suit. The parties in this case were three brothers who were partners in TLS: Russell, Andrew, and John Fish. Among the various claims asserted was a claim by Russell that Andrew and John violated the partnership when each purchased one half of their mother’s partnership interest in TLS for $100,000 payable with interest over a 144-month period. These purchases were, according to Russell, in violation of Section 4.41 of the partnership agreement, which required payment to a withdrawing partner be completed within six months of the partner’s withdrawal and Section 4.43 which required any promissory note to purchase another partner’s interest be secured by a lien upon the partnership interest being purchased. The court determined the sales did not comply with the Section 4.41 requirement, and there was an absence of evidence that Andrew and John failed to comply with Section 4.43. However, the trial court properly granted summary judgment in favor of Andrew and John related to Russell’s claims arising from the sale of their mother’s partnership interest because there was no evidence that Russell or TLS were damaged or injured by deviations from the requirements in these sections.

5. Covenants Not to Compete


Texas Legislative Service (“TLS”) was a legislative tracking service that provided subscribers with information about the activities of the Texas Legislature. TLS became a family partnership in 1953, and the original partnership agreement was amended periodically thereafter. The disputes at issue here involved the TLS partnership agreement executed in 1979, which remained in effect subject to certain amendments not applicable to this suit. The parties in this case were three brothers who were partners in TLS: Russell, Andrew, and John Fish. Among the claims asserted was a claim by Russell that Andrew and John violated a covenant not to compete in Section 7.41 of the partnership agreement by owning, operating, or conducting business with similar legislative tracking services in other states for his own benefit and not in furtherance of TLS’s interests. Russell further alleged that in establishing the businesses in other states Andrew misappropriated TLS’s trade secrets and infringed on TLS’s copyright in the proprietary software systems TLS allegedly owned and used in its business. It was undisputed that Andrew owned and operated legislative tracking services in other states that offered the same basic services that TLS provided in relation to the Texas legislature, the software systems used by the businesses were the same or substantially similar to that used by TLS, and Andrew retained the monetary benefits of these transactions for himself. The court determined there was no evidence that John competed with TLS or misappropriated any of its trade secrets; therefore, the trial court properly granted summary judgment in favor of John as to these claims against him. Regarding the claims against Andrew, the trial court also properly granted summary judgment in Andrew’s favor. The noncompete provision in the partnership agreement applied to former employees of TLS, and Andrew was still a TLS partner and employee. Also, there was no evidence that any of Andrew’s out-of-state businesses competed with TLS in Texas or elsewhere. There was no evidence that Andrew disclosed any confidential information in violation of the confidentiality agreement implicitly embedded in the partnership agreement.
As for the misappropriating trade secrets and copyright infringement claims, an essential element of both claims is that the complainant owned the trade secret or copyright. Here, there was no evidence that TLS owned the software at issue and no evidence to contradict Andrew’s assertion that he owned the software. Thus, the trial court properly granted summary judgment in favor of Andrew on Russell’s claims for misappropriated trade secrets and copyright infringement. Russell also alleged breach of fiduciary duty claims based on alleged competition with the partnership by operating similar businesses in other states, use of the partnership’s proprietary and trade secrets, and failure to disclose competitors and other companies in which Andrew had an interest. These claims were based on the same factual predicates for the claims for breach of contract, misappropriation of trade secrets, and copyright infringement. As a result, to the extent the court affirmed summary judgment on those claims, the court likewise affirmed summary judgment on the related claims for breach of fiduciary duties.

6. Withdrawal/Expulsion


In the 1990s, Eldon Youngblood developed a practice that involved the preparation of large-volume residential mortgage loan documents for a fixed fee. The practice grew, and Youngblood had his law firm hire Ronald Bendalin in 1999 as his associate. In 2003, Youngblood and Bendalin bought the practice from their firm and together formed Youngblood and Bendalin Partnership (“YB Partnership”). YB Partnership negotiated an arrangement with another firm, McGlinchy Stafford PLLC (“McGlinchy”), in which Youngblood and Bendalin would become non-equity partners of McGlinchy, and McGlinchy would become a 20% interest minority partner in a new entity, McGlinchy Stafford and Youngblood & Bendalin, LLP (the “Firm”). YB Partnership owned an 80% interest in the Firm, and the Firm carried out the day-to-day business of a legal services firm. The Firm later created a company called McGlinchy Stafford and Youngblood & Bendalin Mortgage Banking Group, LLC (“MBG”) to employ and lease back the Firm’s employees.

The Firm continued to grow its business until 2007 when the housing market began crashing. The financial impact of the decline caused a reduction in workforce and was felt throughout 2008. In the summer of 2008, Bendalin began representing Vantium Capital (“Vantium”) as one of McGlinchy’s corporate clients. Vantium offered to hire Bendalin, and Bendalin signed a general counsel employment contract with Vantium on November 20, 2008, with a start date of December 2, 2008. On November 21, 2008, Bendalin held a private meeting with Youngblood to inform him of his acceptance of the position at Vantium and his departure from the Firm. Bendalin intended to sell his interest in YB Partnership. With Bendalin withdrawing from YB Partnership, Youngblood testified he understood he would have the first option to purchase Bendalin’s interest, but there was discussion that McGlinchy and individual purchasers might be interested in buying Bendalin’s interest in YB Partnership. Evidence showed that Bendalin expressed his intent to withdraw to various employees of MBG, and a statement signed by Youngblood and an employee present in Bendalin’s initial announcement meeting stated that Bendalin expressed his intention to withdraw from YB Partnership effective December 31, 2008. On December 1, 2008, at a meeting of managers of MBG, Bendalin announced that he was taking the position of general counsel at Vantium and he would no longer be with the Firm or YB Partnership by December 31, 2008. Via email, Youngblood and Bendalin began the dispute over Bendalin’s withdrawal shortly after the Firm-wide announcement. Youngblood requested written notice of Bendalin’s intent to withdraw from the YB Partnership effective December 31, 2008, as well as written consent for Youngblood to transfer a small portion (1%) of his partnership interest to another person prior to the end of the month assuming he was going to purchase Bendalin’s interest in YB Partnership for the fair market value. Bendalin responded that he intended to withdraw as of December 31, 2008, but he could not provide formal written notice of withdrawal or consent to transfer until he and Youngblood had agreed to all terms of the withdrawal. The dispute centered on whether Bendalin’s notice of withdrawal was effective or whether he was merely expressing an intent to withdraw at a later date that was not yet final and depended on an agreement as to the terms of the buyout of his partnership interest in YB Partnership. Bendalin informed McGlinchy’s managing partner and CEO that he was not withdrawing from YB Partnership unless and until he and Youngblood agreed to the terms of the withdrawal. On December 30, 2008, YB Partnership was contending that based on its valuation methods Bendalin owed that he was not withdrawing from YB Partnership unless and until he and Youngblood agreed to the terms of the withdrawal. On December 30, 2008, YB Partnership was contending that based on its valuation methods Bendalin owed
In early 2009, Bendalin resigned as manager of the Firm and agreed that the Firm’s name could be changed to McGlinchy Stafford and Youngblood & Associates, LLP in exchange for Youngblood waiving any right to claim Bendalin was in violation of the partnership agreement for failure to provide services to any of the entities involved. However, Youngblood and Bendalin continued to have differing interpretations as to whether Bendalin withdrew as a partner of YB Partnership and whether the alleged withdrawal was wrongful. For example, Bendalin emailed a banker from Northern Trust, the bank that extended the partnership a line of credit, on February 29, 2009, stating that he had not withdrawn from the partnership and no changes could be made to the account without his consent. Also, Youngblood declined to deliver financial statements for the Firm requested by Bendalin in March 2009, and Bendalin argued he was entitled to them as he remained a 50% partner in the 80% shareholder in the Firm. Mediation attempts failed, and YB Partnership (now known as Youngblood & Associates) filed suit against Bendalin.

YB Partnership sought a declaratory judgment that Bendalin withdrew from the partnership and ceased to be a partner on or before December 31, 2008, and that the withdrawal was wrongful within the meaning of the Texas Revised Partnership Act (TRPA). In addition, YB Partnership asserted a cause of action for breach of the partnership agreement on the basis that Bendalin withdrew prior to ten years of service as agreed to in the partnership agreement. Based on the alleged wrongful withdrawal, YB Partnership contended Bendalin owed the partnership under the redemption provisions of TRPA as though there had been a winding up of the partnership on December 31, 2008. Bendalin filed third-party claims against Youngblood and the two individuals to whom Youngblood had transferred a 1% interest, challenging the validity of the partnership known as Youngblood & Associates and the ownership interest of its three alleged partners because amendments to the partnership agreement were made without his written consent. Bendalin also asserted the affirmative defense of quasi-estoppel on the basis that Youngblood held him out as a partner after the alleged withdrawal in connection with a renewal of the partnership’s line of credit. Bendalin claimed he never withdrew from YB Partnership and was wrongfully expelled. He sought a declaration that he was still a 50% partner in YB Partnership and that any amendments to the partnership agreement or changes in ownership interest were void.

At trial, Bendalin first claimed he never withdrew from YB Partnership because under the partnership agreement written notice was required and he never provided such written notice. Youngblood conceded that no written notice was given, but he claimed written notice was not required because it was not a notice contemplated by the partnership agreement. That is, Youngblood argued that the agreement did not allow Bendalin to withdraw prior to ten years of service to the partnership. The agreement described a “service commitment” for both Youngblood and Bendalin to provide normal services for the partnership for at least the next ten years following its formation. Bendalin contended the service commitment only related to a requisite to entitle him to reserve funds on his departure if he stayed ten years. Under this interpretation, his alleged withdrawal was not wrongful, and he would be entitled to be paid for his interest in the partnership according to the buyout provisions in the agreement. Bendalin also argued that no normal services were performed in the partnership as all business was performed through the Firm and MBG. Thus, he believed he was not in breach of the normal services provision of the partnership agreement despite his position as Vantium’s general counsel as of December 2, 2008, and he claimed that he was still able to perform normal services for McGlinchy and the YB Partnership without being in violation of the agreement. Furthermore, Bendalin complained that he received no money for his partnership interest, which was absorbed by Youngblood in the amendment to the agreement, and the amendment was wrongful because it occurred without Bendalin’s written consent. This case was filed in 2009, and all parties agreed to apply TRPA. The court of appeals explained that the trial court properly applied TRPA rather than the Texas Business Organizations Code because the YB Partnership agreement was signed in 2003. After a bench trial, the court found in favor of YB Partnership. The trial court concluded that when Bendalin signed the contract with Vantium on November 20, 2008, he anticipatorily breached the agreement by making it impossible to continue to provide normal services for the partnership, and Bendalin withdrew from YB Partnership by December 2, 2008, when he began performing services for Vantium. Also, Bendalin’s oral expression of his will to withdraw to Youngblood was notice of withdrawal under TRPA. The trial court further found that Bendalin breached the agreement by not providing normal services for the partnership as agreed to in the service commitment provision of the agreement, and this breach was wrongful under TRPA. Furthermore, Bendalin’s partnership interest was automatically redeemed by YB Partnership at his withdrawal on December 2, 2008, and as a wrongfully withdrawing partner Bendalin was required to contribute to the partnership to satisfy partnership obligations. The trial court also found that after Bendalin’s withdrawal, Youngblood engaged in no conduct to the detriment or disadvantage of Bendalin, and the amendment to the agreement was valid as Bendalin was no longer a partner. Finally, the trial court held that Bendalin’s affirmative defense of quasi-estoppel failed. The court heard expert testimony from both parties as to the redemption value of Bendalin’s interest as of December 2, 2008, assuming a wrongful withdrawal. In the final judgment, the trial court held in favor of the partnership on all issues and ordered Bendalin to pay the partnership an amount for his contribution, interest, and attorney and expert fees.
On appeal, Bendalin argued that the trial court erred by finding he withdrew from YB Partnership as of December 2, 2008, by rejecting his quasi-estoppel argument, in calculating the redemption interest, in awarding expert fees, and in awarding excessive or improper attorney fees. YB Partnership cross-appealed, claiming that the trial court did not order Bendalin to pay enough money because the court did not take into account certain liabilities of YB Partnership in calculating the redemption interest amount. The court of appeals reversed and remanded.

First, the court of appeals held that Bendalin’s withdrawal was effective without written notice. Bendalin argued that the partnership agreement required written notice to withdraw, and since he did not provide such notice he did not withdraw from YB Partnership. The partnership contended that the written notice provision was not triggered because written notice was required only for notices “required or permitted” under the partnership agreement, and Bendalin’s withdrawal before the expiration of his ten-year service commitment was not contemplated in the agreement. However, the court of appeals pointed out that the partnership agreement did contemplate cessation of performing normal services before the completion of the service commitment. The court concluded that the plain terms of the partnership agreement required written notice to withdraw, but the court stated that this conclusion did not necessarily render Bendalin’s oral notice of withdrawal ineffective. The partnership agreement mentioned “notice delivered in any other manner” but was silent as to the effect of oral notice. Thus, the court looked to TRPA to fill the gap. Under TRPA, a partnership agreement may not vary the power to withdraw as a partner where there is an express will to withdraw except to require the notice to be in writing. The court stated that TRPA does not state that oral notice is ineffective where written notice is required, and the court concluded that the requirement that notice be in writing does not extinguish the partner’s power to withdraw in view of the provisions of TRPA conferring the power to withdraw at any time by notice to the partnership. Here, the evidence showed an unequivocal oral withdrawal made by Bendalin. Based on the appellate court’s interpretation of the partnership agreement and TRPA, the court held that the lack of written notice by Bendalin did not render his withdrawal ineffective (commenting that to hold otherwise would be to overlook the practical implications of a partner’s actual departure from a partnership), and the court overruled Bendalin’s point of error claiming that the trial court erred in finding an event of withdrawal.

In a related issue, the court of appeals held that Bendalin’s attempts to rescind his withdrawal were ineffective. Bendalin claimed that any oral withdrawal was revoked when he stated he would not withdraw until he agreed with Youngblood on the terms of the withdrawal. However, the court found that Youngblood’s testimony of Bendalin’s unequivocal oral expression of withdrawal was sufficient for the trial court to find that Bendalin withdrew from the partnership. Under TRPA, once the partnership received notice of an express will to withdraw, Bendalin became a withdrawn partner, and his retractions did not operate to automatically make him a partner again. Bendalin cited no precedent for his retraction argument, and the court overruled Bendalin’s claim that the trial court erred in failing to give effect to the retraction of his withdrawal from the partnership.

Next, the court of appeals held that quasi-estoppel did not negate Bendalin’s withdrawal. Quasi-estoppel was an affirmative defense asserted by Bendalin, who argued that Youngblood was estopped from alleging Bendalin was no longer a partner. This affirmative defense arose from the fact that Northern Trust Bank, which issued a line of credit to YB Partnership, sought renewal of the certificate of deposit securing the credit in September 2009. Youngblood signed in September 2009, and Bendalin signed in October 2009 at the request of YB Partnership. Bendalin suggested that because he was represented as a partner on the loan documents, the trial court erred in failing to apply the doctrine of quasi-estoppel to Youngblood regarding the bank documents. In essence, Bendalin sought to use the quasi-estoppel doctrine to escape the fact of his withdrawal. Quasi-estoppel precludes a party from asserting, to another’s disadvantage, a right inconsistent with a position previously taken. Here, Bendalin contended that listing him and having him sign the bank documents as a partner to secure YB Partnership’s line of credit was wholly inconsistent with the partnership’s position that Bendalin had withdrawn and was a disadvantage to him. The trial court found that Bendalin’s affirmative defense was not supported by sufficient evidence. The court of appeals agreed that Bendalin’s position was contrary to TRPA, which states that representation or conduct indicating that a person is a partner in an existing partnership, if that is not the case, does not itself make that person a partner in the partnership. The court of appeals reasoned that the trial court could have decided that because Bendalin refused to allow alteration of the partnership’s signature card at Northern Trust Bank, Bendalin was attempting to represent himself as a partner and that Youngblood had no choice but to acquiesce out of necessity. Thus, it would not have been inconsistent with YB Partnership’s position that Bendalin was no longer a partner. There was also evidence that quasi-estoppel was not applicable because testimony showed that the representation of Bendalin as a partner was not a detriment to him in that he personally benefited from the funds obtained. Thus, the court held that Bendalin failed to show his entitlement to the affirmative defense of quasi-estoppel as a matter of law.

The court of appeals next addressed when Bendalin’s withdrawal was effective and determined that date to be December 31, 2008. Bendalin complained that the trial court erred in determining that December 2, 2008, the day he
began employment with Vantium, was the effective withdrawal date. The court of appeals agreed with Bendalin that the trial court erred in determining the proper withdrawal date. According to TRPA, withdrawal occurs on the receipt by the partnership of notice of the partner’s express will to withdraw as a partner or on a later date specified in the notice. The trial court found that YB Partnership was notified of Bendalin’s express will to withdraw on November 21, 2008. It was uncontested that the initial notification and later communication between the parties specified a withdrawal date of December 31, 2008, and the trial court erred in finding the date of withdrawal to be December 2, 2008.

The court of appeals next held that Bendalin’s withdrawal was not wrongful under TRPA. The trial court held that Bendalin’s failure to fulfill a ten-year service commitment was an express breach of the agreement and thus fell within TRPA’s wrongful withdrawal provision. According to the court of appeals, the agreement was not for a definite term, was not created for a particular undertaking, and did not specify an event that would require a winding up, so Bendalin’s withdrawal was not wrongful under TRPA. The partnership agreement provided that the partnership would continue until dissolved by the vote of all partners or the bankruptcy of a partner, but the court did not view either of these events as a “specified event” requiring winding up. As to whether Bendalin’s withdrawal constituted a breach of the partnership agreement, YB Partnership claimed the agreement required Bendalin’s service for ten years and that his failure to do so was a breach. Bendalin argued the ten-year time frame specified in the agreement merely entitled him to certain rights and bonuses if he were to serve the partnership for at least ten years and thus had no effect as to whether his withdrawal was wrongful. The court of appeals stated that the definition of “service commitment” in the general definition section of the partnership agreement did not contain a time frame for services. The ten-year time frame was set forth in reference to Bendalin having the ability to receive reserve funds after providing normal services for the partnership for ten consecutive years, and no other term in the agreement stated that Bendalin was required to be a partner and perform normal services for a specified time frame. Bendalin’s right to withdraw was not otherwise restricted. By withdrawing before completing ten years of normal services, Bendalin forfeited his right to partnership reserve funds, but his withdrawal was not a breach of the agreement and thus was not wrongful.

Finally, the court of appeals remanded to determine the amounts to be recovered by the parties. Because the trial court erred in determining that Bendalin wrongfully withdrew as of December 2, 2008, the calculation of Bendalin’s redemption value was inappropriate. The appellate court reversed the damage award and remanded to the trial court to determine the fair value of Bendalin’s partnership interest as of December 31, 2008, the date of his withdrawal. As for expert and attorney fees, the court noted that expert fees are generally not recoverable and that the findings of fact supporting their recovery in this case were conclusory and did not state the trial court’s basis. Because the fees may have been awarded based on the trial court’s erroneous finding that Bendalin’s withdrawal was wrongful, the reversal might change the basis on which the trial court awarded those amounts. Thus, the court of appeals remanded the damages and other awards to the trial court for its reconsideration.

7. Statute of Frauds


Steven Bowman, as Personal Representative of the Estate of William Bowman (“Bowman”), brought suit against Richard Sewing in relation to a partnership for the development of townhomes in Houston. Bowman and Sewing met in the early 1950s, and between 2003 and 2005 Bowman transferred money to Sewing in excess of $200,000 for the purpose of developing, renting, and selling townhomes in Houston. Sewing owned the two properties at issue, and together they were valued at approximately $600,000. Sewing testified at a deposition that the parties’ agreement required Bowman to pay Sewing $300,000 to acquire a half interest in the properties. Bowman alleged that he and Sewing formed a partnership to carry on the development business, and when Bowman died in 2005 he became a withdrawn partner entitled to receive for the redemption of his partnership interest. Sewing testified at trial that the partnership had never formed and that Bowman never agreed to buy the land to become a partner. The trial court entered judgment on the jury verdict in favor of Bowman. On appeal, Sewing asserted error by the trial court in numerous respects, including that the trial court erred in denying his request for directed verdict because Bowman’s partnership claim was precluded by the statute of frauds. That is, Sewing alleged that the claim involved an agreement to transfer real property, and the statute of frauds precluded the enforcement of the agreement because there was no writing signed by Sewing regarding the agreement to transfer the property into a partnership. Sewing argued that Bowman’s partnership redemption claim was couched in terms of a partnership agreement but in reality was a claim for a one-half interest in the two properties at issue. The court of appeals disagreed, stating that Bowman was not using his claim for redemption of a partnership interest to attempt to enforce an otherwise unenforceable contract for the sale of real property. Bowman did not make a claim for a transfer
of title in the properties, and the evidence presented to the jury was only that Bowman sought the value of his partnership interest in a partnership regarding the development and sale of the properties. The court explained that merely because a partnership agreement contemplated transactions in real estate did not transform the partnership itself into a transaction for the sale of real property to which the statute of frauds would apply. The court stated that Bowman’s claim for redemption of his partnership interest may have included an interest in the proceeds from the sale of the properties without resulting in the transfer of an interest in the properties. The appellate court held that the trial court did not err in denying Sewing’s motion for directed verdict because the statute of frauds did not apply to the partnership agreement. Furthermore, although the statute of frauds would have applied if Sewing had transferred the properties to the partnership making the properties partnership assets, the jury could properly consider the market value of the properties to determine Bowman’s partnership interest without considering the properties themselves to be assets of the partnership. The court of appeals also concluded that there was sufficient evidence to support the jury’s finding of a partnership, that there was sufficient evidence to support the jury’s finding of the fair value of Bowman’s partnership interest, and that Bowman was entitled to recover attorney’s fees under the Texas Civil Practice and Remedies Code because the claim for redemption of Bowman’s partnership interest was based on an oral contract.

In a dissenting opinion, one justice maintained that the statute of frauds barred enforcement of the alleged oral contract and Bowman failed to prove any other basis for recovery of damages and attorney’s fees. As discussed in the majority opinion, a distinction exists between property-related agreements that are and are not barred by the statute of frauds. An oral partnership agreement to transfer an ownership interest in land to a partner or the partnership would violate the statute of frauds, but an oral partnership agreement to develop land for resale and share in the sale profits without transferring an ownership interest in the land would not violate the statute of frauds. The majority held that the partnership agreement here was for the development and resale of land without transferring an ownership interest in land, and thus the statute of frauds did not preclude its enforcement. The dissent argued that the facts presented involved a transfer of an ownership interest in land and that the statute of frauds precluded enforcement of the agreement against Sewing since there was no writing signed by Sewing as to the terms of the agreement. On appeal, Bowman contended that the agreement was not to transfer the properties’ ownership but rather it was an agreement to redevelop and share in the profits from the properties’ sale. The dissent stated that the agreement Bowman described on appeal was not the agreement Bowman pled and proved at trial and the agreement upon which the jury based its damages award. That is, Bowman pled and proved at trial that the agreement at issue was for Bowman to acquire a one-half interest in the properties owned by the partnership. The dissent reasoned that such an agreement required Sewing to transfer his ownership interest in the properties to the partnership, and the statute of frauds barred its enforcement since there was an absence of a legally sufficient written agreement and Bowman did not establish the partial performance exception to the statute of frauds.

Carpenter v. Phelps, 391 S.W.3d 143 (Tex. App.—Houston [1st Dist.] 2011, no pet.).

The court analyzed whether a series of documents regarding the acquisition and development of an oil and gas lease satisfied the statute of frauds, and the court concluded they did not. Investors in the lease argued that they were in a partnership with the lessee, but the only evidence of any of the factors indicating a partnership was the alleged agreement that was unenforceable under the statute of frauds. The court stated that an interest in real estate cannot become a partnership asset unless the agreement is in writing as in the case of any other contract concerning the sale of land. Because there was no evidence of any of the factors that indicate the creation of a partnership other than the unenforceable agreement, the evidence did not support the trial court’s finding of a partnership.

8. Illegality

In re Lane, No. 06-12000082-CV, 2012 WL 4101174 (Tex. App.—Texarkana Sept. 19, 2012, no pet.) (mem. op.).

In this dispute between a father and son regarding an automobile dealership in which they both claimed an interest, the son challenged an order to return certain property he had removed from the dealership. The son claimed the partnership with his father was illegal based on a provision of the Texas Transportation Code that prohibits a person from engaging in business as a dealer without a dealer general distinguishing number. He argued that his father’s assistance in the son’s unlicensed efforts to sell cars and the son’s sharing of profits as an alleged partner rendered the partnership illegal. The son relied on a case involving a customs house brokerage partnership in which one of the two partners did not have the required brokerage license and in which the court stated that such a partnership is illegal and void and that the courts will not enforce such a contract of partnership and will leave the parties where it finds them. The court here distinguished the case relied on by the son on the basis that the statute at issue in this case only requires one dealer
general distinguishing number for a location, and the father held such a number. Thus, the trial court did not err in refusing to declare the partnership illegal.


The plaintiff, a partner in the defendant law firm, sued the firm for alleged gender-based discrimination in violation of state and federal statutes. The firm moved the court to stay the action and compel arbitration based on an arbitration clause in the partnership agreement between the plaintiff and the firm’s other individual partners. The court held that there was an agreement to arbitrate between the parties and that the dispute fell within the scope of the arbitration provision. Alternatively, the court held that the firm, as a non-signatory, could compel the plaintiff, a signatory, to arbitrate the claims on the basis of equitable estoppel. Thus, the court stayed the action and ordered the parties to arbitrate the claims.

The plaintiff first argued that there was no agreement to arbitrate between the parties because the firm was not a party to the partnership agreement. The firm argued that it was a party to the partnership agreement and that the question of whether the firm was a party to the partnership agreement must be submitted to the arbitrator. The court agreed with the plaintiff that the threshold issue of whether an agreement to arbitrate exists is for the court rather than the arbitrator to determine, but the court concluded that the firm was a party to the partnership agreement even though the firm was not a signatory to the agreement. The plaintiff relied on several cases for the proposition that the court should deny the motion to compel arbitration based on “the simple fact that [the firm] did not sign its own operating agreement.” The court stated that none of these cases involved LLPs, and none were decided by Texas courts or addressed Texas law. The court agreed with the firm that Texas partnership law and the language of the partnership agreement led to the conclusion that the firm was a party to its partnership agreement. The court did not view the fact that the firm was not a signatory to the partnership agreement as fatal. The court described the partnership agreement as a “master agreement” that addressed much more than just the plaintiff’s relationship with the other partners. The agreement governed “the very existence and operation of the limited liability partnership.” The court pointed out that, Section 152.002(a) provides that, subject to exceptions not applicable in this case, “a partnership agreement governs the relations of the partners and between the partners and the partnership.” The court read this language to encompass the partnership as a party to the partnership agreement. The court rejected the plaintiff’s argument that the following language in the arbitration clause limited its scope to individual partners: “Each party, by signing this agreement, voluntarily, knowingly, and intelligently waives any right such party may otherwise have to seek remedies in court or other forums, including the right to jury trial.” The court viewed this sentence as merely a reaffirmation that the signatories were waiving their rights to seek remedies in any other forum. The entire clause clearly stated that it applied to “any disputes arising under or in connection with this Agreement.” The court found further statutory support for its conclusion in Section 152.211(a)-(b) of the Business Organizations Code, which provides that both a partner and the partnership may maintain an action against the other for breach of the partnership agreement. In addition, the court pointed out that the partnership agreement contained a provision that referred to remedies of the partnership against a partner who breached any provision of the agreement. Thus, based on provisions of the Business Organizations Code addressing partnership agreements in general as well as the partnership agreement at issue in this case, the court concluded that the firm was a party to the partnership agreement such that there was a valid agreement to arbitrate between the plaintiff and the firm.

Next the court analyzed whether the claims in this case fell within the scope of the arbitration clause. The arbitration clause encompassed “[a]ny disputes arising under or in connection with this Agreement, including, without limitation, those involving claims for specific performance or other equitable relief.” The plaintiff argued her claims of intentional discrimination in violation of statutory provisions did not “require legal reliance” on the partnership agreement and thus were not within the scope of the arbitration clause. The court concluded that the phrase “arising under or in connection with” the partnership agreement was broad enough to include the plaintiff’s statutory claims. The plaintiff claimed to be an “employee” based on factors addressed by the partnership agreement, leading the court to conclude that this issue “touched” on the partnership agreement. Similarly, the allegations of gender-based decisions affecting employment opportunities, requirements, and compensation also “touched” on the partnership agreement. Because the arbitration clause was broad, the court stated that the claims need only “touch” on the agreement and that the claims did not “require legal reliance” on the partnership agreement.

The court next addressed the plaintiff’s claim that the arbitration clause was unconscionable. The court concluded that the plaintiff failed to properly allege unconscionability because she failed to argue both substantive and procedural unconscionability. Further, even if she had properly alleged unconscionability, the court rejected the
plaintiff’s argument that the arbitration clause stripped away her statutory remedies. The court did not read the clause to divest the plaintiff of any remedies, but merely as requiring her to submit her claims to an arbitral rather than judicial forum.

As an alternative basis for enforcing the arbitration clause, the court concluded that an equitable estoppel framework provided a basis for the firm as a nonsignatory to enforce the arbitration clause. Because the partnership agreement addressed in detail the factors involved in determining the plaintiff’s status as an employee and the items allegedly affected by the gender-based decisions, the court concluded that the plaintiff’s claims were “‘intertwined with, and dependent upon,’” the partnership agreement, and equitable estoppel permitted the firm to compel arbitration.

10. Forum Selection Clause


The court addressed the enforceability of a forum selection clause in an agreement referred to as a “partnership agreement” in the opinion but which appeared to be an LLC agreement of a Nevada LLC. [The court stated that the “agreement formalized Hill’s position with iDesta USA, LLC, a Nevada limited-liability company,” and a quoted portion of the agreement referred to the “Company,” which the court noted was defined in the agreement as iDesta USA.] The court first addressed whether Marrocco signed the agreement in his individual capacity so as to be personally bound by the agreement, and the court concluded that he did. The court next addressed Marrocco’s argument that the forum selection clause in the agreement was “inherently unjust” because it required Marrocco, a U.K. resident who allegedly had no contacts to Texas other than the agreement at issue, to litigate in Texas. The court held enforcement of the forum selection clause was neither unreasonable nor unjust because “Marrocco bargained away [his rights to assert lack of personal jurisdiction] by signing the partnership agreement with Hill and consenting to the agreement’s forum-selection clause.”

H. No-Compensation Rule


In the course of calculating the capital account balances of the two partners of a partnership for purposes of determining the partners’ financial rights and obligations on winding up, the court discussed a $30,000 distribution received by one of the partners for living expenses during the operation of the partnership. The partner who received this distribution had agreed to be the partnership’s day-to-day operator, i.e., to supply the labor and make the business decisions using the partner’s knowledge of the food industry. The court commented that the $30,000 withdrawn by the partner should not be considered compensation (which would be an expense charged to the partners’ capital accounts 50-50) as opposed to a “distribution” (which would be subtracted from the capital account of the partner receiving the distribution) because the Business Organizations Code provides that absent an agreement to the contrary, a partner is not entitled to receive compensation for services performed for the partnership other than reasonable compensation for services rendered in winding up the partnership business.

I. Statutory Redemption of Withdrawn Partner


The court of appeals reviewed the evidence bearing on the existence of an alleged partnership between Duarte and Rojas and found the evidence was sufficient to support the jury’s finding that there was a partnership between the two men. The jury found that Duarte voluntarily withdrew from the partnership and that the value of Duarte’s one-half interest in the partnership was $119,000 as of May 31, 2005. The trial court entered a judgment in accordance with the verdict in favor of Duarte. Rojas argued on appeal that the jury’s award of $119,000 of damages to Duarte was erroneous because there was no evidence in the record to support the finding that this amount was the value of half of the partnership as of May 31, 2005. The court of appeals agreed and found that the evidence did not provide the jury with a rational basis to calculate damages of this amount on that date. Neither party was able to justify the amount or how the jury may have arrived at that amount. The evidence provided a relatively precise method for calculating the value of the partnership as of December 31, 2008, but the expert’s testimony and report did not identify any other date on which the partnership was or could have been calculated using the same data or methods. Because Duarte failed to prove the amount of his damages with reasonable certainty, the court held that the evidence was legally insufficient to support the
In the 1990s, Eldon Youngblood developed a practice that involved the preparation of large-volume residential mortgage loan documents for a fixed fee. The practice grew, and Youngblood had his law firm hire Ronald Bendalin in 1999 as his associate. In 2003, Youngblood and Bendalin bought the practice from their firm and together formed Youngblood and Bendalin Partnership (“YB Partnership”). YB Partnership negotiated an arrangement with another firm, McGlinchy Stafford PLLC (“McGlinchy”), in which Youngblood and Bendalin would become non-equity partners of McGlinchy, and McGlinchy would become a 20% interest minority partner in a new entity, McGlinchy Stafford and Youngblood & Bendalin, LLP (the “Firm”). YB Partnership owned an 80% interest in the Firm, and the Firm carried out the day-to-day business of a legal services firm. The Firm later created a company called McGlinchy Stafford and Youngblood & Bendalin Mortgage Banking Group, LLC (“MBG”) to employ and lease back the Firm’s employees.

The Firm continued to grow its business until 2007 when the housing market began crashing. The financial impact of the decline caused a reduction in workforce and was felt throughout 2008. In the summer of 2008, Bendalin began representing Vantium Capital (“Vantium”) as one of McGlinchy’s corporate clients. Vantium offered to hire Bendalin, and Bendalin signed a general counsel employment contract with Vantium on November 20, 2008, with a start date of December 2, 2008. On November 21, 2008, Bendalin held a private meeting with Youngblood to inform him of his acceptance of the position at Vantium and his departure from the Firm. Bendalin intended to sell his interest in YB Partnership. With Bendalin withdrawing from YB Partnership, Youngblood testified he understood he would have the first option to purchase Bendalin’s interest, but there was discussion that McGlinchy and individual purchasers might be interested in buying Bendalin’s interest in YB Partnership. Evidence showed that Bendalin expressed his intent to withdraw to various employees of MBG, and a statement signed by Youngblood and an employee present in Bendalin’s initial announcement meeting stated that Bendalin expressed his intention to withdraw from YB Partnership effective December 31, 2008. On December 1, 2008, at a meeting of managers of MBG, Bendalin announced that he was taking the position of general counsel at Vantium and he would no longer be with the Firm or YB Partnership by December 31, 2008. Via email, Youngblood and Bendalin began the dispute over Bendalin’s withdrawal shortly after the Firm-wide announcement. Youngblood requested written notice of Bendalin’s intent to withdraw from the YB Partnership effective December 31, 2008, as well as written consent for Youngblood to transfer a small portion (1%) of his partnership interest to another person prior to the end of the month assuming he was going to purchase Bendalin’s interest in YB Partnership for the fair market value. Bendalin responded that he intended to withdraw as of December 31, 2008, but he could not provide formal written notice of withdrawal or consent to transfer until he and Youngblood had agreed to all terms of the withdrawal. The dispute centered on whether Bendalin’s notice of withdrawal was effective or whether he was merely expressing an intent to withdraw at a later date that was not yet final and depended on an agreement as to the terms of the buyout of his partnership interest in YB Partnership. Bendalin informed McGlinchy’s managing partner and CEO that he was not withdrawing from YB Partnership unless and until he and Youngblood agreed to the terms of the withdrawal. On December 30, 2008, YB Partnership was contending that based on its valuation methods Bendalin owed a contribution obligation to the partnership, Youngblood never purchased Bendalin’s interest (which was absorbed), and Bendalin was unable to sell his partnership interest because Youngblood did not consent as required under the partnership agreement. Bendalin claimed he had not and was not withdrawing indefinitely, but Youngblood proceeded as though Bendalin had withdrawn at the close of business on December 31, 2008 (e.g., cancelling Bendalin’s computer access and benefits, amending the partnership agreement by writing Bendalin out as a partner, transferring a 1% interest to two other individuals, assuming a 98% interest, and changing the name of YB Partnership to “Youngblood & Associates”).

In early 2009, Bendalin resigned as manager of the Firm and agreed that the Firm’s name could be changed to McGlinchy Stafford and Youngblood & Associates, LLP in exchange for Youngblood waiving any right to claim Bendalin was in violation of the partnership agreement for failure to provide services to any of the entities involved. However, Youngblood and Bendalin continued to have differing interpretations as to whether Bendalin withdrew as a partner of YB Partnership and whether the alleged withdrawal was wrongful. For example, Bendalin emailed a banker from Northern Trust, the bank that extended the partnership a line of credit, on February 29, 2009, stating that he had not withdrawn from the partnership and no changes could be made to the account without his consent. Also, Youngblood declined to deliver financial statements for the Firm requested by Bendalin in March 2009, and Bendalin argued he was
written notice was required only for notices “required or permitted” under the partnership agreement, and Bendalin’s withdrawal from YB Partnership. The partnership contended that the written notice provision was not triggered because Bendalin was no longer a partner. Finally, the trial court held that Bendalin’s affirmative defense of quasi-estoppel failed. Youngblood argued that the agreement did not allow Bendalin to withdraw prior to ten years of service to the partnership. The agreement described a “service commitment” for both Youngblood and Bendalin to provide normal services for the partnership for at least the next ten years following its formation. Bendalin contended the service commitment only related to a requisite to entitle him to reserve funds on his departure if he stayed ten years. Under this interpretation, his alleged withdrawal was not wrongful, and he would be entitled to be paid for his interest in the partnership according to the buyout provisions in the agreement. Bendalin also argued that no normal services were performed in the partnership as all business was performed through the Firm and MBG. Thus, he believed he was not in breach of the normal services provision of the partnership agreement despite his position as Vantium’s general counsel as of December 2, 2008, and he claimed that he was still able to perform normal services for McGlinchy and the YB Partnership without being in violation of the agreement. Furthermore, Bendalin complained that he received no money for his interest in the partnership, which was absorbed by Youngblood in the amendment to the agreement, and the amendment was wrongful because it occurred without Bendalin’s written consent. This case was filed in 2009, and all parties agreed to apply TRPA. The court of appeals explained that the trial court properly applied TRPA rather than the Texas Business Organizations Code because the YB Partnership agreement was signed in 2003. After a bench trial, the court found in favor of YB Partnership. The trial court concluded that when Bendalin signed the contract with Vantium on November 20, 2008, he unilaterally breached the agreement by making it impossible to continue to provide normal services for the partnership, and Bendalin withdrew from YB Partnership by December 2, 2008, when he began performing services for Vantium. Also, Bendalin’s oral expression of his will to withdraw to Youngblood was notice of withdrawal under TRPA. The trial court further found that Bendalin breached the agreement by not providing normal services for the partnership as agreed to in the service commitment provision of the agreement, and this breach was wrongful under TRPA. Furthermore, Bendalin’s partnership interest was automatically redeemed by YB Partnership at his withdrawal on December 2, 2008, and as a wrongfully withdrawing partner Bendalin was required to contribute to the partnership to satisfy partnership obligations. The trial court also found that after Bendalin’s withdrawal, Youngblood engaged in no conduct to the detriment or disadvantage of Bendalin, and the amendment to the agreement was valid as Bendalin was no longer a partner. Finally, the trial court held that Bendalin’s affirmative defense of quasi-estoppel failed. The court heard expert testimony from both parties as to the redemption value of Bendalin’s interest as of December 2, 2008, assuming a wrongful withdrawal. In the final judgment, the trial court held in favor of the partnership on all issues and ordered Bendalin to pay the partnership an amount for his contribution, interest, and attorney and expert fees.

On appeal, Bendalin argued that the trial court erred by finding he withdrew from YB Partnership as of December 2, 2008, by rejecting his quasi-estoppel argument, in calculating the redemption interest, in awarding expert fees, and in awarding excessive or improper attorney fees. YB Partnership cross-appealed, claiming that the trial court did not order Bendalin to pay enough money because the court did not take into account certain liabilities of YB Partnership in calculating the redemption interest amount. The court of appeals reversed and remanded.

First, the court of appeals held that Bendalin’s withdrawal was effective without written notice. Bendalin argued that the partnership agreement required written notice to withdraw, and since he did not provide such notice he did not withdraw from YB Partnership. The partnership contended that the written notice provision was not triggered because written notice was required only for notices “required or permitted” under the partnership agreement, and Bendalin’s...
withdrawal before the expiration of his ten-year service commitment was not contemplated in the agreement. However, the court of appeals pointed out that the partnership agreement did contemplate cessation of performing normal services before the completion of the service commitment. The court concluded that the plain terms of the partnership agreement required written notice to withdraw, but the court stated that this conclusion did not necessarily render Bendalin’s oral notice of withdrawal ineffective. The partnership agreement mentioned “notice delivered in any other manner” but was silent as to the effect of oral notice. Thus, the court looked to TRPA to fill the gap. Under TRPA, a partnership agreement may not vary the power to withdraw as a partner where there is an express will to withdraw except to require the notice to be in writing. The court stated that TRPA does not state that oral notice is ineffective where written notice is required, and the court concluded that the requirement that notice be in writing does not extinguish the partner’s power to withdraw in view of the provisions of TRPA conferring the power to withdraw at any time by notice to the partnership. Here, the evidence showed an unequivocal oral withdrawal made by Bendalin. Based on the appellate court’s interpretation of the partnership agreement and TRPA, the court held that the lack of written notice by Bendalin did not render his withdrawal ineffective (commenting that to hold otherwise would be to overlook the practical implications of a partner’s actual departure from a partnership), and the court overruled Bendalin’s point of error claiming that the trial court erred in finding an event of withdrawal.

In a related issue, the court of appeals held that Bendalin’s attempts to rescind his withdrawal were ineffective. Bendalin claimed that any oral withdrawal was revoked when he stated he would not withdraw until he agreed with Youngblood on the terms of the withdrawal. However, the court found that Youngblood’s testimony of Bendalin’s unequivocal oral expression of withdrawal was sufficient for the trial court to find that Bendalin withdrew from the partnership. Under TRPA, once the partnership received notice of an express will to withdraw, Bendalin became a withdrawn partner, and his retractions did not operate to automatically make him a partner again. Bendalin cited no precedent for his retraction argument, and the court overruled Bendalin’s claim that the trial court erred in failing to give effect to the retraction of his withdrawal from the partnership.

Next, the court of appeals held that quasi-estoppel did not negate Bendalin’s withdrawal. Quasi-estoppel was an affirmative defense asserted by Bendalin, who argued that Youngblood was estopped from alleging Bendalin was no longer a partner. This affirmative defense arose from the fact that Northern Trust Bank, which issued a line of credit to YB Partnership, sought renewal of the certificate of deposit securing the credit in September 2009. Youngblood signed in September 2009, and Bendalin signed in October 2009 at the request of YB Partnership. Bendalin suggested that because he was represented as a partner on the loan documents, the trial court erred in failing to apply the doctrine of quasi-estoppel to Youngblood regarding the bank documents. In essence, Bendalin sought to use the quasi-estoppel doctrine to escape the fact of his withdrawal. Quasi-estoppel precludes a party from asserting, to another’s disadvantage, a right inconsistent with a position previously taken. Here, Bendalin contended that listing him and having him sign the bank documents as a partner to secure YB Partnership’s line of credit was wholly inconsistent with the partnership’s position that Bendalin had withdrawn and was a disadvantage to him. The trial court found that Bendalin’s affirmative defense was not supported by sufficient evidence. The court of appeals agreed that Bendalin’s position was contrary to TRPA, which states that representation or conduct indicating that a person is a partner in an existing partnership, if that is not the case, does not itself make that person a partner in the partnership. The court of appeals reasoned that the trial court could have decided that because Bendalin refused to allow alteration of the partnership’s signature card at Northern Trust Bank, Bendalin was attempting to represent himself as a partner and that Youngblood had no choice but to acquiesce out of necessity. Thus, it would not have been inconsistent with YB Partnership’s position that Bendalin was no longer a partner. There was also evidence that quasi-estoppel was not applicable because testimony showed that the representation of Bendalin as a partner was not a detriment to him in that he personally benefited from the funds obtained. Thus, the court held that Bendalin failed to show his entitlement to the affirmative defense of quasi-estoppel as a matter of law.

The court of appeals next addressed when Bendalin’s withdrawal was effective and determined that date to be December 31, 2008. Bendalin complained that the trial court erred in determining that December 2, 2008, the day he began employment with Vantium, was the effective withdrawal date. The court of appeals agreed with Bendalin that the trial court erred in determining the proper withdrawal date. According to TRPA, withdrawal occurs on the receipt by the partnership of notice of the partner’s express will to withdraw as a partner on or on a later date specified in the notice. The trial court found that YB Partnership was notified of Bendalin’s express will to withdraw on November 21, 2008. It was uncontested that the initial notification and later communication between the parties specified a withdrawal date of December 31, 2008, and the trial court erred in finding the date of withdrawal to be December 2, 2008.

The court of appeals next held that Bendalin’s withdrawal was not wrongful under TRPA. The trial court held that Bendalin’s failure to fulfill a ten-year service commitment was an express breach of the agreement and thus fell within TRPA’s wrongful withdrawal provision. According to the court of appeals, the agreement was not for a definite
term, was not created for a particular undertaking, and did not specify an event that would require a winding up, so Bendalin’s withdrawal was not wrongful under TRPA. The partnership agreement provided that the partnership would continue until dissolved by the vote of all partners or the bankruptcy of a partner, but the court did not view either of these events as a “specified event” requiring winding up. As to whether Bendalin’s withdrawal constituted a breach of the partnership agreement, YB Partnership claimed the agreement required Bendalin’s service for ten years and that his failure to do so was a breach. Bendalin argued the ten-year time frame specified in the agreement merely entitled him to certain rights and bonuses if he were to serve the partnership for at least ten years and thus had no effect as to whether his withdrawal was wrongful. The court of appeals stated that the definition of “service commitment” in the general definition section of the partnership agreement did not contain a time frame for services. The ten-year time frame was set forth in reference to Bendalin having the ability to receive reserve funds after providing normal services for the partnership for ten consecutive years, and no other term in the agreement stated that Bendalin was required to be a partner and perform normal services for a specified time frame. Bendalin’s right to withdraw was not otherwise restricted. By withdrawing before completing ten years of normal services, Bendalin forfeited his right to partnership reserve funds, but his withdrawal was not a breach of the agreement and thus was not wrongful.

Finally, the court of appeals remanded to determine the amounts to be recovered by the parties. Because the trial court erred in determining that Bendalin wrongfully withdrew as of December 2, 2008, the calculation of Bendalin’s redemption value was inappropriate. The appellate court reversed the damage award and remanded to the trial court to determine the fair value of Bendalin’s partnership interest as of December 31, 2008, the date of his withdrawal. As for expert and attorney fees, the court noted that expert fees are generally not recoverable and that the findings of fact supporting their recovery in this case were conclusory and did not state the trial court’s basis. Because the fees may have been awarded based on the trial court’s erroneous finding that Bendalin’s withdrawal was wrongful, the reversal might change the basis on which the trial court awarded those amounts. Thus, the court of appeals remanded the damages and other awards to the trial court for its reconsideration.


Steven Bowman, as Personal Representative of the Estate of William Bowman (“Bowman”), brought suit against Richard Sewing in relation to the development of townhomes in Houston. Bowman and Sewing met in the early 1950s, and between 2003 and 2005 Bowman transferred money to Sewing in excess of $200,000 for the purpose of developing, renting, and selling townhomes in Houston. Sewing owned the two properties at issue, and together they were valued at approximately $600,000. Sewing testified at a deposition that the parties’ agreement required Bowman to pay Sewing $300,000 to acquire a half interest in the properties. Bowman alleged that he and Sewing formed a partnership to carry on the development business, and when Bowman died in 2005 he became a withdrawn partner entitled to buyout rights and remedies. Sewing testified at trial that the partnership had never formed and that Bowman never agreed to buy the land to become a partner. The jury found that Bowman and Sewing had bound themselves to a contract but that neither had failed to comply with the contract. The jury also found that Sewing and Bowman had formed a partnership regarding the properties at issue and that the value of Bowman’s partnership interest at the time of his death was $231,743.61. The trial court entered judgment on the jury verdict in favor of Bowman. On appeal, Sewing asserted error by the trial court and maintained, among other points, that the statute of frauds precluded Bowman’s claim for recovery for redemption of a partnership interest, that the evidence was insufficient to support the jury’s finding that the parties formed a partnership, and that the evidence was insufficient to support the jury’s award of redemption of partnership interest. After concluding that the statute of frauds did not apply to the partnership agreement between Bowman and Sewing and that the evidence was sufficient to support the finding of the existence of a partnership, the court addressed Sewing’s challenge to the damages awarded by the jury on Bowman’s claim for redemption of partnership interest. Sewing argued that Bowman presented no competent evidence of the value of his partnership interest at the time of his death. Under the Texas Revised Partnership Act (TRPA), death is an event of withdrawal triggering a redemption, i.e., a buyout, of the withdrawn partner’s partnership interest for the fair value of the partnership interest at the date of withdrawal. Sewing testified as to what money Bowman had transferred to him as well as the value of the properties at issue at the time of Bowman’s death. The court of appeals concluded that Bowman was not required to provide expert testimony on the value of his partnership interest. The jury could have reasonably relied on Sewing’s testimony regarding the value of the properties in determining Bowman’s redemption price. The court pointed out that the statute did not require the jury to determine the exact market value of the properties at the time of Bowman’s death; it merely required the jury to determine the “fair value” of Bowman’s partnership interest at the time of his death. The court concluded that the evidence presented enabled the jury to reasonably determine the fair value of Bowman’s redemption price. Furthermore, the court held that the damages were not excessive in light of the evidence presented, and the jury was entitled to disbelieve Sewing’s testimony regarding expenses made in furtherance of the partnership and
not adjust Bowman’s buyout price accordingly. Finally, the court of appeals held that the trial court did not err in failing to apply set-offs to the jury’s partnership award pursuant to TRPA because Bowman was not a wrongfully withdrawing partner as required to apply the statutory set-off provisions of the statute.

Sewing also argued that the trial court erred in awarding Bowman attorney’s fees. Sewing asserted that Bowman’s plea for recovery of attorney’s fees under Section 38.001 of the Texas Civil Practice and Remedies Code applied only to Bowman’s unsuccessful breach-of-contract claim and that attorney’s fees are not recoverable in an action to recover for redemption of a partnership interest under TRPA absent a showing of vexatious or bad faith conduct pursuant to article 7.01 of TRPA. The court of appeals held that Bowman was entitled to recover attorney’s fees under Section 38.001 of the Texas Civil Practice and Remedies Code, which provides for recovery of attorney’s fees from an individual or corporation if the claim is for an oral or written contract, relying on cases that interpret Section 38.001 to authorize recovery of attorney’s fees for claims based on a contract even if the claim is not for breach of contract. The court of appeals stated that Bowman’s recovery for redemption of his partnership interest was based on an oral agreement even though he did not recover on his breach-of-contract claim, and the trial court thus did not abuse its discretion in awarding attorney’s fees.

J. Dissolution/Winding Up


In a previous interlocutory appeal, the court of appeals held that the trial court erred in failing to grant temporary injunctive relief sought by four physician partners in the face of a capital call that would result in termination of the physicians’ partnership interests in a partnership operating a hospital. After that appeal, the plaintiffs renewed their application for a temporary injunction against the partnership and its managing partner, but the defendants sought to dismiss the application for temporary injunction on the basis of mootness. The defendants argued that they had proceeded with the capital call while the previous appeal was pending and had terminated the plaintiffs’ interests for failing to meet the capital call. According to the defendants, the hospital ceased to operate as a partnership because it was then owned only by its managing partner, a nonprofit entity. The managing partner asserted that it took various actions in order to carry out its status as a nonprofit corporation and comply with regulatory guidelines applicable to a nonprofit hospital, including the following: (1) withdrawing the registration of the partnership as a limited liability partnership with the Texas Secretary of State; (2) filing a new assumed name certificate; (3) filing a final sales tax return for the partnership; (4) terminating, assigning, or changing management and services agreements, equipment leases, insurance coverage, utilities, and supply and vendor agreements; (4) transferring the Medicare and Medicaid provider numbers; (5) registering as the provider of services with several governmental entities and agencies; (6) obtaining or changing accreditations with numerous agencies or entities. Additionally, the defendants asserted that the property where the hospital was located, which was previously leased by the partnership, was purchased by an affiliate of the managing partner. The trial court denied the request for temporary injunction as moot, explaining in its order that the actions sought to be enjoined had already been performed. The plaintiffs then filed this second interlocutory appeal. The court of appeals concluded that the application for injunctive relief was not moot because it did not request that the defendants be required to reverse any acts they had already performed, but merely sought to prevent the defendants from taking future actions pertaining to the governance of the partnership and disposition of its assets. The plaintiffs’ requests in their application for temporary injunctive relief covered actions to terminate their partnership interests and various actions in the partnership agreement that required a specified vote of units held by the physicians. The court stated that the evidence provided by the defendants did not establish that any new development had mooted the plaintiffs’ application for temporary injunctive relief. The defendants based their mootness arguments on two premises: (1) that the physicians’ interests were actually terminated and that the partnership was a defunct entity that survived only to defend the pending litigation; and (2) that the partnership’s assets were conveyed to or otherwise absorbed by the managing partner so that it was too late to preserve the physicians’ interest in maintaining the assets. The court of appeals rejected both premises.

With respect to the purported termination of the physicians’ partnership interests, the court stated that the managing partner may have acted on the assumption that it was authorized to take the actions it took, but the court found in the previous appeal that the physicians demonstrated a probable right to injunctive relief based on the argument that the managing partner’s understanding was incorrect. If, as the plaintiffs had demonstrated was probably the case, the capital call was unauthorized, there was no default and no basis to terminate the physicians’ interests. Even assuming the capital call was legitimate and the physicians defaulted, not all of the actions with regard to documentation required by the partnership agreement had been satisfied to effect the termination of the interests. The court stated that the mere
Rebeles with the funds to start her own business. Leighton viewed the payment as a “severance package” that partnership businesses named in the release. The testimony indicated the agreement was a means of distancing themselves the agreement had any effect on Rebeles' interest in the land they owned jointly and on which they operated the partnership and not the partnership itself. Leighton conceded that neither he nor Rebeles believed partnership itself or her share of the partnership assets. The court noted that the agreement referred only to the businesses that Rebeles had released any claim she had to the partnership assets and that Rebeles had breached her oral contract with Leighton regarding the sale of sand and gravel through her company. The jury found that Rebeles had released any claim to the alleged partnership assets and that Rebeles had breached her oral contract with Leighton regarding the sale of sand and gravel through her company. The jury found that Leighton and Rebeles formed a partnership in 1984 and that an event requiring winding up occurred in 2006. The jury found that Rebeles did not agree to perform administrative and clerical work through her separate company in exchange for a share of the profits from the sales. Rebeles sued Leighton alleging that she and Leighton had formed a partnership during the time they lived together and requesting the trial court to supervise a winding up and divide the partnership assets. Leighton responded to the release agreement. The court stated that the managing partner’s misunderstanding about the effect of its efforts to extinguish the physician’s interests did not have the effect of extinguishing the partnership or any ownership rights the partnership had in the hospital. A dissenting justice took the position that the trial court did not abuse its discretion in denying the application for temporary injunction on the basis of mootness because there was adequate evidence that the plaintiffs sought to enjoin actions that had already occurred.

Leighton v. Rebeles, 399 S.W. 3d 721 (Tex. App.–Dallas 2013, no pet.).

Leighton and Rebeles moved to Dallas, began living together, filed joint tax returns, purchased property as husband and wife, and operated a sand and gravel business together. They purchased two properties that they operated as Paul’s Pit Sand and Gravel and Hutchins Sand & Gravel. After 12 years together, believing she had entered into a common law marriage, Rebeles filed for divorce, but she later learned that there was no record of her divorce from a previous husband, so she and Leighton decided to non-suit the divorce case. To facilitate their separation, they signed an agreement on August 26, 2006, in which Rebeles, for $150,000, agreed “to relinquish all past present, and future interests in Paul’s Pit Sand and Gravel, and in Hutchins Sand & Gravel and any dealings by Paul M. Leighton.” Shortly after signing this agreement, Leighton and Rebeles entered into an oral agreement under which Leighton would sell sand, gravel, and other materials from properties he leased mixed with one of the properties he owned with Rebeles. Rebeles agreed to perform administrative and clerical work through her separate company in exchange for a share of the profits from the sales. Rebeles sued Leighton alleging that she and Leighton had formed a partnership during the time they lived together and requesting the trial court to supervise a winding up and divide the partnership assets. Leighton responded that Rebeles had released any claim to the alleged partnership assets and that Rebeles had breached her oral contract with Leighton regarding the sale of sand and gravel through her company. The jury found that Leighton and Rebeles formed a partnership in 1984 and that an event requiring winding up occurred in 2006. The jury found that Rebeles did not release her claim to the partnership assets but did breach her oral contract with Leighton regarding the sale of materials through her company and was liable for damages. In protracted post-verdict proceedings, the trial court wound up the partnership and divided the assets. The trial court concluded the case by entering a final judgment incorporating its rulings on the verdict and post-verdict winding up of the partnership. In the final judgment, the trial court disregarded the jury’s finding on Leighton’s breach of contract claim. Leighton did not challenge the finding of a partnership on appeal, but he contended that Rebeles unambiguously released any claim she had to the partnership assets in the agreement she signed on August 26, 2006. The court of appeals reviewed testimony of Leighton and Rebeles regarding the release agreement. The court of appeals concluded the agreement was ambiguous and that the evidence was sufficient to support the jury’s finding that the contract was not intended as a release of Rebeles’ claim to her interest in the partnership itself or her share of the partnership assets. The court noted that the agreement referred only to the businesses being operated by the partnership and not the partnership itself. Leighton conceded that neither he nor Rebeles believed the agreement had any effect on Rebeles’ interest in the land they owned jointly and on which they operated the partnership businesses named in the release. The testimony indicated the agreement was a means of distancing themselves in their business activities after the deterioration of their personal relationship. They both testified that it was intended to provide Rebeles with the funds to start her own business. Leighton viewed the payment as a “severance package” that
terminated her employment, and Rebeles testified that she understood that she was relinquishing her involvement in Paul’s Pit and Hutchins Sand & Gravel, that she would have a separate bank account, and that she would no longer receive income from the businesses operated by Leighton. Rebeles testified that the $150,000 represented only a portion of their attempt to separate their business activities and that she requested some other partnership assets. Based on the testimony, the court concluded the jury had reasonably interpreted the agreement as merely the first step in the separation of the partners’ business dealings as Rebeles testified. Leighton’s other contention on appeal was that the trial court erred in disregarding the jury’s finding that Rebeles breached their oral agreement regarding the billing of materials through Rebeles’ separate business. Rebeles argued that the activity was part of the partnership business and was subsumed by and irreconcilable with the jury’s findings on partnership. Leighton argued that the jury could have concluded the agreement was outside the partnership. The court of appeals agreed with Leighton. According to the court, the jury could have concluded that Leighton and Rebeles were not acting as agents of the partnership when they entered into the agreement but were representing their own independent interests. Thus, the court of appeals rendered judgment that Leighton recover damages in the amount found by the jury on his breach of contract claim against Rebeles.

**Buck v. Palmer, 381 S.W.3d 525 (Tex. 2012) (per curiam).**

The issue addressed in this case was whether a partner’s letter and other statements to his co-partner expressing a desire to discontinue their joint venture conclusively established an immediate dissolution of the partnership at that time under the Texas Uniform Partnership Act. The court of appeals affirmed a summary judgment on the basis that the partnership was dissolved by the “express will” of a partner, but the Texas Supreme Court concluded that there was a genuine issue of material fact as to whether the statements at issue were intended to dissolve the partnership.

Buck and Palmer were partners in a joint venture to build a marina and yacht club. The venture borrowed over $7 million, guaranteed by Buck and Palmer. The venture failed after a series of major storms damaged the marina, and litigation by creditors seeking repayment ensued. At the time of the litigation, Buck and Palmer each owned a 20% interest in the venture, and a corporation owned an 80% interest. The litigation culminated in a settlement under which the venture’s debt was reduced to a $600,000 note and the corporation’s 80% interest was transferred to Palmer. After the settlement, the value of the property rose to an estimated value of $4 million.

In 1997, Palmer sued Buck for breach of an oral agreement to transfer Buck’s partnership interest to Palmer in exchange for release from the venture’s indebtedness following the settlement. Buck denied the existence of the contract and sought a determination of the fair value of his interest. Palmer argued that Buck had relinquished his interest even absent the oral contract because Buck expressed his will to dissolve the partnership on several occasions between 1993 and 1995. Palmer principally relied on a 1995 letter in which Buck wrote to Palmer that Buck had no intention of embarking on the land development scenario with Palmer. Relying on the letter as evidence that the venture was dissolved on that date, Palmer argued that Buck was entitled only to a distribution according to the value of Buck’s interest at that time, which Palmer argued was no greater than zero in view of the venture’s indebtedness. The trial court granted Palmer’s motion for summary judgment, and the court of appeals affirmed, reasoning that Buck’s statements to Palmer in 1995 were conclusive evidence of dissolution at that time.

The Texas Supreme Court applied the now expired Texas Uniform Partnership Act, which provided that dissolution is caused “by the express will” of any partner ceasing to be associated with the continued operation of the partnership. The court concluded that the 1995 letter might be some evidence that the partnership was dissolved, but the court viewed other evidence presented by Buck as creating a genuine issue of material fact as to his intent. Specifically, the court pointed to the fact that the settlement agreement signed by Palmer in the venture’s litigation with its creditors after the alleged dissolution listed Buck as a 20% owner. Also, an amended joint venture agreement adopted after the alleged dissolution showed Buck as an owner, and Buck’s affidavit testimony stated that he did not intend to dissolve the venture. Based on this evidence, the court stated that reasonable jurors could differ as to whether Buck intended to dissolve the partnership, merely expressed a desire to relinquish his interest in the future, or simply engaged in hyperbole due to his frustration with the venture’s performance. Thus, the court reversed and remanded the case.


The Johnsons and Graze Out Cattle Co. (“Graze Out”), a closely held corporation, formed a partnership to purchase and operate a catering and special event business in 2005. The Johnsons agreed to be the partnership’s day-to-day operators, i.e., to provide the labor and make the decisions using their knowledge of the food industry, and Graze Out agreed to secure the financing and provide accounting services. The parties did not sign a written partnership agreement but agreed to a 50-50 split of profits and losses. In 2007, the partnership was under water, and Mr. Johnson called Graze Out’s president and told him the partnership would have to be dissolved because it was not making enough

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money to pay its expenses and could not afford a rent increase that went into effect in 2007. At that time, all the partnership’s vendors had been paid. Graze Out had the partnership’s equipment picked up, and the business was closed. In 2008, Graze Out filed a petition for dissolution and an accounting. Following a bench trial, the trial court issued a judgment dissolving the partnership, ordering the Johnsons to pay $28,479 to Graze Out, and requiring Graze Out to auction the equipment in its possession and retain the proceeds. The judgment against the Johnsons would then be reduced by 50% of the sales proceeds. The trial court also awarded Graze Out attorney’s fees and costs. The Johnsons appealed, arguing the evidence was insufficient to establish Graze Out’s liability and damage claim and that there was no basis to award Graze Out attorney’s fees. On appeal, the court of appeals first addressed whether a $70,000 note that provided the funds to purchase the catering business and pay initial operating expenses was a partnership obligation. The note was signed by the president of Graze Out on Graze Out’s behalf, and the guarantors signed in their individual capacities. Neither the note nor any other loan documentation made mention of the partnership, and the note was paid off by the children of Graze Out’s president after the partnership ceased operation, further indicating that the note was not a partnership obligation. Thus, there was no basis for the trial court to presume that the note was a partnership obligation. Next the court of appeals examined the evidence to determine whether the trial court’s judgment reflected the correct calculation of the capital accounts pursuant to the Business Organizations Code (BOC). The court noted that the parties had relied on the Texas Revised Partnership Act (TRPA), which expired January 1, 2010. (Although the court noted that the BOC applies to all partnerships after January 1, 2010, it appears the parties were correct to rely on TRPA since the partnership at issue was formed before the effective date of the BOC and the events in question all occurred before January 1, 2010, but there is no substantive difference between the BOC provisions relied on by the court and the analogous TRPA provisions.) The court explained that a “capital account” is computed by adding a partners’ cash contributions, the agreed value of other property contributed by the partner, and allocations of partnership profits, and subtracting the amount of distributions to the partner and the partner’s share of partnership losses. The court also noted the definition of a “distribution” as a transfer of property, including cash, from a partnership to a partner in the partner’s capacity as a partner. On winding up, capital accounts having a positive balance are a debt of the partnership unless the partners have agreed otherwise. The court then proceeded to walk through the calculation of the partners’ capital accounts. Graze Out’s capital account started out with the proceeds of the note in the amount of $70,000 executed by Graze Out. The evidence showed the Johnsons contributed $10,000 from a personal account, $12,000 worth of equipment, and $1,350 paid for accounting fees, for a total of $23,350. The court considered and rejected the Johnsons’ contention that they should be credited for the contribution of their reputations and goodwill to the partnership. The court acknowledged reputation is a type of goodwill that may be valuable intangible property, but the court found no evidence that distinguished between any intangible value the Johnsons brought to the business and their worth as employees or for services rendered. There was no evidence that clients came to the partnership because of the Johnsons, that the business was marketed using the Johnsons’ names, or that there was a change in the value after it was purchased by the partnership and operated by the Johnsons. The court then addressed the distributions received by each partner. During the operation of the partnership, $27,074 was paid on the Graze Out note, so that amount constituted a distribution to Graze Out. The Johnsons received a $30,000 distribution for living expenses. The court commented that the $30,000 withdrawn by the Johnsons should not be considered compensation (which would be an expense charged to the partners’ capital accounts 50-50) as opposed to a “distribution” (which would be subtracted from the capital account of the partner receiving the distribution) because the BOC provides that absent an agreement to the contrary, a partner is not entitled to receive compensation for services performed for the partnership other than reasonable compensation for services rendered in winding up the partnership business. Because the partners agreed to split profits and losses 50-50, and all other expenses had been paid, the court credited each partner with half of the amounts distributed to each partner and then subtracted the distribution of $30,000 from the Johnsons’ capital account and the distribution of $27,074 from Graze Out’s capital account. Because the partnership lacked the funds to cover the amounts in the capital accounts, there was a capital loss that had to be allocated. Allocating the loss 50-50 per the partners’ agreement resulted in a negative balance in the Johnsons’ capital account in the amount of $24,787, and a positive balance in Graze Out’s capital account in a like amount. Thus, the court of appeals modified the trial court’s judgment against the Johnsons by reducing the amount in the trial court’s judgment from $28,479 to $27,787. Finally, the court calculated the pre-judgment interest owed Graze Out and addressed the award of attorney’s fees to Graze Out. The court concluded that Graze Out was entitled to recover attorney’s fees because Section 38.001(8) of the Civil Practice and Remedies Code allows a party to recover reasonable attorney’s fees in a suit based on breach of an oral or written contract, and a partnership agreement is a contract.
Leighton v. Rebeles, 343 S.W.3d 270 (Tex. App.—Dallas 2011, no pet.).

The plaintiff sought judicially supervised winding up of a partnership with the defendant, and the defendant denied the existence of a partnership. Following a trial in which the jury found the existence of a partnership, the trial court entered an interlocutory order appointing a special master and enjoining the parties from conducting certain activities with respect to partnership property pending the winding up of the partnership. The defendant objected to the temporary injunction on various grounds. As a threshold issue in the appeal, the court addressed the plaintiff’s claim that the court of appeals lacked jurisdiction over the appeal. The Civil Practice and Remedies Code allows interlocutory appeal in narrow circumstances, including where an interlocutory order “grants or refuses a temporary injunction as provided by Chapter 65.” The plaintiff argued that the statute did not confer jurisdiction over this appeal because the trial court’s order was entered pursuant to provisions of the Business Organizations Code (BOC) and its predecessor, the Texas Revised Partnership Act (TRPA). The defendant argued that an injunction entered under Section 11.054 of the BOC is an injunction within the scope of Section 65.011(3) of the Texas Civil Practice and Remedies Code. The court noted that neither BOC Section 11.054 nor TRPA Section 8.03(a)(3) specifically authorizes an injunction, but both provisions authorize the trial court to make any order “that the circumstances require.” The trial court found that the circumstances required an order enjoining the parties from certain activities to protect partnership property pending winding up, and the court concluded that the order was, in part, an injunction under the principles of equity and statutes of Texas relating to injunctions as embraced by Section 65.011(3) of the Civil Practice and Remedies Code. Thus, the court had jurisdiction over the interlocutory appeal. The court then determined that the trial court abused its discretion in entering the order because it did not include a date for trial on the merits of the ultimate requested relief as required by Rule 683 of the Texas Rules of Civil Procedure. Although a trial on the merits had taken place, the trial court had postponed entry of a final judgment with ultimate relief pending receipt of the special master’s report. The trial court set a date for submission of the report but did not specify that it was a “trial date” for purposes of the injunction. The court found nothing in the BOC or TRPA that excused temporary injunctions in furtherance of the winding up of a partnership from the requirements of Rule 683, and the court thus dissolved the temporary injunction and remanded for further proceedings.

K. Injunctive Relief


In addressing the irreparable injury requirement that generally must be met for injunctive relief, the court considered whether the Texas Business Organizations Code (BOC) authorizes injunctive relief in the partnership context without a showing of irreparable injury. The plaintiffs, physician partners in a hospital partnership, argued that they did not need to show irreparable injury because Section 152.211 of the BOC authorizes “equitable” relief to enforce a partner’s rights. Alternatively, the plaintiffs argued that they met the irreparable injury requirement if they were required to do so. The court analyzed Section 152.211 of the BOC and concluded it did not contain the kind of express language required to supersede the common law’s irreparable injury requirement for injunctive relief. However, the court agreed with the plaintiffs that they had satisfied the requisite showing of irreparable injury. Although the court stated that termination of their partnership interests alone would not demonstrate that damages would be an inadequate remedy, termination of their interests in this case would involve the loss of several management rights, including the right to participate in selecting a governing board representative who wielded 49% of the voting interest and could block several major decisions. Money damages would not provide adequate compensation for the loss of these management rights because the rights could not be measured by a pecuniary standard and were unique and irreplaceable. See also Patel v. St. Luke’s Sugar Land Partnership, L.L.P., ___ S.W.3d ___, 2013 WL 5947500 (Tex. App.–Houston [1st Dist.] 2013, pet. filed), summarized under heading “Dissolution/Winding Up.”

Leighton v. Rebeles, 343 S.W.3d 270 (Tex. App.—Dallas 2011, no pet.).

See summary above under heading “Dissolution/Winding Up.”

L. Divorce of Partner


The wife in this divorce action appealed the trial court’s property division in the divorce decree, arguing that the trial court applied the wrong standard in valuing the husband’s partnership interest in KPMG, LLP (“KPMG”) by failing to account for commercial goodwill. The husband became a “Class B principal” in KPMG, a public accounting
firm with approximately 1,900 partners and principals, soon after the parties married. The partnership agreement of KPMG described two types of members: principals and partners. Principals were parties who were not CPAs, but the partnership agreement provided that their relationship was “intended to be that of a partner in a partnership,” governed by the law, “both statutory and common law, respecting partners and partnerships.” The KPMG partnership agreement provided that a principal had a “deposit account” with the firm and that on withdrawal, death, or retirement of the member, the member’s deposit or capital account would be liquidated or distributed to the member in exchange for his interest in the firm. The agreement prohibited mortgage or assignment of any interest of the member in the firm.

At trial, the husband and his expert testified that the net value of the husband’s interest was $14,100, calculated by subtracting the $709,000 unpaid balance of the loan to fund the husband’s capital account from the $715,000 value of his capital account. The wife’s expert testified that the market value of the husband’s interest was $2.4 million. The trial court awarded the husband all interest he owned in KPMG, including his capital account. The trial court also allocated to the husband the loan against his KPMG capital account. The court of appeals summarized the testimony of the wife’s expert, the husband, the KPMG national director of partner care, and the husband’s expert regarding the husband’s interest, and quoted from the record regarding the trial court’s finding that the husband’s partnership interest had a value of $14,000. The husband and the KPMG witness testified that the husband’s capital account balance was $715,000 and that the balance of his loan from a third-party lender to fund the capital account was $700,900 resulting in a net balance of $14,100. The husband testified that this was the value of his interest. The KPMG witness explained that, under the KPMG partnership agreement, the husband did not have any ownership interest that could be sold, transferred, given away, or inherited. The husband’s expert testified that an important valuation issue was whether there was any goodwill associated with a professional practice and, if so, whether it was personal goodwill or commercial goodwill. He testified further about these types of goodwill. He also testified about the importance of corporate governance in valuation of interests in professional practices and noted provisions of the KPMG agreement and the offer letter signed by the husband which provided that the only way for the husband to get value for his interest was to sell it back to the firm for the balance in the capital account and pay off the loan. The husband’s expert also criticized the report of the wife’s expert in several respects. The wife’s expert testified that KPMG had goodwill in excess of the individual partners although his report did not use the term goodwill or make a distinction between commercial and personal goodwill. The wife’s expert also acknowledged that his report did not mention the KPMG partnership agreement and that his valuation ignored the offer letter. The trial court found that the partnership interest had a value of $14,000 and stated that it divided the community estate by allocating approximately 50% to each party.

The court of appeals discussed case law addressing goodwill and the appropriate way to deal with valuation of business interests in the divorce context. The wife argued that the trial court had incorrectly relied on Mandell v. Mandell instead of Keith v. Keith to value the partnership interest because the KPMG agreement only addressed when a member left and not valuation in a divorce context. Mandell was a case involving a closely held corporation in which the shareholder agreement contained a specific contractual provision addressing valuation in the case of divorce and restrictions on who could own and purchase the stock and at what price. In Mandell, the court distinguished earlier property division cases, such as Keith, in which partnership agreements did not address what would happen in the event of a divorce. The court of appeals agreed that the older partnership cases appeared more similar to the case at hand but pointed out that the trial court had expressly stated that it did not find that the contract controlled. The wife argued that goodwill was the key factor in determining the value of the husband’s partnership interest and that the restrictions in the KPMG agreement should not be the sole method of establishing the value. Determining that a professional practice has goodwill that is subject to division on divorce requires a determination that there is goodwill independent of the personal ability of the professional spouse and that this goodwill has a commercial value in which the marital estate is entitled to share. The court stated that KPMG, with its 1,900 partners and principals, was similar, but on a grander scale, to the firm in Finn v. Finn, in which a large law firm was involved. In Finn, as in this case, the partnership agreement made no provision for compensating a partner for the firm’s goodwill in the event of death or divorce. In Finn, however, there was evidence that the law firm had goodwill independent of the husband’s professional abilities whereas the evidence about commercial goodwill in this case was vague and conflicting. To the extent the trial court had sufficient evidence to conclude that commercial goodwill existed in some form, the court of appeals continued its analysis to determine whether the trial court’s division was “just and right.” The court focused its discussion on the approaches taken by the majority and concurring opinions in Finn v Finn. The court noted that in Keith it had followed the concurring opinion in Finn. In Keith, the court concluded that the formula in a partnership agreement that applied to death or withdrawal was not necessarily determinative of the value of the spouse’s interest in the ongoing partnership as of the time of divorce. Ultimately, however, the court pointed out that questions of whether a business possesses goodwill and what comprises it are fact questions for the trial court. The court of appeals concluded that the trial court in this case could have determined that the wife’s expert lacked credibility and could have chosen to believe the husband’s witnesses, in
which case the trial court could have reasonably reached the conclusion it did— that the husband’s partnership interest had the lower value ascribed to it by the husband’s expert and that commercial goodwill, if any, was presently unaccessible, but that it might someday have value in the post-divorce future. Thus, the court of appeals affirmed the trial court’s judgment.


In the divorce proceeding of Danette Pappas (“Danette”) and William Michael Pappas (“Michael”), both parties requested an equal division of the community estate. Following a bench trial, the trial court granted the parties’ petitions for divorce and awarded each real and personal property valued at almost an equal amount. On appeal, Danette asserted that the trial court abused its discretion by making numerous errors when valuing the property in the community estate, which she alleged resulted in a division of the estate that was so disproportionate as to be manifestly unjust. Among other issues, Danette contended that the trial court erred in valuing the community interest in a rental-storage business known as “Northwest Hills” that Michael co-owned and operated in a partnership with his father and that the trial court failed to dispose of a community interest in the real property on which Michael co-owned and operated a business for carpet cleaning known as “Best Way Carpet” in a partnership with a friend.

Danette alleged on appeal that the trial court erred in determining the value of the community estate related to real property used by Northwest Hills, a partnership owned by Michael and his father. Northwest Hills was a rental-storage business that operated on several lots in three blocks in a development. The blocks (i.e., Blocks 1, 7, and 8) were acquired and improved at different times over an extended period of years both before and during Danette and Michael’s marriage. It was undisputed that Michael acquired an interest in the Northwest Hills partnership in 1989 before he married Danette. The parties disputed the extent of Michael’s ownership interest in the partnership and whether some of the real property used in the business should be characterized as partnership, separate, or community property. The partnership agreement specified that the two partners had equal ownership interests, however Michael and his father testified that Michael held a 49% ownership interest. Danette argued that the trial court significantly undervalued the community’s interest in Blocks 1 and 7. The issues in relation to these blocks at trial were whether the lots were community property or partnership property, the extent of Michael’s ownership interest in the partnership, and the value of the property and the business. The lots in Block 1 were purchased in 1998 by Michael, Danette, and Michele’s parents, and buildings were constructed on those lots with funds borrowed by the same four people. Michele’s father provided uncontroverted testimony that the lots in Block 1 were acquired for use by the partnership, the funds used to buy the property came from the income retained by the partnership, the construction loans were paid by the partnership from income retained by the partnership, and the property was used by the partnership exclusively and treated as partnership property on tax returns. As for the lots in Block 7, Michael’s father purchased the lots before forming the partnership with Michael. In 2003, Michael purchased a 49% interest in the Block 7 property with a $150,000 seller-financed note payable to his father in order to bring the property into the partnership and consolidate the accounting books. Each month, the partnership distributed $1,500 to Michael, which he used to pay down the note to his father. At the time of trial, approximately $58,000 remained unpaid on the note. The experts for both Michael and Danette valued the Northwest Hills partnership at $2.22 million and $2.23 million respectively using an income-capitalization method. Using a cost approach to valuation, both parties’ experts valued the business at approximately $1.9 million. Essentially, the experts agreed on the overall value of the business. The dispute between the experts involved the applicability and extent of discounts to be applied to Michael’s interest in the business. That is, the question was whether Michael held an interest in Northwest Hills that was properly characterized as “non-controlling.” Michael and his father testified that Michael held a 49% interest in the partnership, which was confirmed by other documents admitted at trial and the transaction involving Michael’s purchase of a 49% interest in Block 7. The partnership agreement, however, listed the two men as equal owners. Danette’s expert testified that the value of the partnership should not be discounted because of the equal ownership. Michael’s expert disagreed and testified that discounts applied due to the lack of control and lack of marketability/liquidity either way because even a 50% ownership interest was properly characterized as a non-controlling interest. In the final divorce decree, the trial court awarded Michael the business known as Northwest Hills, including all community interest in the three Blocks, and the court found that Block 8 was Michael’s separate property. To the extent the trial court concluded that the property used in the storage business was either community or separate property, the appellate court noted that the trial court implicitly determined that it was not partnership property because partnership property is neither community property nor separate property in nature. Although the trial court did not expressly make findings resolving the disputes about Michael’s ownership percentage or the applicable discounts, the court’s valuation of the community’s interest in Northwest Hills was consistent with the application of a non-controlling interest discount and a finding that Michael owned a 49% interest in the partnership. On appeal, Danette contended that the trial court
undervalued the value of Northwest Hills and the community’s interest in the partnership, and the court of appeals agreed. Although the trial court did not explain its methodology in valuing Northwest Hills, the appellate court stated that it appeared as though the trial court followed Michael’s reasoning that all Blocks were partnership property. In addition, the only block with a community property interest was Block 7, which Michael purchased after marriage and paid for with profits distributed to him by the partnership. The trial court also allowed the discount based on Michael’s non-controlling interest and further reduced it by the outstanding debt owed to his father. The trial court found the community interest in the Northwest Hills partnership to be $82,125. Even given deference to the trial court’s determination regarding applicable discounts, the appellate court found that there were errors in the trial court’s valuation of the business (e.g., failure to attribute any value to the miscellaneous improvements on the property and, more importantly, failing to assign any value to Block 1 as having a community interest) that so significantly undervalued the community’s interest in Northwest Hills as awarded by the court that a new division of the marital estate was required. The court of appeals sustained Danette’s point of error holding that the trial court’s valuation of the community interest in the Northwest Hills partnership was so disproportionate as to constitute an abuse of discretion requiring the appellate court to remand the cause for a new just and right division of the community estate.

Danette next argued that the trial court abused its discretion by not valuing and disposing of the community’s interest in two lots upon which Best Way Carpet (“Best Way”) operated. Michael formed Best Way, a carpet cleaning business, as a partnership with a friend after his marriage to Danette. It was undisputed that Michael’s interest in the partnership was community property and that he held an equal ownership interest. The trial court awarded Michael the interest in Best Way based on Michael’s expert witness testimony, which applied discounts for lack of control and marketability/liquidity. Danette did not dispute the trial court’s valuation of the business or application of the discounts, but she did argue that the trial court failed to dispose of the community’s 50% interest in the real property of the business – the lots upon which it operated. There was no dispute as to the value of the lots themselves, so the only issue was whether the trial court disposed of the property in the final divorce decree. The court of appeals stated that the trial court did not specifically mention or designate the Best Way lots or real property in valuing and awarding Best Way to Michael. However, by adopting the valuation of the business proposed by Michael’s expert, the trial court appeared to account for the value of the lots as a major component of the business’s value and thus valued and disposed of this property in its award to Michael of an undivided one-half interest in Best Way. The court of appeals overruled Danette’s point of error complaining about the disposition of the lots used by Best Way. The court of appeals did note that the trial court awarded a separate lot not in dispute differently than it did the two lots questioned by Danette. Since the appellate court reversed the trial court and remanded the entire community estate for a new just and right division due to the trial court’s error in valuing and dividing the community’s interest in the Northwest Hills rental-storage business in the final divorce decree, the court of appeals remarked that the trial court would have the opportunity to revisit its valuation and disposition of the three lots owned by Best Way.

M. Partnership’s or Partner’s Standing to Sue

**In re Fernandez, Bankruptcy No. 11-10486, Adversary No. 11-1011, 2012 WL 1424940 (Bankr. S.D. Tex. Apr. 24, 2012).**

Fernandez filed this proceeding against another individual alleging that the individual was his business partner and that the individual had converted a prefabricated fiberglass building that was property of the partnership. Fernandez sought turnover of the prefabricated building and asserted claims for theft by conversion, breach of contract, and other causes of action. The claims asserted were not listed in Fernandez’s bankruptcy schedules although the building itself was scheduled. The court held that only the trustee had standing to pursue the claims because only the trustee has standing to pursue claims that are property of the bankruptcy estate. Although the trustee had abandoned all scheduled property, the claims asserted were not listed on the bankruptcy schedules and continued to belong to the bankruptcy estate even after the scheduled assets were abandoned. Although the building was scheduled, the listing of the building had nothing to do with whether Fernandez’s claims for breach of contract, fraudulent inducement, and intentional distress were scheduled. Further, the court stated that claims for turnover, due process (taking), and theft by conversion could not be brought by Fernandez in his individual capacity because the prefabricated building was allegedly property of the partnership. Finally, Fernandez argued that the partnership should be dissolved, but such an action was not before the court and, if filed, would also be outside the court’s subject matter jurisdiction.
N. Pro Se Representation


The debtor filed this adversary proceeding pro se, and the court concluded that the debtor did not have standing to assert the claims. Some of the claims involved a building that allegedly belonged to a partnership between the debtor and another individual, and the court stated that the debtor did not have standing to assert claims on behalf of the partnership in his individual capacity. The court further noted that the partnership would have to be represented by counsel.

O. Personal Jurisdiction

_Guarino v. 11327 Reeder Road, Inc._, No. 05-12-01573-CV, 2013 WL 4478202 (Tex. App.–Dallas Aug. 20, 2013, no pet.) (mem. op.).

As part of its argument that a nonresident individual was subject to personal jurisdiction in Texas, the plaintiff alleged that the individual frequently referred to the plaintiff's president and owner as his partner. The court said that this fact did not support the exercise of personal jurisdiction over the nonresident even assuming the allegation was sufficient to allege the actual formation of a partnership because a partnership’s contacts are not imputed to its partners. The fact of partnership is not sufficient to show purposeful availment by a partner.

P. Sufficiency of Pleadings and Service of Process on Partners or Partnership


In this suit to collect delinquent property taxes, the taxing authorities served Ronald Reed, as partner of the partnership that held record title to the property. The warranty deed filed of record showed that Hit City, a Texas general partnership consisting of Gregory Reed and Ronald Reed, took title to the property. Ronald and Gregory testified, however, that Ronald gave Gregory his partnership interest and that Hit City was now a sole proprietorship. The question was whether service upon Ronald, a former partner in Hit City, was sufficient to authorize a judgment against Hit City. The court held that the taxing units were entitled to rely on the recitations in the deed filed of record when attempting to determine ownership of the property for purposes of effecting service of process. There was no evidence that there was any notice or documentation of the dissolution of the partnership such that the taxing authorities could ever have discovered the change in the partnership’s status. Because the Civil Practice and Remedies Code provides that citation served on one member of a partnership authorizes a judgment against the partnership, the court held that service upon Ronald was effective to authorize a judgment against Hit City.

Q. Recovery of Attorney’s Fees in Suits Against Partnership or Suits Between Partners


Johnson-Barton Joint Venture (“J&B”), a joint venture formed by lawyers Nick Johnson and Dan Barton, entered into a referral agreement with Fleming & Associates, L.L.P. (“F&A”) regarding the referral of Fen-Phen cases by J&B to R&A. The letter agreement addressed the division of fees between the parties and the handling of expenses. After F&A had favorably resolved most of the cases referred to it by J&B, F&A paid J&B for most of the cases and sent a letter with a “distribution statement” explaining deductions for certain “client non-reimbursable expenses.” J&B contended that these deductions were improper because the referral agreement provided that F&A would be responsible for all litigation costs on cases referred to F&A. J&B filed suit against Fleming and F&A alleging breach of the referral agreement. The trial court granted J&B summary judgment on its breach of contract claim against F&A and also awarded J&B attorney’s fees against F&A. On appeal, F&A argued that the trial court erred in awarding attorney’s fees against F&A under Section 38.001 of the Texas Civil Practice and Remedies Code. Section 38.001(8) of the Texas Civil Practice and Remedies Code provides that a “person” may recover attorney’s fees from an “individual or corporation” for a claim under an oral or written contract. “Person” is defined in the Texas Code Construction Act to include a corporation, various other specified entities including a partnership, and “any other legal entity.” Neither “individual” nor “corporation” is defined in the Code Construction Act or in Chapter 38 of the Civil Practice and Remedies Code. Thus, the court applied the ordinary meanings of those terms. F&A was an LLP and thus was neither an individual nor a corporation. In addition, the court explained that the statutory interpretation doctrine of _expressio unius est exclusion_
alterious in the context of the circumstances under which the statute was enacted and its predecessor provision supported the court’s reasoning. The predecessor statute, Article 2226 of the Texas Revised Civil Statutes, provided that “any person, corporation, partnership, or other legal entity,” could recover fees from a “person or corporation.” When the legislature recodified the provision in the Civil Practice and Remedies Code, it intended no substantive change. The revisor’s note indicates that the term “person” was changed to “individual” to avoid application of the Code Construction Act’s definition of “person,” which could lead to liability for governmental entities. General statements by the legislature that no substantive change was intended must be considered with the specific language used, and the codification rather than the repealed statute must be given effect in the event of a conflict. The court of appeals concluded that the plain language of Section 38.001(8) does not permit a person to recover attorney’s fees against a partnership, and the trial court erred in awarding attorney’s fees against F&A.


The Johnsons and Graze Out Cattle Co. (“Graze Out”), a closely held corporation, formed a partnership in 2005. In 2008, Graze Out filed a petition for dissolution and an accounting. Following a bench trial, the trial court issued a judgment dissolving the partnership, ordering the Johnsons to pay $28,479 to Graze Out subject to a credit to be applied upon the sale of certain equipment. On appeal, the court of appeals modified the trial court’s judgment based on the court of appeals’ calculation of the partners’ capital accounts, reducing the amount in the trial court’s judgment from $28,479 to $27,787. The Johnsons challenged the trial court’s award of attorney’s fees to Graze Out, but the court held that Graze Out was entitled to recover attorney’s fees because Section 38.001(8) of the Civil Practice and Remedies Code allows a party to recover reasonable attorney’s fees in a suit based on breach of an oral or written contract, and a partnership agreement is a contract.


Steven Bowman, as Personal Representative of the Estate of William Bowman (“Bowman”), brought suit against Richard Sewing alleging that Bowman and Sewing formed a partnership and that when Bowman died in 2005 he became a withdrawn partner entitled to buyout rights and remedies. The jury found that Bowman and Sewing had bound themselves to a contract but that neither had failed to comply with the contract. The jury also found that Sewing and Bowman had formed a partnership and that the value of Bowman’s partnership interest at the time of his death was $231,743.61. Sewing argued that the trial court erred in awarding Bowman attorney’s fees. Sewing asserted that Bowman’s plea for recovery of attorney’s fees under Section 38.001 of the Texas Civil Practice and Remedies Code applied only to Bowman’s unsuccessful breach-of-contract claim and that attorney’s fees are not recoverable in an action to recover for redemption of a partnership interest under the Texas Revised Partnership Act (“TRPA”) absent a showing of vexatious or bad faith conduct pursuant to article 7.01 of TRPA. The court of appeals held that Bowman was entitled to recover attorney’s fees under Section 38.001 of the Texas Civil Practice and Remedies Code, which provides for recovery of attorney’s fees from an individual or corporation if the claim is for an oral or written contract, relying on cases that interpret Section 38.001 to authorize recovery of attorney’s fees for claims based on a contract even if the claim is not for breach of contract. The court of appeals stated that Bowman’s recovery for redemption of his partnership interest was based on an oral agreement even though he did not recover on his breach-of-contract claim, and the trial court thus did not abuse its discretion in awarding attorney’s fees.

R. Limitations in Suit Against Partners After Judgment Against Partnership


American Star Energy and Minerals Corporation (“American”) obtained a judgment against S & J Investments, a Texas general partnership. When the judgment could not be satisfied through the assets of the partnership, American sued the individual partners of the partnership. It was undisputed that the cause of action on which the judgment against the partnership was based accrued more than four years before the partners were sued individually, but American argued that its suit against the partners was timely because it sued the partners within four years of the date of the judgment. The partners argued that they had to be sued within the same limitations period applicable to the suit against the partnership, and the court of appeals agreed. The court based its conclusion on Sections 152.304-152.306 of the Texas Business Organizations Code, which provide that partners are jointly and severally liable for the obligations of the partnership, that an action may be brought against a partnership and any or all of its partners in the same or separate actions, and that, although a judgment against a partnership is not by itself a judgment against a partner, a judgment may
be entered against a partner who has been served with process in a suit against the partnership. The court stated that these provisions recognize both the existence of a chose in action against the individual partners and its accrual at the same time the claim accrues against the partnership. American argued that it sued on the judgment against the partnership rather than the claim on which the judgment was founded, relying on In re Jones, 161 B.R. 180 (Bankr. N.D. Tex. 1993) and Evanston Insurance Co. v. Dillard Department Stores, Inc., 602 F.3d 610 (5th Cir. 2010). The court rejected the reasoning in those cases because the courts in those cases did not address the applicable provisions of the Texas Business Organizations Code.

A concurring justice wrote to address two points. First, the concurring justice stated that the Texas Supreme Court’s opinion in In re Allocat Claims Service, L.P., 356 S.W.3d 455 (Tex. 2011) did not require a different conclusion. In that case, the supreme court held that the Texas Revised Partnership Act unequivocally embraced the entity theory of partnership. However, the legislature retained the joint and several liability of partners as a feature of partnership law, and the concurring justice did not see any intention by the legislature to distinguish between the cause of action against the partnership and the cause of action against the partners. Second, the concurring justice stated that Fifth Circuit precedent contradicted the bankruptcy court’s conclusion in In re Jones that under the entity theory a partner logically has no liability until the partnership has liability.

The lengthiest opinion in this case was the dissenting opinion. The dissenting opinion describes in more detail the protracted history of American’s judgment against the partnership, which included two appeals that concluded with the Texas Supreme Court’s denial of a petition for review in each instance. When American finally proceeded to collect the judgment, the partnership asserted its assets were insufficient to satisfy it. The dissenting justice then discussed at length the rationale that the cause of action asserted against the partners was not a breach-of-contract cause of action but rather an action based on the statutory liability of the partners for the partnership’s obligation on the contract. The dissenting justice pointed out that the Texas Business Organizations Code generally does not permit a partnership creditor from pursuing a partner’s assets unless the creditor has obtained an unsatisfied judgment against the partnership as well as a judgment against the partner, either in the same suit or in separate actions. The dissenting justice did not interpret American’s ability to sue the partners and the partnership in the same action to mean that the cause of action against the partners was based on breach of contract since American did not contract with the partners and was required to obtain a judgment against the partnership before pursuing the partners’ property. The dissenting justice likened the situation to that in which a third-party claim for indemnification may be asserted against a party who may be liable for all or part of a plaintiff’s claims. Further, the dissenting justice argued that the policies underlying statutes of limitations were not implicated here because American timely pursued its claim against the partnership, and American’s claim against the partners did not arise until a judgment against the partnership meeting the requirements of Section 152.306(b) was obtained. Thus, the dissenting justice would have held that American’s claim against the partners did not arise until a final judgment was entered against the partnership that remained unsatisfied for ninety days after it was entered.

III. Recent Texas Cases Involving Limited Partnerships

A. General Partner’s Personal Liability


The plaintiff sued Stephen Brewer and BW Office Partners I, LP on an unpaid promissory note signed by Brewer on behalf of the partnership as “General Partner.” The trial court held that both Brewer and the partnership were liable but apportioned damages rather than imposing joint and several liability. The court of appeals stated that the trial court reasonably could have found Brewer liable on any of three bases: (1) Brewer was a general partner of the partnership; (2) Brewer represented to the plaintiff that Brewer was a general partner of the partnership, and the plaintiff relied on that representation in extending credit in good faith; or (3) Brewer personally guaranteed the loan to the partnership. Any of these theories would result in joint and several liability of Brewer for the partnership’s debt. The record contained no basis to apportion damages. If Brewer was a general partner, he was jointly and severally liable under Tex. Bus. Orgs. Code § 152.304(a). If Brewer represented to the plaintiff that he was a general partner, and the plaintiff relied on that representation in good faith in extending credit, then Brewer was liable as if he were a partner under the doctrine of partnership by estoppel. Again, he would be jointly and severally liable. Finally, personal liability as a guarantor would extend as far as the partnership’s liability, and Brewer would be jointly and severally liable for the partnership’s unpaid debt. Accordingly, the trial court erred in apportioning damages, and the court of appeals modified the judgment to include joint and several liability for the full amount of the trial court’s award.

The court granted summary judgment holding the general partner of a limited partnership liable on a promissory note executed on behalf of the limited partnership. The court relied on Section 152.304 of the Texas Business Organizations Code, which provides that all partners are jointly and severally liable for all obligations of the partnership, along with Section 153.152(b), which provides that a general partner of a limited partnership has the liabilities of a partner in a partnership without limited partners to a person other than the partnership and the other partners.


A judgment was entered against a homebuilder, McClure Brothers Custom Homes, L.P., and its general partner, McClure Brothers, LLC. Although McClure Brothers, LLC was a “named insured” as a homebuilder under an insurance policy, its liability under the judgment was not covered because the LLC was not “insured” even though it was a “named insured.” The portion of the policy defining who was an insured stated that “[n]o person is an insured with respect to the conduct of any current or past partnership or joint venture that is not shown as a Named Insured in the Declarations.” Thus, the LLC was not insured for the liability of the limited partnership of which it was a general partner because the limited partnership was not named as an insured. Because the LLC was held liable in this case for the acts or omissions of a limited partnership that was not listed as a named insured, the policy did not cover the LLC’s liability in this case.


The plaintiff sought to impose joint and several personal liability on a limited partnership, the limited partnership’s general partner, and two individuals who contracted with the plaintiff in their individual capacities. The general partner was a trust of which the two individuals were the trustees, and the court explained that the plaintiff sued the individuals in their individual capacities and in their capacities as trustees of the trust. The court noted the joint and several personal liability of general partners of a limited partnership for the partnership’s obligations under Sections 153.152(b) and 152.304 of the Texas Business Organizations Code as well as the rule in Texas that suits against a trust must be brought against its legal representative, the trustee.


The corporate general partner of a limited partnership argued that it was not liable on a contract executed on behalf of the limited partnership because the corporation was not a party to the contract. The court of appeals held that the corporation was liable on the contract to the extent the limited partnership was liable on the contract based on the corporation’s status as a general partner of the limited partnership. General partners are jointly and severally liable with each other and the partnership for partnership debts under Texas law. Thus, to the extent the limited partnership was liable on the contract, its general partner was jointly and severally liable. The corporation’s liability arose from its status as a general partner of a limited partnership regardless of whether the corporation itself was a party to the agreement.


Dallas Gas Partners, LP (“DGP”), a Texas limited partnership, had previously been found liable for breaching a covenant not to sue. The court in this opinion determined that DGP’s general partner was liable for DGP’s breach because the general partner of a limited partnership is always liable for the debts and obligations of the partnership. The court cited Section 4.03(b) of the Texas Revised Limited Partnership Act for the proposition that a general partner of a limited partnership has the liabilities of a partner in a traditional partnership without limited partners to persons other than the partnership and the other partners, and the court cited Section 3.04 of the Texas Revised Partnership Act for the proposition that all partners in a traditional partnership are liable jointly and severally for all debts and obligations of the partnership. The court also cited Section 153.152 of the Texas Business Organizations Code, which provides that a general partner of a limited partnership has the liabilities of a partner in a partnership without limited partners to a person other than the partnership and the other partners.

B. Authority of General Partner or Other Agent


The plaintiff provided oilfield and fluid disposal services on a lease originally entered into by Seven N. Holdings, L.P. (“Seven Holdings”) and subsequently assigned to a related limited partnership, 7N Oil & Gas Bonanza,
The records at the Texas Railroad Commission showed 7N Oil & Gas as the operator of the lease, but incorrectly showed the address for Seven Holdings. 7N Oil & Gas was in Houston, and Seven Holdings was in Aubrey. The same LLC served as general partner for each of the limited partnerships. Jerry and Laurie Nickell served in various capacities for the two partnerships. Jerry Nickell hired a contract pumper to perform work on the lease, and the contract pumper requested the services of the plaintiff. The contract pumper told the plaintiff to send the invoices to 7N Oil & Gas. The plaintiff sent 22 invoices to Seven Holdings' address in Aubrey. Unsure of the proper party to bill, the plaintiff used various names, including “7N Holdings, L.P.”, “7N Oil and Gas,” and “7N Holding Company.” 7N Oil & Gas initially paid two invoices, but the other 20 were not paid. The plaintiff eventually checked the real estate records in an attempt to find out who was the proper party to pursue for payment, and the plaintiff found the original lease to Seven Holdings but did not discover the assignment to 7N Oil & Gas. The plaintiff made demand on Seven Holdings for payment and contacted Jerry Nickell several times. Jerry Nickell refused to pay and provided no explanation for not paying. The plaintiff filed a lien on the lease and brought suit to foreclose the lien against Seven Holdings. When Seven Holdings responded with a verified denial that indicated 7N Oil & Gas was the proper party, the plaintiff added 7N Oil & Gas as a defendant. Almost two years after the plaintiff first demanded payment, 7N Oil & Gas sent the plaintiff a cashier’s check for the balance of the unpaid invoices. Because the check did not include interest and attorney’s fees, the plaintiff refused to accept it. The trial court maintained the lien and held Seven Holdings and 7N Oil & Gas liable to the plaintiff for $16,000 in attorney’s fees and costs.

On appeal, the partnerships argued that Seven Holdings could not be held liable for the debts of 7N Oil & Gas because there was no evidence to suggest that the two distinct partnerships acted as one. The plaintiff contended that the evidence at trial showed a long history of muddled transactions between the two partnerships sufficient to support joint and several liability. The court of appeals discussed the agency doctrine of apparent authority and concluded that the trial court did not err in holding the two partnerships jointly and severally liable based on the plaintiff’s testimony that Jerry Nickell did not explain his refusal to pay and did not claim that the plaintiff billed the wrong partnership until after the plaintiff filed suit. 7N Oil & Gas claimed in this suit that it did not pay because the plaintiff billed the wrong partnership, but 7N Oil & Gas paid the first two invoices without objection, explanation, or request that the plaintiff change the billing. The plaintiff and the contract pumper who requested the plaintiff’s services testified that they could not identify which partnership they were employed by because Jerry Nickell operated the lease either personally or as an agent of both partnerships. Their testimony was supported by documents that showed Jerry Nickell used the two partnership names and addresses interchangeably in Railroad Commission filings. The court of appeals deferred to the trial court’s resolution of disputed facts. The court of appeals also concluded that the trial court was authorized to award attorney’s fees under Sections 56.041 and 53.156 of the Property Code and Section 38.0001(1) and (2) of the Civil Practice and Remedies Code.


This wrongful foreclosure action arose out of the foreclosure of a limited partnership’s property that was pledged by the general partner of that limited partnership to secure another limited partnership’s note. The lender asserted a third-party claim against the limited partnership whose property was pledged (Anzalduas Business Park, L.P. or “Anzalduas LP”) for a declaratory judgment that the general partner of that partnership (Anzalduas Business Park GP or “Anzalduas GP”) had actual or apparent authority to pledge Anzalduas LP’s property as collateral for the other partnership’s note. The court granted summary judgment in favor of the lender on its claim for declaratory judgment. The court concluded that Anzalduas GP had actual authority to act as the agent of Anzalduas LP in executing the deed of trust at issue because the partnership agreement provided that the general partner was authorized to execute security instruments and agreements on behalf of the partnership on such terms and conditions as the general partner in its sole discretion deemed proper.


The court held that the plaintiff was entitled to its proposed judgment based on the court’s prior summary judgment in favor of the plaintiff for breach of a covenant not to sue contained in an LLC Membership Purchase Agreement. Muse, a defendant limited partner, argued that the plaintiff’s claim for breach of contract failed because it did not prove “but for” causation. Muse argued that the plaintiff alleged only that Muse agreed with other limited partners that the limited partnership should file a lawsuit and that he signed a check to the limited partnership. Muse argued that his agreement to filing suit was not required and that a general partner has authority to file suit in the name of the limited partnership when a majority-in-interest of the partners agree to that action. Since the general partner along with another limited partner who signed the fee agreement with the law firm constituted 55.8% of the interest in the
limited partnership, Muse argued they did not need his agreement to pursue the litigation. Muse also argued that the plaintiff did not present evidence that the check he signed was used to fund the litigation. Muse argued that the Texas Business Organizations Code protects limited partners from liability for actions taken by the limited partnership as a matter of public policy, and Muse characterized his actions as falling within statutory safe harbors provided to limited partners who act as a member or manager of an LLC general partner, consult with or advise the general partner on any matter, and guarantee or assume obligations of the partnership. The plaintiff countered that the court had already twice determined that Muse was individually liable for the plaintiff’s damages. The plaintiff characterized the causation argument as a belated, redundant, and meritless attempt to relitigate the merits of the court’s summary judgment. The court stated that it fully agreed with the plaintiff that it was entitled to judgment and that Muse’s objections lacked merit.


In this wrongful termination suit, the plaintiff alleged that he was fired for refusing to perform an illegal act when the plaintiff refused to participate in the repossession of equipment under circumstances that the plaintiff argued would have constituted criminal trespassing. The court concluded that entry into the building where the equipment was located would not have constituted criminal trespassing because effective consent to enter had been obtained from the president of the construction company that owned the equipment and occupied the premises. The construction company was organized as a limited partnership, and the plaintiff argued that the individual who gave consent was only a limited partner with a 29% interest in the limited partnership and that the management company owned by the individual was no longer the general partner. The court stated that the individual was able to give effective consent because, whatever the limits of her authority as a limited partner under the partnership agreement, she had possession of the premises through her possession of the key and had a greater right to possession than the plaintiff.

**Reid Road Municipal Utility District No. 2 v. Speedy Stop Food Stores, Ltd.**, 337 S.W.3d 846 (Tex. 2011).

The court in this case addressed the application of the Property Owner Rule to a limited partnership. Under this rule, a property owner who is familiar with the market value of his property may testify regarding that market value even if he is not qualified or designated as an expert witness. Recognizing that an entity necessarily testifies through its agents and representatives, the court found the need to limit the scope of the agents and representatives who are permitted to testify on the entity’s behalf under this rule. The court held that those who may testify in this regard are limited to officers of the entity in managerial positions with duties related to the property, or employees of the entity with substantially equivalent positions and duties. In this case, the court held that an officer of the corporate general partner of the limited partnership that owned the property did not fall into the category of entity representatives to whom the Property Owner Rule applies because he was not an employee or officer of the limited partnership. Justice Willet, joined by Justice Lehmann, pointed out in a separate opinion that limited partnerships commonly consist of passive limited partners and a corporate general partner and that the court’s treatment of the Property Owner Rule means that many, if not most, limited partnerships could never proffer a witness on the value of their property under the Property Owner Rule. This is so because there is no particular need for a limited partnership to have any managerial employees since limited partnerships are managed by the general partner(s). Pointing out that the court contemplates application of the Property Owner Rule to a managing officer of the entity owning the property or an employee of the entity in a “substantially equivalent” position, Justice Willet states that he would hold that a managing officer of the corporate general partner with duties relating to the property may testify as to the value of the partnership property without being qualified as an expert provided the officer is familiar with the specific property in issue and its value.


This case involved a contract between a sole proprietorship and a limited partnership that were owned by the same person. Geis formed a real estate development limited partnership with an LLC general partner of which he was the sole member and manager. Geis was also the sole limited partner of the limited partnership. The limited partnership entered into a contract for architectural services with Rio Architects, a sole proprietorship owned by Geis. The limited partnership filed bankruptcy, and the plaintiff bought the limited partnership’s claim against Rio Architects in an auction conducted by the trustee. The plaintiff sought rescission of the contract with Rio Architects and return of the fee paid by the limited partnership, claiming that the contract was unlawful because Rio Architects failed to employ or associate with a licensed architect when the plans were created. Geis asserted the defense of in pari delicto. He argued that the limited partnership was in pari delicto because his knowledge that the contract was illegal was imputed equally to the limited partnership and the sole proprietorship since he was the only person authorized to act on behalf of the limited partnership. The court rejected this argument because the record supported the trial court’s findings that the limited
partnership did not have knowledge that Rio Architects was violating the statutes and regulations governing the practice of architecture. The court pointed to testimony by Geis that he lacked knowledge of the work of Rio’s employees, particularly a design architect briefly employed by the firm and found to have violated regulations of the Texas Board of Architectural Examiners with respect to the project. The court also stated that Geis advanced no particular legal theory to explain why any knowledge he possessed should be imputed to the limited partnership. Geis argued that his knowledge should be imputed because he was the only one authorized to act for the limited partnership, but the court stressed that partnerships are legally distinct entities from individual partners and that limited liability companies are likewise separate entities from their members or managers.

C. Statutory Liability Protection of Limited Partner


The plaintiff sought to hold Harris personally liable on breach of contract and warranty claims arising out of the plaintiff’s purchase of 42 off-the-road tires from a limited partnership. The jury found that Harris, a limited partner, participated in control of the limited partnership and that the plaintiff reasonably believed that Harris was a general partner based on his conduct. Harris argued that there was no evidence that he participated in the control of the business so as to render him liable because he engaged only in conduct protected by the safe harbor provisions of Section 153.103(1)(A), (B), and (E) of the Texas Business Organizations Code. Specifically, Harris claimed that he was acting at all times in his capacity as the managing member of the LLC general partner or as president and CEO of the limited partnership. At trial, however, the evidence showed that Harris, while negotiating a contract with the plaintiff, signed correspondence identifying himself as “Partner–Colorado OTR LP,” not as an agent, employee, or officer of the partnership. Further, he handed out business cards representing himself as “partner.” The plaintiff’s witnesses testified that they believed Harris was the person in charge at the limited partnership’s business and that they were unaware that he was president of the company. The court concluded that this was ample evidence to support the jury’s findings that Harris participated in the control of the limited partnership as if he were a general partner and that, as a result of his conduct, the plaintiff reasonably believed that Harris was a general partner when the plaintiff agreed to the contract.


Dr. Nguyen formed a limited partnership, PLTQ Lotus Group, L.P. (“PLTQ”), for the purpose of developing a piece of real estate into a medical center. Nguyen met Yu, a real estate developer who primarily developed shopping centers, and Yu convinced Nguyen to acquire adjacent property and develop the property into a shopping center instead of a medical center. Yu conducted his real estate development work primarily through Peterson Group, Inc. (“Peterson Group”). Yu formed a limited partnership, PGI Development Group, L.P. (“PGI LP”), for the purpose of developing the shopping center with PLTQ. Peterson I Realty GP, Inc. was the general partner of PGI LP. Yu was a limited partner of PGI LP and the president of Peterson Group and Peterson I Realty GP, Inc. Two development agreements pertaining to the shopping center were executed by PLTQ. The first development agreement was a one-page agreement generally establishing the developer’s responsibilities and obligating PLTQ to pay Peterson Group a developer fee. Yu signed this contract as president of Peterson Group. The second development agreement was a more detailed agreement, and this agreement identified PGI LP as the developer. The second agreement was signed on behalf of PGI LP by Peterson I Realty GP, Inc., the general partner. Yu signed for Peterson I Realty GP, Inc., as its president. Various problems and disagreements arose over the course of the project, and the parties ended up suing each other. The case went to trial, and the jury found, inter alia, that PGI LP failed to comply with the development agreement. No alter-ego question was presented to the jury, but the trial court granted a directed verdict that PGI LP was the alter ego of both Peterson Group and Yu. The trial court made no alter-ego findings involving the corporate general partner.

Yu and Peterson Group argued on appeal that the alter-ego theory of veil piercing does not apply to limited partnerships. The court of appeals stated that Texas courts have uniformly declined to apply the alter-ego theory to pierce a limited partnership’s veil to impose the partnership’s liabilities on a limited partner. The court pointed out that, unlike a person doing business with a corporation, a person doing business with a limited partnership always has recourse against a general partner, whose identity is readily ascertainable from periodic filings with the Secretary of State. In contrast to general partners, the court explained that limited partners are generally protected from liability for the limited partnership’s obligations unless they take some action to subject themselves to liability. Section 153.102 of the Texas Business Organizations Code provides two exceptions to the liability protection of a limited partner: (1) the limited partner is also a general partner; or (2) in addition to the exercise of the limited partner’s rights and powers as a limited partner, the limited partner participates in the control of the business. Liability under the second exception is limited to
a person who transacts business with the limited partnership reasonably believing, based on the limited partner’s conduct, that the limited partner is a general partner. The court characterized liability under these circumstances as an application of ordinary partnership law rather than an exercise of veil piercing. The court also pointed out that the Business Organizations Code contains an extensive list of actions that do not constitute participation in “control of the business” for purposes of imposing liability on a limited partner under the statute. The actions relevant to this appeal include acting as a contractor for or an officer or other agent of the limited partnership, acting as a contractor for or an agent or employee of a general partner, or acting as an officer, director, or stockholder of a corporate general partner.

PLTQ relied on common-law veil-piercing principles to impose liability on Yu and Peterson Group rather than any statutory provisions. The court of appeals concluded that the cases relied on by PLTQ did not actually apply the alter-ego theory or any other veil-piercing theory to subject a limited partner to liability. Further, the court pointed out that the development agreement was entered into by PGI LP and that the agreement expressly provided that the developer’s liability was limited to PGI LP’s assets. Although Peterson I Realty GP, Inc. was originally sued, it was later nonsuited, and PLTQ chose to proceed solely against PGI LP, Peterson Group, and Yu. The court of appeals stated that corporate veil piercing has been applied to owners and operators of corporations and has never been indiscriminately applied to “arguably responsible bystanders.” To the extent equitable veil piercing could be applied to a limited partnership, the court stated that it would only apply to impose liability on constituents analogous to those in the corporate context, such as limited partners and managers responsible for controlling the business. In addition, it would be limited to circumstances in which the limited partnership was used to perpetrate actual fraud for the direct personal benefit of the defendant. The court pointed out that a limited partnership’s general partner might itself be subject to veil piercing if it is a limited liability entity such as a corporation. PLTQ did not seek that remedy in this case. Here, the only two identifiable parties behind PGI LP’s limited partnership structure were its general partner (Peterson I Realty GP, Inc.) and its limited partner (Yu). PLTQ abandoned its claim seeking to pierce the veil of the general partner and did not plead or prove that Peterson Group was a limited partner so as to pursue liability under Section 153.102 of the Business Organizations Code or equitable veil piercing. Finally, PLTQ did not assert that Yu, as a limited partner, could be liable under Section 153.102. In particular, there was no allegation or proof that PLTQ had a reasonable belief that Yu was a general partner. The court concluded that imposing liability under equitable veil-piercing doctrine would eviscerate the statutory framework governing liability.

In a dissent, Justice Keyes argued at length that veil-piercing principles should apply to limited partnerships and that the trial court’s application of the alter-ego doctrine in this case should be affirmed.


A limited partnership, Dallas Gas Partners, L.P. (“DGP”), contracted to buy a gas processing plant and eventually assigned the contract to its general partner, an LLC owned by Muse, Nelson, and Weiss, who were also limited partners of DGP. Muse, Nelson, and Weiss sold their membership interests in the LLC to Prospect Energy Corporation (“Prospect”) in order to effectuate resolution of a dispute with Prospect that involved the acquisition by Prospect of the gas processing plant. The parties memorialized the transaction in three documents: (1) a unanimous written consent of the partners of DGP approving assignment of the contract to purchase the gas processing plant to the LLC general partner; (2) an LLC membership interest purchase agreement, which included a mutual release and covenant not to sue; and (3) a consent and agreement of limited partners in which each of the limited partners agreed to and ratified the mutual release and covenant not to sue contained in the LLC membership interest purchase agreement. DGP sued Prospect two months later, and Prospect counterclaimed for breach of the covenant not to sue and added claims against Muse, Nelson, and Weiss. The district court concluded that DGP was bound by the release and that Muse, Nelson, and Weiss were individually bound as well. Nelson and Muse appealed, arguing that they were not individually liable for breach of the release and covenant not to sue for three reasons. First, they argued that they signed the LLC membership interest purchase agreement containing the mutual release as partners of DGP and not in their personal capacities. Second, they argued that they were not involved in control of the business. Third, they argued that they had not breached the covenant not to sue because DGP was the plaintiff and not the individuals. The court rejected all these arguments. With respect to their first argument, Nelson and Muse contended that the district court was estopped from finding the partners signed the LLC membership interest purchase agreement in their personal capacities by having previously found that Prospect could enforce the covenant not to sue against DGP. The court of appeals pointed out that the lower court found that Nelson and Muse signed the consent and agreement of limited partners (which agreed to and ratified the mutual release and covenant not to sue), in their capacities as partners of DGP, but the district court made no such finding with respect to the LLC membership interest purchase agreement. The language of the LLC membership interest purchase agreement made clear that Nelson, Muse, and Weiss were signing as individuals, and the transfer
described by the agreement could not have been on the part of DGP because DGP owned no interest in the LLC. The court next discussed the argument that DGP received all the consideration and that Nelson and Muse received no consideration for their promise not to sue. The court found no reason to overturn the district court’s holding that Muse, Nelson, and Weiss retained significant consideration. Finally, the court of appeals rejected the argument that Nelson and Weiss did not breach the covenant not to sue because DGP was the plaintiff in the suit. Nelson and Muse did not dispute that they personally funded DGP’s suit. Under an interpretation that gave effect to all of the terms of the agreement, the court concluded that Nelson and Muse breached the agreement by funding the lawsuit.


The appellant filed a petition in intervention in a case in which a judgment had been entered against a limited partnership and its LLC general partner and a receiver of the property of the limited partnership and general partner had been appointed. The appellant was a limited partner and member of the judgment debtors, and the appellant sought to appeal a modified order of the trial court appointing receiver and an order severing the limited partnership from the underlying cause. The judgment creditor argued that the appellant lacked standing to appeal because the appellant was not a party to the underlying judgment or to the trial court’s subsequent severance or modified order appointing a receiver. The appellant argued that it had standing under the virtual representation doctrine. In connection with the first element of the virtual representation doctrine, the appellant argued that it was bound to the judgment as the sole limited partner of the limited partnership and sole member of the LLC general partner. The court stated that the appellant mischaracterized the liability of a limited partner or LLC member for judgments against the entity. Under Section 153.102(a) of the Business Organizations Code, a limited partner is not liable for the obligations of the limited partnership unless the limited partner is also a general partner or, in addition to the exercise of the limited partner’s rights and powers, it participates in the control of the business. Under Section 153.102(b), even if the limited partner participates in the control of the business, the limited partner is liable only to persons who transact business with the limited partnership reasonably believing, based on the limited partner’s conduct, that the limited partner is a general partner. The appellant was not a general partner of the limited partnership and had made no showing that any party in the underlying cause believed that the limited partner was a general partner based on its conduct. Thus, the limited partner was not bound by the judgment against the limited partnership by virtue being a limited partner.


The payee on a note sued Basaldua on the note, and the trial court granted summary judgment in favor of Basaldua. The court of appeals affirmed the trial court’s judgment. The note was signed by Tom Gallagher as president of NE Houston GP Management, LLC, as general partner of Northeast Houston G.P., L.P., as general partner of the maker of the note, Northeast Houston Hospital, Ltd. The plaintiff acknowledged that Basaldua did not sign the note, but argued that Basaldua was personally liable on the note by virtue of Section 153.102(a)(1) and (b) of the Texas Business Organizations Code, which states that a limited partner is not liable for the obligations of the limited partnership unless the limited partner is also a general partner or participates in the control of the business, in which case a limited partner is liable to a third party who transacts business with the limited partnership reasonably believing, based on the limited partner’s conduct, that the limited partner is a general partner. The uncontroverted affidavit of Basaldua established that he was a limited partner of Northeast Houston Hospital, Ltd., was never a general partner of Northeast Houston Hospital, Ltd., never participated in the control of Northeast Houston Hospital, Ltd., and was never affiliated with NE Houston GP Management, LLC or Northeast Houston G.P., L.P. The plaintiff argued that a fact issue was created by the fact that Basaldua signed a letter agreement with the plaintiff as CEO of Greater North Houston Physicians Alliance, Ltd. (“GNHPA”). The letter agreement set forth the terms of a settlement with the plaintiff regarding unpaid architectural fees incurred for the construction of a hospital. Under the letter agreement, a sum of money was to be paid to the plaintiff, and a promissory note was to be delivered. The plaintiff admitted that the terms of the letter agreement had been satisfied because the note was delivered. The court stated that Basaldua’s execution of the letter agreement on behalf of GNHPA was irrelevant to Basaldua’s liability on the note. The plaintiff did not sue Basaldua for breach of the letter agreement, nor was there any breach of the letter agreement. The plaintiff sued Basaldua on the note, in which Northeast Houston Hospital, Ltd., not GNHPA or Basaldua, promised to pay the plaintiff. The fact that Basaldua signed the letter agreement as GNHPA’s CEO did not make him liable for payment on the note, which was a separate contract that Northeast Houston Hospital, Ltd. promised to pay.

The court held that the plaintiff was entitled to its proposed judgment based on the court’s prior summary judgment in favor of the plaintiff for breach of a covenant not to sue contained in an LLC Membership Purchase Agreement. Muse, a defendant limited partner, argued that the plaintiff’s claim for breach of contract failed because it did not prove “but for” causation. Muse argued that the plaintiff alleged only that Muse agreed with other limited partners that the limited partnership should file a lawsuit and that he signed a check to the limited partnership. Muse argued that his agreement to filing suit was not required and that a general partner has authority to file suit in the name of the limited partnership when a majority-in-interest of the partners agree to that action. Since the general partner along with another limited partner who signed the fee agreement with the law firm constituted 55.8% of the interest in the limited partnership, Muse argued they did not need his agreement to pursue the litigation. Muse also argued that the plaintiff did not present evidence that the check he signed was used to fund the litigation. Muse argued that the Texas Business Organizations Code protects limited partners from liability for actions taken by the limited partnership as a matter of public policy, and Muse characterized his actions as falling within statutory safe harbors provided to limited partners who act as a member or manager of an LLC general partner, consult with or advise the general partner on any matter, and guarantee or assume obligations of the partnership. The plaintiff countered that the court had already twice determined that Muse was individually liable for the plaintiff’s damages. The plaintiff characterized the causation argument as a belated, redundant, and meritless attempt to relitigate the merits of the court’s summary judgment. The court stated that it fully agreed with the plaintiff that it was entitled to judgment and that Muse’s objections lacked merit.


The plaintiff sued a real estate investment trust, a Delaware limited partnership, and the LLC general partner of the limited partnership, asserting breach of contract and various other claims in connection with an agreement between the limited partnership and the plaintiff regarding improvements made by the plaintiff on property owned by the limited partnership and leased to the plaintiff. The limited partnership and its general partner were subsidiaries of the REIT, and the plaintiff alleged that the limited partnership was a “mere shell company” created for the purpose of holding the property for the REIT. The plaintiff sought to hold the REIT liable on an alter ego theory, and the REIT moved for summary judgment. The parties agreed that Delaware law governed whether the REIT could be held liable under an alter ego theory for the limited partnership’s actions. The court examined the summary judgment evidence and found that there was a material question of fact with regard to whether the REIT was liable to the plaintiff as the alter ego of the limited partnership under Delaware law. The REIT argued that alter ego liability does not apply to limited partnerships, but the court was not persuaded by this argument. The REIT relied upon Texas cases for the proposition that alter ego liability or corporate veil piercing is inapplicable to partnerships because the general partner is always liable. The court noted that Texas law also states that a limited partner is not liable for the obligations of a limited partnership unless the limited partner participates in the control of the business. The court stated that the summary judgment evidence raised fact questions as to the REIT’s participation in and control of the limited partnership’s business and whether the plaintiff believed it was dealing with a general partner. Thus, the court concluded that, even if Texas law applied, summary judgment should not be granted solely on the basis that alter ego liability does not apply to limited partnerships.


The court noted that veil piercing theories do not apply to Texas limited partnerships to reach limited partners, but the court held limited partners in this case liable for breach of a covenant not to sue because the limited partners signed the covenant in their individual capacities.


The plaintiff sued a limited partnership and its general partner for copyright infringement. In the midst of the litigation, the limited partnership and general partner filed for bankruptcy. The plaintiff joined various individual defendants who were limited partners of the bankrupt limited partnership. In this summary judgment proceeding, the plaintiff sought to obtain summary judgment against the individual defendants on their liability for copyright infringement. The individual defendants argued that, as limited partners, they could not be held liable for the obligations of the partnership. The court acknowledged that a limited partner generally is not liable for the obligations of a limited
partnership unless: (1) the limited partner is also a general partner; or (2) in addition to the exercise of the limited partner’s rights and powers as a limited partner, the limited partner participates in the control of the business. The plaintiff argued that these individual defendants had the legal power and ability to supervise and control the activities of the limited partnership and its general partner and had a financial interest in them and were therefore vicariously liable for the copyright violation. The court denied summary judgment, holding that questions of material fact existed as to the individual defendants’ degree of control and possible vicarious liability.

D. Piercing Veil of Limited Partnership, General Partner, or Affiliate


The plaintiff contracted to provide various therapy services for a limited partnership engaged in the business of providing home health care services. After the limited partnership stopped paying the plaintiff, the plaintiff sued the limited partnership, numerous related entities (another limited partnership, two corporations, and numerous LLCs), and individuals who were limited partners, officers, and members of these entities. The court in this opinion addressed a motion to dismiss in which the individual defendants argued that the plaintiff failed to state a veil-piercing claim against them. The court addressed the scope of the motion and concluded that it only pertained to the individuals’ liability with respect to one Texas corporation and six Texas LLCs because the individual defendants relied on Section 21.223 of the Texas Business Organizations Code, which the court pointed out applied only to Texas corporations and Texas LLCs. Tex. Bus. Orgs. Code §§ 21.223, 1.102, 1.104, 101.002. Thus, the court said the motion did not relate to the individuals’ liability with respect to the two Texas limited partnerships, a foreign corporation, and three foreign LLCs.


The plaintiff provided oilfield and fluid disposal services on a lease originally entered into by Seven N. Holdings, L.P. (“Seven Holdings”) and subsequently assigned to a related limited partnership, 7N Oil & Gas Bonanza, L.P. (“7N Oil & Gas”). The records at the Texas Railroad Commission showed 7N Oil & Gas as the operator of the lease, but incorrectly showed the address for Seven Holdings. 7N Oil & Gas was in Houston, and Seven Holdings was in Aubrey. The same LLC served as general partner for each of the limited partnerships. Jerry and Laurie Nickell served in various capacities for the two partnerships. Jerry Nickell hired a contract pumper to perform work on the lease, and the contract pumper requested the services of the plaintiff. The contract pumper told the plaintiff to send the invoices to 7N Oil & Gas. The plaintiff sent 22 invoices to Seven Holdings’ address in Aubrey. Unsure of the proper party to bill, the plaintiff used various names, including “7N Holdings, L.P.,” 7N Oil and Gas,” and “7N Holding Company.” 7N Oil & Gas initially paid two invoices, but the other 20 were not paid. The plaintiff eventually checked the real estate records in an attempt to find out who was the proper party to pursue for payment, and the plaintiff found the original lease to Seven Holdings but did not discover the assignment to 7N Oil & Gas. The plaintiff made demand on Seven Holdings for payment and contacted Jerry Nickell several times. Jerry Nickell refused to pay and provided no explanation for not paying. The plaintiff filed a lien on the lease and brought suit to foreclose the lien against Seven Holdings. When Seven Holdings responded with a verified denial that indicated 7N Oil & Gas was the proper party, the plaintiff added 7N Oil & Gas as a defendant. Almost two years after the plaintiff first demanded payment, 7N Oil & Gas sent the plaintiff a cashier’s check for the balance of the unpaid invoices. Because the check did not include interest and attorney’s fees, the plaintiff refused to accept it. The trial court maintained the lien and held Seven Holdings and 7N Oil & Gas liable for $16,000 in attorney’s fees and costs.

On appeal, the partnerships argued that Seven Holdings could not be held liable for the debts of 7N Oil & Gas because there was no evidence to suggest that the two distinct partnerships acted as one. The plaintiff contended that the evidence at trial showed a long history of muddled transactions between the two partnerships sufficient to support joint and several liability. The court of appeals discussed the agency doctrine of apparent authority and concluded that the trial court did not err in holding the two partnerships jointly and severally liable based on the plaintiff’s testimony that Jerry Nickell did not explain his refusal to pay and did not claim that the plaintiff billed the wrong partnership until after the plaintiff filed suit. 7N Oil & Gas claimed in this suit that it did not pay because the plaintiff billed the wrong partnership, but 7N Oil & Gas paid the first two invoices without objection, explanation, or request that the plaintiff change the billing. The plaintiff and the contract pumper who requested the plaintiff’s services testified that they could not identify which partnership they were employed by because Jerry Nickell operated the lease either personally or as an agent of both partnerships. Their testimony was supported by documents that showed Jerry Nickell used the two partnership names and addresses interchangeably in Railroad Commission filings. The court of appeals deferred to the
The parties in this case asserted claims against each other arising out of a real estate development project. The court found as a matter of law that the limited partnership developer was the alter ego of an individual and an affiliated corporation and that the individual and corporation were thus liable for the limited partnership’s breach of its development agreement. The court of appeals held that the trial court erred in holding the individual and his corporation liable as alter egos of the limited partnership.

Dr. Nguyen formed a limited partnership, PLTQ Lotus Group, L.P. (“PLTQ”), for the purpose of developing a piece of real estate into a medical center. Nguyen met Yu, a real estate developer who primarily developed shopping centers, and Yu convinced Nguyen to acquire adjacent property and develop the property into a shopping center instead of a medical center. Yu conducted his real estate development work primarily through Peterson Group, Inc. (“Peterson Group”). Yu formed a limited partnership, PGI Development Group, L.P. (“PGI LP”), for the purpose of developing the shopping center with PLTQ. Peterson I Realty GP, Inc. was the general partner of PGI LP. Yu was a limited partner of PGI LP and the president of Peterson Group and Peterson I Realty GP, Inc. Two development agreements pertaining to the shopping center were executed by PLTQ. The first development agreement was a one-page agreement generally establishing the developer’s responsibilities and obligating PLTQ to pay Peterson Group a developer fee. Yu signed this contract as president of Peterson Group. The second development agreement was a more detailed agreement, and this agreement identified PGI LP as the developer. The second agreement was signed on behalf of PGI by Peterson I Realty GP, Inc., the general partner. Yu signed for Peterson I Realty GP, Inc., as its president. Various problems and disagreements arose over the course of the project, and the parties ended up suing each other. The case went to trial, and the jury found, inter alia, that PGI LP failed to comply with the development agreement. No alter-ego question was presented to the jury, but the trial court granted a directed verdict that PGI LP was the alter ego of both Peterson Group and Yu. The trial court made no alter-ego findings involving the corporate general partner.

Yu and Peterson Group argued on appeal that the alter-ego theory of veil piercing does not apply to limited partnerships. The court of appeals stated that Texas courts have uniformly declined to apply the alter-ego theory to pierce a limited partnership’s veil to impose the partnership’s liabilities on a limited partner. The court pointed out that, unlike a person doing business with a corporation, a person doing business with a limited partnership always has recourse against a general partner, whose identity is readily ascertainable from periodic filings with the Secretary of State. In contrast to general partners, the court explained that limited partners are generally protected from liability for the limited partnership’s obligations unless they take some action to subject themselves to liability. Section 153.102 of the Texas Business Organizations Code provides two exceptions to the liability protection of a limited partner: (1) the limited partner is also a general partner; or (2) in addition to the exercise of the limited partner’s rights and powers as a limited partner, the limited partner participates in the control of the business. Liability under the second exception is limited to a person who transacts business with the limited partnership reasonably believing, based on the limited partner’s conduct, that the limited partner is a general partner. The court characterized liability under these circumstances as an application of ordinary partnership law rather than an exercise of veil piercing. The court also pointed out that the Business Organizations Code contains an extensive list of actions that do not constitute participation in “control of the business” for purposes of imposing liability on a limited partner under the statute. The actions relevant to this appeal include acting as a contractor for or an officer or other agent of the limited partnership, acting as a contractor for or an agent or employee of a general partner, or acting as an officer, director, or stockholder of a corporate general partner.

PLTQ relied on common-law veil-piercing principles to impose liability on Yu and Peterson Group rather than any statutory provisions. The court of appeals concluded that the cases relied on by PLTQ did not actually apply the alter-ego theory or any other veil-piercing theory to subject a limited partner to liability. Further, the court pointed out that the development agreement was entered into by PGI LP and that the agreement expressly provided that the developer’s liability was limited to PGI LP’s assets. Although Peterson I Realty GP, Inc. was originally sued, it was later nonsuited, and PLTQ chose to proceed solely against PGI LP, Peterson Group, and Yu. The court of appeals stated that corporate veil piercing has been applied to owners and operators of corporations and has never been indiscriminately applied to “arguably responsible bystanders.” To the extent equitable veil piercing could be applied to a limited partnership, the court stated that it would only apply to impose liability on constituents analogous to those in the corporate context, such as limited partners and managers responsible for controlling the business. In addition, it would be limited to circumstances in which the limited partnership was used to perpetrate actual fraud for the direct personal
benefit of the defendant. The court pointed out that a limited partnership’s general partner might itself be subject to veil piercing if it is a limited liability entity such as a corporation. PLTQ did not seek that remedy in this case. The court also noted that adherence to corporate formalities has been de-emphasized, and the court thus disagreed with the dissent’s suggestion that application of veil piercing in this case should hinge on speculation that PGI LP failed to comply with regulatory formalities. Here, the only two identifiable parties behind PGI LP’s limited partnership structure were its general partner (Peterson I Realty GP, Inc.) and its limited partner (Yu). PLTQ abandoned its claim seeking to pierce the veil of the general partner and did not plead or prove that Peterson Group was a limited partner so as to pursue liability under Section 153.102 of the Business Organizations Code or equitable veil piercing. Finally, PLTQ did not assert that Yu, as a limited partner, could be liable under Section 153.102. In particular, there was no allegation or proof that PLTQ had a reasonable belief that Yu was a general partner. The court concluded that imposing liability under equitable veil-piercing doctrine would eviscerate the statutory framework governing liability.

In a dissent, Justice Keyes argued at length that veil-piercing principles should apply to limited partnerships and that the trial court’s application of the alter-ego doctrine in this case should be affirmed. According to the dissent, “[t]he purpose and spirit of the alter ego statute cannot be evaded merely by forming an illusory, special purpose phantom entity in the form of a limited partnership, with an equally illusory corporation as its general partner, to shield another entity and an individual from liability for their actions under a contract they procured and would be obligated to perform in their own name had not illusory corporate and limited partnership entities been formed.”


This adversary proceeding was brought in the bankruptcy cases of a limited partnership, the limited partnership’s LLC general partner, and the individual who owned 100% of the LLC and 28% of the limited partnership. The Chapter 7 trustees for these debtors brought this action to recover preferential and fraudulent transfers, and to pierce the corporate veil of various entities affiliated with the entity debtors. Some of the defendants sought dismissal of claims that were based on transfers made by non-debtor entities. The defendants argued that the trustees must show that the non-debtor entities should be substantively consolidated under bankruptcy law with one or more debtors in order to assert claims for transfers made by the non-debtor entities. The court stated that the trustees did not have to plead substantive consolidation because they stated claims for state-law reverse veil piercing with respect to the entities and thus had standing to assert fraudulent or preferential transfer claims based on transfers from the non-debtor entities. The court relied upon *ASARCO LLC v. Americas Min. Corp.*, 382 B.R. 49 (S.D. Tex. 2007) for the proposition that a debtor can pursue its wholly owned subsidiary’s fraudulent transfer claim where state-law veil-piercing requirements are met. The court explained that traditional veil piercing uses the alter ego doctrine to include the assets of a shareholder as assets of a corporation while the common law doctrine of reverse veil piercing counts the assets of a corporation or other entity as the assets of its shareholder. In this case, the trustees sought to count the assets of the non-debtor entities as assets of the debtors. The court reviewed specific facts alleged by the trustees that supported the allegation that the entities were a sham and were not truly separate from the debtors and that the sham entities were used to facilitate the fraudulent diversion of assets. The court concluded that the allegations adequately stated a claim for reverse veil piercing under Texas law.


The plaintiff sued a real estate investment trust, a Delaware limited partnership, and the LLC general partner of the limited partnership, asserting breach of contract and various other claims in connection with an agreement between the limited partnership and the plaintiff regarding improvements made by the plaintiff on property owned by the limited partnership and leased to the plaintiff. The limited partnership and its general partner were subsidiaries of the REIT, and the plaintiff alleged that the limited partnership was a “mere shell company” created for the purpose of holding the property for the REIT. The plaintiff sought to hold the REIT liable on an alter ego theory, and the REIT moved for summary judgment. The parties agreed that Delaware law governed whether the REIT could be held liable under an alter ego theory for the limited partnership’s actions. The REIT argued that the plaintiff could not show that the REIT exercised domination and control over the limited partnership because the REIT was neither the general partner nor the limited partner. The REIT argued that it did not control the limited partnership because it was only a minority owner of the limited partner and the approval of the majority owner of the limited partner was required for major decisions of the limited partnership. The court examined the summary judgment evidence and found that there was a material question of fact with regard to whether the REIT was liable to the plaintiff as the alter ego of the limited partnership under Delaware law. The evidence created fact questions as to whether the limited partnership ever was solvent or properly
capitalized, as to whether corporate formalities were observed by the limited partnership or its general partner, as to siphoning of funds, functioning as a facade, and as to an element of fraud, injustice, or unfairness. In the course of its discussion, the court pointed out that there was evidence that the entity that was the limited partner had no employees and no board, was located at the REIT’s headquarters, and had its tax returns filed by the REIT, and the court found questions of fact remained as to whether the REIT controlled the limited partner. The court was not persuaded by the REIT’s argument that alter ego liability does not apply to limited partnerships. The court noted that Texas law also states that a limited partner is not liable for the obligations of a limited partnership unless the limited partner is also a general partner or, in addition to the exercise of the limited partner’s rights and powers, the limited partner participates in the control of the business. The court stated that the summary judgment evidence raised fact questions as to the REIT’s participation in and control of the limited partnership’s business and whether the plaintiff believed it was dealing with a general partner. Thus, the court concluded that, even if Texas law applied, summary judgment should not be granted solely on the basis that alter ego liability does not apply to limited partnerships.


The court noted that veil piercing theories do not apply to Texas limited partnerships to reach limited partners, but the court held limited partners in this case liable for breach of a covenant not to sue because the limited partners signed the covenant in their individual capacities.

E. Partnership By Estoppel


The plaintiff sued Stephen Brewer and BW Office Partners I, LP on an unpaid promissory note signed by Brewer on behalf of the partnership as “General Partner.” The trial court held that both Brewer and the partnership were liable but apportioned damages rather than imposing joint and several liability. The court of appeals stated that the trial court reasonably could have found Brewer liable on any of three bases: (1) Brewer was a general partner of the partnership; (2) Brewer represented to the plaintiff that Brewer was a general partner of the partnership, and the plaintiff relied on that representation in extending credit in good faith; or (3) Brewer personally guaranteed the loan to the partnership. Any of these theories would result in joint and several liability of Brewer for the partnership’s debt. The record contained no basis to apportion damages. If Brewer was a general partner, he was jointly and severally liable under Tex. Bus. Orgs. Code § 152.304(a). If Brewer represented to the plaintiff that he was a general partner, and the plaintiff relied on that representation in good faith in extending credit, then Brewer was liable as if he were a partner under the doctrine of partnership by estoppel. Again, he would be jointly and severally liable. Finally, personal liability as a guarantor would extend as far as the partnership’s liability, and Brewer would be jointly and severally liable for the partnership’s unpaid debt. Accordingly, the trial court erred in apportioning damages, and the court of appeals modified the judgment to include joint and several liability for the full amount of the trial court’s award.

F. Fiduciary Duty of Partners and Affiliates


The bankruptcy court in this adversary proceeding determined that the debtor, Edelman, was liable for trespass, breach of fiduciary duties, theft, and fraud based on actions he took while serving as vice president of the LLC general partner of a limited partnership that developed and operated a condominium project. The liability included exemplary damages as well as actual damages and was nondischargeable.

With respect to the breach of fiduciary duty claim, Edelman admitted that he owed a duty to the LLC general partner as vice president of the LLC, and he admitted that the LLC owed a fiduciary duty to the limited partnership as its general partner, but Edelman denied that he owed a fiduciary duty to the limited partnership. The court concluded that Edelman owed a fiduciary duty to the limited partnership based on his control of the limited partnership’s operations through his position as vice president of the LLC general partner. The court concluded that the LLC’s claim for breach of fiduciary duty failed because the facts underlying the LLC’s claim were the same as the limited partnership’s, and the allegations and evidence focused on injury to the limited partnership or benefit to Edelman at the limited partnership’s
provisions of Section 523 of the Bankruptcy Code, i.e., Sections 523(a)(2)(A), (a)(4), and/or (a)(6). The court also

as actual damages were appropriate.

Edelman’s failure to disclose that his wife was not a licensed real estate broker, the court concluded exemplary as well

to which he had access. With respect to the limited partnership’s successful claim for fraud by non-disclosure based on

been discovered by Wiggins in the limited partnership’s books and records and the books and records of a related LLC

revealed how the funds were being used. Thus, the fraud by nondisclosure claims failed as to the matters that could have

had a legal right to the information under the limited partnership agreement and the evidence did not show that Wiggins

adversely to them, but knowledge that Wiggins had an equal opportunity to discover could be imputed to the LLC general

partner and the limited partnership. The court relied on the fact that the limited partnership agreement gave partners the

claims were taken intentionally and resulted in a benefit, fraud could be presumed so as to support exemplary damages with

respect to this breach as well.

In addition to breaches of fiduciary duty, the court found that Edelman’s occupancy of the condominium unit without a lease and without paying rent constituted trespass against the limited partnership, and his improper draws on the loan violated the Texas Theft Liability Act as to the limited partnership. The court also found that Edelman committed fraud by nondisclosure with respect to his failure to disclose that his wife was not a licensed real estate broker. This fraud by nondisclosure damaged the limited partnership, but the LLC general partner and Wiggins failed to show how either of them suffered any injury independent of the limited partnership’s injury, and their fraud claims in this regard thus failed. Other claims by Wiggins, the LLC general partner, and the limited partnership for fraud by nondisclosure also failed. The other claims were based on Edelman’s wrongful transfer and personal use of the limited partnership’s funds and Edelman’s personal use of the condominium unit and draws on the loan were done with malice. The court stated that there was no evidence that Edelman, a non-lawyer, knew that it was illegal for his wife to be paid a commission on the sales of the units, but because these actions were taken intentionally and resulted in a benefit, fraud could be presumed so as to support exemplary damages with respect to this breach as well.

The court concluded that all of Edelman’s liabilities in this action were nondischargeable under one or more provisions of Section 523 of the Bankruptcy Code, i.e., Sections 523(a)(2)(A), (a)(4), and/or (a)(6). The court also explained that some of the damages under the various claims were duplicative and that the limited partnership was entitled to only a single recovery.

In this opinion, the bankruptcy court denied a motion to dismiss the involuntary Chapter 11 petition and made a preliminary determination that the directors of the LLC general partner of the limited partnership debtor owed fiduciary duties to the bankruptcy estate notwithstanding the provisions of the partnership agreement that disclaimed fiduciary duties. The debtor was a Delaware limited partnership with an LLC as the sole general partner. The LLC had four directors, each of whom was selected by an owner of the LLC (two by Comcast, one by the Rockets, and one by the Astros). Certain decisions required unanimity of the directors. The defendants argued that the Chapter 11 bankruptcy petition should be dismissed as futile because the Astros’ exercise of its veto right through its appointed director rendered any hope of reorganization futile. The court rejected this argument, concluding that the directors owed fiduciary duties to the bankruptcy estate and would not act in breach of their duties. The court acknowledged that the limited partnership was structured in such a way as to disclaim any state-law fiduciary responsibilities by the partners, but the court rejected the defendants’ contention that the parties created a bankruptcy-remote structure that absolved its directors of fiduciary responsibilities. The court reasoned that fiduciary duties to the estate rest with a debtor-in-possession’s directors in a Chapter 11 case where no trustee is appointed. The court stated that “[t]he individuals who manage the Estate’s affairs—whether ‘officers and managing employees’ [citation omitted] or puppeteers acting through a general partner—must respect the fiduciary sanctity of the operation of a bankruptcy estate.” The court stated that the Astros could choose to leave its seat on the board vacant, but that any individual who chose to serve on the board of the general partner would be required to honor fiduciary responsibilities. The court explained that the fiduciary duties to the estate were owed by the director selected by the Astros and not by the Astros themselves, leaving the Astros free to participate in hearings and oppose actions and defend contractual rights possessed under its media rights agreement with the debtor. In a footnote, the court stated that it was making only a preliminary determination that the directors owed fiduciary duties for purposes of the threshold determination of whether the case was futile. The court characterized its belief that the directors owed fiduciary responsibilities as “strongly” held, but noted that the parties had not fully briefed the issue of the directors’ fiduciary responsibilities and found it unnecessary to reach any final conclusion on the matter unless and until an alleged breach of duty occurred.

ART Midwest, Inc. v. Atlantic Limited Partnership XII, 742 F.3d 206 (5th Cir. 2014).

The parties in this case sued one another after a real estate transaction between the parties collapsed, and this appeal was the second appeal in the case. The real estate transaction at issue involved an agreement by the plaintiffs to acquire eight apartment complexes from the defendants and was structured so that a limited partnership intermediary would be the nominal buyer. (For ease of reference, the court in this opinion referred to the “patchwork of contracts” governing the transaction collectively as “the agreement.”) The plaintiffs purported to terminate the deal on behalf of the partnership because of a title problem, but the defendants contended that they did not default in their obligations and that the plaintiffs did not have the right to terminate the agreement. The plaintiffs sued for fraud on the basis that the defendants misrepresented matters regarding the title to the property and seeking a declaratory judgment that the plaintiffs properly terminated the deal. The defendants countersued the plaintiffs for breaching the agreement by improperly terminating it. The jury found that the plaintiffs properly terminated the deal but that the defendants did not commit fraud. In the first appeal, a panel of the Fifth Circuit held that there was no failure by the defendants to render marketable title and thus no default by the defendants entitling the plaintiffs to terminate. On remand, the district court granted partial summary judgment for the defendants holding that the plaintiffs improperly terminated the agreement and that the plaintiffs owed capital contributions to the partnership under the agreement. The district court put the remaining issues, including whether the plaintiffs breached a fiduciary duty to the defendants and the amount of damages, before a jury. The plaintiffs challenged the jury’s finding that they breached the fiduciary duties they owed as partners. The court of appeals stated that Texas law supports, and the plaintiffs did not dispute, that the plaintiffs, as partners, owed the defendants a fiduciary duty. The court of appeals concluded that a reasonable jury could have determined that the plaintiffs breached their fiduciary duty to the defendants because the evidence supported a finding that the plaintiffs used another entity as a “strawman” to acquire the partnership’s property when it was sold in a foreclosure sale. The defendants introduced evidence of a state court judgment, affirmed by a court of appeals, finding that the defendants used a “strawman” to purchase the property. The defendants also introduced testimony confirming details underlying the state judgment.


The trustee of a Delaware limited partnership’s bankruptcy estate sued John Speer for breach of fiduciary duties owed to the limited partnership based on distributions made to Speer to make payments on loans that financed Speer’s
purchase of a 50% interest in the partnership. The founder of the limited partnership’s business sold 50% of the equity to entities owned by Speer in 1998. In 2006, Speer bought out the remaining 50% owned by the founder, and Speer became the sole owner of the limited partnership through entities he controlled. Speer sought summary judgment on the breach of fiduciary duty claims on the basis that, as the limited partnership’s sole owner, he could not be liable for breaching a fiduciary duty to himself. The court noted that it had stated in a prior opinion that Speer was in effect the only owner of the limited partnership after the 2006 buyout and that Delaware limited partnership law is clear that a company’s sole owner cannot breach a fiduciary duty to the wholly owned company. The trustee did not cite a case finding that a sole partner of a limited partnership can be liable for breaching a fiduciary duty to the partnership, but the trustee argued that a limited partnership may assert a claim for breach of fiduciary duty against its general partner. The trustee reasoned that if the limited partnership could assert a claim for breach of fiduciary duty against Speer, then the trustee may assert the claim in its capacity as trustee of the bankruptcy estate. However, the court stated that Delaware does not allow a limited partnership to assert claims on its own behalf. The court stated that the purpose of the Delaware “common name” statute, which allows partnerships to sue and be sued in the partnership name, is to permit a plaintiff to file a suit against an unincorporated association using a common name without having to identify all the members, but it does not allow a limited partnership to assert on its own behalf a claim against a general partner. The court distinguished cases such as In re USA Cafes in which Delaware courts rejected the notion that directors of a corporation owe no fiduciary duty to a partnership or LLC controlled by that corporation. The court stated that these cases do not hold that a partnership may assert claims on its own behalf but rather stand for the established proposition that a parent corporation may owe duties to a subsidiary corporation that it controls and may be liable for self-dealing transactions. For example, the court stated that a corporate general partner could be liable to the limited partnership and its limited partners if the corporate general partner formed a new entity and then caused the general partner to sell partnership assets to the new entity at an unfairly low price. The court distinguished the trustee’s claims because the trustee did not claim that Speer intentionally injured the limited partnership to benefit another corporate entity that Speer owned or controlled.


Felder and Hagee were each 49.5% limited partners of a limited partnership that owned real estate, and each owned 50% of the corporate general partner. Felder was the sole director and officer of the corporate general partner. When the limited partnership was formed, Felder and Hagee were married, and when they divorced they entered into an agreement governing disposition of the limited partnership’s properties. The parties entered into a compromise settlement agreement (CSA) when a dispute arose concerning the disposition of the last tract of land owned by the partnership. Under the CSA, Hagee agreed to purchase 108 acres out of the remaining 395-acre tract simultaneously with the sale of the other 287 acres. Hagee challenged the trial court’s summary judgment ruling that Felder had authority to sell the limited partnership’s remaining asset over her objection. She claimed it was a “major decision” requiring her consent under the limited partnership agreement. Hagee also argued that the sale was a sale of substantially all the assets of the corporate general partner requiring her consent as a shareholder. The court stated that Hagee’s argument as a shareholder of the corporate general partner failed because her consent was required under the articles of incorporation only in relation to a sale of all or substantially all of the corporation’s assets. The 287-acre tract was not an asset of the corporation, and thus the provision was inapplicable. With regard to Hagee’s argument as a limited partner, the court concluded that she consented to the sale of the property by entering into the CSA assuming the limited partnership agreement required her consent for the sale. Because Hagee had consented, it was not necessary for the court to determine whether the limited partnership agreement required her consent as a sale of property that “would make it impossible to carry on the ordinary business of the Partnership.” The court stated that Hagee’s sole recourse in complaining about the timing and terms of the sale was her breach of fiduciary duty claim because Felder owed her a fiduciary duty to ensure that the timing and terms of the sale were fair and equitable, but the jury rejected that claim. The jury was instructed that Felder owed fiduciary duties to Hagee as a limited partner because Felder was the sole director of the general partner of the limited partnership. The jury then was asked whether Felder proved he complied with his duties by showing that: (1) the sale of the property was fair and equitable to Hagee; (2) Felder made reasonable use of the confidence placed in him by Hagee; (3) Felder acted in the utmost good faith and exercised the most scrupulous honesty toward Hagee; (4) Felder placed the interests of Hagee before his own, did not use the advantage of his position to gain any benefit for himself at Hagee’s expense, and did not place himself in any position where his self-interest might conflict with his obligations as a fiduciary; and (5) Felder fully and fairly disclosed all important information to Hagee concerning the transactions. The jury was also instructed that Felder, as the sole director of the general partner, was authorized to sell the tract without Hagee’s consent and that Felder was conclusively presumed to have acted in good faith if he acted in reliance upon the opinion of third-party consultants that he reasonably believed were within the
husband’s breach of fiduciary duty and ratified the breach of duty by knowingly accepting the benefits derived from the
were excepted from discharge. Additionally, the court concluded that Deborah Lau knowingly participated in her
made by John Lau were debts for both fraud and defalcation by John Lau while acting in a fiduciary capacity and as such
designated for investment in the Melissa Property and the amounts provided by the plaintiffs pursuant to the capital calls
in favor of a heightened culpability standard requiring "'knowledge of, or gross recklessness in respect to, the improper
523(a)(4) of the Bankruptcy Code, the United States Supreme Court recently rejected an objective recklessness standard
managing member of the managing general partner. The court noted that, for purposes of a "defalcation" under Section
that John Lau stood in a fiduciary relationship with Melissa Fourteen, Ltd. and its limited partners because he was the
trust'' and that the general partner's fiduciary duty also encompasses "a duty of full disclosure of all matters affecting
partnership ‘‘stands in the same fiduciary capacity to the limited partners as a trustee stands to the beneficiaries of a
best interest of the partnership.'’ The court further stated that the general partner acting in complete control of a limited


The debtors, John and Deborah Lau, were in the real estate business, and the plaintiffs sought a determination
that the Laus’ debts for the plaintiffs’ losses in real estate ventures managed by the Laus were nondischargeable on
various grounds, including as debts arising from fraud or defalcation in a fiduciary capacity. The plaintiffs’ claims
related to their investments in the acquisition of a tract of land in Melissa, Texas (the "Melissa Property") and the
development of another tract of land in Texas. John Lau, as managing member of JNC Partners, LLC (“JNC”), accepted
$600,000 from the plaintiffs and agreed to hold the funds until it was determined how to allocate and apply the funds
between the Melissa Property and the other project. Deborah Lau was also a manager of JNC and was active in its
business operations. Once it was determined how much the plaintiffs were investing in each property, Melissa Fourteen,
Ltd., a limited partnership, was formed for the acquisition of the Melissa Property. JNC became the general partner of
the limited partnership, and the plaintiffs became limited partners. The limited partnership agreement provided that title
to the Melissa Property would be taken in the limited partnership, but John Lau, as managing member of JNC, acquired
the Melissa Property in the name of JNC. Deborah Lau executed the closing documents as attorney-in-fact for John Lau,
both in his individual and managerial capacities. Thus, contrary to John Lau’s representations to the plaintiffs and the
terms of the limited partnership agreement, the Melissa Property was not acquired by the limited partnership, nor did JNC
ever convey the Melissa Property to the limited partnership. Thereafter, John Lau, as managing member of the managing
general partner of the limited partnership, issued capital calls to the plaintiffs based on false representations regarding
the partnership and its financial needs. The capital infusions were diverted by John Lau for his own business purposes
and those of JNC. JNC eventually sold the Melissa Property and satisfied JNC’s indebtedness and that of the Laus on
their guaranties. The plaintiffs received no return on their investments in the Melissa Property.

The court discussed the fiduciary duty of a general partner to the limited partnership and its limited partners
under Texas law, relying on opinions of Texas courts of appeals and federal courts applying Texas law. The court
characterized the fiduciary duty of the general partner to the limited partners as “the highest of fiduciary duties” and
stated that “‘managing partners owe trust obligations to the partnership, having a duty of loyalty and due care as well as
being under an obligation to discharge their duties in good faith and in the reasonable belief that they are acting in the
best interest of the partnership.’” The court further stated that the general partner acting in complete control of a limited
partnership “‘stands in the same fiduciary capacity to the limited partners as a trustee stands to the beneficiaries of a
trust’” and that the general partner’s fiduciary duty also encompasses “‘a duty of full disclosure of all matters affecting
the partnership.’” The court went on to address fiduciary duties in a “two-tiered partnership arrangement,” concluding
that John Lau stood in a fiduciary relationship with Melissa Fourteen, Ltd. and its limited partners because he was the
managing member of the managing general partner. The court noted that, for purposes of a “defalcation” under Section
523(a)(4) of the Bankruptcy Code, the United States Supreme Court recently rejected an objective recklessness standard
in favor of a heightened culpability standard requiring “‘knowledge of, or gross recklessness in respect to, the improper
nature of the relevant fiduciary behavior.’” The court concluded that the amount of the plaintiffs’ initial investment
designated for investment in the Melissa Property and the amounts provided by the plaintiffs pursuant to the capital calls
made by John Lau were debts for both fraud and defalcation by John Lau while acting in a fiduciary capacity and as such
were excepted from discharge. Additionally, the court concluded that Deborah Lau knowingly participated in her
husband’s breach of fiduciary duty and ratified the breach of duty by knowingly accepting the benefits derived from the
breach. Thus, Deborah Lau’s liability for these debts was excepted from discharge as well.
The trustee of a limited partnership’s bankruptcy estate sued Michael Manners, an individual, and his affiliated companies for breach of fiduciary duty, conspiracy to breach fiduciary duty, and aiding breach of fiduciary duty in connection with the buyout of Manners’ limited partnership interest by the other partner. In 1998, Manners, the founder and CEO of the limited partnership’s business, sold 50% of the equity to John Speer and retained a 50% interest as a limited partner through a corporation. An entity owned by Speer became the 1% general partner, and another Speer entity became a 49% limited partner. The partners entered into an amended and restated limited partnership agreement in connection with this transaction in 1998. In 2006, Speer bought out the remaining 50% owned by Manners, and Manners became “Chairman Emeritus” of the limited partnership. The trustee alleged that Manners and Speer devised a scheme to take money out of the limited partnership to finance Speer’s 2006 buyout of Manners without reflecting a loss in equity on the partnership’s balance sheet. The trustee also argued that Manners breached the duties of loyalty and care owed as a limited partner by selling his ownership in the limited partnership to Speer. The trustee relied on Delaware case law stating that the statute literally prevents creditors, the right to sue on behalf of the partnership. The statute gives a limited partner the right to bring a derivative suit if the general partner refuses to do so, and the court noted Delaware Revised Limited Partnership Act gives only the general partner the power and control typically associated with the title, and there was no summary judgment evidence showing that Manners acted on behalf of the limited partnership’s property or actively managed the limited partnership as Chairman Emeritus. The court stated that a title does not give rise to fiduciary duties without a showing of the possession or use of power and control typically associated with the title, and there was no summary judgment evidence showing that Manners acted on behalf of the limited partnership, held property for its benefit, or exercised control over its governance as Chairman Emeritus.

The court concluded that Manners did not owe the limited partnership any fiduciary duty under Delaware law because he was a passive limited partner, and the position of Chairman Emeritus did not involve the exercise of discretionary authority or active management of the limited partnership. As a limited partner, Manners owed no default fiduciary duties to the partnership because the limited partnership agreement expressly granted the general partner and its president, Speer, the control that gives rise to fiduciary duties, and expressly precluded limited partners from participating in the management and control of the business. The court stated that the trustee was correct in arguing that Manners could nonetheless have fiduciary obligations if he undertook an active role in the limited partnership, but the court rejected the argument that attending meetings with upper management and having access to records evidenced control over the limited partnership or its property. The court also rejected the argument that the salaried role of “Chairman Emeritus” gave rise to fiduciary obligations. The court acknowledged the trustee’s argument that an individual may have fiduciary obligations based on traditional agency principles, but the evidence that Manners received a salary, medical benefits, a car, and an expense account was not evidence that Manners exercised control over the limited partnership’s property or actively managed the limited partnership as Chairman Emeritus. The court stated that a title does not give rise to a fiduciary duty without a showing of the possession or use of power and control typically associated with the title, and there was no summary judgment evidence showing that Manners acted on behalf of the limited partnership, held property for its benefit, or exercised control over its governance as Chairman Emeritus.

The court discussed allegations that Speers as well as Manners owed fiduciary obligations to the partnership and noted that the trustee did not allege that Manners or Speers were fiduciaries as to the partnership’s creditors. The court stated that if Manners had discretionary control over the limited partnership, any resulting fiduciary duties would run to Speer as the only other partner, and the Delaware Revised Limited Partnership Act gives only the general partner the right to sue on behalf of the partnership. The statute gives a limited partner the right to bring a derivative suit if the general partner refuses to do so, and the court noted Delaware case law stating that the statute literally prevents creditors, or anyone else other than a partner, from suing on behalf of the partnership. The court stated that to the extent the trustee sued on the partnership’s behalf, he lacked derivative standing. In addition, the court stated that the trustee appeared to be suing Manners for breaching a fiduciary duty he owed to Speer by negotiating and entering into an arms-length transaction with Speer. The court stated that the trustee “provided no legal support for the proposition that a contract
executed knowingly and voluntarily between a partnership’s equity owners could be the basis for the partnership to sue for breach of a fiduciary duty the equity owners owed to the partnership.”

With respect to the trustee’s claim that Manners conspired with Speer to breach Speer’s fiduciary duty, the court stated that whether Speer breached a fiduciary duty to the limited partnership was a question of Delaware law while the question of whether Manners conspired to breach that duty was a question of Texas law. Speers was the president and CEO of the limited partnership and sole director, sole shareholder, and president of the corporate general partner; thus, Speer owed fiduciary duties to the limited partnership’s partners. To support an inference of liability on the part of Manners for aiding Speer in a breach of fiduciary duty, the court had to show an actionable breach by Speers and that Manners was aware he was participating in the breach. The court said that the trustee’s conspiracy claim appeared to consist of either (1) suing Manners on behalf of Manners for the role Manners played in helping Speer breach fiduciary duties that Speers owed to Manners, or (2) suing Manners on Speer’s behalf for the transaction that Speers negotiated for his own benefit. The court stated that the trustee cited no legal support for the proposition that a partnership’s bankruptcy trustee may sue the only two partners for breaching fiduciary duties that they owed to each other by agreeing to an arm’s-length transaction with disclosed terms. The trustee also argued that Manners conspired to breach the fiduciary duties Speer owed the limited partnership after the 2006 buyout, but the court stated that Delaware law is clear that a company’s sole owner cannot breach fiduciary duties owed to his wholly owned company. The court stated that the trustee cited no authority for the proposition that a non-owner can be liable for conspiring with the sole owner of a partnership for breaching duties that the owner owes himself. According to the court, “Whatever might be said about Speer’s questionable distributions and loan payments, [the trustee] has not pointed to summary-judgment evidence of, or a legal basis for, finding that the buyout and related distributions gave rise to a breach of fiduciary duty. Speer owed a fiduciary duty to Manners when he was a limited partner, before 2006. After 2006, Speer was effectively the sole owner and partner of [the limited partnership].”


A state district court in Harris County entered a summary judgment against Wyckoff in her suit against Buggs. The judgment awarded Buggs damages and ordered that KLAR Collections, L.P. (“KLAR”) be wound up and terminated. KLAR had inventory, fixtures, and other assets, and Wyckoff transferred KLAR’s assets to an entity of which Wyckoff was the sole shareholder and used them in her business, claiming she had never been in partnership with Buggs. Buggs filed an adversary proceeding in Wyckoff’s bankruptcy, seeking an exception to discharge. Wyckoff sought summary judgment on Buggs’ claim for exception to discharge. The court stated that the state court’s order established the existence of a partnership regardless of Wyckoff’s belief, and she had a duty to comply with the order. Wyckoff offered no explanation of why her disposition of the assets was not a defalcation. The court held that there was at least a genuine issue of fact regarding whether Wyckoff’s failure to comply with the state court’s order was a defalcation of Wyckoff’s fiduciary duty.


The Douglasses alleged mismanagement and fraud by John Beakley and related entities in connection with the investment of their funds. According to the Douglasses’ complaint, John Beakley convinced them to allow Beakley, through Beakley & Associates, P.C. (“BAPC”), to serve as their investment advisor, and BAPC set up various limited partnerships of which FLP Management, Inc. (“FLP”) was the managing general partner. The Douglasses alleged that Beakley convinced them that BAPC would be best able to manage their money because of their longstanding church, familial, and accounting relationship and that he would assure that their financial interests were protected. The Douglasses provided funds that were invested by BAPC and FLP in limited partnerships at least partly owned by Beakley and his family, and the Douglasses alleged various acts of mismanagement and wrongdoing. At the time of this opinion, the claims against John Beakley and one of the entity defendants had been severed pursuant to their bankruptcy filings, and the plaintiffs had restricted most of their claims to BAPC and FLP, alleging that Beakley acted through or on behalf of these two entities in his capacity as partner, officer, authorized agent, vice-principal, or employee. The court recognized that a principal may be vicariously liable for conduct of its agent if the agent acted with actual or apparent authority or if the principal ratified the conduct and, without deciding whether Beakley in fact acted with actual or apparent authority or whether the principal ratified his conduct, the court declined to dismiss the amended complaint as to the Beakley entities for failure to plead that they were vicariously liable for Beakley’s actions. With respect to the breach of fiduciary duty claims, the court pointed out that Texas recognizes two types of fiduciary duties: formal (arising as a matter of law in relationships such as attorney and client, principal and agent, partners, and joint venturers) and informal (where there is a close personal relationship of trust and confidence). The court concluded that the amended complaint alleged both an informal fiduciary relationship between the Douglasses and Beakley and a formal relationship...
between the Douglasses and BAPC and FLP, either as principal and agent or partners. Further, the amended complaint alleged that BAPC and FLP failed to make proper disclosures, improperly commingled funds, and charged the Douglasses excessive fees that harmed the Douglasses and enriched the defendants. Thus, the complaint overall stated a claim for breach of fiduciary duty.

_George, Leick, and Wilmer were the limited partners of a limited partnership formed to sell insurance. The limited partners were also the shareholders of the corporate general partner. The partnership agreement contained provisions regarding voluntary or involuntary termination of a limited partner’s association with the partnership. If the termination was voluntary, the agreement required the departing partner to sell his or her interest to the partnership or other partners according to a prescribed formula. If the termination was involuntary, the departing partner relinquished his or her interest in the partnership on the day of departure, and no payment to the departing partner was required. However, the remaining partners could determine that a payment would be made to an involuntarily terminated partner._

_George and Wilmer decided to terminate Leick’s association with the partnership on October 3, 2008, for a variety of reasons including Leick’s lack of business production. After informing Leick that they were terminating him as a partner, they changed bank signature cards for the partnership and removed all partnership financial records from Leick’s possession. George and Wilmer allowed Leick to return to the office on October 6 and 7 to tie up loose ends. On October 13, the remaining partners offered Leick the amount of money they believed he would be entitled to if he were voluntarily terminating his association with the partnership. Leick rejected the amount and insisted George and Wilmer had miscalculated such that he would be owed a larger amount as a voluntarily terminated partner. On October 17, the remaining partners responded through their attorney that Leick was not entitled to any amount under the agreement as an involuntarily terminated partner. At that time, the remaining partners made another offer to Leick in an amount somewhat less than the original offer and stated that the offer would be reduced further if the matter proceeded. On November 12, 2008, the partnership and the remaining partners filed suit against Leick seeking a declaratory judgment that Leick was involuntarily terminated and that the plaintiffs were not required to make any payment to Leick. Leick answered and filed counterclaims for breach of contract and breach of fiduciary duty. At trial, the court granted the plaintiffs’ motion for directed verdict on Leick’s cause of action for breach of fiduciary duty. The jury found that Leick did not voluntarily terminate his status as a partner before the plaintiffs involuntarily terminated him and that the plaintiffs complied with the agreement when involuntarily terminating Leick. The jury also found that the plaintiffs should have paid Leick the amount of the original offer as an involuntarily terminated partner. The trial court entered judgment awarding Leick damages and attorney’s fees._

On appeal, the plaintiffs argued that the trial court erred when submitting the jury question inquiring as to what amount should have been paid to Leick as an involuntarily terminated partner. The plaintiffs complained that this question improperly included an implied covenant of fair dealing in the partnership agreement by instructing the jury that “the remaining partners were obligated to act fairly and reasonably toward the involuntarily terminated partner” when the partners were deciding whether and what amount Leick should have been paid as an involuntarily terminated partner. The appellate court agreed that an implied covenant was inserted into the partnership agreement by this instruction and explained that implied covenants are not favored in Texas law. The court stated that a court will not imply a covenant simply to make a contract “‘fair, wise, or just’” and that it must be apparent from the written terms of an agreement that the implied covenant was so clearly within the contemplation of the parties that they deemed it unnecessary to express it. Leick argued that the instruction that the remaining partners were obligated to act fairly and reasonably toward an involuntarily terminated partner was proper because it set forth the law governing relations between partners in effect at the time of the contract and was thus incorporated into the contract. Leick pointed to the Texas Revised Partnership Act (TRPA) and Texas common law regarding the relationship between partners. The court acknowledged that TRPA provides that a partner is obligated to act reasonably and in good faith and owes the other partners and the partnership duties of loyalty and care, but the court stated that the plaintiffs did not owe Leick these duties because he was no longer a partner after he was terminated and departed from the partnership. According to the court, there was no evidence that Leick remained a partner after October 14, 2008, and the plaintiffs did not have the heightened duty toward Leick set forth in TRPA or the common law after that date. The court stated that any negotiations regarding payment to Leick prior to his involuntary termination no longer mattered because the plaintiffs owed him nothing under the partnership agreement or the law cited by Leick once he was involuntarily terminated and departed. Thus, the trial court erred in imposing a duty to act fairly and reasonably in determining whether and what amount to pay Leick as an involuntarily terminated partner. Without the court-imposed duty of acting fairly and reasonably toward Leick, the only amount Leick was required to be paid was any amount the partners desired to pay Leick, and it was undisputed that they desired to pay nothing. The trial court should have disregarded the jury’s answer to this issue since the amount to be paid was entirely...
in the plaintiffs’ discretion, and the appellate court reversed and rendered a take-nothing judgment on Leick’s breach of contract claim.

Leick claimed on appeal that the trial court erred in granting the plaintiffs’ motion for directed verdict on his cause of action for breach of fiduciary duty. The court stated in a footnote that Texas law is not clear as to whether limited partners owe each other fiduciary duties, and the court made no determination in this case whether the limited partners owed each other fiduciary duties. Assuming the plaintiffs owed a duty to Leick while he was a partner, they owed him no fiduciary duty after he ceased to be a partner. The partnership agreement made clear that Leick relinquished his partnership interest when he was terminated and departed, which the evidence showed occurred at the latest on October 14, 2008. Thus, the plaintiffs owed no fiduciary duty to Leick as a partner from that date on. Leick alleged that the plaintiffs breached their fiduciary duties by failing to pay fair value for his partnership interest, but the court explained that when the plaintiffs filed suit on November 12, 2008, seeking a declaration that no required payment existed under the agreement, Leick was no longer a partner, and the plaintiffs thus had no fiduciary duty toward Leick as a partner when they decided to make no payments to him. Leick argued that he presented evidence that Wilmer and George secretly conspired to terminate his partnership interest by involuntarily terminating him, that they failed to negotiate in good faith with him about the value of his interest, and that they funded the lawsuit with money Leick otherwise would have received from his interest in the partnership. The court stated that George and Wilmer had no fiduciary duty to remain partners with Leick, so the involuntary termination in compliance with the agreement in and of itself could not constitute a breach of fiduciary duty by the plaintiffs. As to Leick’s contention that the plaintiffs violated their fiduciary duty to him when they continued to decrease their offered payment, the court again disagreed with Leick because he was no longer a partner as of October 14, 2008, and the plaintiffs’ actions did not violate any fiduciary duty to Leick as a partner after that date. To the extent the offer of payment made on October 13 might have occurred before the involuntary termination and might have breached a fiduciary duty to Leick, the court stated that any such breach could not have caused Leick damages because he was thereafter involuntarily terminated, relinquished his partnership interest, and was not entitled to any payment under the agreement. Finally, with respect to Leick’s claim that the plaintiffs breached their fiduciary duty by funding the lawsuit against him with profits Leick would have otherwise received, the court stated that Leick was no longer a partner and had relinquished his partnership interest when the lawsuit was filed. Thus, Leick would not have been entitled to the profits paid to the attorney in any event.


The plaintiffs in this case were limited partners of a hedge fund organized as a Delaware limited partnership. The plaintiffs’ suit arose out of the total loss of their investments in the hedge fund, but the plaintiffs did not sue the primary actors. The plaintiffs sued The Perot Family Trust, Hill Air Company I, L.L.C. (d/b/a Perot Investments), and Petrus Securities, L.P. (collectively, “the Perot Entities”) and two individuals, Blasnik and Karmin, who were employed by the hedge fund’s general partner (and also held positions in various other non-defendant entities and the Perot Entities). The plaintiffs alleged that the defendants owed fiduciary duties to the hedge fund and the limited partners by virtue of control over the hedge fund and its general partner. The plaintiffs alleged breach of fiduciary duty claims based on mismanagement, misrepresentations, and nondisclosure by the defendants. The plaintiffs also alleged aiding and abetting and vicarious liability for breach of fiduciary duty on the part of certain defendants. In a previous opinion, the court dismissed the plaintiff’s claims subject to an opportunity to replead. This opinion addressed motions to dismiss filed by the Perot Entities and the two individual defendants after the plaintiffs amended their complaint.

The alleged liability of Perot Investments for breach of fiduciary duty was based on allegations that Perot Investments benefitted itself at the expense of the hedge fund and the limited partners by mismanaging the assets of the hedge fund and misrepresenting and concealing the trading positions of the foreign fund through which the hedge fund invested. To pursue a breach of fiduciary duty claim against Perot Investments under Delaware law (i.e., under In re USA Cafes, L.P. Litigation and its progeny), the plaintiffs had to allege specific facts that support a reasonable inference that Perot Investments exercised control over the hedge fund in connection with the alleged mismanagement and misrepresentations to benefit itself at the limited partnership’s expense. The court held in its previous opinion that allegations that Perot Investments provided “management services” to the general partner of the hedge fund were insufficient to demonstrate control, and the amended complaint was similarly deficient to the extent the plaintiffs relied on the rendering of such services. The plaintiffs tried to cure the deficiency by pointing to statements made in the hedge fund’s marketing materials, private placement memoranda, and due diligence questionnaires, but the court concluded the pleadings still fell short. Also, the plaintiffs attempted to plead that Perot Investments exercised control over the hedge fund through H. Ross Perot, Sr., but the plaintiffs failed to show that Mr. Perot was acting as an agent for Perot Investments when he allegedly reviewed, oversaw, and approved the hedge fund’s strategies and decisions. Because the plaintiffs failed to allege sufficient facts to support a reasonable inference that Perot Investments exercised direct or
indirect control over the hedge fund, Perot Investments could not be liable for breach of fiduciary duty, and the claims against it were dismissed.

With respect to the alleged liability of The Perot Family Trust for breach of fiduciary duty by mismanaging the assets of the hedge fund and misrepresenting and concealing the foreign fund’s trading positions, the court stated that Texas law is not as well-developed as Delaware law in this area, but that Texas law (i.e., In re Bennett and cases discussed therein, as well as In re Harwood) also focuses on the exercise of control, rather than mere ownership or ability to control, in assessing whether affiliates of general partners owe fiduciary duties. Thus the allegation of The Perot Family Trust’s ownership of the general partner alone was not sufficient to demonstrate control. The plaintiffs also pointed to statements in the hedge fund’s private placement memorandum and a securities filing by a non-defendant entity, but the court concluded that the statements were not sufficient to show The Perot Family Trust exercised control over the hedge fund in connection with the alleged mismanagement and misrepresentations. Finally, the plaintiffs did not plead facts sufficient to show Mr. Perot acted on behalf of The Perot Family Trust when allegedly exercising control over the hedge fund’s activities. Thus, the claims against The Perot Family Trust were dismissed.

The individual defendants, Blasnik and Karmin, by virtue of their positions with the general partner of the hedge fund, had a fiduciary duty under In re USA C afes and its progeny not to act to benefit themselves at the expense of the hedge fund or its limited partners. The plaintiffs alleged that Blasnik and Karmin mismanaged the assets of the hedge fund and the foreign fund through which it invested by engaging in risky trading to generate more fees for themselves, but the court concluded that the plaintiffs failed to allege sufficient facts to support a reasonable inference that Blasnik and Karmin exercised control over the hedge fund to benefit themselves at the hedge fund’s expense. Thus, the mismanagement breach of fiduciary duty claim did not survive. The plaintiffs did succeed, however, in alleging sufficient facts to state a plausible claim for misrepresentation/nondisclosure by Blasnik and Karmin so as to be able to proceed with a so-called “holder claim” under Delaware law. Blasnik and Karmin argued that an unjust enrichment claim for disgorgement of the management and incentive fees paid to Blasnik and Karmin was unavailable to the plaintiffs because the limited partnership agreement governed the relationship of the parties and a party ordinarily cannot recover for unjust enrichment when a contract governs the relationship. Although the court acknowledged that a limited partnership agreement is a “contract” under Delaware law, the court could not rule out the possibility that the plaintiffs could not succeed on an unjust enrichment claim against Blasnik and Karmin based on a breach of their fiduciary duty of loyalty by misrepresentation/nondisclosure.

The court dismissed claims against the Perot Entities for aiding and abetting breaches of fiduciary duty committed by the individual defendants because the amended complaint did not allege facts sufficient to support an inference that the entities knowingly participated in the individuals’ breach of fiduciary duties as required under both Texas and Delaware law. Allegations regarding the involvement of Mr. Perot were insufficient because the pleadings did not contain facts sufficient to infer that Mr. Perot was acting on behalf of any of the Perot Entities in conducting the alleged activities. The court concluded that the allegations in the amended complaint were sufficient to support an inference that Karmin knowingly participated in Basnik’s breach of fiduciary duty by misrepresentation/nondisclosure, so the plaintiffs were allowed to proceed on the alternative aiding and abetting theory of liability as to Karmin.

Finally, the court concluded that the pleadings regarding vicarious liability of the Perot Entities for breach of fiduciary duty liability based on the acts of Blasnik and Karmin suffered from the same deficiencies identified in the court’s previous opinion. Because the allegations regarding the capacity in which the individuals were acting and the nature of their activities as within the scope of employment were conclusory and lacked specificity, the vicarious liability claims were dismissed.


This case involved a dispute over whether a former limited partner breached his fiduciary duty to the limited partnership and whether he breached the limited partnership agreement. Jiles Daniels and Judith Daniels married in 1997 and formed a number of business entities in 2000 to construct and manage apartment complexes near Prairie View A&M University. The couple formed Empty Eye, Inc., and the corporation, Jiles, and Judith signed a limited partnership agreement to form Empty Eye & Associates, L.P. Jiles and Judith each owned half of the shares of the corporation and were corporate officers. The corporation owned one percent of the limited partnership and served as its general partner, and Jiles and Judith were the limited partners. The entities built two complexes and planned to build a third called the “Cochran Project” in 2005. The partnership bought land and obtained financing from a bank. Pursuant to the loan agreement, Jiles and Judith both signed a personal guaranty of the partnership’s indebtedness, but each guaranty could be rescinded if no funds had been advanced. The partnership entered into contracts with contractors for work by the fall of 2006, but Jiles and Judith had begun having marital difficulties. In December 2006, Jiles filed for divorce. The bank had not advanced any funds on the Cochran Project at that point. In January 2007, Jiles informed Judith he did not want
In 2002, Lew Anderton and William Cawley formed two partnerships for the purpose of acquiring and developing land. Cascades Properties, Ltd. (“Cascades Ltd.”) was formed to develop the land that would form a business partner. Also, Jiles and Judith used the partnership to buy, develop, and manage real estate for rental purposes but evidence showed that Jiles participated in developing the partnership’s business plan, and Judith trusted him as a trusted Jiles to act in its best interest such that Jiles owed a fiduciary duty to the corporation as its president and to Judith as his spouse. The court found there was evidence from which the jury could properly find that the partnership justifiably trusted Jiles to act in its best interest such that Jiles owed a fiduciary duty to the partnership. The facts were disputed, but evidence showed that Jiles participated in developing the partnership’s business plan, and Judith trusted him as a business partner. Also, Jiles and Judith used the partnership to buy, develop, and manage real estate for rental purposes and also for building and buying their residence. Jiles and Judith personally guaranteed payment of the partnership’s debt to commercial lenders even though they were limited partners and thus not obligated to do so. The court found that, viewed in the light most favorable to the jury verdict, the evidence was legally sufficient to support the jury finding that Jiles had a fiduciary relationship with the partnership. Thus, the appellate court overruled Jiles’s argument that he did not owe the partnership a fiduciary duty which could form the basis of a claim for breach of fiduciary duty and affirmed the portion of the trial court’s ruling that awarded damages to the partnership for Jiles’s breach of fiduciary duty. Next, Jiles maintained that the trial court erred in awarding damages for breach of contract because the evidence was insufficient to support the finding that he breached the agreement. The court examined the written agreement and agreed with Jiles. Nothing in the agreement required Jiles to guarantee the partnership’s debts or restricted his right to rescind a guaranty given. In addition, no request for a guaranty was made by the general partner in writing as required by the agreement, and there was no evidence of a call for capital contributions for which the guaranty by Jiles could have been indirectly or remotely made. Most importantly, the terms of the agreement allowed Jiles to rescind the guaranty if no funds had been advanced, which were the circumstances present. Rescinding the guaranty was not evidence that Jiles breached the agreement. The appellate court reversed the trial court’s ruling on the claim for breach of contract holding that the evidence was legally insufficient to support the jury’s finding that Jiles breached the agreement.

In a dissenting opinion, one justice maintained that the evidence was legally insufficient to support the holding that Jiles owed the partnership a fiduciary duty. The dissent disagreed with imposing an informal fiduciary duty on a limited partner based on the formal fiduciary duties the limited partner owed to Judith and the corporation, the other two parties involved in the business transaction at issue. In a lengthy examination of historical case law regarding fiduciary duties, the dissent argued that the “combination of relationships” analysis endorsed by the majority resulted in “fiduciary duty by association,” disregarded the status of the limited partnership as a separate legal person, and was contrary to Texas law. Because no party pled or proved a theory to disregard the distinction between legal persons, evidence of Jiles’s relationship with and duties to Judith and the corporation was not evidence regarding Jiles’s relationship with and duties to the partnership. The dissenting justice would have reversed the trial court’s judgment and rendered a take-nothing verdict in favor of Jiles holding that Jiles owed no fiduciary duty to the partnership. The dissent agreed with the majority that Jiles did not breach the agreement.


In 2002, Lew Anderton and William Cawley formed two partnerships for the purpose of acquiring and developing land. The jury found that Jiles breached his fiduciary duty to the partnership and the corporation and awarded damages on that basis. The jury also found that Jiles breached the limited partnership agreement and awarded the plaintiffs damages for breach of contract. The trial court rendered judgment that Jiles breached his fiduciary duty to the partnership and awarded damages to the partnership on the claim. The trial court also rendered judgment that Jiles breached the partnership agreement and awarded Judith and the corporation damages for breach of contract. Jiles appealed.

On appeal, Jiles argued that the evidence was legally insufficient to support the finding that he owed a fiduciary duty to the partnership and that he breached the partnership agreement. First, Jiles alleged that he owed no fiduciary duty to the partnership and that the evidence was thus insufficient to show that he breached such a duty. The court of appeals explained that a fiduciary is a person who occupies a position of peculiar confidence towards another, and formal and informal fiduciary relationships are possible. If a business transaction is involved, a special relationship of trust and confidence (i.e., a fiduciary relationship) must exist prior to and apart from the agreement that is the basis of the suit. Jiles did not object to the jury charge, so that was the standard by which the appellate court measured the sufficiency of the evidence. The question regarding the existence of a fiduciary relationship between Jiles and the partnership was accompanied by instructions regarding fiduciary relationships and the fact that a limited partner did not owe a fiduciary duty to a limited partnership or another limited partner simply because of the status as a limited partner. The court analyzed the evidence and stated that before the Cochran Project began, Jiles owed a fiduciary duty to every other member of the partnership. That is, he owed a fiduciary duty to the corporation as its president and to Judith as his spouse. The court found there was evidence from which the jury could properly find that the partnership justifiably trusted Jiles to act in its best interest such that Jiles owed a fiduciary duty to the partnership. The facts were disputed, but evidence showed that Jiles participated in developing the partnership’s business plan, and Judith trusted him as a business partner. Also, Jiles and Judith used the partnership to buy, develop, and manage real estate for rental purposes and also for building and buying their residence. Jiles and Judith personally guaranteed payment of the partnership’s debt to commercial lenders even though they were limited partners and thus not obligated to do so. The court found that, viewed in the light most favorable to the jury verdict, the evidence was legally sufficient to support the jury finding that Jiles had a fiduciary relationship with the partnership. Thus, the appellate court overruled Jiles’s argument that he did not owe the partnership a fiduciary duty which could form the basis of a claim for breach of fiduciary duty and affirmed the portion of the trial court’s ruling that awarded damages to the partnership for Jiles’s breach of fiduciary duty. Next, Jiles maintained that the trial court erred in awarding damages for breach of contract because the evidence was insufficient to support the finding that he breached the agreement. The court examined the written agreement and agreed with Jiles. Nothing in the agreement required Jiles to guarantee the partnership’s debts or restricted his right to rescind a guaranty given. In addition, no request for a guaranty was made by the general partner in writing as required by the agreement, and there was no evidence of a call for capital contributions for which the guaranty by Jiles could have been indirectly or remotely made. Most importantly, the terms of the agreement allowed Jiles to rescind the guaranty if no funds had been advanced, which were the circumstances present. Rescinding the guaranty was not evidence that Jiles breached the agreement. The appellate court reversed the trial court’s ruling on the claim for breach of contract holding that the evidence was legally insufficient to support the jury’s finding that Jiles breached the agreement.

In a dissenting opinion, one justice maintained that the evidence was legally insufficient to support the holding that Jiles owed the partnership a fiduciary duty. The dissent disagreed with imposing an informal fiduciary duty on a limited partner based on the formal fiduciary duties the limited partner owed to Judith and the corporation, the other two parties involved in the business transaction at issue. In a lengthy examination of historical case law regarding fiduciary duties, the dissent argued that the “combination of relationships” analysis endorsed by the majority resulted in “fiduciary duty by association,” disregarded the status of the limited partnership as a separate legal person, and was contrary to Texas law. Because no party pled or proved a theory to disregard the distinction between legal persons, evidence of Jiles’s relationship with and duties to Judith and the corporation was not evidence regarding Jiles’s relationship with and duties to the partnership. The dissenting justice would have reversed the trial court’s judgment and rendered a take-nothing verdict in favor of Jiles holding that Jiles owed no fiduciary duty to the partnership. The dissent agreed with the majority that Jiles did not breach the agreement.


In 2002, Lew Anderton and William Cawley formed two partnerships for the purpose of acquiring and developing land. Cascades Properties, Ltd. (“Cascades Ltd.”) was formed to develop the land that would form a
residential development, and Bellwood Lake Partnership, Ltd. (“Bellwood Ltd.”) was formed to acquire and improve an adjoining existing golf course. During the development, Cascades Ltd. borrowed funds from Park Cities Bank (the “Bank”), where Cawley was a shareholder, director, and member of the loan committee. Anderson consented to the loans from the Bank. Bellwood Ltd. also borrowed money from the Bank to fund the development project with Anderton’s consent. Both partners made unsuccessful attempts to buy each other out as the project continued and expenses increased. Various entities became involved as the partnership attempted to secure funding for the development. Cawley-PB Funding, LP (“Cawley-PB Funding”), an entity owned by Cawley, loaned the partnerships money for the developments. Disputes arose, Anderton filed suit in May 2008, and Anderton resigned from his position as the principal of the general partner of the two partnerships in June 2008. Cawley-Cascade GP, LLC (“Cawley-Cascade”), which was controlled by Cawley, became the general partner of Cascades Ltd. Cawley and Anderton executed a letter agreement in September 2008 that contemplated a future settlement agreement to resolve their disputes and included a covenant by Anderton not to sue for future transactions in which Cawley or his affiliates acquired Cascade Ltd.’s debt. Cawley-PB Funding acquired Cascades Ltd.’s debt and made a capital call on the partners of Cascade Ltd., but no contributions were made. In February 2009, Cawley-PB Funding gave Cascades Ltd. notice of default and acceleration of the debt. Cawley-PB Funding instigated a foreclosure sale, and in June 2009 it purchased the property by bidding the amount of the outstanding debt on the loan. Cascades Ltd. was thus divested of all its assets, destroying the value of Anderton’s interest in that partnership. Anderton asserted numerous theories of liability against Cawley and other defendants, including breach of fiduciary duty and aiding and abetting breach of fiduciary duty. Anderton also alleged that Cawley and the Bank conspired to allow a Cawley-controlled entity called BOT Real Estate, LLC (“BOT”) to acquire the Bellwood Ltd. property after a supposed failure of Bellwood Ltd. to pay property taxes which in actuality had been paid by the Bank. BOT argued a counterclaim against Anderton on his guaranty of the Bellwood Ltd. loan seeking to recover the amount of the deficiency remaining after BOT foreclosed on Bellwood Ltd.’s property. The defendants filed motions for summary judgment. As to the claims for breach of fiduciary duty, the trial court granted summary judgment in favor of the defendants and ordered Anderton take nothing on his claims. The trial court further awarded BOT damages against Anderton based on his personal guaranty of the Bellwood Ltd. loan. Anderton appealed. On appeal, Anderton raised evidence that Bellwood Ltd. was not in default on its loan when BOT foreclosed on the partnership’s property because BOT had secretly transferred funds to the Bank sufficient to pay Bellwood Ltd.’s property taxes, thereby curing the partnership’s default. The court of appeals found there was a genuine issue of material fact as to whether BOT’s payment cured Bellwood Ltd.’s default so as to affect whether Anderton was liable after foreclosure based on his personal guaranty of the loan. Thus, the trial court erred in granting summary judgment in favor of BOT on its counterclaim against Anderton. Next, Anderton argued that the trial court erred in granting summary judgment in favor of the defendants on Anderton’s claims for breach of fiduciary duty and aiding and abetting breach of fiduciary duty. The elements of a claim for breach of fiduciary duty are: (1) a fiduciary relationship existed between the plaintiff and defendant; (2) the defendant breached its fiduciary duty to the plaintiff; and (3) the defendant’s breach resulted in injury to the plaintiff or benefit to the defendant. The defendants claimed Anderton produced no evidence of the second and third elements. The court disagreed and concluded that Anderton provided enough evidence to raise a genuine fact issue as to breach. A sworn affidavit by Anderton supported his claim that Cawley obtained control of Cascades Ltd., caused the partnership to default on loans owed to an entity controlled by Cawley, and foreclosed on the partnership’s assets to take those assets for himself and destroy the value of Anderton’s partnership interest. In doing so, the defendants relied on an outstanding loan of $14 million to acquire property that had been appraised for over $76 million less than two years earlier. The court explained that a reasonable and fair-minded juror could differ as to whether the defendants breached their fiduciary duty to Anderton because a juror could conclude that the defendants did not make reasonable use of the confidence Anderton placed in them as his partners and that Cawley benefitted at the expense of his partner Anderton. The evidence also showed the defendants diverted Cascade Ltd.’s revenues from debt services to expenses so as to cause a default and thereby destroy the value of Anderton’s partnership interest, which was conduct unfair and inequitable to Anderton. In addition, the defendants’ conduct was done in secrecy, and Cawley failed to disclose to Anderton that the property taxes had been paid so as to prevent Anderton from taking any action to protect his interests. The court held that summary judgment in favor of the defendants on Anderton’s claim for breach of fiduciary duty could not be sustained on the element of breach because there was evidence that the defendants deliberately and unfairly managed the partnership so as to cause a default and foreclosure to the defendants’ ultimate benefit and Anderton’s detriment. Furthermore, the court held that the evidence raised a genuine issue of material fact as to the third element of Anderton’s claim for breach of fiduciary duty because a reasonable and fair-minded jury could find, as discussed previously, that the defendants’ actions harmed the value of Anderton’s partnership interest and benefitted the defendants. Therefore, the trial court erred in granting the defendants’ motion for summary judgment on the breach of fiduciary duty claim by Anderton. Because summary judgment was improper on the claim for breach of fiduciary duty, the appellate court held...
that the trial court also erred in granting summary judgment in favor of the defendants on Anderton’s claims for aiding and abetting breach of fiduciary duty.

The appellate court also held that the defendants’ affirmative defenses did not form a basis for granting a summary judgment in their favor on Anderton’s claim for breach of fiduciary duty. The defendants contended that Anderton released or waived his claims in a letter agreement in which the parties attempted to resolve their disputes. The appellate court examined the evidence and found that Anderton’s covenant not to sue was limited to claims arising from the defendants’ acquisition of Cascade Ltd.’s debt, and the release did not encompass any breaches of fiduciary duty that went beyond the mere acquisition of the partnership’s debt as occurred here. The defendants also were not entitled to summary judgment based on their affirmative defenses of statute of frauds (i.e., not a defense to an action for damages for breach of fiduciary duty) or the parol evidence rule.


This case involved a dispute over the existence and breach of fiduciary duties in a business venture that operated by means of a limited liability company and limited partnership. An individual who was both a minority member of the LLC and a limited partner of the limited partnership sued the individual who was both the controlling member of the LLC and a fellow limited partner to recover withheld profit distributions. The trial court entered a judgment on the jury verdict that found the controlling member breached his fiduciary duties to the minority member. The court of appeals reversed and remanded holding: (1) the LLC agreement imposed fiduciary duties on the controlling member; (2) the limited partner relationship by itself did not give rise to a direct fiduciary duty between the individuals; (3) the trial court committed harmful error by commingling valid and invalid theories in instructing the jury that the controlling member had fiduciary duties with respect to operations of both the LLC and the limited partnership; and (4) any withheld profit distributions originated from the operations of the limited partnership in which the controlling member’s fiduciary duties had been contractually disclaimed.

In February 2003, John Wimberly and Douglas Strebel went into business together. They formed a limited liability company that came to be known as Black River Capital, LLC (the “LLC”). Wimberly, Strebel, and their spouses executed an amended and restated LLC agreement effective January 2004 in which they memorialized terms and provisions for the business. Under the amended agreement, Strebel and Wimberly were the members, with 60% and 40% sharing ratios, respectively; Strebel, Wimberly, and their spouses comprised a board of managers who had to be consulted on certain major decisions; and Strebel was designated as the “Managing Manager and CEO” of the LLC with broad decision making and management powers. In addition, the agreement provided that the managers had fiduciary duties to the LLC and the members equivalent to the fiduciary duties of directors of Delaware corporations, and members had fiduciary duties to the LLC comparable to stockholders of Delaware corporations. Wimberly, Strebel, and their spouses also formed Black River Capital Partners, LP (the “limited partnership”) in 2005. Under the limited partnership agreement, the LLC was designated as the general partner with broad authority to control the limited partnership, and Wimberly, Strebel, and their spouses became limited partners who agreed not to act for the limited partnership. The limited partnership agreement provided that the general partner had no duties except those expressly set forth in the agreement, and no provision in the agreement imposed fiduciary duties on the general partner.

In 2007, Wimberly and Strebel had a disagreement regarding the profit distributions related to their business ventures. Wimberly sued Strebel to recover profit distributions Strebel allegedly withheld. Wimberly asserted numerous causes of action contending essentially that Strebel acted in bad faith and breached his fiduciary duties to deprive Wimberly of distributions by retroactively reducing Wimberly’s distribution percentages and shifting money from profit bonuses to reduce funds available for profit distributions. The trial court instructed the jury that Strebel owed Wimberly fiduciary duties based on their relationship as co-owners of the LLC (with Strebel as the majority owner and managing manager) and their relationship as partners in the limited partnership. The jury found that Strebel breached his fiduciary duties to Wimberly. Strebel appealed arguing that he did not owe Wimberly any fiduciary duties and that any acts allegedly depriving Wimberly of distributions were permitted based on the parties’ contractual agreements. The court of appeals analyzed the existence and application of fiduciary duties Strebel owed Wimberly.

First, the parties agreed that whether Strebel owed Wimberly fiduciary duties based on their limited liability company relationship depended on the interpretation of the language in the LLC agreement. The LLC agreement was governed by Delaware law. Under the Delaware LLC Act, parties are given broad freedom to contract. The existence and scope of fiduciary duties thus must be determined by reference to the LLC agreement. Here, the LLC agreement stated that managers shall have fiduciary duties to the LLC and the members equivalent to the fiduciary duties of directors of Delaware corporations except as otherwise provided in the agreement. Strebel contended that as the managing manager he owed fiduciary duties to the LLC and its members collectively rather than to Wimberly individually. Wimberly responded that such an interpretation was illogical as it was contrary to the plain meaning of the
language of the agreement, which included fiduciary duties to members. Wimberly also asserted that, unless default fiduciary duties are specifically disavowed by contract, Delaware courts have treated LLC members as owing each other the traditional fiduciary duties that directors owe a corporation. The court of appeals sided with Wimberly and held that the trial court correctly interpreted the LLC agreement as imposing fiduciary duties on Strebel as the managing manager to Wimberly as an individual member. The court viewed the reference in the agreement to the duties of corporate directors as describing the type of duties owed, not limiting those to whom the duties are owed. The language of the LLC agreement specified that the managers shall have fiduciary duties to members. Any other interpretation would render the phrase superfluous. Thus, the trial court did not err in instructing the jury that Strebel owed Wimberly fiduciary duties as the managing manager of the LLC.

The parties also agreed that whether Strebel owed Wimberly fiduciary duties based on their limited partnership relationship depended on whether limited partners owe each other fiduciary duties under Texas law. The limited partnership agreement was governed by the Texas Revised Limited Partnership Act (“TRLPA”). The agreement here was silent as to any fiduciary duties owed between and among the limited partners. The trial court instructed the jury that Strebel owed Wimberly fiduciary duties based on their relationship as partners in the limited partnership. Strebel argued on appeal that such an instruction was erroneous because status as a limited partner is insufficient to create fiduciary duties under Texas law, and the limited partnership agreement expressly disclaimed any fiduciary duties owed by the general partner. Wimberly argued that fiduciary duties did exist because the TRLPA specified that in any case not provided for under the TRLPA, the Texas Revised Partnership Act (“TRPA”) governed. According to Wimberly, because the TRLPA contained no provisions regarding duties owed by limited partners to each other, the TRPA provision that a partner owes to the partnership and the other partners a duty of loyalty and a duty of care controlled. The court of appeals discussed cases decided by Texas courts of appeals as well as the Fifth Circuit Court of Appeals and concluded that the mere status as a limited partner does not give rise to fiduciary duties despite some broad language in some of the cases to that effect. However, a party’s status as a limited partner does not insulate that party from the imposition of fiduciary duties that arise when a limited partner also takes on a nonpassive role by exercising control over the partnership in a way that justifies recognition of such duties by contract. Thus, entering into an additional relationship or role in which the limited partner controls or manages the limited partnership’s affairs may create fiduciary duties to other limited partners. For example, if a limited partner also served as an officer of the limited partnership, then that partner may owe fiduciary duties to the partnership and other limited partners based on the agency relationship without regard to the role as a limited partner. The existence and scope of the fiduciary duties would be defined not by the laws governing limited partners but rather by the relevant laws and contracts governing the role under which the party exercised the authority. In this case, the relationship between Strebel and Wimberly as limited partners in the limited partnership did not give rise to a direct fiduciary duty to each other. The trial court’s instruction that Strebel owed Wimberly fiduciary duties as partners in the limited partnership was erroneous. Furthermore, the instructions were erroneous to the extent they conveyed that Strebel owed Wimberly fiduciary duties in Strebel’s capacity as the managing manager of the LLC that served as the general partner of the limited partnership because the limited partnership agreement expressly disclaimed any fiduciary duties owed to the limited partners by the general partner itself. The trial court’s jury instruction failed to account for the legal effect of this disclaimer. Thus, the trial court wrongly included in its jury instructions the existence of fiduciary duties owed by Strebel to Wimberly in relation to the limited partnership.

Strebel argued that the trial court committed harmful error in the jury instructions by commingling valid and invalid theories. The trial court instructed the jury that Strebel owed Wimberly fiduciary duties based on the LLC agreement, which was correct, and because of the limited partnership relationship, which was incorrect. Because of the commingling, it was impossible to determine if the jury finding that Strebel breached his fiduciary duties was based on a valid or invalid theory. Furthermore, the court of appeals concluded that Wimberly’s recovery under the improper jury question failed on causation grounds. The damages alleged by Wimberly were caused by the actions of the limited partnership’s general partner (i.e., the LLC) in exercising its exclusive authority to run the limited partnership and Strebel’s alleged control of the general partner. Courts have recognized that general partners in a limited partnership owe fiduciary duties to limited partners, but courts have also acknowledged the importance of honoring parties’ contractual terms defining the scope of their obligations and agreement, including limiting fiduciary duties that may otherwise exist. Honoring such contractual agreements is especially important in arms-length business transactions in which the parties are sophisticated businessmen represented by counsel, as the parties were here. In this case, there was an express contractual disclaimer in the limited partnership agreement of fiduciary duties owed by the Strebel-controlled general partner to the limited partners, and there was no jury question regarding breaches by the general partner. Because Wimberly sought recovery based on actions that were all taken in Strebel’s capacity as managing manager of the general partner, the court held that the waiver of fiduciary duties in the limited partnership agreement foreclosed Wimberly’s recovery on his breach of fiduciary duty claim. Applying the fiduciary duties Strebel owed Wimberly in the LLC.
relationship, as Wimberly urged, would render meaningless the express disclaimer of fiduciary duties in the limited partnership agreement under which the parties were operating. Since Wimberly failed to demonstrate that Strebel took actions that caused Wimberly’s lost distribution damages while acting within the scope of any fiduciary duties that existed between the parties (inasmuch as the parties had contractually disclaimed the fiduciary duties related to the actions by Strebel at issue) the judgment, which was based on the jury’s finding of breach of fiduciary duty, was reversed. The case was remanded for consideration of alternative liability and damages findings.


In this adversary proceeding in the bankruptcy cases of a limited partnership and two LLCs (the “debtors”), the Chapter 7 trustee and certain creditors of the debtors asserted claims for breach of fiduciary duty and aiding and abetting breach of fiduciary duty in connection with the alleged usurpation of “corporate” opportunities of the debtors. The court stated that the usurpation of corporate opportunities doctrine only applies to officers, directors, and major shareholders who are fiduciaries. One of the defendants, Charles Cheatham, was alleged to be an officer or director of the debtors, and the plaintiffs alleged that Cheatham “ceded operating control” of the debtors to another defendant, Dave Morgan. The plaintiffs did not allege that Dave Morgan actually held a position with the debtors and did not allege that Morgan was a de facto officer of the debtors. The court stated that there is no case law addressing whether a de facto officer may be sued for usurpation of corporate opportunity, but the court concluded that the plaintiffs could state a claim against Morgan for usurpation of corporate opportunities only if they alleged facts independent of his misconduct showing he was a de facto officer or director of one or more debtors. The plaintiffs thus failed to state a claim for breach of fiduciary duty by usurpation of corporate opportunity against any defendant except Cheatham, but the plaintiffs were given leave to amend their pleadings to allege that Morgan was a de facto officer or director of one or more debtors. The court said that the plaintiffs stated a claim against Morgan for aiding and abetting Cheatham’s breach of fiduciary duty by usurpation of corporate opportunities, citing case law for the proposition that a third party becomes a joint tortfeasor with a fiduciary when the third party knowingly participates in a breach of duty by the fiduciary.


Terrill Horton, a successful and wealthy businessman, wanted to invest in a tax shelter that would reduce his income tax liability. In furtherance of that goal, Horton invested in a limited partnership promoted by American Housing Foundation (“AHF”) and its founder/president, Steve Sterquell. AHF was a nonprofit organization involved in HUD projects, and this particular limited partnership was formed to invest in properties damaged by Hurricane Ike. Horton made a contribution and received a 99.99% interest as a limited partner in the limited partnership. AHF obtained a .01% interest as general partner in the limited partnership. Horton also made a loan of $1.4 million to the partnership, which was guaranteed by AHF. Horton understood that the partnership would generate $15 million in losses that would result in a $3 million tax refund for him. A tax expert testified that the transaction was an abusive tax shelter and that Horton’s claimed reliance on Sterquell was unreasonable. The bankruptcy court concluded that the guaranty was constructively fraudulent and disallowed Horton’s claim against AHF on the guaranty. The court also rejected a breach of fiduciary duty claim by Horton against AHF. Horton argued that AHF, as general partner of the limited partnership, breached its fiduciary duty by employing and permitting Sterquell to use funds and assets of the limited partnership to the benefit of AHF and not the limited partnership, causing Horton the loss of his $1.4 million loan, interest, and attorney’s fees. The court stated that the claim ignored the big picture in which Horton knew the loan funds were to be used in Sterquell’s “housing fund” and Horton’s primary objective was obtaining tax relief in the form of a $3 million tax refund. The court did not understand how such circumstances gave rise to a breach of fiduciary duty. The other problem identified by the court was Horton’s lack of standing to assert his claim on behalf of the limited partnership. The court discussed the ability of a limited partner to bring against a general partner a direct claim, derivative claim, or class action, depending upon the alleged cause of harm and alleged harm suffered. The court noted the authority conferred on a limited partner to assert a claim on behalf of the limited partnership under Section 153.401 of the Texas Business Organizations Code when the general partner has failed to do so or is unlikely to do so (and characterized the situation as one in which Horton would have qualified given the unlikelihood of AHF suing itself). The court explained that Horton’s injury stemmed from injury to the partnership and thus was not a “personal” claim. Horton could have sued derivatively but chose not to do so, and he was precluded from bringing the claim directly.
and the court agreed with the bankruptcy and district courts that the board’s entrustment in Harwood of the management of a limited partnership that was general partner of the limited partnership. The court focused on Harwood’s control, as officer and director of the general partner, over its affairs to justify recognition of fiduciary obligations to the partnership. Harwood relied on the fact that he was not the sole shareholder or the president and sole owner of the general partner to justify not exercising a level of control over the limited partnership in a manner analogous to those cases that owes a fiduciary duty to the partnership. The court rejected Harwood’s argument that he owed no duty to the partnership since he was not a partner and did not exercise a level of control over the affairs of the partnership.

In re Bennett, 565 F.3d 171 (5th Cir. 2009) to conclude that an individual who was managing the limited partnership, Bender, who was president, a director, and a 50% shareholder of the corporate general partner of a limited partnership, owed a fiduciary duty to the partnership and that he engaged in a misapplication of fiduciary property. This count required the State to prove that Bender unlawfully appropriated $200,000 or more from the partnership for purposes of Section 523(a)(4). The court emphasized that it is not only the control that the officer actually exerts over the partnership’s affairs that constitutes a misapplication of funds, but also the trust and confidence placed in the hands of the controlling officer, that leads to a finding of a fiduciary relationship for purposes of Section 523(a)(4). The court discussed the evidence as it related to this offense and concluded the jury could rationally have found Bender guilty of misapplication of fiduciary property.

In re Harwood, 637 F.3d 615 (5th Cir. 2011).

The Fifth Circuit Court of Appeals affirmed the district court’s judgment affirming the bankruptcy court’s judgment that the debtor’s debts arising from loans obtained from a limited partnership managed by the debtor in his capacity as officer and director of the general partner were nondischargeable under Section 523(a)(4). The court of appeals agreed with the lower courts that Harwood, who was president, a director, and a 50% shareholder of the corporate general partner of a limited partnership, owed a fiduciary duty to the partnership and that he engaged in a misapplication of funds in connection with loans he obtained from the limited partnership. The court relied upon In re Bennett, 989 F.2d 779 (5th Cir. 1993) and McBeth v. Carpenter, 565 F.3d 171 (5th Cir. 2009) to conclude that an officer of a corporate general partner who is entrusted with the management of the limited partnership and who exercises control over the limited partnership in a manner analogous to those cases owes a fiduciary duty to the partnership that satisfies Section 523(a)(4). The court emphasized that it is not only the control that the officer actually exerts over the partnership, but also the trust and confidence placed in the hands of the controlling officer, that leads to a finding of a fiduciary relationship for purposes of Section 523(a)(4). Thus, the court examined the evidence regarding the control entrusted to and exercised by Harwood to ascertain whether he owed a fiduciary duty to both tiers of the organization. Harwood did not dispute that he owed a fiduciary duty to the corporate general partner as an officer and director of the corporation but contended he owed no duty to the partnership since he was not a partner and did not exercise a level of control over its affairs to justify recognition of fiduciary obligations to the partnership. The court rejected Harwood’s attempt to distinguish the cases relied upon by the court. Harwood relied on the fact that he was not the sole shareholder and sole director of the corporate general partner, whereas In re Bennett involved an individual who was managing partner of a limited partnership that was general partner of the limited partnership, and McBeth v. Carpenter involved the president and sole owner of the general partner of the limited partnership. The court focused on Harwood’s control, and the court agreed with the bankruptcy and district courts that the board’s entrustment in Harwood of the management...
of the partnership’s affairs combined with the practically complete control that Harwood actually exercised over the partnership’s management compelled the conclusion that Harwood stood in the same fiduciary capacity to the limited partners as a trustee to beneficiaries of a trust. Thus, Harwood acted in a fiduciary capacity within the meaning of Section 523(a)(4). The court also agreed with the bankruptcy court’s conclusion that Harwood’s debt resulted from a defalcation (i.e., a willful neglect of duty based on a recklessness standard) based on Harwood’s failure to record deeds of trust securing two notes representing personal loans Harwood caused the partnership to make to him. The bankruptcy court found the evidence insufficient to show that the making of the loans themselves was a willful neglect of duty (noting that the loans were not made surreptitiously and that the board was at least generally aware of and approved their existence), but concluded that the failure to record the deeds of trust did constitute a willful neglect of duty to the partnership. Harwood argued that the responsibility for recording the deeds of trust rested with the other shareholder/officer of the corporate general partner and that he could not be denied a discharge for taking additional, incomplete steps to secure the loans if the loans did not amount to a defalcation. The court rejected both of these arguments. Harwood was an experienced banker, and he knew the other shareholder/officer had no banking expertise and no particular knowledge of sound lending practices. Further, Harwood knew that failure to properly record the deeds of trust worked to his benefit (by allowing him to pledge the property to obtain additional funds from a bank) and could have a devastating effect on the partnership’s ability to collect. Thus, the court concluded that the bankruptcy court did not err in concluding that Harwood recklessly breached his duty to the partnership by failing to perfect the liens even if the existence of the loans themselves was not a defalcation.


The plaintiff in an adversarial proceeding against a Chapter 7 debtor sought to have her claim against the defendant debtor excepted from discharge under Section 523(a)(4) of the Bankruptcy Code, which excepts from discharge a debt from fraud or defalcation while acting in a fiduciary capacity. Before the debtor’s bankruptcy, the plaintiff and her then-husband embarked on a business venture with the debtor. The venture was structured as a limited partnership in which the plaintiff was a limited partner. The general partner was a corporation of which the debtor was a director, president, and 51% shareholder. The plaintiff was also a shareholder in the corporate general partner. The plaintiff claimed that the debtor committed fraud or defalcation while acting in a fiduciary capacity and breached fiduciary duties owed to the corporate general partner, the limited partnership, and the plaintiff as an equity owner of these entities. According to the plaintiff, the debtor treated the limited partnership as his own personal “piggy bank,” using limited partnership funds for many personal expenses.

In determining whether the debtor owed a non-dischargeable debt to the plaintiff under Section 523(a)(4) of the Bankruptcy Code, the court first examined whether the debtor was acting in a fiduciary capacity vis-à-vis the plaintiff. After noting that the debtor, as an officer and director of the corporate general partner, stood in a fiduciary relationship to the corporation and its shareholders under Texas corporate law, the court proceeded to analyze the nature of the relationship of the corporate general partner to the partnership and the limited partners under Texas partnership law. The court noted that a large amount of common law stands for the proposition that a general partner occupies a fiduciary role with respect to the limited partners, but the court recognized that significant amendments to the Texas partnership statutes in 1994 impact the analysis of fiduciary duties in the partnership context. The court summarized the statutory developments, explaining that the Texas Uniform Partnership Act (“TUPA”) only used the term “fiduciary” when referring to a partner’s duty to account for any benefit and hold as trustee any profits obtained in connection with the partnership without the consent of other partners, but that case law under TUPA consistently referred to a partner as a fiduciary. In 1994, however, the Texas Revised Partnership Act (“TRPA”) rejected the notion of a partner as a trustee and specifically set forth the duties of partners in precise terms. The Official Comments also pointed out that these changes were meant to reign in the loose use of fiduciary concepts. Finally, the Texas Business Organizations Code contains language nearly identical to TRPA. Despite these changes since TUPA, the court noted that very little case law has addressed the significance of the changes. The court pointed out that the Fifth Circuit case of In re Gupta, 394 F.3d 347 (5th Cir. 2004), came closest to confronting the significance of the changes. In that case, the Fifth Circuit did not tackle the meaning or ramifications of the new Texas partnership statute with respect to the notion of “fiduciary capacity” under Section 523(a)(4) but did note that partners still owe “special duties to each other,” some of which “may rise to the level of a ‘fiduciary’ for purposes of § 523(a)(4).” A few years later, without mentioning the statutory changes, the Fifth Circuit, in McBeth v. Carpenter, 565 F.3d 171 (5th Cir. 2009), held that all partners in a partnership are fiduciaries. Ultimately, the bankruptcy court in this case concluded that the changes in Texas statutory partnership law in recent years expunged the concept of a partner as a per se fiduciary but did not eliminate the fiduciary status of a managing general partner because of the control exercised by such a partner. The court reasoned that the new statutory language, which makes clear that a partner is not per se a fiduciary, puts partners and partnerships on a parity with shareholders and
corporations in that shareholders do not generally owe fiduciary duties to other shareholders. Based on the roles in which fiduciary duties are owed in the corporate context and longstanding case law regarding the fiduciary duties of a managing partner in the partnership context, the court concluded that control is the key to determining whether a partner is a fiduciary. Thus, the court held that Texas case law holding that there is an express trust that satisfies the strict test for “fiduciary capacity” under Section 523(a)(4) is still good law in the context of a managing general partner.

The court then looked at the two-tiered structure of the limited partnership to determine how it affected the fiduciary duties owed by the debtor. As noted above, the debtor was president, a director, and 51% shareholder of the corporate general partner. The court relied on two Fifth Circuit cases, In re Bennett, 989 F.2d 779 (5th Cir. 1993) and McBeth v. Carpenter, 565 F.3d 171 (5th Cir. 2009), to conclude that the debtor, as manager of the managing general partner, owed fiduciary duties to the partnership and the partners. In Bennett, the Fifth Circuit held that the fiduciary obligations imposed on managing partners of a limited partnership under Texas law were sufficient to meet the Section 523(a)(4) test and that the same level of fiduciary duty should apply to the managing partner of a managing partner. McBeth was not a Section 523(a)(4) case, but the Fifth Circuit again held that a person or entity acting in complete control of a limited partnership stands in the same fiduciary capacity to the limited partners as a trustee stands to the beneficiary of a trust even in a two-tiered partnership structure. Thus, the court concluded that the debtor owed the plaintiff fiduciary duties through at least two avenues: (1) in his capacity as officer and director of the corporate general partner (since the plaintiff was a shareholder); and (2) in his capacity as the control person/operator of the general partner (since the plaintiff was a limited partner).

The court next analyzed whether the debtor committed a defalcation in a fiduciary capacity, i.e., whether he breached or neglected fiduciary duties, whether he was at least reckless in doing so, and whether a reasonable person in the debtor’s position reasonably should have known better. The court described the duties of loyalty and care and the obligation of good faith set forth in TRPA and further noted how cases have described a partner’s duties. The court then concluded that the debtor committed defalcation while acting in his fiduciary capacity by repeatedly spending partnership funds for his own personal use and allowing others involved in the business to do the same. The court stated that lack of fraudulent intent and apparent lack of business savvy did not matter because a reasonable person should have known better. The court stated that spending partnership funds for one’s lavish lifestyle is not administering the partnership’s affairs solely for the benefit of the partnership, nor was the debtor complying with the partnership agreement, abiding by his duty not to misapply funds, acting with utmost good faith, fairness, and honesty, or making full disclosure of matters affecting the partnership.

Finally, the court determined the amount of the “debt” to the plaintiff that had arisen as a result of the debtor’s defalcation. The court measured this debt based on the amount of the misappropriated partnership funds. Since the plaintiff primarily contributed “sweat equity” to the limited partnership, loss of partnership investment was not a practical measure. Also, lost profits were not available because the court was unable to calculate them with reasonable certainty. Thus, based on the expert testimony of a team of forensic accountants, the court determined that the debtor misappropriated approximately $1.7 million to the plaintiff’s detriment. The court then apportioned this amount based on the plaintiff’s partnership interest and deducted a small amount of personal expenses that the plaintiff appeared to have misappropriated approximately $1.7 million to the plaintiff's detriment. The court then apportioned this amount based on the plaintiff’s partnership interest and deducted a small amount of personal expenses that the plaintiff appeared to have made that were not recorded as a partnership draw. The court also awarded exemplary damages because Texas courts have held that breach of fiduciary duty is a tort for which exemplary damages may be recoverable and there was clear and convincing evidence that the standard for exemplary damages under the Texas Civil Practice and Remedies Code was met. Under the Texas Civil Practice and Remedies Code, exemplary damages may only be awarded if a claimant proves by clear and convincing evidence that the harm to the claimant resulted from actual fraud, malice, or gross negligence. Although the court concluded there was no actual fraud or malice on the part of the debtor, the court found the evidence did establish gross negligence as defined by the statute.

G. Interpretation and Enforcement of Limited Partnership Agreement

1. Fiduciary Duties


In this opinion, the bankruptcy court denied a motion to dismiss the involuntary Chapter 11 petition and made a preliminary determination that the directors of the LLC general partner of the limited partnership debtor owed fiduciary duties to the bankruptcy estate notwithstanding the provisions of the partnership agreement that disclaimed fiduciary duties. The debtor was a Delaware limited partnership with an LLC as the sole general partner. The LLC had four directors, each of whom was selected by an owner of the LLC (two by Comcast, one by the Rockets, and one by the
the implied covenant was so clearly within the contemplation of the parties that they deemed it unnecessary to express simply to make a contract ‘‘fair, wise, or just’’ and that it must be apparent from the written terms of an agreement that explained that implied covenants are not favored in Texas law. The court stated that a court will not imply a covenant

The appellate court agreed that an implied covenant was inserted into the partnership agreement by this instruction and the partners were deciding whether and what amount Leick should have been paid as an involuntarily terminated partner. The trial court entered judgment awarding Leick damages and attorney’s fees.

On appeal, the plaintiffs argued that the trial court erred when submitting the jury question inquiring as to what amount should have been paid to Leick as an involuntarily terminated partner. The plaintiffs complained that this question improperly included an implied covenant of fair dealing in the partnership agreement by instructing the jury that “the remaining partners were obligated to act fairly and reasonably toward the involuntarily terminated partner” when the partners were deciding whether and what amount Leick should have been paid as an involuntarily terminated partner. The appellate court agreed that an implied covenant was inserted into the partnership agreement by this instruction and explained that implied covenants are not favored in Texas law. The court stated that a court will not imply a covenant simply to make a contract “‘fair, wise, or just’” and that it must be apparent from the written terms of an agreement that the implied covenant was so clearly within the contemplation of the parties that they deemed it unnecessary to express.


George, Leick, and Wilmer were the limited partners of a limited partnership formed to sell insurance. The limited partners were also the shareholders of the corporate general partner. The partnership agreement contained provisions regarding voluntary or involuntary termination of a limited partner’s association with the partnership. If the termination was voluntary, the agreement required the departing partner to sell his or her interest to the partnership or other partners according to a prescribed formula. If the termination was involuntary, the departing partner relinquished his or her interest in the partnership on the day of departure, and no payment to the departing partner was required. However, the remaining partners could determine that a payment would be made to an involuntarily terminated partner. George and Wilmer decided to terminate Leick’s association with the partnership on October 3, 2008, for a variety of reasons including Leick’s lack of business production. After informing Leick that they were terminating him as a partner, they changed bank signature cards for the partnership and removed all partnership financial records from Leick’s possession. George and Wilmer allowed Leick to return to the office on October 6 and 7 to tie up loose ends. On October 13, the remaining partners offered Leick the amount of money they believed he would be entitled to if he were voluntarily terminating his association with the partnership. Leick rejected the amount and insisted George and Wilmer had miscalculated such that he would be owed a larger amount as a voluntarily terminated partner. On October 17, the remaining partners responded through their attorney that Leick was not entitled to any amount under the agreement as an involuntarily terminated partner. At that time, the remaining partners made another offer to Leick in an amount somewhat less than the original offer and stated that the offer would be reduced further if the matter proceeded. On November 12, 2008, the partnership and the remaining partners filed suit against Leick seeking a declaratory judgment that Leick was involuntarily terminated and that the plaintiffs were not required to make any payment to Leick. Leick answered and filed counterclaims for breach of contract and breach of fiduciary duty. At trial, the court granted the plaintiffs’ motion for directed verdict on Leick’s cause of action for breach of fiduciary duty. The jury found that Leick did not voluntarily terminate his status as a partner before the plaintiffs involuntarily terminated him and that the plaintiffs complied with the agreement when involuntarily terminating Leick. The jury also found that the plaintiffs should have paid Leick the amount of the original offer as an involuntarily terminated partner. The trial court entered judgment awarding Leick damages and attorney’s fees.
it. Leick argued that the instruction that the remaining partners were obligated to act fairly and reasonably toward an involuntarily terminated partner was proper because it set forth the law governing relations between partners in effect at the time of the contract and was thus incorporated into the contract. Leick pointed to the Texas Revised Partnership Act (TRPA) and Texas common law regarding the relationship between partners. The court acknowledged that TRPA provides that a partner is obligated to act reasonably and in good faith and owes the other partners and the partnership duties of loyalty and care, but the court stated that the plaintiffs did not owe Leick these duties because he was no longer a partner after he was terminated and departed from the partnership. According to the court, there was no evidence that Leick remained a partner after October 14, 2008, and the plaintiffs did not have the heightened duty toward Leick set forth in TRPA or the common law after that date. The court stated that any negotiations regarding payment to Leick prior to his involuntary termination no longer mattered because the plaintiffs owed him nothing under the partnership agreement or the law cited by Leick once he was involuntarily terminated and departed. Thus, the trial court erred in imposing a duty to act fairly and reasonably in determining whether and what amount to pay Leick as an involuntarily terminated partner. Without the court-imposed duty of acting fairly and reasonably toward Leick, the only amount Leick was required to be paid was any amount the partners desired to pay Leick, and it was undisputed that they desired to pay nothing. The trial court should have disregarded the jury’s answer to this issue since the amount to be paid was entirely in the plaintiffs’ discretion, and the appellate court reversed and rendered a take-nothing judgment on Leick’s breach of contract claim.

Leick claimed on appeal that the trial court erred in granting the plaintiffs’ motion for directed verdict on his cause of action for breach of fiduciary duty. The court stated in a footnote that Texas law is not clear as to whether limited partners owe each other fiduciary duties, and the court made no determination in this case whether the limited partners owed each other fiduciary duties. Assuming the plaintiffs owed a duty to Leick while he was a partner, they owed him no fiduciary duty after he ceased to be a partner. The partnership agreement made clear that Leick relinquished his partnership interest when he was terminated and departed, which the evidence showed occurred at the latest on October 14, 2008. Thus, the plaintiffs owed no fiduciary duty to Leick as a partner from that date on. Leick alleged that the plaintiffs breached their fiduciary duties by failing to pay fair value for his partnership interest, but the court explained that when the plaintiffs filed suit on November 12, 2008, seeking a declaration that no required payment existed under the agreement, Leick was no longer a partner, and the plaintiffs thus had no fiduciary duty toward Leick as a partner when they decided to make no payments to him. Leick argued that he presented evidence that Wilmer and George secretly conspired to terminate his partnership interest by involuntarily terminating him, that they failed to negotiate in good faith with him about the value of his interest, and that they funded the lawsuit with money Leick otherwise would have received from his interest in the partnership. The court stated that George and Wilmer had no fiduciary duty to remain partners with Leick, so the involuntary termination in compliance with the agreement in and of itself could not constitute a breach of fiduciary duty by the plaintiffs. As to Leick’s contention that the plaintiffs violated their fiduciary duty to him when they continued to decrease their offered payment, the court again disagreed with Leick because he was no longer a partner as of October 14, 2008, and the plaintiffs’ actions did not violate any fiduciary duty to Leick as a partner after that date. To the extent the offer of payment made on October 13 might have occurred before the involuntary termination and might have breached a fiduciary duty to Leick, the court stated that any such breach could not have caused Leick damages because he was thereafter involuntarily terminated, relinquished his partnership interest, and was not entitled to any payment under the agreement. Finally, with respect to Leick’s claim that the plaintiffs breached their fiduciary duty by funding the lawsuit against him with profits Leick would have otherwise received, the court stated that Leick was no longer a partner and had relinquished his partnership interest when the lawsuit was filed. Thus, Leick would not have been entitled to the profits paid to the attorney in any event.


This case involved a dispute over the existence and breach of fiduciary duties in a business venture that operated by means of a limited liability company and limited partnership. An individual who was both a minority member of the LLC and a limited partner of the limited partnership sued the individual who was both the controlling member of the LLC and a fellow limited partner to recover withheld profit distributions. The trial court entered a judgment on the jury verdict that found the controlling member breached his fiduciary duties to the minority member. The court of appeals reversed and remanded holding: (1) the LLC agreement imposed fiduciary duties on the controlling member; (2) the limited partner relationship by itself did not give rise to a direct fiduciary duty between the individuals; (3) the trial court committed harmful error by commingling valid and invalid theories in instructing the jury that the controlling member had fiduciary duties with respect to operations of both the LLC and the limited partnership; and (4) any withheld profit distributions originated from the operations of the limited partnership in which the controlling member’s fiduciary duties had been contractually disclaimer.
In February 2003, John Wimberly and Douglas Strebel went into business together. They formed a limited liability company that came to be known as Black River Capital, LLC (the “LLC”). Wimberly, Strebel, and their spouses executed an amended and restated LLC agreement effective January 2004 in which they memorialized terms and provided specifics as to the business. Under the amended agreement, Strebel and Wimberly were the members, with 60% and 40% sharing ratios, respectively; Strebel, Wimberly, and their spouses comprised a board of managers who had to be consulted on certain major decisions; and Strebel was designated as the “Managing Manager and CEO” of the LLC with broad decision making and management powers. In addition, the agreement provided that the managers had fiduciary duties to the LLC and the members equivalent to the fiduciary duties of directors of Delaware corporations, and members had fiduciary duties to the LLC comparable to stockholders of Delaware corporations. Wimberly, Strebel, and their spouses also formed Black River Capital Partners, LP (the “limited partnership”) in 2005. Under the limited partnership agreement, the LLC was designated as the general partner with broad authority to control the limited partnership, and Wimberly, Strebel, and their spouses became limited partners who agreed not to act for the limited partnership. The limited partnership agreement provided that the general partner had no duties except those expressly set forth in the agreement, and no provision in the agreement imposed fiduciary duties on the general partner.

In 2007, Wimberly and Strebel had a disagreement regarding the profit distributions related to their business ventures. Wimberly sued Strebel to recover profit distributions Strebel allegedly withheld. Wimberly asserted numerous causes of action contending essentially that Strebel acted in bad faith and breached his fiduciary duties to deprive Wimberly of distributions by retroactively reducing Wimberly’s distribution percentages and shifting money from profit to bonuses to reduce funds available for profit distributions. The trial court instructed the jury that Strebel owed Wimberly fiduciary duties based on their relationship as co-owners of the LLC (with Strebel as the majority owner and managing manager) and their relationship as partners in the limited partnership. The jury found that Strebel breached his fiduciary duties to Wimberly. Strebel appealed arguing that he did not owe Wimberly any fiduciary duties and that any acts allegedly depriving Wimberly of distributions were permitted based on the parties’ contractual agreements. The court of appeals analyzed the existence and application of fiduciary duties Strebel owed Wimberly.

First, the parties agreed that whether Strebel owed Wimberly fiduciary duties based on their limited liability company relationship depended on the interpretation of the language in the LLC agreement. The LLC agreement was governed by Delaware law. Under the Delaware LLC Act, parties are given broad freedom to contract. The LLC agreement stated that managers shall have fiduciary duties to the LLC and the members equivalent to the fiduciary duties of directors of Delaware corporations except as otherwise provided in the agreement. Strebel contended that as the managing manager he owed fiduciary duties to the LLC and its members collectively rather than to Wimberly individually. Wimberly responded that such an interpretation was illogical as it was contrary to the plain meaning of the language of the agreement, which included fiduciary duties to members. Wimberly also asserted that, unless default fiduciary duties are specifically disavowed by contract, Delaware courts have treated LLC members as owing each other the traditional fiduciary duties that directors owe a corporation. The court of appeals sided with Wimberly and held that the trial court correctly interpreted the LLC agreement as imposing fiduciary duties on Strebel as the managing manager to Wimberly as an individual member. The court viewed the reference in the agreement to the duties of corporate directors as describing the type of duties owed, not limiting those to whom the duties are owed. The language of the LLC agreement specified that the managers shall have fiduciary duties to members. Any other interpretation would render the phrase superfluous. Thus, the trial court did not err in instructing the jury that Strebel owed Wimberly fiduciary duties as the managing manager of the LLC.

The parties also agreed that whether Strebel owed Wimberly fiduciary duties based on their limited partnership relationship depended on whether limited partners owe each other fiduciary duties under Texas law. The limited partnership agreement was governed by the Texas Revised Limited Partnership Act (“TRLPA”). The agreement here was silent as to any fiduciary duties owed between and among the limited partners. The trial court instructed the jury that Strebel owed Wimberly fiduciary duties based on their relationship as partners in the limited partnership. Strebel argued on appeal that such an instruction was erroneous because status as a limited partner is insufficient to create fiduciary duties under Texas law, and the limited partnership agreement expressly disclaimed any fiduciary duties owed by the general partner. The court of appeals concluded that the mere status as a limited partner does not give rise to fiduciary duties despite some broad language in some of the cases to that effect. However, a party’s status as a limited partner does not insulate that party from the imposition of fiduciary duties that arise when a limited partner also takes on a nonpassive role by exercising control over the partnership in a way that justifies recognition of such duties or by contract. In this case, the relationship between Strebel and Wimberly as limited partners in the limited partnership did not give rise to a direct fiduciary duty to each other. The trial court’s instruction that Strebel owed Wimberly fiduciary duties as partners in the limited partnership was erroneous. Furthermore, the instructions were erroneous to the extent they conveyed that Strebel owed Wimberly fiduciary duties in Strebel’s capacity as the managing manager of the LLC.
that served as the general partner of the limited partnership because the limited partnership agreement expressly disclaimed any fiduciary duties owed to the limited partners by the general partner itself. The trial court’s jury instruction failed to account for the legal effect of this disclaimer. Thus, the trial court wrongly included in its jury instructions the existence of fiduciary duties owed by Strebel to Wimberly in relation to the limited partnership.

Strebel argued that the trial court committed harmful error in the jury instructions by commingling valid and invalid theories. The trial court instructed the jury that Strebel owed Wimberly fiduciary duties based on the LLC agreement, which was correct, and because of the limited partnership relationship, which was incorrect. Because of the commingling, it was impossible to determine if the jury finding that Strebel breached his fiduciary duties was based on a valid or invalid theory. Furthermore, the court of appeals concluded that Wimberly’s recovery under the improper jury question failed on causation grounds. The damages alleged by Wimberly were caused by the actions of the limited partnership’s general partner (i.e., the LLC) in exercising its exclusive authority to run the limited partnership and Strebel’s alleged control of the general partner. Courts have recognized that general partners in a limited partnership owe fiduciary duties to limited partners, but courts have also acknowledged the importance of honoring parties’ contractual terms defining the scope of their obligations and agreement, including limiting fiduciary duties that may otherwise exist. Honoring such contractual agreements is especially important in arms-length business transactions in which the parties are sophisticated businessmen represented by counsel, as the parties were here. In this case, there was an express contractual disclaimer in the limited partnership agreement of fiduciary duties owed by the Strebel-controlled general partner to the limited partners, and there was no jury question regarding breaches by the general partner. Because Wimberly sought recovery based on actions that were all taken in Strebel’s capacity as managing manager of the general partner, the court held that the waiver of fiduciary duties in the limited partnership agreement foreclosed Wimberly’s recovery on his breach of fiduciary duty claim. Applying the fiduciary duties Strebel owed Wimberly in the LLC relationship, as Wimberly urged, would render meaningless the express disclaimer of fiduciary duties in the limited partnership agreement under which the parties were operating. Since Wimberly failed to demonstrate that Strebel took actions that caused Wimberly’s lost distribution damages while acting within the scope of any fiduciary duties that existed between the parties (inasmuch as the parties had contractually disclaimed the fiduciary duties related to the actions by Strebel at issue) the judgment, which was based on the jury’s finding of breach of fiduciary duty, was reversed. The case was remanded for consideration of alternative liability and damages findings.


Bender was found guilty of theft and misapplying property in connection with his receipt of funds from a limited partnership. Bender was one of three named managers of the corporate general partner of the limited partnership, but it was undisputed at trial that he was effectively the sole manager. Bender admitted receiving $932,000 from the partnership but testified that all the payments were proper. He characterized the payments as director’s fees, management fees, legal and accounting fees, syndication fees, and reimbursement of expenses. He admitted diverting $43,000 to a business he was attempting to start in Houston. One of the investors testified that Bender had orally promised investors that he would not receive any salary or fees until the limited partnership was profitable. Bender denied making this statement and argued that this parol evidence was not admissible to alter the terms of the written partnership agreement and private placement memorandum, but the court held that the parol evidence rule is not a procedural rule and that Bender’s reliance on the rule was mistaken. The court concluded that the evidence was sufficient to support Bender’s convictions. The theft charge required the State to prove that Bender unlawfully appropriated $200,000 or more from the complainants by creating or confirming by words or conduct a false impression of fact that was likely to affect the complainants’ judgment in the transaction and that Bender did not believe to be true, i.e., that the partnership funds would be expended on the business operation of the partnership when in fact Bender expended the funds in a manner inconsistent with the business operations of the partnership. The court discussed the evidence as it related to this offense and concluded the jury could rationally have found Bender guilty. The court also found the evidence sufficient to convict Bender of misapplication of fiduciary property. This count required the State to prove that Bender intentionally, knowingly, or recklessly misapplied $200,000 or more that he held as a fiduciary for the benefit of the complainants by expending partnership funds in a manner inconsistent with its business operations and that involved a substantial risk of loss. Under the Penal Code, the term “fiduciary” includes an officer or manager carrying on fiduciary functions on behalf of a fiduciary. The court stated that it did not understand Bender to argue that he was not accountable as a fiduciary under the partnership agreement. Bender argued that his withdrawals of partnership funds did not violate the partnership agreement because he had “absolute authority” to manage the partnership assets. However, the court stated that Bender had a fiduciary responsibility under the partnership agreement to exercise his management responsibilities solely for the benefit of the partnership, and his authority as manager did not allow him to expend the limited
participation’s assets in any manner he saw fit. Though Bender asserted that he was entitled to most of the money as compensation for services and reimbursement of expenses, the court stated that the jury was not obliged to credit his testimony in light of other evidence that he hid the payments and lacked documentation to justify them. Thus, the jury could rationally infer that there was no legitimate business purpose for the withdrawals and that the withdrawals constituted misappropriation of funds.

2. Financial Rights

*ART Midwest, Inc. v. Atlantic Limited Partnership XII,* 742 F.3d 206 (5th Cir. 2014).

The parties in this case sued one another after a real estate transaction between the parties collapsed, and this appeal was the second appeal in the case. The real estate transaction at issue involved an agreement by the plaintiffs to acquire eight apartment complexes from the defendants and was structured so that a limited partnership intermediary would be the nominal buyer. (For ease of reference, the court in this opinion referred to the “patchwork of contracts” governing the transaction collectively as “the agreement.”) The plaintiffs purported to terminate the deal on behalf of the partnership because of a title problem, but the defendants contended that they did not default in their obligations and that the plaintiffs did not have the right to terminate the agreement. The plaintiffs sued for fraud on the basis that the defendants misrepresented matters regarding the title to the property and seeking a declaratory judgment that the plaintiffs properly terminated the deal. The defendants countersued the plaintiffs for breaching the agreement by improperly terminating it. The jury found that the plaintiffs properly terminated the deal but that the defendants did not commit fraud. In the first appeal, a panel of the Fifth Circuit held that there was no failure by the defendants to render marketable title and thus no default by the defendants entitling the plaintiffs to terminate. On remand, the district court granted partial summary judgment for the defendants holding that the plaintiffs improperly terminated the agreement and that the plaintiffs owed capital contributions to the partnership under the agreement. The district court put the remaining issues, including the amount of damages, before a jury. The jury found that the plaintiffs owed capital contributions under the agreement in the amounts of $7.4 million as of February 1, 2001, and $10.6 million as of February 1, 2002. The district court combined these amounts, and the defendants argued on appeal that the district court erred because the amounts overlapped. The court of appeals concluded that the evidence and oral arguments revealed that the $10.6 million encompassed the $7.4 million and there was no basis for the double counting. Thus, the court reversed and remanded so that the district court could determine which amount was the proper measure of damages. The court of appeals rejected the plaintiffs’ argument that the defendants’ failure to obtain an annual appraisal as required by the agreement excused the plaintiffs from their contribution obligations. The court of appeals concluded that the plaintiffs defaulted by purporting to terminate the deal two years before the defendants were obligated to perform the appraisal and that the plaintiffs’ default excused the defendants from conducting the appraisal. The plaintiffs argued that the defendants lacked standing to bring a claim for partnership property under the contribution provision of the agreement, but the court stated that a partner may individually sue for the benefit of the partnership and other partners. The parties did not dispute that one of the defendants was a partner, and the record showed that it had argued from the inception of the case that the plaintiffs owed contributions to the partnership under the agreement. The court thus concluded that the defendants sued for the benefit of the partnership and other partners and had standing.


Investors in real estate projects structured as layered limited partnerships sued the management company, general partners, and related parties for fraud and other claims after the collapse of the real estate empire. The original plaintiffs settled, and additional investors intervened and tried certain claims. Some of the intervening investors appealed on certain issues. One of the issues related to whether the trial court had properly determined the allocation of the proceeds of the sale of property in one of the limited partnerships. A limited partner who was determined to be entitled to 50% of the distribution from the sale claimed that the other limited partner was not entitled to 49% of the distribution because a portion of the $1.9 million capital contribution of the 49% limited partner was booked by the general partner as an account receivable of over $800,000. The partnership agreement required each limited partner to contribute $1.9 million for their partnership interests and provided that allocations to the limited partners would be made “according to their relative Capital Contributions.” The partnership agreement provided that the partners would contribute cash and that those amounts would constitute the initial capital accounts. The agreement also provided for the making of non-cash contributions to be valued at gross market value as determined by the contributing partner and the general partner. The partnership operated in this manner for several years and filed tax returns based on relative interests of the limited partners of 50% and 49%. There was evidence that other distributions were made on this basis. The 50% limited partner argued that the account receivable was never valued at fair market value by the general partner and contributing partner
as provided by the partnership agreement, but the receivable was carried on the books at face value for several years as part of the 49% limited partner’s capital contribution, and the books formed the basis for tax returns and distributions before the management company that maintained the accounting records ceased operating. This was some evidence of the value of the receivable according to the court of appeals. Because the partnership agreement provided that capital contributions could include non-cash property, the court saw no reason under the agreement that the account receivable from the limited partner could not be considered part of its capital contribution. The court concluded the evidence was sufficient to support the trial court’s declaratory judgment regarding the proceeds of the sale of the limited partnership’s property. The court noted that the receiver for the general partner testified that he would collect the receivable when the distribution was made.


In December 2009, a limited partner, Elliott, lent $36,000 to the limited partnership to enable the partnership to pay its property taxes and some other expenses. The partnership executed a note in favor of Elliott that required payment in full no later than December 31, 2010. When Elliott demanded payment in January 2011, the partnership took the position that the note violated the partnership agreement because it had a specific due date and was therefore unenforceable. Section 7.03 of the limited partnership agreement contained a provision that stated: “Partnership expenses and mortgages shall be promptly paid in the normal order of business. Loans from limited partners (including interest) shall be repaid quarterly, as net profits are available to do so in the judgment of the general partner.” The partnership argued that a note given to a limited partner in exchange for a loan could only state that the loan “be repaid quarterly as net profits are available to do so in the judgment of the general partner.” In other words, the partnership took the position that it never had to repay the limited partner’s note unless “net profits” were available. The general partner informed Elliott that sufficient funds were not available for repayment of the note in the general partner’s judgment. After a bench trial, the trial court concluded that Section 7.03 of the partnership agreement prohibited agreements that would require loans from limited partners to be paid by a specific due date and that the note must be reformed to comply with the partnership agreement. Further, the trial court concluded that Elliott breached the partnership agreement and his duty of loyalty by taking and attempting to enforce the note. The trial court did not find the partnership suffered any damages, however. The judgment required Elliott to pay the limited partnership $67,000 in attorney’s fees. Elliott’s sole argument on appeal was that the limited partnership waived compliance with Section 7.03 of the partnership agreement by executing promissory notes to numerous other limited partners with specific due dates; he did not argue that the note was valid and enforceable as written for any reason other than waiver. A waiver exists if a party intentionally relinquishes a known right or engages in intentional conduct inconsistent with claiming that right. The court of appeals concluded that there was no waiver because the partnership agreement did not give the limited partnership the right to refuse to repay a loan from a limited partner unless and until net profits are available. The court concluded that the agreement was not ambiguous and that it did not manifest an intent that limited partner loans cannot be made due and payable on or by a specific date. Section 7.03 merely imposed an additional burden to repay quarterly if possible instead of waiting until the due date. This interpretation, said the court, was consistent with the sample promissory note attached to the partnership agreement. Further, the court stated that it would reach the same result even if it found the agreement was ambiguous based on the construction of the parties represented by numerous previous promissory notes to limited partners with a fixed due date. Next the court addressed a request by Elliott to reform the note to provide that the note is due and payable when the limited partnership has net profits available to pay it. Because this was the only relief requested, and Elliott did not argue that the trial court erred by reforming the note at all, the court granted this relief. The court reversed the trial court’s award of attorney’s fees to the limited partnership because the limited partnership was only awarded equitable relief and did not recover damages. Although Section 38.001(8) of the Civil Practice and Remedies Code provides that a party may recover reasonable attorney’s fees from an individual or corporation in a suit on an oral or written contract, the Texas Supreme Court has held that a party must recover damages to recover attorney’s fees under Section 38.001(8). The limited partnership urged that it gained something of value through the reformation, but reformation is an equitable remedy. Finally, the court of appeals rejected the limited partnership’s claim for attorney’s fees under the Uniform Declaratory Judgments Act in the Civil Practice and Remedies Code. In its amended petition, the limited partnership recast its request for reformation of the contract as a request for declaratory judgment, but the court said it was obvious the limited partnership “simply repackaged” its cause of action for reformation, and a party may not plead for declaratory relief simply to pave the way to recover attorney’s fees.

George, Leick, and Wilmer were the limited partners of a limited partnership formed to sell insurance. The limited partners were also the shareholders of the corporate general partner. The partnership agreement contained provisions regarding voluntary or involuntary termination of a limited partner’s association with the partnership. If the termination was voluntary, the agreement required the departing partner to sell his or her interest to the partnership or other partners according to a prescribed formula. If the termination was involuntary, the departing partner relinquished his or her interest in the partnership on the day of departure, and no payment to the departing partner was required. However, the remaining partners could determine that a payment would be made to an involuntarily terminated partner. George and Wilmer decided to terminate Leick’s association with the partnership on October 3, 2008, for a variety of reasons including Leick’s lack of business production. After informing Leick that they were terminating him as a partner, they changed bank signature cards for the partnership and removed all partnership financial records from Leick’s possession. George and Wilmer allowed Leick to return to the office on October 6 and 7 to tie up loose ends. On October 13, the remaining partners offered Leick the amount of money they believed he would be entitled to if he were voluntarily terminating his association with the partnership. Leick rejected the amount and insisted George and Wilmer had miscalculated such that he would be owed a larger amount as a voluntarily terminated partner. On October 17, the remaining partners responded through their attorney that Leick was not entitled to any amount under the agreement as an involuntarily terminated partner. At that time, the remaining partners made another offer to Leick in an amount somewhat less than the original offer and stated that the offer would be reduced further if the matter proceeded. On November 12, 2008, the partnership and the remaining partners filed suit against Leick seeking a declaratory judgment that Leick was involuntarily terminated and that the plaintiffs were not required to make any payment to Leick. Leick answered and filed counterclaims for breach of contract and breach of fiduciary duty. At trial, the court granted the plaintiffs’ motion for directed verdict on Leick’s cause of action for breach of fiduciary duty. The jury found that Leick did not voluntarily terminate his status as a partner before the plaintiffs involuntarily terminated him and that the plaintiffs complied with the agreement when involuntarily terminating Leick. The jury also found that the plaintiffs should have paid Leick the amount of the original offer as an involuntarily terminated partner. The trial court entered judgment awarding Leick damages and attorney’s fees.

On appeal, the plaintiffs argued that the trial court erred when submitting the jury question inquiring as to what amount should have been paid to Leick as an involuntarily terminated partner. The plaintiffs complained that this question improperly included an implied covenant of fair dealing in the partnership agreement by instructing the jury that “the remaining partners were obligated to act fairly and reasonably toward the involuntarily terminated partner” when the partners were deciding whether and what amount Leick should have been paid as an involuntarily terminated partner. The appellate court agreed that an implied covenant was inserted into the partnership agreement by this instruction and explained that implied covenants are not favored in Texas law. The court stated that a court will not imply a covenant simply to make a contract “‘fair, wise, or just’” and that it must be apparent from the written terms of an agreement that the implied covenant was so clearly within the contemplation of the parties that they deemed it unnecessary to express it. Leick argued that the instruction that the remaining partners were obligated to act fairly and reasonably toward an involuntarily terminated partner was proper because it set forth the law governing relations between partners in effect at the time of the contract and was thus incorporated into the contract. Leick pointed to the Texas Revised Partnership Act (TRPA) and Texas common law regarding the relationship between partners. The court acknowledged that TRPA provides that a partner is obligated to act reasonably and in good faith and owes the other partners and the partnership duties of loyalty and care, but the court stated that the plaintiffs did not owe Leick these duties because he was no longer a partner after he was terminated and departed from the partnership. According to the court, there was no evidence that Leick remained a partner after October 14, 2008, and the plaintiffs did not have the heightened duty toward Leick set forth in TRPA or the common law after that date. The court stated that any negotiations regarding payment to Leick prior to his involuntary termination no longer mattered because the plaintiffs owed him nothing under the partnership agreement or the law cited by Leick once he was involuntarily terminated and departed. Thus, the trial court erred in imposing a duty to act fairly and reasonably in determining whether and what amount to pay Leick as an involuntarily terminated partner. Without the court-imposed duty of acting fairly and reasonably toward Leick, the only amount Leick was required to be paid was any amount the partners desired to pay Leick, and it was undisputed that they desired to pay nothing. The trial court should have disregarded the jury’s answer to this issue since the amount to be paid was entirely in the plaintiffs’ discretion, and the appellate court reversed and rendered a take-nothing judgment on Leick’s breach of contract claim.

Leick claimed on appeal that the trial court erred in granting the plaintiffs’ motion for directed verdict on his cause of action for breach of fiduciary duty. The court stated in a footnote that Texas law is not clear as to whether limited partners owe each other fiduciary duties, and the court made no determination in this case whether the limited
partners owed each other fiduciary duties. Assuming the plaintiffs owed a duty to Leick while he was a partner, they owed him no fiduciary duty after he ceased to be a partner. The partnership agreement made clear that Leick relinquished his partnership interest when he was terminated and departed, which the evidence showed occurred at the latest on October 14, 2008. Thus, the plaintiffs owed no fiduciary duty to Leick as a partner from that date on. Leick alleged that the plaintiffs breached their fiduciary duties by failing to pay fair value for his partnership interest, but the court explained that when the plaintiffs filed suit on November 12, 2008, seeking a declaration that no required payment existed under the agreement, Leick was no longer a partner, and the plaintiffs thus had no fiduciary duty toward Leick as a partner when they decided to make no payments to him. Leick argued that he presented evidence that Wilmer and George secretly conspired to terminate his partnership interest by involuntarily terminating him, that they failed to negotiate in good faith with him about the value of his interest, and that they funded the lawsuit with money Leick otherwise would have received from his interest in the partnership. The court stated that George and Wilmer had no fiduciary duty to remain partners with Leick, so the involuntary termination in compliance with the agreement in and of itself could not constitute a breach of fiduciary duty by the plaintiffs. As to Leick’s contention that the plaintiffs violated their fiduciary duty to him when they continued to decrease their offered payment, the court again disagreed with Leick because he was no longer a partner as of October 14, 2008, and the plaintiffs’ actions did not violate any fiduciary duty to Leick as a partner after that date. To the extent the offer of payment made on October 13 might have occurred before the involuntary termination and might have breached a fiduciary duty to Leick, the court stated that any such breach could not have caused Leick damages because he was thereafter involuntarily terminated, relinquished his partnership interest, and was not entitled to any payment under the agreement. Finally, with respect to Leick’s claim that the plaintiffs breached their fiduciary duty by funding the lawsuit against him with profits Leick would have otherwise received, the court stated that Leick was no longer a partner and had relinquished his partnership interest when the lawsuit was filed. Thus, Leick would not have been entitled to the profits paid to the attorney in any event.


This case involved a dispute over whether a former limited partner breached his fiduciary duty to the limited partnership and whether he breached the limited partnership agreement. Jiles Daniels and Judith Daniels married in 1997 and formed a number of business entities in 2000 to construct and manage apartment complexes near Prairie View A&M University. The couple formed Empty Eye, Inc., and the corporation, Jiles, and Judith signed a limited partnership agreement to form Empty Eye & Associates, L.P. Jiles and Judith each owned half of the shares of the corporation and were corporate officers. The corporation owned one percent of the limited partnership and served as its general partner, and Jiles and Judith were the limited partners. The entities built two complexes and planned to build a third called the “Cochran Project” in 2005. The partnership bought land and obtained financing from a bank. Pursuant to the loan agreement, Jiles and Judith both signed a personal guaranty of the partnership’s indebtedness, but each guaranty could be rescinded if no funds had been advanced. The partnership entered into contracts with contractors for work by the fall of 2006, but Jiles and Judith had begun having marital difficulties. In December 2006, Jiles filed for divorce. The bank had not advanced any funds on the Cochran Project at that point. In January 2007, Jiles informed Judith he did not want to proceed with the project, and in February 2007 Jiles rescinded his personal guaranty on the construction loan and asked the bank not to advance any funds for the Cochran Project. Shortly thereafter, the bank rescinded the construction loan. In January 2008, Judith, the partnership, and the corporation sued Jiles for breach of fiduciary duty and breach of contract. The jury found that Jiles breached his fiduciary duty to the partnership and the corporation and awarded damages on that basis. The jury also found that Jiles breached the limited partnership agreement and awarded the plaintiffs damages for breach of contract. The trial court rendered judgment that Jiles breached his fiduciary duty to the partnership and awarded damages to the partnership on the claim. The trial court also rendered judgment that Jiles breached the partnership agreement and awarded Judith and the corporation damages for breach of contract. Jiles appealed.

On appeal, Jiles argued that the evidence was legally insufficient to support the finding that he owed a fiduciary duty to the partnership and that he breached the partnership agreement. The court of appeals first concluded that, viewed in the light most favorable to the jury verdict, the evidence was legally sufficient to support the jury finding that Jiles had a fiduciary relationship with the partnership. Thus, the court overruled Jiles’s argument that he did not owe the partnership a fiduciary duty, which could form the basis of a claim for breach of fiduciary duty and affirmed the portion of the trial court’s ruling that awarded damages to the partnership for Jiles’s breach of fiduciary duty. Next, Jiles maintained that the trial court erred in awarding damages for breach of contract because the evidence was insufficient to support the finding that he breached the agreement. The court examined the written agreement and agreed with Jiles. Nothing in the agreement required Jiles to guarantee the partnership’s debts or restricted his right to rescind a guaranty given. In addition, no request for a guaranty was made by the general partner in writing as required by the agreement,
and there was no evidence of a call for capital contributions for which the guaranty by Jiles could have been indirectly or remotely made. Most importantly, the terms of the agreement allowed Jiles to rescind the guaranty if no funds had been advanced, which were the circumstances present. Rescinding the guaranty was not evidence that Jiles breached the agreement. The appellate court reversed the trial court’s ruling on the claim for breach of contract holding that the evidence was legally insufficient to support the jury’s finding that Jiles breached the agreement.


The plaintiffs, limited partners in Tuckerbrook/SB Global Special Situations Fund, L.P. (“GSS”), a Delaware limited partnership, sued the partnership, the general partner, and the managing member of the general partner for breach of the partnership agreement after the limited partners gave notice of withdrawal but were not paid their capital accounts and continued to be charged management fees. Under the partnership agreement, the management of GSS was vested exclusively in its general partner, Tuckerbrook/SB Global Special Situations Fund GP, L.L.C. (“GSS GP”). Tuckerbrook Alternative Investments, L.P. (“Tuckerbrook”) was a managing member of GSS GP with a fifty percent ownership interest and served as the investment manager and management company of GSS GP. Banerjee was hired to launch GSS along with serving as its portfolio manager. Under the partnership agreement, the limited partners had a right to withdraw from GSS if: “Banerjee dies, becomes incompetent or disabled (i.e., unable by reason of disease, illness or injury, to perform his functions as the managing member of the General Partner for 90 consecutive days), or ceases to be directly or indirectly involved in the activities of the General Partner.” In 2008, a letter was sent to the limited partners informing them that Banerjee had been terminated from his position as GSS’s portfolio manager but would continue to be a managing member of GSS GP. A month later, the plaintiffs notified GSS that they were withdrawing from the limited partnership based on “Banarjee’s lack of involvement in activities of” GSS GP. The defendants did not immediately act on the withdrawal notices, and Tuckerbrook declared GSS to be in dissolution in January 2009. The plaintiffs filed suit alleging that the defendants had breached the partnership agreement by failing to return their capital accounts in GSS and by charging the plaintiffs management fees after their withdrawal from GSS. The district court granted summary judgment in favor of the defendants on the basis that Banarjee remained active in the management of GSS GP. The partnership agreement gave the limited partners the right to withdraw from GSS if Banarjee “ceases to be directly or indirectly involved in the activities of [GSS GP],” and the district court defined the term “involved” to mean “to engage as a participant.” This definition was accepted by the parties. Thus, the primary issue was whether Banerjee had ceased to directly or indirectly “engage as a participant” in the activities of GSS GP. The court of appeals concluded that the record fully supported the conclusion of the district court that Banarjee “remained both directly and indirectly involved in the management of GSS, GP” following Banarjee’s termination. In Tuckerbrook’s letter advising the limited partners of Banerjee’s termination, Tuckerbrook noted that Banerjee would continue to be a managing member of GSS GP. Within days of Banerjee’s termination, Banerjee corresponded with the limited partners in GSS, counsel for GSS, GSS’s administrator, and GSS’s bank, stating that GSS GP could not act without Banerjee’s approval because he retained authority as a managing member and fifty percent owner of GSS GP. After this communication from Banerjee, GSS’s administrator took the position that it could not make disbursements to Tuckerbrook or take other actions without Banerjee’s approval. The court reviewed other evidence that showed Banarjee did in fact exert his influence even though Tuckerbrook might not have wanted Banarjee to maintain any authority. The court rejected the plaintiffs’ argument that the partnership agreement was ambiguous, finding the plaintiffs’ alternative interpretations of the withdrawal provision to be unnecessarily narrow and strained. The court also rejected an argument by the plaintiffs that Tuckerbrook could not challenge whether the withdrawal clause was triggered because Tuckerbrook itself submitted a withdrawal notice in its capacity as a managing member of another limited partner. The court of appeals agreed with the district court’s conclusion that the defendants were not estopped from challenging the validity of the plaintiffs’ withdrawal notices because there was no evidence that Tuckerbrook benefitted or that the plaintiffs relied to their detriment on the withdrawal notice submitted by Tuckerbrook.

Stone v. Midland Multifamily Equity REIT, 334 S.W. 3d 371 (Tex. App.—Dallas 2011, no pet.).

A limited partner sued the limited partnership and its general partner for failure to pay a preferred return and sued the general partner and an individual on a guaranty of the obligation. The trial court granted the limited partner summary judgment in part based on an affidavit of Gary C. Beck, who attested to facts regarding execution of the partnership agreement and guaranty, obligations under those documents, performance of obligations by the limited partner, alleged defaults by the defendants, and amounts allegedly owed by the defendants. The individual defendant objected to the affidavit on the grounds that Beck failed to establish the basis for his personal knowledge regarding the matters asserted in the affidavit. In the affidavit, Beck had merely described his relationship to the case by including a
statement of his position as Senior Vice President and Managing Director of the advisory service that worked with the limited partner. Beck did not describe what activities or responsibilities were encompassed within his position or explain how his job duties afforded him knowledge about the execution of the partnership agreement and the guaranty. The court concluded that summary judgment was improper because Beck’s affidavit was legally insufficient to support the factual allegations against the general partner in the limited partner’s summary judgment motion.


Valerus Compression Services, L.P. v. Austin, 417 S.W.3d 202 (Tex. App.–Houston [14th Dist.] Nov. 21, 2013, no pet.).

A limited partnership hired William Austin to serve as CFO of the partnership, and Austin purchased limited partnership interests governed by a partnership agreement that required arbitration of “all disputes arising out of or in connection with this Agreement.” The following year, Austin and the limited partnership executed a separation agreement reflecting the termination of Austin’s employment and addressing various matters, including Austin’s limited partnership interests. The separation agreement permitted Austin to retain his limited partnership interests without any forced redemption under the partnership agreement but allowed Austin to request the partnership to redeem the interests under the partnership agreement, in which event the partnership had the right but no obligation to redeem the interests. The separation agreement also contained a venue provision and a merger clause. When Austin began working for another company, the partnership notified Austin that his employment violated the noncompetition provision of the partnership agreement and permitted the partnership to forcibly redeem his partnership interests under the partnership agreement. The partnership redeemed Austin’s interests, and Austin sued for a declaratory judgment that the separation agreement remained in full force and effect, that Austin was not in breach of the separation agreement, that Austin was entitled to retain his partnership interests, and that the limited partnership must reissue his interests and return the certificates representing his interests. Austin also sued for conversion of his partnership interests and breach of the separation agreement. The limited partnership moved to compel arbitration and initiated an arbitration proceeding in which it sought declaratory relief. Austin opposed the motion to compel arbitration on the basis that the venue and merger provisions of the separation agreement operated to revoke or extinguish the arbitration provision of the partnership agreement with respect to the forcible redemption of his partnership interests. The court denied the motion to compel arbitration and granted Austin a stay of the arbitration proceedings. The court of appeals concluded that the trial court erred in denying the motion to compel arbitration and in granting a stay of the arbitration proceeding. The parties agreed that the separation agreement did not contain language expressly extinguishing the partnership agreement or its arbitration provision and that the partnership agreement and its arbitration agreement remained in effect as to some claims, but Austin argued that the provisions of the separation agreement permitting him to retain his partnership interests without forcible redemption along with the venue provision and merger clause revoked the arbitration agreement with respect to forced redemption of his interests. The court of appeals stated that the mere presence of venue and merger provisions does not invalidate an arbitration agreement when the provisions can be harmonized, and the court concluded that the venue clause in the separation agreement could be harmonized with the arbitration provision because the venue clause expressly contemplated both litigation and arbitration proceedings. The court next concluded that Austin’s claims fell within the scope of the arbitration clause. Austin argued that his claims were based only on the separation agreement, but the court concluded that adjudicating Austin’s claims would require interpretation of terms of the partnership agreement. Because Austin’s allegations were factually intertwined with arbitrable claims or otherwise touched on the subject matter of the partnership agreement, his claims fell within the scope of the arbitration clause.


Mehta signed a limited partnership agreement that contained an arbitration provision. Bathija signed the agreement on behalf of the limited partnership’s general partner. Mehta later sued the limited partnership, Bathija, and two other defendants, Satya, Inc. (the “corporation”) and Ali, for fraud in connection with his investment in the limited partnership. Mehta alleged that Bathija and Ali owned the corporation and the limited partnership and were the sole managers of the general partner. He additionally alleged that Bathija operated the limited partnership and that Bathija, Ali, and the corporation were agents of one another and were acting within the scope of their authority when committing the torts alleged in Mehta’s petition. The defendants sought to compel arbitration. The court of appeals concluded that Mehta’s claims fell within the scope of the arbitration clause, which covered “any dispute...between [the partners] relating to” the partnership agreement. Additionally, the court concluded that the defendants were entitled to enforce the arbitration provision even though Bathija did not sign the agreement in his individual capacity, and Ali and the
corporation did not sign it all. Mehta alleged that Bathija, Ali, the corporation, and the limited partnership were agents of one another, and the agents of a signatory to an agreement containing an arbitration clause can enforce the provision as to claims related to the agreement. Thus, the court affirmed the order compelling arbitration.


Three investors in two limited partnerships sued their CPA and his firm in connection with the CPA’s role in their investments. The CPA advised them regarding the opportunity to invest in the partnerships and was also a limited partner in the limited partnerships. The investors claimed that the CPA failed to disclose material information to them in connection with their investments, and the CPA and his firm sought to compel arbitration under arbitration provisions in the limited partnership agreements. The court first rejected an argument that the arbitration clause was ambiguous and circular because it required arbitration of any dispute in connection with the partnership agreement “that has not been or cannot be resolved under Section 9.1.” Section 9.1 was the arbitration provision, so the cross reference was a cross reference to the section itself. The court construed the provision to evince a clear intent to arbitrate unresolved disputes and held that the section did not fail for ambiguity. Next the court addressed the scope of the arbitration clause. The plaintiffs argued that the tort claims were not so interwoven with the partnership agreement that the claims could not be maintained without reference to the agreement. The plaintiffs also argued that their claims did not rely on the terms of the partnership agreements or allege that the CPA breached the agreement in any way, but rather arose solely from his independent duties as their CPA. The court stated that the presumption in favor of arbitration was particularly strong when the clause was broad as it was here (i.e., covering “any dispute arising out of, under, in connection with or in relation to” the partnership agreement). The basis of the claims was the CPA’s allegedly faulty or deceptive advice and counsel related to the investments represented by the partnership agreements, and the court characterized the claims as inextricably enmeshed and factually interwoven with the partnership agreements, the execution of which was the end result of the CPA’s services. The court stated that this was “admittedly a close, factually unique case” but concluded that the claims were conceivably “related to” the partnership agreements and that the court must defer on the side of arbitrability. Because the claims against the CPA’s firm were based on vicarious liability, those claims were likewise arbitrable. The scope of the arbitration clause was not limited to disputes solely between the parties, and the CPA’s firm was entitled to compel arbitration.


The court determined that an arbitration panel did not exceed its powers with respect to a provision contained in a limited partnership agreement and a shareholder agreement between the parties. The provisions in issue were put provisions that required the seller to deliver documents and assignments reasonably requested by the purchaser. The purchaser complained that the arbitrators had rewritten the agreements by requiring the purchaser to pay the put prices even if the seller failed to deliver documents reasonably requested. The court concluded that the arbitrators had the authority to interpret the contractual provisions in issue pursuant to the arbitration clause in the limited partnership and shareholder agreements that authorized the arbitrators to resolve “any dispute arising out of or relating to” the agreements. The arbitration award made clear that the purchaser must fulfill its payment obligation and that the seller must deliver the ownership interests and that nonperformance of the obligation to deliver documents did not authorize delayed performance by either party. That is, the arbitration panel interpreted the document delivery provisions as covenants rather than conditions to performance. When it made this determination it was applying the law and interpreting the agreements, not rewriting them, and the court stated that it did not have authority to second guess the panel’s decision on the merits of the contract interpretation.


A limited partnership agreement contained a clause requiring disputes arising out of the partnership agreement to be resolved in arbitration, and the partnership sought to stay this litigation on the basis that the claims on the loans at issue were subject to arbitration between the partners and thus “referable to arbitration” under Section 3 of the Federal Arbitration Act based on the partnership agreement. The court held that the partnership could not invoke the arbitration clause because it was not a party to the partnership agreement. The court said that the United States Supreme Court has allowed non-parties to invoke Section 3 of the Federal Arbitration Act when “the relevant state contract law allows [the non-parties] to enforce the agreement.” The court said that the partnership did not assert any grounds under state contract
law to show that it was entitled to enforce the partnership agreement, and the trial court thus did not err in denying the limited partnership’s motion to stay.


A limited partner sought removal of the general partner in a limited partnership by arbitration. The limited partner asserted that arbitration was required based on a provision in the partnership agreement that provided for removal of the general partner on specified grounds “as determined by an independent third-party mediator.” The trial court disagreed, and the limited partner appealed. On appeal, the court applied contract principles in interpreting the disputed provision in the partnership agreement and focused on the plain language of the agreement. The court distinguished between the process of mediation and arbitration and concluded that the reference to a mediator did not manifest a plain, clear, and certain intention to submit the partner removal issue to a third party for binding and final resolution. Thus, the court affirmed the trial court’s denial of the motion to compel arbitration.

### 4. Transfer Restrictions and Buyout Provisions


When Vega’s company was purchased by a limited partnership, Vega received units in the limited partnership and became employed by the limited partnership. Under his agreements with the limited partnership, Vega was entitled to sell his partnership interest back to the limited partnership if his employment was terminated without cause. After Vega was terminated, he sued the limited partnership for breach of contract and sought to require the limited partnership to repurchase his partnership interest for a price determined in accordance with a particular provision of the partnership agreement. The jury found that Vega was terminated without cause and assessed the value of his partnership interest at $1.98 million based on the testimony of Vega’s expert. The trial court granted a motion to disregard the expert’s testimony on the basis that it was unreliable and entered a JNOV. On appeal, the court examined the expert’s testimony and agreed with the trial court that it was unreliable. The provision of the partnership agreement that addressed valuation of the partnership interest specified the items to be included in the valuation and specified that no value be placed on goodwill or the name of the partnership. The expert failed to use existing generally accepted guidelines for concluding that no value was assigned to goodwill and also failed to demonstrate a reliable basis for contradictory opinions that his valuation assigned no goodwill to the limited partnership and, if it did, only assigned a $60,000 value to it. While the evidence was not legally sufficient to support the jury’s award, it constituted some evidence of value, and the trial court erred in rendering a take-nothing JNOV. Because liability was disputed, the court remanded for a new trial on all issues.


The court determined that an arbitration panel did not exceed its powers with respect to a provision contained in a limited partnership agreement and a shareholder agreement between the parties. The provisions in issue were put provisions that required the seller to deliver documents and assignments reasonably requested by the purchaser. The purchaser complained that the arbitrators had rewritten the agreements by requiring the purchaser to pay the put prices even if the seller failed to deliver documents reasonably requested. The court concluded that the arbitrators had the authority to interpret the contractual provisions in issue pursuant to the arbitration clause in the limited partnership and shareholder agreements that authorized the arbitrators to resolve “any dispute arising out of or relating to” the agreements. The arbitration award made clear that the purchaser must fulfill its payment obligation and that the seller must deliver the ownership interests and that nonperformance of the obligation to deliver documents did not authorize delayed performance by either party. That is, the arbitration panel interpreted the document delivery provisions as covenants rather than conditions to performance. When it made this determination it was applying the law and interpreting the agreements, not rewriting them, and the court stated that it did not have authority to second guess the panel’s decision on the merits of the contract interpretation.


Vicki Milner entered into a mediated settlement agreement (MSA) with her husband, Jack Milner, in their divorce proceeding. The MSA provided that Jack agreed to transfer to Vicki all of his “beneficial interest and record title in and to” a limited partnership and its LLC general partner subject to existing liabilities and the partnership agreement. Vicki agreed to substitute herself for Jack by assuming the outstanding liabilities of both entities. The exhibits to the MSA contained documents for all the partners to sign consenting to the transfer of Jack’s limited
partnership interest as well as his interest in the LLC general partner. There were three limited partners, Jack, Jack’s brother, and a third individual, Michael Hill. Jack and Vicki signed the consent document on the day they entered the MSA, but the other partners did not sign it that day. Jack’s brother signed the consent a few days later but then sold his interest to Hill a few days after signing the consent. The draft divorce decree proposed by Jack differed from the MSA in that it did not refer to any required consent of partners and simply contained an assignment of interest for Jack to execute. Vicki asserted that it was her understanding that the MSA was contingent on the consent of all partners to the transfer. Vicki withdrew her consent to the MSA based on this discrepancy, and Jack reasserted his motion that the court enter his previously filed draft of the divorce decree. The trial court signed the decree, which merely provided for the assignment of Jack’s partnership interest and did not mention the consent requirement or contain additional signature lines for the other partners. Arguing that the divorce decree did not properly reflect the MSA, Vicki filed a motion for a new trial, which was denied. The consent issue was important because the partnership agreement did not require the consent of the partners for Jack to merely assign his interest to Vicki, but consent of all the partners was required for her to become a substituted limited partner. Hill never signed the exhibits to the MSA, thus preventing Vicki from obtaining the consent required for her to become a limited partner. Because the rights of a limited partner are greater than an assignee, the distinction had a potential impact on the value of the transferred interest. The court of appeals concluded that the trial court abused its discretion by not setting aside the MSA because there was no meeting of the minds regarding the nature of the transferred interest in the limited partnership. The Texas Supreme Court examined the language of the MSA and concluded that it was ambiguous as to whether it required Vicki’s substitution as a limited partner. Thus, there was a fact question as to the parties’ intent requiring remand of the case to the trial court for the mediator to resolve the ambiguity. The court noted that Jack plainly agreed to transfer his “beneficial interest and record title” in the partnership and LLC, but the MSA did not explain what this entailed. The phrase was not defined in either the MSA or the partnership agreement, and the court cited various dictionary definitions and case law addressing these terms. The court pointed out that the term “beneficial ownership interest” used in the title of the MSA exhibits does not appear in the legal dictionary and is not clearly defined in Texas law. The court concluded that the references in the MSA to both “beneficial interest and record title” and “beneficial ownership,” standing alone, were consistent with either an assignment of the partnership interest or transfer of full limited partnership rights. The court examined the provisions of the partnership agreement, which recognized that a person acquiring a partnership interest could do so by substitution as a full partner or by assignment. The partnership agreement characterized an ownership transfer as either an authorized transfer, one to which all partners consented, or an unauthorized transfer, which the partnership agreement contemplated would typically result from death, divorce, or incompetency of a partner. The partnership agreement specifically addressed divorce of a partner by providing that a former spouse would not be considered a substituted partner or have any voting rights or rights relative to the operating or management of the partnership except as provided in the agreement or the Texas Revised Limited Partnership Act. The court explained that the partnership agreement permitted a former spouse, like any other person, to be substituted as a partner if all other partners consented, which consent could be withheld or granted in the sole discretion of the partners. Jack argued that the parties intended no more than an unauthorized assignment of his partnership interest due to the absence of an express requirement or contingency in the MSA that the consent of the other partners be obtained. The supreme court did not agree that the absence of such an express provision clearly confirmed the parties’ intent. The court pointed out that the MSA might have used the term “assignee,” which was defined in the partnership agreement with reference to the Texas Revised Limited Partnership Act, rather than “beneficial interest and record title” if the intention was merely to assign Jack’s partnership interest. The supreme court also pointed that the phrase “beneficial interest and record title” was used in the partnership agreement when referring to what could only be transferred by unanimous consent. The court stated that references in the MSA to “beneficial interest and record title” and the consent requirement in the partnership agreement along with the inclusion of consent forms to be signed by the other partners suggested the admission of a substitute partner rather than a mere assignment. In sum, the court concluded that the question of what Jack promised to deliver was not clear and that the parties’ intent was a question of fact.

A dissent by Justice Johnson joined by Justices Green and Willet argued that the language of the MSA was unambiguous and required only that Jack transfer his interest and sign the consent. Like the majority, the dissenting justices discussed the relationship of the MSA to the partnership agreement and the terminology used therein, but the dissent concluded that the only reasonable construction of the MSA was that Jack and Vicki agreed that Jack’s transfer of his interests were subject to the partnership agreement provisions requiring consent of all partners to admit Vicki as a limited partner and that the MSA did not compel Jack to obtain the consent of other partners or imply an unexpressed material contingency that Vicki be admitted as a limited partner.
5. Removal of General Partner

Driveway Austin GP, LLC v. Turbo Partners, LLC, 409 S.W.3d 197 (Tex. App.–Amarillo 2013, pet. granted, judgm’t vacated w.r.m.).

Driveway Austin, LP, a limited partnership that was formed to build and operate a road racing and off-road motorsports training and entertainment complex, was governed by a partnership agreement that named Driveway Austin GP, LLC (“Driveway”) as the general partner and provided for 2 classes of limited partners. Class A limited partners provided the capital, and Class B partners provided no capital. The partnership agreement expressly provided that the general partner could only be removed by a 100% vote of the Class B limited partners, but the partnership agreement also provided that “[e]xcept as herein otherwise expressly provided,” the partnership agreement could only be amended by a written consent of a majority in interest of the limited partners. After certain Class A limited partners became dissatisfied with the business, they executed an Action by Written Consent of Limited Partners in Lieu of Special Meeting that purported to amend the provision of the limited partnership agreement regarding removal of a general partner to provide that the general partner could be removed by the vote or written consent of a majority in interest of Class A limited partners. Driveway attempted to appease the Class A partners, but Class A limited partners subsequently executed another Action by Written Consent of Limited Partners in Lieu of Special Meeting that purported to amend the partnership agreement to remove Driveway as general partner and substitute Turbo Partners, LLC (“Turbo”), as the general partner. Turbo filed a certificate of amendment with the Texas Secretary of State to reflect that Turbo was the general partner, but Driveway thwarted Turbo’s efforts when it attempted to assume control of the partnership’s operations. Turbo filed suit against Driveway seeking a declaratory judgment that the two amendments were valid and that Turbo was the general partner. Each party moved for summary judgment, and the trial court granted summary judgment in favor of Turbo.

The court of appeals concluded that the provisions of the limited partnership agreement were not ambiguous and that the amendments effected by the Class A limited partners were valid such that Turbo replaced Driveway as general partner. The court applied general principles of contract interpretation and construction to the following two provisions at issue:

9.06 Amendment of Agreement. A. Except as herein otherwise expressly provided, this Agreement may be amended, supplemented or restated only by a written consent of a Majority in Interest of the Limited Partners....

3.08 Removal and Withdrawal of General Partner. The General Partner may be removed by the Partners, but only for good cause, at a special meeting of the Partners called for such purpose by the vote-holders of one hundred percent (100%) of the Class B Units.

Neither party cited any Texas authority directly addressing the proper construction of a contract that allows amendment by majority vote but that requires unanimity for certain actions. Applying common rules of grammar to Section 9.06 led the court to the conclusion that the provision allowed the partnership agreement to be amended, supplemented, or restated by a majority in interest of the limited partners unless the agreement otherwise expressly provided a different requirement for amendment, supplementation, or restatement of the agreement. The court pointed out that the agreement did actually expressly provide different requirements for amending the voting rights of limited partners in distributable cash, cash flow from a terminating capital transaction or profits and losses for tax purposes, or allocations among the limited partners. The partnership agreement also provided for certain instances in which the general partner alone could amend the agreement. While Section 3.08 provided a different vote to remove a general partner, nothing in that provision or the rest of the partnership agreement expressly provided a different requirement for amending Section 3.08. The court rejected Driveway’s argument that Section 3.08’s express provision requiring the unanimous vote of Class B limited partners to remove the general partner fell within the exception in Section 9.06. The summary judgment evidence showed that a majority in interest of the limited partners gave written consent to the first written consent amending the removal provision and to the second written consent removing Driveway as general partner and replacing it with Turbo. Thus, the court affirmed the court’s summary judgment in favor of Turbo. The court also rejected an argument by Driveway that Turbo did not have standing to seek a declaration of rights under the partnership agreement. Since the court concluded that Turbo was properly substituted as general partner, it was a party to the partnership agreement. A person interested under a written contract may bring an action for declaratory judgment to have determined any question of construction or validity arising under the contract and to obtain a declaration of rights, status, or other legal relations under the contract. When Turbo filed its petition, a controversy existed as to whether it or
Dissolution

**ART Midwest, Inc. v. Atlantic Limited Partnership XII**, 742 F.3d 206 (5th Cir. 2014).

The parties in this case sued one another after a real estate transaction between the parties collapsed, and this appeal was the second appeal in the case. The real estate transaction at issue involved an agreement by the plaintiffs to acquire eight apartment complexes from the defendants and was structured so that a limited partnership intermediary would be the nominal buyer. (For ease of reference, the court in this opinion referred to the “patchwork of contracts” governing the transaction collectively as “the agreement.”) The plaintiffs purported to terminate the deal on behalf of the partnership because of a title problem, but the defendants contended that they did not default in their obligations and that the plaintiffs did not have the right to terminate the agreement. The plaintiffs sued for fraud on the basis that the defendants misrepresented matters regarding the title to the property and seeking a declaratory judgment that the plaintiffs properly terminated the deal. The defendants countersued the plaintiffs for breaching the agreement by improperly terminating it. The jury found that the plaintiffs properly terminated the deal but that the defendants did not commit fraud. In the first appeal, a panel of the Fifth Circuit held that there was no failure by the defendants to render marketable title and thus no default by the defendants entitling the plaintiffs to terminate. On remand, the district court granted partial summary judgment for the defendants holding that the plaintiffs improperly terminated the agreement and that the plaintiffs owed capital contributions to the partnership under the agreement. The district court put the remaining issues, including whether the plaintiffs breached a fiduciary duty to the defendants and the amount of damages, before a jury. The jury found that the plaintiffs breached a fiduciary duty to the defendants owed capital contributions under the agreement. The plaintiffs appealed and one of the issues on appeal was the partnership’s dissolution date. The agreement provided that the partnership was dissolved 90 days after the sale or other disposition of all or substantially all of the assets of the partnership. In the first proceeding, the district court found that the plaintiffs’ March 22, 1999 letter purporting to terminate the deal dissolved the partnership, but on remand the district court found that the partnership dissolved on May 20, 2002. The court of appeals concluded that the plain language of the agreement supported the district court’s finding that the partnership dissolved on May 20, 2002. The agreement provided that the partnership dissolved 90 days after the “disposition” of “all of substantially all of the assets” of the partnership, and the dictionary defines “dispose” to mean “transfer or part with, as by selling.” The court found that all or substantially all of the partnership’s assets were disposed of as a result of a judicial foreclosure. The plaintiffs did not dispute that the partnership did not part with the assets until the February 19, 2002 decree of foreclosure, and the district court thus did not err in finding that the partnership dissolved 90 days after the decree on May 20, 2002. The district court’s earlier finding was based on its conclusion that the plaintiffs terminated the deal on March 22, 1999, but the panel’s holding in the first appeal that the defendants tendered marketable title meant that the plaintiffs could not terminate based on a claim of bad title, and the district court was required to revisit the issue of the dissolution date. The plaintiffs argued that the filing of a certificate of cancellation with the Secretary of State confirmed under the Texas Revised Limited Partnership Act that the partnership dissolved on March 22, 1999, but the court stated that the plain language of the agreement controlled. The court noted that the plaintiffs did not dispute the district court’s finding that the partnership dissolved 90 days after the decree on May 20, 2002. The court of appeals concluded that the plain language of the agreement provided that the partnership was dissolved 90 days after the sale or other disposition of all or substantially all of the assets of the partnership. The plaintiffs appealed and one of the issues on appeal was the partnership’s dissolution date. The agreement provided that the partnership was dissolved 90 days after the sale or other disposition of all or substantially all of the assets of the partnership. 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The plaintiffs did not dispute that the partnership did not part with the assets until the February 19, 2002 decree of foreclosure, and the district court thus did not err in finding that the partnership dissolved 90 days after the decree on May 20, 2002. The district court’s earlier finding was based on its conclusion that the plaintiffs terminated the deal on March 22, 1999, but the panel’s holding in the first appeal that the defendants tendered marketable title meant that the plaintiffs could not terminate based on a claim of bad title, and the district court was required to revisit the issue of the dissolution date. The plaintiffs argued that the filing of a certificate of cancellation with the Secretary of State confirmed under the Texas Revised Limited Partnership Act that the partnership dissolved on March 22, 1999, but the court stated that the plain language of the agreement controlled. The court noted that the plaintiffs did not dispute the district court’s finding that the certificate was filed without authority and was ineffective to terminate the partnership. The plaintiffs argued that the district court’s second dissolution finding revived a partnership that had effectively been dead for nearly a decade in violation of the equitable mootness doctrine, but the court said that the plaintiffs did not identify a persuasive reason to apply that bankruptcy-specific doctrine to this case.
This case involved a dispute regarding the breakup of a medical practice group engaged in a cardiology practice. Dr. Bhatia sued the other members of the group over Bhatia’s interest in a limited partnership that was one of the entities involved in the practice. In 2003, Bhatia and the other four cardiologists who were owners of the entities began having business disputes. The practice involved several related business entities, including North Houston Heart Center, PLLC (“NHHC”), which was the clinical practice, and the Northwest Houston Cardiovascular Imaging Center II, Ltd. (“the Imaging Center”), which was the provider of diagnostic testing to clients of NHHC. The defendants made plans to begin a new practice in a different building, and Bhatia planned to practice in the current building. On February 17, 2003, a meeting for NHHC was noticed, and on that day the five doctors voted unanimously to dissolve “the organization” as of September 1, 2003. No specific entity was expressly mentioned in the meeting notice or vote on the dissolution, but there was testimony that the partners treated the various entities as a “unitary bucket” so that the vote to dissolve the organization was effective to dissolve all of the business entities. Bhatia and some of the defendants met on September 15, 2003, to discuss the allocation of equipment. Several accounting experts later testified that Bhatia received at least his fair share of the equipment, his patient files, and cash distribution in the winding up of the business, and liabilities were disposed of with the defendants satisfying the debts after Bhatia failed to complete his contributions. After September 30, 2003, the defendants moved into and opened their new building while continuing to treat patients as they had at the current building with some of the same employees and equipment. Bhatia continued to practice at the current building with some of the same employees and equipment.

Bhatia subsequently sued the other doctors and the entities involved in the practice for, among other causes of action, breach of fiduciary duty, breach of contract as to the partnership agreement, conversion, and misappropriation of partnership assets. The defendants counterclaimed for breach of fiduciary duty, conversion, and misappropriation, among other claims. In essence, Bhatia alleged at trial and on appeal that the Imaging Center never properly and officially dissolved, so when the defendants continued performing diagnostic testing of patients at their new location with much of the same equipment and many of the same employees it was in effect a continuation of the Imaging Center. Bhatia thus argued that he was entitled to the value of his interest as a withdrawing partner in an ongoing partnership rather than the value of his interest in a dissolved or defunct partnership. At trial, the jury found that neither the plaintiff nor the defendants committed any of the alleged causes of action other than breach of their fiduciary duties. The jury did not award damages to anyone. The trial court entered judgment in accordance with the jury’s verdict and awarded attorney’s fees to the defendants as the “prevailing parties” as authorized by the partnership agreement. Bhatia appealed on numerous grounds.

First, Bhatia contended that the partnership continued as an ongoing concern after the date of dissolution and that he was thus entitled to the fair market value of his partnership interest. Bhatia made a number of arguments to support his allegation that the trial court erred in its judgment on this issue. Bhatia alleged that the trial court should have awarded him the fair market value of his interest in the Imaging Center as of September 30, 2003, as a matter of law due to his “disassociation” from the partnership, which he characterized as a withdrawal under the Texas Revised Limited Partnership Act, an expulsion or transfer of his interest under the Texas Revised Partnership Act, or a repurchase of his interest under the partnership agreement. However, none of the statutory provisions relied upon by Bhatia on appeal were raised at trial, and the court of appeals stated that it could not reverse the trial court’s judgment based on a theory of recovery that was not pled and proven below. Further, Bhatia’s arguments presumed that the Imaging Center continued as a going concern after September 30, 2003. If the Imaging Center did not continue to operate after that date, Bhatia’s argument that he was a withdrawing or expelled partner or that his interest had been transferred or repurchased because he no longer participated was without merit. The court of appeals determined that the evidence at trial failed to conclusively demonstrate that the Imaging Center continued as a going concern after September 30, 2003. For example, the evidence showed that Bhatia and the other doctors each made arrangements before September 30, 2003, to form new business entities that would provide essentially the same services as the Imaging Center, with each having some of the same equipment and employees as the partnership had, but neither conducted business as the Imaging Center. In addition, Bhatia neither pled nor proved any theory to establish a basis for piercing the corporate veil or why the business form of the new entities should be disregarded or treated as a continuation of the Imaging Center. Thus, Bhatia did not demonstrate that the trial court should have awarded him the value of his interest in a going concern as a matter of law.

Next, Bhatia contended that the jury’s finding that no breach of the partnership agreement occurred was not supported by sufficient evidence because the Imaging Center was not formally dissolved in accordance with the partnership agreement, which required written consent of the general partner and limited partners holding 2/3 of the partnership interests held by all limited partners. The defendants argued that the meeting fulfilled the written consent requirement because it was recorded by audiotape and later transcribed and made a part of the formal minutes of the
George and Wilmer allowed Leick to return to the office on October 6 and 7 to tie up loose ends. On October 3, 2008, George and Wilmer decided to terminate Leick’s association with the partnership for a variety of reasons. However, the remaining partners could determine that a payment would be made to an involuntarily terminated partner. His or her interest in the partnership on the day of departure, and no payment to the departing partner was required. If the termination was voluntary, the agreement required the departing partner to sell his or her interest to the partnership or other partners according to a prescribed formula. If the termination was involuntary, the departing partner relinquished his or her interest in the partnership’s assets. The court of appeals concluded that the defendants’ expert used an improper method in determining the value of Bhatia’s interest because the expert relied on book value rather than fair market value of the partnership assets. The court determined that among the many causes of action, the focus at trial and on appeal was Bhatia’s claim for breach of fiduciary duty and breach of contract. These two claims were intermingled and were the bases for the vast majority of testimony and the essence of Bhatia’s contention that he was entitled to $7.29 million in actual damages. According to Bhatia and his expert, if the Imaging Center were not in operation after the dissolution, Bhatia would be entitled to the fair market value of his interest in the continuing business, which the expert calculated to be $7.29 million. Bhatia also complained about the procedures used to allocate the assets of the Imaging Center post dissolution. The defendants’ expert testified that if the Imaging Center dissolved, Bhatia would be entitled to only his percentage interest in the value of the dissolved partnership’s assets. Bhatia further contended that the defendants’ expert used an improper method in determining the value of Bhatia’s interest because the expert relied on book value rather than fair market value of the partnership assets. The court of appeals concluded that the expert’s testimony indicated that the expert did not simply look at book value, but undertook to derive a market value of the assets. In addition, several experts testified that if the Imaging Center were not a continuing concern, Bhatia received at least his fair share of the partnership’s assets, including cash distributions, equipment, and files related to his patients. There was also evidence that Bhatia failed to pay for his share of the partnership’s liabilities, and the debts were satisfied by the defendants. Thus, Bhatia failed to conclusively establish his entitlement to damages or that the jury’s finding of zero damages was against the great weight and preponderance of the evidence.

Finally, Bhatia alleged that the trial court erred in awarding attorney’s fees to the defendants as the “parties prevailing” under the partnership agreement. The partnership agreement provided that if any litigation was initiated by any partner against another partner or the partnership relating to the agreement or the subject matter of the partnership agreement, the “party prevailing” in the litigation was entitled to recover reasonable attorney’s fees incurred in connection with the litigation. Since the partnership agreement did not define “party prevailing,” the court of appeals assumed the parties meant for the phrase’s ordinary meaning to apply. The court of appeals cited previous cases in which it has concluded that the “prevailing party” in similar contract provisions meant the party that prevailed on the “main action” or the “main issue” in the litigation. Typically, for defendants to prevail would require a take-nothing judgment on the main issue in the case. The court determined that among the many causes of action, the focus at trial and on appeal was Bhatia’s claim for breach of fiduciary duty and breach of contract. These two claims were intermingled and were the bases for the vast majority of testimony and the essence of Bhatia’s contention that he was entitled to $7.29 million in actual damages. According to the court of appeals, it was clear which party prevailed on these two claims. The jury failed to find that the defendants breached the partnership agreement, and while the jury found that the defendants breached their fiduciary duties, it also found that the breach did not cause any actual damages to Bhatia. The purpose of the plaintiff’s lawsuit was to recover damages, and he failed to do so. The purpose of the defendants’ defense was to avoid paying damages, and they were successful in that regard. Thus, the trial court did not err in awarding the defendants attorney’s fees per the partnership agreement.

7. Withdrawal of Limited Partner


George, Leick, and Wilmer were the limited partners of a limited partnership formed to sell insurance. The limited partners were also the shareholders of the corporate general partner. The partnership agreement contained provisions regarding voluntary or involuntary termination of a limited partner’s association with the partnership. If the termination was voluntary, the agreement required the departing partner to sell his or her interest to the partnership or other partners according to a prescribed formula. If the termination was involuntary, the departing partner relinquished his or her interest in the partnership on the day of departure, and no payment to the departing partner was required. However, the remaining partners could determine that a payment would be made to an involuntarily terminated partner. George and Wilmer decided to terminate Leick’s association with the partnership on October 3, 2008, for a variety of reasons including Leick’s lack of business production. After informing Leick that they were terminating him as a partner, they changed bank signature cards for the partnership and removed all partnership financial records from Leick’s possession. George and Wilmer allowed Leick to return to the office on October 6 and 7 to tie up loose ends. On October
the remaining partners offered Leick the amount of money they believed he would be entitled to if he were voluntarily terminating his association with the partnership. Leick rejected the amount and insisted George and Wilmer had miscalculated such that he would be owed a larger amount as a voluntarily terminated partner. On October 17, the remaining partners responded through their attorney that Leick was not entitled to any amount under the agreement as an involuntarily terminated partner. At that time, the remaining partners made another offer to Leick in an amount somewhat less than the original offer and stated that the offer would be reduced further if the matter proceeded. On November 12, 2008, the partnership and the remaining partners filed suit against Leick seeking a declaratory judgment that Leick was involuntarily terminated and that the plaintiffs were not required to make any payment to Leick. Leick answered and filed counterclaims for breach of contract and breach of fiduciary duty. At trial, the court granted the plaintiffs’ motion for directed verdict on Leick’s cause of action for breach of fiduciary duty. The jury found that Leick did not voluntarily terminate his status as a partner before the plaintiffs involuntarily terminated him and that the plaintiffs complied with the agreement when involuntarily terminating Leick. The jury also found that the plaintiffs should have paid Leick the amount of the original offer as an involuntarily terminated partner. The trial court entered judgment awarding Leick damages and attorney’s fees.

On appeal, the plaintiffs argued that the trial court erred when submitting the jury question inquiring as to what amount should have been paid to Leick as an involuntarily terminated partner. The plaintiffs complained that this question improperly included an implied covenant of fair dealing in the partnership agreement by instructing the jury that “the remaining partners were obligated to act fairly and reasonably toward the involuntarily terminated partner” when the partners were deciding whether and what amount Leick should have been paid as an involuntarily terminated partner. The appellate court agreed that an implied covenant was inserted into the partnership agreement by this instruction and explained that implied covenants are not favored in Texas law. The court stated that a covenant simply to make a contract “‘fair, wise, or just’” and that it must be apparent from the written terms of an agreement that the implied covenant was so clearly within the contemplation of the parties that they deemed it unnecessary to express it. Leick argued that the instruction that the remaining partners were obligated to act fairly and reasonably toward an involuntarily terminated partner was proper because it set forth the law governing relations between partners in effect at the time of the contract and was thus incorporated into the contract. Leick pointed to the Texas Revised Partnership Act (TRPA) and Texas common law regarding the relationship between partners. The court acknowledged that TRPA provides that a partner is obligated to act reasonably and in good faith and owes the other partners and the partnership duties of loyalty and care, but the court stated that the plaintiffs did not owe Leick these duties because he was no longer a partner after he was terminated and departed from the partnership. According to the court, there was no evidence that Leick remained a partner after October 14, 2008, and the plaintiffs did not have the heightened duty toward Leick set forth in TRPA or the common law after that date. The court stated that any negotiations regarding payment to Leick prior to his involuntary termination no longer mattered because the plaintiffs owed him nothing under the partnership agreement or the law cited by Leick once he was involuntarily terminated and departed. Thus, the trial court erred in imposing a duty to act fairly and reasonably in determining whether and what amount to pay Leick as an involuntarily terminated partner. Without the court-imposed duty of acting fairly and reasonably toward Leick, the only amount Leick was required to be paid was any amount the partners desired to pay Leick, and it was undisputed that they desired to pay nothing. The trial court should have disregarded the jury’s answer to this issue since the amount to be paid was entirely in the plaintiffs’ discretion, and the appellate court reversed and rendered a take-nothing judgment on Leick’s breach of contract claim.

Leick claimed on appeal that the trial court erred in granting the plaintiffs’ motion for directed verdict on his cause of action for breach of fiduciary duty. The court stated in a footnote that Texas law is not clear as to whether limited partners owe each other fiduciary duties, and the court made no determination in this case whether the limited partners owed each other fiduciary duties. Assuming the plaintiffs owed a duty to Leick while he was a partner, they owed him no fiduciary duty after he ceased to be a partner. The partnership agreement made clear that Leick relinquished his partnership interest when he was terminated and departed, which the evidence showed occurred at the latest on October 14, 2008. Thus, the plaintiffs owed no fiduciary duty to Leick as a partner from that date on. Leick alleged that the plaintiffs breached their fiduciary duties by failing to pay fair value for his partnership interest, but the court explained that when the plaintiffs filed suit on November 12, 2008, seeking a declaration that no required payment existed under the agreement, Leick was no longer a partner, and the plaintiffs thus had no fiduciary duty toward Leick as a partner when they decided to make no payments to him. Leick argued that he presented evidence that Wilmer and George secretly conspired to terminate his partnership interest by involuntarily terminating him, that they failed to negotiate in good faith with him about the value of his interest, and that they funded the lawsuit with money Leick otherwise would have received from his interest in the partnership. The court stated that George and Wilmer had no fiduciary duty to remain partners with Leick, so the involuntary termination in compliance with the agreement in and of

The plaintiffs, limited partners in Tuckerbrook/SB Global Special Situations Fund, L.P. (“GSS”), a Delaware limited partnership, sued the partnership, the general partner, and the managing member of the general partner for breach of the partnership agreement after the limited partners gave notice of withdrawal but were not paid their capital accounts and continued to be charged management fees. Under the partnership agreement, the management of GSS was vested exclusively in its general partner, Tuckerbrook/SB Global Special Situations Fund GP, L.L.C. (“GSS GP”). Tuckerbrook Alternative Investments, L.P. (“Tuckerbrook”) was a managing member of GSS GP with a fifty percent ownership interest and served as the investment manager and management company of GSS GP. Banerjee was hired to launch GSS along with serving as its portfolio manager. Under the partnership agreement, the limited partners had a right to withdraw from GSS if: “Banerjee dies, becomes incompetent or disabled (i.e., unable by reason of disease, illness or injury, to perform his functions as the managing member of the General Partner for 90 consecutive days), or ceases to be directly or indirectly involved in the activities of the General Partner.” In 2008, a letter was sent to the limited partners informing them that Banerjee had been terminated from his position as GSS’s portfolio manager but would continue to be a managing member of GSS GP. A month later, the plaintiffs notified GSS that they were withdrawing from the limited partnership based on “Banarjee’s lack of involvement in activities of” GSS GP. The defendants did not immediately act on the withdrawal notices, and Tuckerbrook declared GSS to be in dissolution in January 2009. The plaintiffs filed suit alleging that the defendants had breached the partnership agreement by failing to return their capital accounts in GSS and by charging the plaintiffs management fees after their withdrawal from GSS. The district court granted summary judgment in favor of the defendants on the basis that Banarjee remained active in the management of GSS GP. The partnership agreement gave the limited partners the right to withdraw from GSS if Banerjee “ceases to be directly or indirectly involved in the activities of [GSS GP],” and the district court defined the term “involved” to mean “to engage as a participant.” This definition was accepted by the parties. Thus, the primary issue was whether Banerjee had ceased to directly or indirectly “engage as a participant” in the activities of GSS GP. The court of appeals concluded that the record fully supported the conclusion of the district court that Banarjee “remained both directly and indirectly involved in the management of GSS, GP” following Banarjee’s termination. In Tuckerbrook’s letter advising the limited partners of Banarjee’s termination, Tuckerbrook noted that Banerjee would continue to be a managing member of GSS GP. Within days of Banarjee’s termination, Banerjee corresponded with the limited partners in GSS, counsel for GSS, GSS’s administrator, and GSS’s bank, stating that GSS GP could not act without Banerjee’s approval because he retained authority as a managing member and fifty percent owner of GSS GP. After this communication from Banarjee, GSS’s administrator took the position that it could not make disbursements to Tuckerbrook or take other actions without Banerjee's approval. The court reviewed other evidence that showed Banerjee did in fact exert his influence even though Tuckerbrook might not have wanted Banerjee to maintain any authority. The court rejected the plaintiffs’ argument that the partnership agreement was ambiguous, finding the plaintiffs’ alternative interpretations of the withdrawal provision to be unnecessarily narrow and strained. The court also rejected an argument by the plaintiffs that Tuckerbrook could not challenge whether the withdrawal clause was triggered because Tuckerbrook itself submitted a withdrawal notice in its capacity as a managing member of another limited partner. The court of appeals agreed with the district court’s conclusion that the defendants were not estopped from challenging the validity of the plaintiffs’ withdrawal notices because there was no evidence that Tuckerbrook benefitted or that the plaintiffs relied to their detriment on the withdrawal notice submitted by Tuckerbrook.
8. Amendment of Partnership Agreement

*Driveway Austin GP, LLC v. Turbo Partners, LLC*, 409 S.W.3d 197 (Tex. App.–Amarillo 2013, pet. granted, judgm’t vacated w.r.m.).

Driveway Austin, LP, a limited partnership that was formed to build and operate a road racing and off-road motorsports training and entertainment complex, was governed by a partnership agreement that named Driveway Austin GP, LLC (“Driveway”) as the general partner and provided for 2 classes of limited partners. Class A limited partners provided the capital, and Class B partners provided no capital. The partnership agreement expressly provided that the general partner could only be removed by a 100% vote of the Class B limited partners, but the partnership agreement also provided that “[e]xcept as herein otherwise expressly provided,” the partnership agreement could only be amended by a written consent of a majority in interest of the limited partners. After certain Class A limited partners became dissatisfied with the business, they executed an Action by Written Consent of Limited Partners in Lieu of Special Meeting that purported to amend the provision of the limited partnership agreement regarding removal of a general partner to provide that the general partner could be removed by the vote or written consent of a majority in interest of Class A limited partners. Driveway attempted to appease the Class A partners, but Class A limited partners subsequently executed another Action by Written Consent of Limited Partners in Lieu of Special Meeting that purported to amend the partnership agreement to remove Driveway as general partner and substitute Turbo Partners, LLC (“Turbo”), as the general partner. Turbo filed a certificate of amendment with the Texas Secretary of State to reflect that Turbo was the general partner, but Driveway thwarted Turbo’s efforts when it attempted to assume control of the partnership’s operations. Turbo filed suit against Driveway seeking a declaratory judgment that the two amendments were valid and that Turbo was the general partner. Each party moved for summary judgment, and the trial court granted summary judgment in favor of Turbo.

The court of appeals concluded that the provisions of the limited partnership agreement were not ambiguous and that the amendments effected by the Class A limited partners were valid such that Turbo replaced Driveway as general partner. The court applied general principles of contract interpretation and construction to the following two provisions at issue:

9.06 Amendment of Agreement. A. Except as herein otherwise expressly provided, this Agreement may be amended, supplemented or restated only by a written consent of a Majority in Interest of the Limited Partners....

3.08 Removal and Withdrawal of General Partner. The General Partner may be removed by the Partners, but only for good cause, at a special meeting of the Partners called for such purpose by the vote-holders of one hundred percent (100%) of the Class B Units.

Neither party cited any Texas authority directly addressing the proper construction of a contract that allows amendment by majority vote but that requires unanimity for certain actions. Applying common rules of grammar to Section 9.06 led the court to the conclusion that the provision allowed the partnership agreement to be amended, supplemented, or restated by a majority in interest of the limited partners unless the agreement otherwise expressly provided a different requirement for amendment, supplementation, or restatement of the agreement. The court pointed out that the agreement did actually expressly provide different requirements for amending the voting rights of limited partners in distributable cash, cash flow from a terminating capital transaction or profits and losses for tax purposes, or allocations among the limited partners. The partnership agreement also provided for certain instances in which the general partner alone could amend the agreement. While Section 3.08 provided a different vote to remove a general partner, nothing in that provision or the rest of the partnership agreement expressly provided a different requirement for amending Section 3.08. The court rejected Driveway’s argument that Section 3.08’s express provision requiring the unanimous vote of Class B limited partners to remove the general partner fell within the exception in Section 9.06. The summary judgment evidence showed that a majority in interest of the limited partners gave written consent to the first written consent amending the removal provision and to the second written consent removing Driveway as general partner and replacing it with Turbo. Thus, the court affirmed the court’s summary judgment in favor of Turbo. The court also rejected an argument by Driveway that Turbo did not have standing to seek a declaration of rights under the partnership agreement. Since the court concluded that Turbo was properly substituted as general partner, it was a party to the partnership agreement. A person interested under a written contract may bring an action for declaratory judgment to have determined any question of construction or validity arising under the contract and to obtain a declaration of rights, status, or other legal relations under the contract. When Turbo filed its petition, a controversy existed as to whether it or
Driway was the general partner of the limited partnership. Thus, the court concluded that Turbo had standing to bring the action.

A dissenting justice argued that the requirement of unanimous consent of the Class B partners to removal of a partner under Section 3.08 was an exception to the majority in interest vote required for an amendment of the partnership agreement under Section 9.06. The dissenting justice emphasized contract construction principles that required a harmonious, reasonable, and equitable construction of the partnership agreement. Guided by such principles and application of common rules of grammar, the dissenting justice argued that the parties clearly intended for the limiting provision “except as herein otherwise expressly provided” to apply to the vote necessary to effectuate an amendment rather than the act of amending. Because Turbo’s construction of the partnership agreement rendered the protections provided by Section 3.08 illusory and meaningless, the dissenting justice did not find that construction to be reasonable, necessary, or appropriate.

9. Attorney’s Fees


This case involved a dispute regarding the breakup of a medical practice group engaged in a cardiology practice. The practice involved several related business entities, including a limited partnership of which Dr. Bhatia and four other doctors were the limited partners. At a meeting called for one of the entities a vote was taken to dissolve “the organization.” Bhatia contended that this action was not sufficient to satisfy the requirements for a vote to dissolve a limited partnership that was one of the entities involved in the practice and that Bhatia was not adequately compensated for his interest in the limited partnership in the break-up of the medical practice. Bhatia sued the other doctors and the entities involved in the practice for, among other causes of action, breach of fiduciary duty, breach of contract as to the partnership agreement, conversion, and misappropriation of partnership assets. The defendants counterclaimed for breach of fiduciary duty, conversion, and misappropriation, among other claims. At trial, the jury found that neither the plaintiff nor the defendants committed any of the alleged causes of action other than breach of their fiduciary duties. The jury did not award damages to anyone. The trial court entered judgment in accordance with the jury’s verdict and awarded attorney’s fees to the defendants as the “prevailing parties” as authorized by the partnership agreement. Bhatia appealed on numerous grounds. On appeal, the court of appeals rejected Bhatia’s arguments that the trial court erred in entering a take-nothing judgment on Bhatia’s causes of action. Bhatia also alleged that the trial court erred in awarding attorney’s fees to the defendants as the “parties prevailing” under the partnership agreement. The partnership agreement provided that if any litigation was initiated by any partner against another partner or the partnership relating to the agreement or the subject matter of the partnership agreement, the “party prevailing” in the litigation was entitled to recover reasonable attorney’s fees incurred in connection with the litigation. Since the partnership agreement did not define “party prevailing,” the court of appeals assumed the parties meant for the phrase’s ordinary meaning to apply. The court of appeals cited previous cases in which it has concluded that the “prevailing party” in similar contract provisions meant the party that prevailed on the “main action” or the “main issue” in the litigation. Typically, for defendants to prevail would require a take-nothing judgment on the main issue in the case. The court determined that among the many causes of action, the focus at trial and on appeal was Bhatia’s claim for breach of fiduciary duty and breach of contract. These two claims were intermingled and were the bases for the vast majority of testimony and the essence of Bhatia’s contention that he was entitled to $7.29 million in actual damages. According to the court of appeals, it was clear which party prevailed on these two claims. The jury failed to find that the defendants breached the partnership agreement, and while the jury found that the defendants breached their fiduciary duties, it also found that the breach did not cause any actual damages to Bhatia. The purpose of the plaintiff’s lawsuit was to recover damages, and he failed to do so. The purpose of the defendants’ defense was to avoid paying damages, and they were successful in that regard. Thus, the trial court did not err in awarding the defendants attorney’s fees per the partnership agreement.

10. Indemnification


Houston Baseball Partners, LLC sued Comcast Corporation, Drayton McLane, and others in state court for fraud, fraudulent inducement, fraud by nondisclosure, negligent misrepresentation, and civil conspiracy based on alleged misrepresentations that the plaintiff claimed caused it to pay an inflated purchase price for the Houston Astros and its interest in the Houston Regional Sports Network, L.P. (the “Network”). Comcast removed the action, and the plaintiff
sought remand. The court’s analysis of its jurisdiction revolved around indemnification provisions in two agreements. The Network’s limited partnership agreement contained an indemnification clause that indemnified the defendants for acts or omissions on behalf of the Network excluding gross negligence, fraud, or willful misconduct. Also, a services agreement to which the Network was a party contained an indemnification clause that indemnified Comcast with respect to performance of its obligations under the agreement. Like the limited partnership agreement, the services agreement excluded indemnification for gross negligence, fraud, or willful misconduct. The parties agreed that the indemnification provisions were governed by Delaware law. The court discussed whether it had jurisdiction under Section 1334(b), specifically on the basis that the action was related to a case under Title 11. The defendants argued that there were two bases for related-to jurisdiction: (1) the contractual indemnification rights the defendants had against the Network, and (2) the possibility that a successful outcome for the plaintiff would diminish the Network’s value, thereby affecting the estate. The standard in the Fifth Circuit for related-to jurisdiction is whether the outcome of the proceedings could conceivably have any effect on the estate being administered in bankruptcy. The plaintiff argued that the indemnification provisions did not cover the defendants because Comcast was not performing its duties under the services agreement and the McLane parties’ acts were not taken on behalf of the Network. Additionally, even if the defendants’ alleged conduct was performed on behalf of the Network or under the services agreement, the plaintiff argued that the alleged conduct fell within the exclusions of gross negligence, fraud, or willful misconduct. The court concluded that the factual allegations underpinning the plaintiff’s claims alleged conduct within the scope of the duties of the services agreement or conduct on behalf of the Network. Further, there was the possibility that the defendants would be entitled to indemnification since the plaintiff’s claims included negligent misrepresentation. If the plaintiff failed on the fraud, fraudulent inducement, fraud by nondisclosure, and civil conspiracy claims but succeeded on the negligent misrepresentation claim, the Network would be obligated to indemnify the defendants. Under the broad test that required only a finding of a conceivable effect on the Network’s estate, the court concluded that it had related-to jurisdiction. The court concluded that it did not have jurisdiction over a claim that a McLane entity breached the purchase agreement with the plaintiff because the McLane entity was not acting on behalf of the Network when it entered into the purchase agreement with the plaintiff, and the Network could not be required to indemnify it with respect to this cause of action. The court remanded that cause of action to state court and stated that it would hold a hearing to determine whether the remaining claims should be remanded for reasons other than an absence of subject matter jurisdiction.

11. Unilateral Mistake


Edward Wernecke created three family limited partnerships during his marriage to Michele. The partnership property consisted of farming and ranching operations owned or purchased by Edward and a life estate in property inherited by Edward from his parents with a remainder to his children. Edward drafted the partnership agreements, and each agreement recited a purpose to preserve the properties as a single economic unit and pass it on to the children and grandchildren. Each agreement also stated that only direct descendants of Edward and Michele may become additional limited partners. Five children were born during the marriage, including Joshua, who was named as an original limited partner in the partnerships. In 2010, Edward and Michele divorced, and Edward learned during the divorce proceedings that Joshua was not his biological son. Edward executed amendments to the partnership agreements removing Michele and Joshua as partners, and Michele and Joshua sought the fair value of their interests pursuant to Tex. Bus. Orgs. Code § 153.111 (providing that a withdrawing limited partner is entitled to receive within a reasonable time after withdrawal the fair value of the limited partner’s interest). In response, the partnerships filed this suit seeking a declaration that the partnership agreements were rescinded as to Joshua based on unilateral mistake. The trial court granted summary judgment on the basis of unilateral mistake, and the court of appeals affirmed. For a court to set aside a contract based on unilateral mistake a party must show: (1) the mistake is of such great consequence that enforcement of the contract would be unconscionable; (2) the mistake relates to a material feature of the contract; (3) the mistake occurred despite ordinary care; and (4) setting aside the contract does not prejudice the other party except for the loss of the bargain. The partnerships met their initial burden of showing their entitlement as a matter of law, and Michele and Joshua did not meet their burden to produce evidence raising a fact issue. First, the partnerships established that enforcement of the agreements would be unconscionable because the partnership agreements showed that keeping Joshua as a partner would essentially disinherit Edward’s true heirs of a portion of his estate and give a non-heir rights with respect to the partnership property. Second, the partnership agreements provided that only direct descendants of Edward and Michele were eligible to become limited partners, indicating that the identity of the limited partners was a material provision. Third, an affidavit of Edward’s brother-in-law stated that Edward was in shock and disbelief when it was determined that
Joshua was not his biological child, establishing that Edward’s mistake occurred despite his ordinary care. Finally, the agreements themselves showed that setting aside the agreements would not prejudice Joshua except for the loss of the bargain. Michele and Joshua argued that the identity of the limited partners was not material, but the court concluded that they did not raise a fact issue on the element of materiality. Thus, summary judgment in favor of the partnerships was proper.

H. Partnership Property


The debtors, John and Deborah Lau, were in the real estate business, and the plaintiffs sought a determination that the Laus’ debts for the plaintiffs’ losses in real estate ventures managed by the Laus were nondischargeable on various grounds, including as debts arising from fraud or defalcation in a fiduciary capacity and embezzlement. The plaintiffs gave John Lau, as managing member of the Laus’ real estate LLC, $600,000 to invest in two real estate ventures. One of the ventures was structured as a limited partnership. The Laus’ LLC was the general partner, and the plaintiffs were limited partners. Contrary to representations to the plaintiffs and the terms of the limited partnership agreement, the Laus’ LLC took title to the tract of land that was to be obtained by the limited partnership. A portion of the plaintiffs’ claims against the Laus related to capital calls issued by John Lau, as managing member of the managing general partner of the limited partnership, based on false representations regarding the partnership and its financial needs. The capital infusions were diverted by John Lau for his own business purposes and those of the Laus’ LLC. The plaintiffs received no return on their investments in the tract of land that was to have been acquired by the limited partnership. Although the court concluded that the Laus’ debts to the plaintiffs were excepted from discharge as debts arising from fraud and defalcation in a fiduciary capacity, the court stated that a claim arising from a manager’s embezzlement of funds intended for the use and benefit of a company would belong to the company rather than the individual shareholders or members. Thus, the court held that the diversion of the funds received in the capital call was embezzlement as to the limited partnership and not its limited partners, and embezzlement was not a basis for an exception to discharge as to the plaintiffs.


Wallace died leaving a will that left to his wife “any residences which we shall own at my death and in which we shall then customarily reside all or any part of the year.” Wallace and his wife used two houses: a home in McKinney owned by Wallace and his wife under a deed in their name and a lake house on Lake Texoma owned by a limited partnership under a deed in the limited partnership’s name. Wallace and his wife were the only limited and general partners of the partnership. Wallace’s daughter (who had been cut out of the family trust to which Wallace bequeathed all property not otherwise provided for in his will) argued that it was Wallace’s intent to leave the lake house to his wife (who had also died by this time) and that the will should be so construed. The court held that the language of the will was unambiguous and that it was undisputed that the lake house was owned by the partnership. Partnership property is owned by the partnership, not by the individual partners. Wallace could only convey property he owned, and the court could not construe the will as conveying property Wallace did not own. Thus, the trial court did not err in relying on partnership law to determine that the lake house was owned by the partnership.


Whether a creditor had a perfected, enforceable security interest in a loader on which it sought to foreclose turned on whether the loader was purchased by an individual, Martinez, in his individual capacity or on behalf of a limited partnership in which Martinez was a partner. It was undisputed that the partnership had an interest in the collateral; the critical issue was whether Martinez also had rights in the collateral. Because partnership property is not property of the partners and a partner has no interest in partnership property, the status of partner did not permit Martinez to individually convey a security interest in partnership property. The court looked to Section 152.102 of the Texas Business Organizations Code (BOC), which contains provisions for determining when property is partnership property or property of an individual partner. The court noted that this provision applied to a limited partnership by virtue of Section 153.003 of the BOC, which provides that the general partnership provisions of the BOC apply to a limited partnership unless the limited partnership provisions contradict the general partnership provisions. The creditor relied on a retail installment contract that named the partnership and Martinez in the “Buyer” field. The court found that the
agreement indicated that the partnership acquired the loader “in the name of the partnership” for purposes of Section 152.102 and that the statute thus characterized the loader as partnership property if the agreement controlled. The court concluded that, aside from partnership law, there was a genuine issue of material fact as to whether Martinez should be considered a “Buyer” under the agreement. Although Martinez was listed as a buyer, only the box for “Corporation/LLC/LP” was checked, and the “Individual/Sole Proprietor” box was notably not checked. Martinez signed the first page as an “Owner,” but the top of each of the next five pages only identified the partnership as the buyer. These aspects of the agreement rendered it ambiguous, and the creditor failed to demonstrate by extrinsic evidence that the parties intended Martinez to be a buyer under the agreement. Martinez testified that he did not individually buy the loader, and the creditor’s current position that Martinez was a buyer contradicted its original assessment of the transaction as reflected in an affidavit of one of the creditor’s employees and a demand letter sent by the creditor. In sum, the summary judgment record did not conclusively establish that Martinez had an individual interest in the loader that make him a debtor who could grant a security interest in the loader.


Mr. and Mrs. Williams owned a large estate for which they had an estate plan that provided for a family trust. At the death of Mr. Williams, the family trust terminated and was split into two shares that funded two trusts. Mrs. Williams served as trustee of both shares. Under the estate plan of Mr. and Mrs. Williams, the trusts’ assets would devolve into six trusts for the benefit of the couple’s grandchildren on the death of Mrs. Williams. After Mr. Williams died, Mrs. Williams began discussions with her longtime accountant, Rayford Keller, and his son, Lane Keller, regarding protection and disposition of the assets in the two trusts. Ultimately, Mrs. Williams decided to form a family limited partnership with the two trusts as limited partners and an LLC general partner initially owned by Mrs. Williams. The trusts were to fund the partnership, and a spreadsheet was prepared showing the assets that would be transferred to the partnership. Mrs. Williams became ill and was hospitalized. While in the hospital, Mrs. Williams reviewed and signed a partnership agreement (in her capacity as trustee of the two trusts and president of the general partner), which Lane Keller presented and explained to her. The district court found that Mrs. Williams understood what she was doing. Mrs. Williams signed the documents multiple times, and Lane Keller notarized the signatures. Schedule A to the partnership agreement designating the initial capital contributions of the partners was left blank. The initial capital contributions that were to be inserted into these blanks were not otherwise discernible from the partnership agreement itself, but there was evidence of Mrs. Williams’ intent regarding these amounts in the form of extensive notes and spreadsheets. The articles of organization for the LLC general partner and the certificate of limited partnership were filed on May 11, 2000, and Lane Keller intended to finalize and fund the LLC and limited partnership within a week. Mrs. Williams died on May 15, 2000, and the Kellers initially believed that they failed to fully create and fund the limited partnership before Mrs. Williams’ death and ceased attempts to activate the limited partnership and LLC. In February 2001, Mrs. Williams’ estate filed a federal estate tax return and paid $147 million in estate taxes. Approximately a year after Mrs. Williams’ death, Lane Keller reconsidered his position after attending a CLE seminar, and the Kellers decided to move forward with finalizing the partnership documentation, including formally transferring the bonds to the partnership. When the Kellers realized that having successfully established the partnership meant the estate lacked liquidity to issue a $147 million estate tax payment, the advisors restructured the transaction as a $114 million loan from the partnership retroactive to February 2001. The estate later sought a refund based on discounts applicable to the partnership interests and a deduction for accrued interest on the loan from the partnership to pay the taxes. The district court found that Mrs. Williams intended the bonds to be transferred to the partnership at the time she signed the partnership agreement, that her intent bound all the relevant entities (i.e., the LLC, as general partner, and the two trusts, as limited partners), that the partnership was created for a limited, non-tax-related purpose, and that the trusts received full and adequate consideration when they received the partnership interests in exchange for contributing the bonds. Relying on Texas law, the district court held that Mrs. Williams’ intent to transfer the bonds to the partnership was sufficient to transfer the bonds regardless of record title or the absence of a writing confirming the transfer. On appeal, the court of appeals agreed with the district court. The valuation discount sought by the estate hinged on whether the bonds were effectively transferred to the partnership. The court of appeals recognized that “well-established principles of Texas law provide that the intent of an owner to make an asset partnership property will cause the asset to be the property of the partnership.” The court stated that this principle clearly applied to acquisition of property by existing partnerships, and for settling title to property where legal title rests in the partnership but the property is actually used by a partner in his personal capacity, or vice-versa, citing numerous Texas cases to that effect. The court noted that this case involved a slightly different context in that the question was whether title to property passed to the family limited partnership contemporaneous with its formation rather than addressing property acquired or used by an already-formed partnership. Further, the partnership in this case was a limited partnership rather than a general partnership. Because the Texas Revised Limited Partnership Act (TRLPA)
provided that the applicable statute governing general partnerships and the rules of law and equity govern in a case not provided for by TRLPA, and Texas courts have continually emphasized the controlling nature of partnership intent in comprehensive terms, the court’s Erie guess was that Texas courts would apply the rule from Logan v. Logan, 156 S.W.2d 507 (Tex. 1941) that intent of the parties controls whether newly acquired property belongs to a partner or the partnership. The Government relied on the provision of TRLPA providing that a limited partner’s promise to contribute or otherwise transfer property to a limited partnership is not enforceable unless set out in writing and signed by the limited partner, but the court stated that this provision was inapposite because the bonds were transferred immediately by forming the partnership and executing the partnership agreement with the intent to transfer the bonds. This intent conferred equitable title on the partnership. The Government also argued that the record keeping requirements of TRLPA required Schedule A to the partnership agreement to be filled out before Mrs. Williams’ death. The court discussed the statutory record keeping provision and concluded that it was more sensibly construed as a mandatory record keeping provision, the breach of which may give rise to a suit for violating duties between partners, as opposed to a provision that invalidates noncompliant property transfers. The court also discussed Church v. United States, 85 A.F.T.R.2d 2000-804 (W.D. Tex. 2000), aff’d, 268 F.3d 1063 (5th Cir. 2001), in which the court held that the family limited partnership at issue was in substantial compliance with TRLPA despite several defects in forming the limited partnership. The court stated that it need not decide in this case the effect of a failure to file the formation documents with the Secretary of State before the decedent’s death, but the court noted the difficulty of reconciling the Government’s argument that a failure to comply with record keeping requirements invalidates an underlying transfer when the failure to file the formation documents did not invalidate the entity’s formation in Church. Finally, the Government argued that the limited partnership ceased to exist on Mrs. Williams’ death because her death triggered the termination of the trusts and the assignment of their limited partnership interests. Because a limited partnership is defined by statute as a partnership having one or more limited partners and cancellation of the certificate of limited partnership is required when there are no limited partners, the Government asserted that a limited partnership must surrender its certificate of limited partnership for cancellation and dissolve when it ceases to have limited partners. The court characterized this argument as “superficially plausible,” but concluded that it ran afoof of TRLPA, which provided that a limited partnership dissolved only on four specified events that did not include expiration of limited partners. Additionally, TRLPA set forth when the limited partnership must or may not wind up on withdrawal of a partner and included the assignment of a limited partnership interest did not dissolve the partnership. In sum, the court rejected all of the Government’s challenges to the “overarching rule” in Texas that intent determines property ownership. Mrs. Williams transferred the bonds before her death to the family limited partnership, and the district court correctly applied the relevant discount.

**Hern Family Limited Partnership v. Compass Bank, 863 F.Supp.2d 613 (S.D. Tex. 2012).**

The plaintiffs, a limited partner in a limited partnership and an investor in the limited partnership who had not yet been admitted as a limited partner, asserted claims based on the defendant’s refusal to honor a loan commitment. The court concluded that the plaintiffs could not assert the claims because the claims belonged to the limited partnership’s bankruptcy estate. Although the plaintiffs asserted that they suffered direct damages, including the loss of funds invested by one of the plaintiffs in reliance on the loan commitment, the court concluded that the plaintiffs’ injuries were only indirect injuries resulting from the direct injury suffered by the limited partnership as a result of the defendant’s alleged breach of contract with the limited partnership.


In this divorce proceeding, Smith argued that the trial court erred in granting partial summary judgment that Grayson’s partnership interest in a limited partnership was his separate property. Before Smith and Grayson were married, Grayson acquired an interest of 48,300 units in a limited partnership. During the marriage, he did not purchase any additional units, but his percentage interest increased as a result of the partnership’s purchase of interests from withdrawing partners. Grayson’s share of each year’s partnership profits was added to his capital account balance pursuant to the partnership agreement, and Grayson received distributions from his capital account during the marriage, but the partnership retained a portion of his share of income in his capital account to use as operating expenses. The trial court granted Grayson’s motion for partial summary judgment that his partnership interest was separate property, and the decree after trial of other issues confirmed Grayson’s interest in the partnership as separate property. On appeal, Smith argued: (1) all of the partnership income Grayson earned during the marriage, whether distributed or retained, was community property; (2) the partnership used Grayson’s retained community property income to buy out other partners’ interests, resulting in an increased interest for Grayson acquired during the marriage, which should be characterized as community property; (3) the retention of a portion of community income in Grayson’s capital account with his separate
property resulted in commingling so that the presumption of community property applied to the entire partnership interest. Grayson countered that only the distributed income was community property, that the retained funds were partnership property, and that all of Smith’s arguments failed on that basis. After reviewing basic marital property characterization rules, the court reviewed their application to a partnership interest. The court noted that the Texas Supreme Court has determined that the only partnership-related property that can be awarded on divorce is the partnership interest, not partnership property. A partnership interest is a partner’s right to receive his share of profits and losses and to receive distributions. Partnership property is not property of the individual partners, and a partnership interest does not include an ownership interest in partnership property. A partner does not retain an ownership interest in his capital contribution; the contribution becomes partnership property. Thus, the partner’s right to receive his share of the profits is the only partnership right subject to characterization. Here, the undisputed summary judgment evidence established that Grayson acquired his partnership interest before marriage and purchased no additional units during marriage. A portion of his share of the income earned on his partnership interest was distributed, and a portion was retained by the partnership for operating expenses. During the marriage, the partnership acquired units from retiring or withdrawing partners, thus increasing Grayson’s percentage interest. The court rejected Smith’s argument that the portion of Grayson’s income retained by the partnership constituted community property. Partnership earnings are owned by the partnership prior to distribution and cannot be characterized. The portion of partnership income retained in Grayson’s capital account was thus partnership property and as such was neither separate nor community property of Grayson or Smith. Further, the court concluded that, assuming the funds in Grayson’s capital account were used in purchasing units of withdrawing partners, the funds and repurchased units were partnership property. The court stated that the summary judgment evidence showed that the only resulting increase in Grayson’s interest was the increase in the proportional percentage of his interest resulting from a reduction in the total number of partnership units and that there was no actual increase in Grayson’s interest. Even if the repurchase somehow were construed to result in an actual increase in Grayson’s interest, the court said that the increase in interest would remain partnership property and would not constitute property acquired after marriage until distributed. Because the portion of partnership income retained in Grayson’s capital account was partnership property, its retention could not result in the commingling of community and separate property. Thus, the trial court did not err in granting the partial summary judgment.


The court held that a limited partnership held an insurable interest in property owned by the partnership’s wholly owned LLC subsidiary. The court compared the situation to cases in which courts have held that a shareholder of a corporation has an insurable interest in property of the corporation.

*Reid Road Municipal Utility District No. 2 v. Speedy Stop Food Stores, Ltd.*, 337 S.W.3d 846 (Tex. 2011).

The court in this case addressed the application of the Property Owner Rule to a limited partnership. Under this rule, a property owner who is familiar with the market value of his property may testify regarding that market value even if he is not qualified or designated as an expert witness. Recognizing that an entity necessarily testifies through its agents and representatives, the court found the need to limit the scope of the agents and representatives who are permitted to testify on the entity’s behalf under this rule. The court held that those who may testify in this regard are limited to officers of the entity in managerial positions with duties related to the property, or employees of the entity with substantially equivalent positions and duties. In this case, the court held that an officer of the corporate general partner of the limited partnership that owned the property did not fall into the category of entity representatives to whom the Property Owner Rule applies because he was not an employee or officer of the limited partnership. Citing provisions of the Business Organizations Code regarding partnership property, the court pointed out that the corporate general partner was not the owner of the property. Justice Willet, joined by Justice Lehrmann, pointed out in a separate opinion that limited partnerships commonly consist of passive limited partners and a corporate general partner and that the court’s treatment of the Property Owner Rule means that many, if not most, limited partnerships could never proffer a witness on the value of their property under the Property Owner Rule. This is so because there is no particular need for a limited partnership to have any managerial employees since limited partnerships are managed by the general partner(s). Pointing out that the court contemplates application of the Property Owner Rule to a managing officer of the entity owning the property or an employee of the entity in a “substantially equivalent” position, Justice Willet states that he would hold that a managing officer of the corporate general partner with duties relating to the property may testify as to the value of the partnership property without being qualified as an expert provided the officer is familiar with the specific property in issue and its value.
I. Assignment of Interest and Admission of Partner


After a judgment entered in the Northern District of Texas was registered in the Southern District, this court issued an order for turnover relief and appointment of a receiver requiring the judgment debtors, Gary Kornman and various related entities, to turn over all nonexempt property to the receiver. Kornman executed a conveyance of interest on behalf of himself and all judgment debtors in which the judgment debtors conveyed all of their right, title, and interest to property identified in the conveyance. Kornman objected to the court’s ruling as to the effect of the conveyance in certain respects. With respect to several limited partnerships, the court ruled that the receiver owned 100% of the limited partnerships and that the receiver was the sole person in control of the limited partnerships. Kornman stipulated to the receiver’s 100% ownership interest but contested that the receiver was the sole person in control of the limited partnerships. A corporation that was wholly owned by Kornman was the 1% general partner of each limited partnership, and the 99% limited partner of each partnership was a trust that was also a judgment debtor. Because he was the 100% shareholder of the corporate general partner, Kornman’s assignment of his stock to the receiver resulted in the receiver’s obtaining the ability to manage the business and affairs of the corporation and thus act as general partner. With respect to the trust’s assignment of its 99% interests in the partnerships, the court concluded that the assignments caused the trusts to cease to be a limited partner. The court relied on withdrawal provisions in Chapter 152 of the Texas Business Organizations Code, which governs general partnerships, because Chapter 153, which governs limited partnerships, does not define events of withdrawal for a limited partner. Section 153.003(a) specifies that the provisions of Chapter 152 govern limited partnerships in a case not provided for by Chapter 153. The court stated that Section 153.110 (which allows withdrawal of a limited partner only as provided by the partnership agreement) only deals with voluntary withdrawal and that there is no provision of Chapter 153 superseding the provisions of Chapter 152 dealing with withdrawal as a matter of law. The court relied upon Sections 152.501(a) (specifying that a person ceases to be a partner on an event of withdrawal) and 152.501(b)(6)(B) (specifying that an assignment for the benefit of a creditor is an event of withdrawal) to conclude that the trust’s assignment of its limited partnership interests constituted an event of withdrawal that caused the trust to cease to be a limited partner. As assignee of the trust’s limited partnership interests, the receiver could become a limited partner with the consent of all partners under Section 153.253(a)(2). Since the receiver owned and managed the affairs of the sole general partner and could admit himself as limited partner, the receiver was the sole person in control of the partnerships.

J. Withdrawal of Limited Partner


After a judgment entered in the Northern District of Texas was registered in the Southern District, this court issued an order for turnover relief and appointment of a receiver requiring the judgment debtors, Gary Kornman and various related entities, to turn over all nonexempt property to the receiver. Kornman executed a conveyance of interest on behalf of himself and all judgment debtors in which the judgment debtors conveyed all of their right, title, and interest to property identified in the conveyance. Kornman objected to the court’s ruling as to the effect of the conveyance in certain respects. With respect to several limited partnerships, the court ruled that the receiver owned 100% of the limited partnerships and that the receiver was the sole person in control of the limited partnerships. Kornman stipulated to the receiver’s 100% ownership interest but contested that the receiver was the sole person in control of the limited partnerships. A corporation that was wholly owned by Kornman was the 1% general partner of each limited partnership, and the 99% limited partner of each partnership was a trust that was also a judgment debtor. Because he was the 100% shareholder of the corporate general partner, Kornman’s assignment of his stock to the receiver resulted in the receiver’s obtaining the ability to manage the business and affairs of the corporation and thus act as general partner. With respect to the trust’s assignment of its 99% interests in the partnerships, the court concluded that the assignments caused the trusts to cease to be a limited partner. The court relied on withdrawal provisions in Chapter 152 of the Texas Business Organizations Code, which governs general partnerships, because Chapter 153, which governs limited partnerships, does not define events of withdrawal for a limited partner. Section 153.003(a) specifies that the provisions of Chapter 152 govern limited partnerships in a case not provided for by Chapter 153. The court stated that Section 153.110 (which allows withdrawal of a limited partner only as provided by the partnership agreement) only deals with voluntary withdrawal and that there is no provision of Chapter 153 superseding the provisions of Chapter 152 dealing with withdrawal as a matter of law. The court relied upon Sections 152.501(a) (specifying that a person ceases to be a partner on an event of withdrawal) and 152.501(b)(6)(B) (specifying that an assignment for the benefit of a creditor is an event of withdrawal) to conclude that the trust’s assignment of its limited partnership interests constituted an event of withdrawal.
withdrawal that caused the trust to cease to be a limited partner. As assignee of the trust’s limited partnership interests, the receiver could become a limited partner with the consent of all partners under Section 153.253(a)(2). Since the receiver owned and managed the affairs of the sole general partner and could admit himself as limited partner, the receiver was the sole person in control of the partnerships.

K. Dissolution/ Winding Up


This case involved a dispute regarding the breakup of a medical practice group engaged in a cardiology practice. Dr. Bhatia sued the other members of the group over Bhatia’s interest in a limited partnership that was one of the entities involved in the practice. In 2003, Bhatia and the other four cardiologists who were owners of the entities began having business disputes. The practice involved several related business entities, including North Houston Heart Center, PLLC (“NHHC”), which was the clinical practice, and the Northwest Houston Cardiovascular Imaging Center II, Ltd. (“the Imaging Center”), which was the provider of diagnostic testing to clients of NHHC. The defendants made plans to begin a new practice in a different building, and Bhatia planned to practice in the current building. On February 17, 2003, a meeting for NHHC was noticed, and on that day the five doctors voted unanimously to dissolve “the organization” as of September 1, 2003. No specific entity was expressly mentioned in the meeting notice or vote on the dissolution, but there was testimony that the partners treated the various entities as a “unitary bucket” so that the vote to dissolve the organization was effective to dissolve all of the business entities. Bhatia and some of the defendants met on September 15, 2003, to discuss the allocation of equipment. Several accounting experts later testified that Bhatia received at least his fair share of the equipment, his patient files, and cash distribution in the winding up of the business, and liabilities were disposed of with the defendants satisfying the debts after Bhatia failed to complete his contributions. After September 30, 2003, the defendants moved into and opened their new building while continuing to treat patients as they had at the current building with some of the same employees and equipment. Bhatia continued to practice at the current building with some of the same employees and equipment.

Bhatia subsequently sued the other doctors and the entities involved in the practice for, among other causes of action, breach of fiduciary duty, breach of contract as to the partnership agreement, conversion, and misappropriation of partnership assets. The defendants counterclaimed for breach of fiduciary duty, conversion, and misappropriation, among other claims. In essence, Bhatia alleged at trial and on appeal that the Imaging Center never properly and officially dissolved, so when the defendants continued performing diagnostic testing of patients at their new location with much of the same equipment and many of the same employees it was in effect a continuation of the Imaging Center. Bhatia thus argued that he was entitled to the value of his interest as a withdrawing partner in an ongoing partnership rather than the value of his interest in a dissolved or defunct partnership. At trial, the jury found that neither the plaintiff nor the defendants committed any of the alleged causes of action other than breach of their fiduciary duties. The jury did not award damages to anyone. The trial court entered judgment in accordance with the jury’s verdict and awarded attorney’s fees to the defendants as the “prevailing parties” as authorized by the partnership agreement. Bhatia appealed on numerous grounds.

First, Bhatia contended that the partnership continued as an ongoing concern after the date of dissolution and that he was thus entitled to the fair market value of his partnership interest. Bhatia made a number of arguments to support his allegation that the trial court erred in its judgment on this issue. Bhatia alleged that the trial court should have awarded him the fair market value of his interest in the Imaging Center as of September 30, 2003, as a matter of law due to his “disassociation” from the partnership, which he characterized as a withdrawal under the Texas Revised Limited Partnership Act, an expulsion or transfer of his interest under the Texas Revised Partnership Act, or a repurchase of his interest under the partnership agreement. However, none of the statutory provisions relied upon by Bhatia on appeal were raised at trial, and the court of appeals stated that it could not reverse the trial court’s judgment based on a theory of recovery that was not pled and proven below. Further, Bhatia’s arguments presumed that the Imaging Center continued as a going concern after September 30, 2003. If the Imaging Center did not continue to operate after that date, Bhatia’s argument that he was a withdrawing or expelled partner or that his interest had been transferred or repurchased because he no longer participated was without merit. The court of appeals determined that the evidence at trial failed to conclusively demonstrate that the Imaging Center continued as a going concern after September 30, 2003. For example, the evidence showed that Bhatia and the other doctors each made arrangements before September 30, 2003, to form new business entities that would provide essentially the same services as the Imaging Center, with each having some of the same equipment and employees as the partnership had, but neither conducted business as the Imaging Center. In addition, Bhatia neither pled nor proved any theory to establish a basis for piercing the corporate veil or why the business form
of the new entities should be disregarded or treated as a continuation of the Imaging Center. Thus, Bhatia did not demonstrate that the trial court should have awarded him the value of his interest in a going concern as a matter of law.

Next, Bhatia contended that the jury’s finding that no breach of the partnership agreement occurred was not supported by sufficient evidence because the Imaging Center was not formally dissolved in accordance with the partnership agreement, which required written consent of the general partner and limited partners holding 2/3 of the partnership interests held by all limited partners. The defendants argued that the meeting fulfilled the written consent requirement because it was recorded by audiotape and later transcribed and made a part of the formal minutes of the meeting. Bhatia pointed out that the notice of the meeting only referred to NHHC and not the Imaging Center, but the court responded that if Bhatia participated in the meeting and did not object to consideration of the dissolution of the Imaging Center, the Texas Business Organizations Code would preclude him from later denying that the action was properly raised and considered. Although the court of appeals acknowledged that the evidence showed that the vote on dissolution did not expressly mention the Imaging Center, testimony by one of the partners and a business structures expert explained that the partners treated the various entities as a “unitary bucket.” Thus, the court held that Bhatia failed to conclusively establish that the defendants breached the partnership agreement in dissolving the partnership or that the jury’s failure to find a breach was against the great weight and preponderance of the evidence.

Bhatia next contended that the evidence was insufficient to support the jury’s finding that he suffered no damages from the defendants’ breach of fiduciary duties to him. According to Bhatia and his expert, if the Imaging Center continued in operation after the dissolution, Bhatia would be entitled to the fair market value of his interest in the continuing business, which the expert calculated to be $7.29 million. Bhatia also complained about the procedures used to allocate the assets of the Imaging Center post dissolution. The defendants’ expert testified that if the Imaging Center dissolved, Bhatia would be entitled to only his percentage interest in the value of the dissolved partnership’s assets. Bhatia further contended that the defendants’ expert used an improper method in determining the value of Bhatia’s interest because the expert relied on book value rather than fair market value of the partnership assets. The court of appeals concluded that the expert’s testimony indicated that the expert did not simply look at book value, but undertook to derive a market value of the assets. In addition, several experts testified that if the Imaging Center were not a continuing concern, Bhatia received at least his fair share of the partnership’s assets, including cash distributions, equipment, and files related to his patients. There was also evidence that Bhatia failed to pay for his share of the partnership’s liabilities, and the debts were satisfied by the defendants. Thus, Bhatia failed to conclusively establish his entitlement to damages or that the jury’s finding of zero damages was against the great weight and preponderance of the evidence.

Finally, Bhatia alleged that the trial court erred in awarding attorney’s fees to the defendants as the “parties prevailing” under the partnership agreement. According to the court of appeals, it was clear which party prevailed on these two claims. The jury failed to find that the defendants breached the partnership agreement, and while the jury found that the defendants breached their fiduciary duties, it also found that the breach did not cause any actual damages to Bhatia. The purpose of the plaintiff’s lawsuit was to recover damages, and he failed to do so. The purpose of the defendants’ defense was to avoid paying damages, and they were successful in that regard. Thus, the trial court did not err in awarding the defendants attorney’s fees per the partnership agreement.

**Keller v. U.S., 697 F.3d 238 (5th Cir. 2012).**

Mr. and Mrs. Williams owned a large estate for which they had an estate plan that provided for a family trust. At the death of Mr. Williams, the family trust terminated and was split into two shares that funded two trusts. Mrs. Williams served as trustee of both shares. Under the estate plan of Mr. and Mrs. Williams, the trusts’ assets would devolve into six trusts for the benefit of the couple’s grandchildren on the death of Mrs. Williams. After Mr. Williams died, Mrs. Williams began discussions with her longtime accountant, Rayford Keller, and his son, Lane Keller, regarding protection and disposition of the assets in the two trusts. Ultimately, Mrs. Williams decided to form a family limited partnership with the two trusts as limited partners and an LLC general partner initially owned by Mrs. Williams. The trusts were to fund the partnership, and a spreadsheet was prepared showing the assets that would be transferred to the partnership. Mrs. Williams became ill and was hospitalized. While in the hospital, Mrs. Williams reviewed and signed a partnership agreement (in her capacity as trustee of the two trusts and president of the general partner), which Lane Keller presented and explained to her. The district court found that Mrs. Williams understood what she was doing. Mrs. Williams signed the documents multiple times, and Lane Keller notarized the signatures. Schedule A to the partnership agreement designating the initial capital contributions of the partners was left blank. The initial capital contributions that were to be inserted into these blanks were not otherwise discernible from the partnership agreement itself, but there was evidence of Mrs. Williams’ intent regarding these amounts in the form of extensive notes and spreadsheets. The articles of organization for the LLC general partner and the certificate of limited partnership were filed on May 11, 2000, and
Lane Keller intended to finalize and fund the LLC and limited partnership within a week. Mrs. Williams died on May 15, 2000, and the Kellers initially believed that they failed to fully create and fund the limited partnership before Mrs. Williams’ death and ceased attempts to activate the limited partnership and LLC. In February 2001, Mrs. Williams’ estate filed a federal estate tax return and paid $147 million in estate taxes. Approximately a year after Mrs. Williams’ death, Lane Keller reconsidered his position after attending a CLE seminar, and the Kellers decided to move forward with finalizing the partnership documentation, including formally transferring bonds to the partnership. The estate later sought a refund based on discounts applicable to the partnership interests and a deduction for accrued interest on the loan from the partnership to pay the taxes. The district court found that Mrs. Williams intended the bonds to be transferred to the partnership at the time she signed the partnership agreement, that her intent bound all the relevant entities (i.e., the LLC, as general partner, and the two trusts, as limited partners), that the partnership was created for a limited, non-tax-related purpose, and that the trusts received full and adequate consideration when they received the partnership interests in exchange for contributing the bonds. Relying on Texas law, the district court held that Mrs. Williams’ intent to transfer the bonds to the partnership was sufficient to transfer the bonds regardless of record title or the absence of a writing confirming the transfer. On appeal, the court of appeals agreed with the district court. One of the arguments made by the Government was that the limited partnership ceased to exist on Mrs. Williams’ death because her death triggered the termination of the trusts and the assignment of their limited partnership interests. Because the Texas Revised Limited Partnership Act (TRLPA) defined a limited partnership as having one or more limited partners and because the statute required cancellation of the certificate of limited partnership when there were no limited partners, the Government asserted that a limited partnership must surrender its certificate of limited partnership for cancellation and dissolve when it ceased to have limited partners. The court characterized this argument as “superficially plausible,” but concluded that it ran afoul of TRLPA, which provided that a limited partnership dissolved only on four specified events that did not include departure of limited partners. Additionally, TRLPA set forth when limited partnership must or may not wind up on withdrawal of a general partner and specified that assignment of a limited partnership interest did not dissolve the partnership. The court held that Mrs. Williams transferred the bonds before her death to the family limited partnership, and the district court correctly applied the relevant discount.


A defendant asked the court to dismiss a defunct limited partnership from this action because it asserted that no such entity existed. The court determined that the limited partnership terminated on March 31, 2006, and the court recognized that Section 11.356(c) of the Texas Business Organizations Code extinguishes claims against a terminated entity brought more than three years after termination. The plaintiffs did not file this lawsuit until June 25, 2010, more than three years after the limited partnership was terminated. Accordingly, the court concluded that the plaintiffs’ claims against the limited partnership were extinguished, and the court dismissed the limited partnership from the action.

**L. Record Keeping Requirements and Access to Books and Records**


The bankruptcy court in this adversary proceeding determined that the debtor (Edelman) was liable for trespass, breach of fiduciary duties, theft, and fraud based on actions he took while serving as vice president of the LLC general partner of a limited partnership that developed and operated a condominium project. Certain claims by the LLC general partner, the LLC general partner’s sole member (Wiggins), and the limited partnership failed. Claims based on Edelman’s wrongful transfer and personal use of the limited partnership’s funds and Edelman’s personal use of a condominium unit without a lease and without paying rent failed as to all plaintiffs because the evidence did not establish that the plaintiffs did not have an equal opportunity to learn the truth about Edelman’s actions through access to books and records of the partnership and another entity. Edelman’s knowledge was not imputed to the LLC general partner and the limited partnership since Edelman was acting adversely to them, but knowledge that Wiggins had an equal opportunity to discover could be imputed to the LLC general partner and the limited partnership. The court relied on the fact that the limited partnership agreement gave partners the right to access to all of the partnership’s records. Wiggins testified that he demanded access and that Edelman blocked his efforts, but there was no evidence Wiggins took any steps beyond asking Edelman. The court stated that Wiggins had a legal right to the information under the limited partnership agreement and the evidence did not show that Wiggins could not have obtained access had he done more than merely ask Edelman. With respect to knowledge of the improper use of the limited partnership’s funds by a related LLC, the related LLC was owned 50% by Wiggins and 50% by Edelman, and Wiggins had a right under that LLC’s regulations...
to access its books and records, which would have revealed how the funds were being used. Thus, the fraud by nondisclosure claims failed as to the matters that could have been discovered by Wiggins in the limited partnership’s books and records and the books and records of a related LLC to which he had access.


A former member of an LLC and former partner of a limited partnership sued for a declaratory judgment that he was entitled to access the books and records of the LLC and limited partnership for the period of time during which he was member and partner. The plaintiff alleged that he had requested access to the books and records and that he was refused access. The limited partnership and LLC filed special exceptions asserting that the plaintiff did not allege facts establishing a justiciable controversy. The plaintiff did not amend his petition, and the defendants filed a plea to the jurisdiction and asked for dismissal, which the trial court granted. The court of appeals held that the trial court erred in granting the plea and dismissing the cause. A person whose rights are affected by a statute or contract may have a trial court determine a question arising under the statute or contract and obtain a declaration of the person’s rights. A declaratory judgment is appropriate if there is a justiciable controversy as to the rights and status of the parties and the controversy will be resolved by the declaration. A justiciable controversy is a real and substantial controversy and not merely a theoretical dispute. Section 3.151 of the Texas Business Organizations Code lists the books and records a filing entity must keep, and Section 3.153 provides that each owner or member of a filing entity may examine the books and records required to be maintained under Section 3.151 along with other books and records required for that particular type of filing entity. A “filing entity” includes a limited partnership and LLC. Tex. Bus. Orgs. Code § 1.002(22). More specific provisions regarding the rights of an LLC member and a partner in a limited partnership to examine the entity’s books and records are set forth in Sections 101.502 and 153.552, respectively. The plaintiff’s petition alleged that he requested and was denied access to the books and records of the defendant LLC and defendant limited partnership. The crux of the parties’ dispute was whether the Business Organizations Code and the governing documents of the entities allowed the plaintiff ongoing access to the books and records for the period of time he was a member and partner even after he ceased to be a member or partner. The court of appeals stated that this was a real and substantial controversy, that the plaintiff’s petition provided fair notice of his claim, and that a declaration of the plaintiff’s rights to examine the books and records at issue would resolve the controversy. Thus, it was error for the trial court to grant the special exceptions and plea to the jurisdiction. The LLC and limited partnership argued that the plaintiff’s claim for declaratory relief was improper because the plaintiff could have sought access to the books and records by filing a mandamus or Rule 202 deposition, but the court stated that the existence of another adequate remedy does not bar the right to maintain a declaratory judgment action. The plaintiff properly sought a declaratory judgment because he sought a declaration of his rights to examine the books and records under the Business Organizations Code and the governing documents of the entities.


The Government argued on appeal that the transfer of bonds by two trusts as limited partners to a family limited partnership formed shortly before the death of the decedent trustee of the trusts was not effective because the schedule to the limited partnership agreement showing contributions was left blank and there was no other formal documentation of the transfer. The court found that there was evidence of the decedent’s intent that the bonds be transferred when she signed the limited partnership agreement and other organizational documents as president of the LLC general partner and trustee of the trusts. Extensive spreadsheets, notes, and certain other evidence showed that the decedent’s intent was to transfer the bonds from the trusts to the limited partnership. After the decedent died, her advisors initially believed that they failed to fully create and fund the limited partnership and ceased attempts to activate the limited partnership and LLC. Her estate filed a federal estate tax return and paid estate taxes. Approximately a year after the decedent’s death, her advisors reconsidered their position and decided to move forward with finalizing the partnership documentation, including formally transferring the bonds to the partnership. The estate then sought a refund based on discounts applicable to the partnership interests. The district court found that the decedent intended the bonds to be transferred to the partnership at the time she signed the partnership agreement, that her intent bound all the relevant entities (i.e., the LLC, as general partner, and the two trusts, as limited partners), that the partnership was created for a limited, non-tax-related purpose, and that the trusts received full and adequate consideration when they received the partnership interests in exchange for contributing the bonds. Relying on Texas law, the district court held that the decedent’s intent to transfer the bonds to the partnership was sufficient to transfer the bonds regardless of record title or the absence of a writing confirming the transfer. On appeal, the court of appeals agreed with the district court. One of the Government’s arguments on appeal was that the record keeping requirements of the Texas Revised Limited
Partnership Act (TRLPA) required the schedule to the partnership agreement showing contributions to be filled out before the decedent’s death. The court discussed the statutory record keeping provision and concluded that it was more sensibly construed as a mandatory record keeping provision, the breach of which may give rise to a suit for violating duties between partners, as opposed to a provision that invalidates noncompliant property transfers. The court also discussed *Church v. United States*, 85 A.F.T.R.2d 2000-804 (W.D. Tex. 2000), aff’d, 268 F.3d 1063 (5th Cir. 2001), in which the court held that the family limited partnership at issue was in substantial compliance with TRLPA despite several defects in forming the limited partnership. The court stated that it need not decide in this case the effect of a failure to file the formation documents with the Secretary of State before the decedent’s death, but the court noted the difficulty of reconciling the Government’s argument that a failure to comply with record keeping requirements invalidates an underlying transfer when the failure to file the formation documents did not invalidate the entity’s formation in *Church*.


Texas Legislative Service (“TLS”) was a legislative tracking service that provided subscribers with information about the activities of the Texas Legislature. TLS became a family partnership in 1953, and the original partnership agreement was amended periodically thereafter. The disputes at issue here involved the TLS partnership agreement executed in 1979, which remained in effect subject to certain amendments not applicable to this suit. The partnership included members of the Fish family. The parties in this case were three brothers who were partners in TLS: Russell, Andrew, and John Fish. One of the issues in this case related to Russell’s access to TLS’s books and records. Russell contended that Andrew and John breached Section 1.5 of the partnership agreement by repeatedly denying him access to TLS’s books and records. The court found there was no evidence to support this claim, and in fact the record affirmatively established that neither Andrew nor John ever denied Russell such access. There was no evidence that the partnership’s books or records were not maintained at TLS’s principal place of business or were not made available for partner access at all times per the partnership agreement. The trial court properly granted summary judgment in favor of Andrew and John as to this claim and any breach of fiduciary duty claims predicated on the same allegations.

**M. Receivership**


Investors in a limited partnership obtained appointment of a receiver for the partnership under Section 11.404 of the Business Organizations Code based on numerous problems in the management of the partnership identified by a forensic accountant. On appeal, the court concluded that the evidence showed ongoing mismanagement of the limited partnership’s funds and affairs, the existence of liens, and a pending lawsuit for repossession of equipment of the limited partnership and monies owed. Thus, the court held that the trial court did not abuse its discretion by concluding that the standard for appointment of a receiver under Section 11.404(b) was met.

**N. Effect of Merger or Conversion**


In 2000, Ancor Holdings LLC (“Ancor LLC”) executed a guaranty agreement in favor of a bank. The guaranty agreement prohibited Ancor LLC from merging unless it was the survivor and further provided that it could not change its legal structure without the bank’s permission. When Ancor LLC failed to pay the guaranty, the bank’s successor sued it in Dallas County. After three years of arbitration, the plaintiff obtained a judgment against Ancor LLC confirming the arbitrator’s award. A few months later, the plaintiff discovered that eight years earlier Ancor LLC had merged into a limited partnership, Ancor Holdings L.P. (“Ancor LP”). The agreement and plan of merger provided that Ancor LP assumed all the liabilities of Ancor LLC. The plaintiff sought to modify the judgment to include Ancor LP on the grounds of misnomer. Ancor LLC opposed the modification on the grounds that Ancor LLC and Ancor LP were two separate and distinct entities and that a misidentification had occurred. That case was appealed to the Dallas Court of Appeals, and meanwhile the plaintiff brought this suit against Ancor LP and its partners for satisfaction of the judgment against Ancor LLC. The plaintiff sought declaratory judgment that the limited partnership was liable on the judgment and asserted various causes of action sounding in contract and tort. Ancor LP and its partners sought summary judgment on the declaratory judgment and contract claims on the grounds of res judicata and limitations. The trial court granted
summary judgment for Ancor LP and its partners and dismissed the plaintiff’s claims. On appeal, the plaintiff argued that Ancor LP and its partners had not met the elements of res judicata. According to Ancor LP and its partners, the plaintiffs’ claims were barred because they could have been brought in the earlier action. In the appeal of the earlier case, the Dallas Court of Appeals concluded that Ancor LLC and Ancor LP were two separate and distinct entities, and because Ancor LP was not served, it could not be included in the judgment. The court of appeals in this case concluded that Ancor LP and the partners had not established all of the elements required for res judicata because they had not established that the parties in this action were the same or in privity with the parties in the original action. In fact, Ancor LP and its partners had asserted in their motion for summary judgment that Ancor LP was not a party to the judgment in the first action. Thus, the trial court erred in granting summary judgment on the basis of res judicata. The court of appeals next concluded that Ancor LP and its partners were estopped to assert limitations as a defense because their current position—that Ancor LLC did not exist as an independent entity following its merger with Ancor LP—was inconsistent with their previous successful one—that Ancor LLC and Ancor LP were separate and distinct entities. This position was intentional, not inadvertent. Two of the partner defendants in this action testified in the previous action that they served as officers of Ancor LLC and that it was a viable entity. In this case, however, they claimed that Ancor LLC ceased to be a viable, ongoing entity after the merger. Thus, the court of appeals concluded that Ancor LP and its partners were estopped to assert limitations as an affirmative defense in this action.


Tandan, the defendant, argued for the first time on appeal that the court lacked jurisdiction because the plaintiff limited partnership “is not the proper party to bring suit and thus, it lacks standing, which warrants dismissal.” Tandan pointed out that the contract at issue was with “Affordable Power Plan” rather than “Affordable Power, L.P.” He attached to his appellate brief a copy of a certificate of conversion that converted “Affordable Power, Inc.” to “Affordable Power, L.P.” and a certificate of formation for “Affordable Power, L.P.” Tandan contended that the entity named “Affordable Plan, L.P.” appeared to be the party with standing to bring the claims. Affordable Power, L.P. contended that the issue was one of capacity rather than standing and that the issue was waived because it was not raised by a verified pleading. The court explained that standing focuses on whether a party has a sufficient relationship with the lawsuit so as to have a justiciable interest, whereas the issue of capacity is a procedural issue dealing with personal qualifications to bring suit. The court further explained that a person has standing when it is personally aggrieved, regardless of whether it is acting with legal authority; a party has capacity when it has the legal authority to act regardless of whether it has a justiciable interest. The court agreed that the issue raised by Tandan was a challenge to capacity that was required to be raised by a verified pleading in the trial court, and the issue was thus waived by Tandan’s failure to raise it in the trial court.

Wasserberg v. Flooring Services of Texas, LLC, 376 S.W.3d 202 (Tex. App.–Houston [14th Dist.] 2012, no pet.).

The plaintiff sought to hold Wasserberg and Felt liable as guarantors for amounts owed for goods and services sold by the plaintiff to Waterhill Companies Limited (“WCL”). In 2002, Wasserberg and Felt signed a credit application on behalf of Waterhill Company, LLC, in which Wasserberg and Felt purported to “personally guarantee all indebtedness hereunder” in order to obtain credit from Flooring Services of Texas, L.P. Waterhill Company, LLC converted into WCL in 2003, and Flooring Services of Texas, L.P. merged into Flooring Services of Texas, LLC (the “plaintiff”) in 2007. Goods and services were provided on credit before and after these transactions. The guarantors argued that they were not liable for debts incurred after these transactions (i.e., debts incurred by WCL, the converted entity, for goods and services provided by the plaintiff, the survivor of the merger) because the terms of a guaranty must be strictly followed and “neither the party seeking to enforce the guaranty[ies] nor the party whose performance was guaranteed is named in the existing document.” The court of appeals held that the trial court properly concluded that the guaranties were applicable to debts incurred after Waterhill Company, LLC converted into WCL because the Texas conversion statutes and the articles of conversion filed with the Secretary of State provided that the converting entity continues in existence in the organizational form of the converted entity. (Relying on a statement in the articles of conversion, the court erroneously referred to the Texas Business Corporation Act rather than the Texas Limited Liability Company Act, but the conversion statutes for partnerships, corporations, and LLCs all contained similar language.) The court of appeals also rejected the argument that the guaranties did not apply to indebtedness for goods and services provided by the plaintiff, Flooring Services of Texas, LLC, as the survivor of a merger with Flooring Services of Texas, L.P. The guarantors argued that the guaranties did not cover these post-merger transactions because the guaranties did not name the plaintiff or refer to its “successors or assigns.” The court noted that the Texas merger statutes provide that all rights of the parties to the merger are allocated and vested in the surviving entity without the need for any formal transfer or assignment. The court also distinguished other Texas cases relied upon by the guarantors. According to the court, unlike
a guaranty that covered payment for goods sold by Ford Marketing Corporation (which was held not to be enforceable by Ford Motor Company for goods sold by it as the post-merger successor), the document in this case referred to “all indebtedness hereunder” and was not limited to goods and services provided by Flooring Services of Texas, L.P. Additionally, the court rejected the argument that Texas cases have required language extending a guaranty to actions by a successor entity in order for a successor to enforce the guaranty.

O. Divorce of Partner


Vicki Milner entered into a mediated settlement agreement (MSA) with her husband, Jack Milner, in their divorce proceeding. The MSA provided that Jack agreed to transfer to Vicki all of his “beneficial interest and record title in and to” a limited partnership and its LLC general partner subject to existing liabilities and the partnership agreement. The exhibits to the MSA contained documents for all the partners to sign consenting to the transfer of Jack’s limited partnership interest as well as his interest in the LLC general partner. There were three limited partners, Jack, Jack’s brother, and a third individual, Michael Hill. Jack and Vicki signed the consent document on the day they entered the MSA, but the other partners did not sign it that day. Jack’s brother signed the consent a few days later but then sold his interest to Hill a few days after signing the consent. The draft divorce decree proposed by Jack differed from the MSA in that it did not refer to any required consent of partners and simply contained an assignment of interest for Jack to execute. Vicki asserted that it was her understanding that the MSA was contingent on the consent of all partners to the transfer. Vicki withdrew her consent to the MSA based on this discrepancy, and Jack reasserted his motion that the court enter his previously filed draft of the divorce decree. The trial court signed the decree, which merely provided for the assignment of Jack’s partnership interest and did not mention the consent requirement or contain additional signature lines for the other partners. Arguing that the divorce decree did not properly reflect the MSA, Vicki filed a motion for a new trial, which was denied. The consent issue was important because the partnership agreement did not require the consent of the partners for Jack merely to assign his interest to Vicki, but consent of all the partners was required for her to become a substituted limited partner. Hill never signed the exhibits to the MSA, thus preventing Vicki from obtaining the consent required for her to become a limited partner. Because the rights of a limited partner are greater than an assignee, the distinction had a potential impact on the value of the transferred interest. The court of appeals concluded that the trial court abused its discretion by not setting aside the MSA because there was no meeting of the minds regarding the nature of the transferred interest in the limited partnership. The Texas Supreme Court examined the language of the MSA and concluded that it was ambiguous as to whether it required Vicki’s substitution as a limited partner. Thus, there was a fact question as to the parties’ intent requiring remand of the case to the trial court for the mediator to resolve the ambiguity. A dissent by Justice Johnson joined by Justices Green and Willet argued that the language of the MSA was unambiguous and required only that Jack transfer his interest and sign the consent. The dissenting justices concluded that the only reasonable construction of the MSA was that Jack and Vicki agreed that Jack’s transfer of his interests were subject to the partnership agreement provisions requiring consent of all partners to admit Vicki as a limited partner and that the MSA did not compel Jack to obtain the consent of other partners or imply an unexpressed material contingency that Vicki be admitted as a limited partner.


In this divorce proceeding, Smith argued that the trial court erred in granting partial summary judgment that Grayson’s partnership interest in a limited partnership was his separate property. Before Smith and Grayson were married, Grayson acquired an interest of 48,300 units in a limited partnership. During the marriage, he did not purchase any additional units, but his percentage interest increased as a result of the partnership’s purchase of interests from withdrawing partners. Grayson’s share of each year’s partnership profits was added to his capital account balance pursuant to the partnership agreement, and Grayson received distributions from his capital account during the marriage, but the partnership retained a portion of his share of income in his capital account to use as operating expenses. The trial court granted Grayson’s motion for partial summary judgment that his partnership interest was separate property, and the decree after trial of other issues confirmed Grayson’s interest in the partnership as separate property. On appeal, Smith argued: (1) all of the partnership income Grayson earned during the marriage, whether distributed or retained, was community property; (2) the partnership used Grayson’s retained community property income to buy out other partners’ interests, resulting in an increased interest for Grayson acquired during the marriage, which should be characterized as community property; (3) the retention of a portion of community income in Grayson’s capital account with his separate property resulted in commingling so that the presumption of community property applied to the entire partnership
Grayson countered that only the distributed income was community property, that the retained funds were partnership property, and that all of Smith’s arguments failed on that basis. After reviewing basic marital property characterization rules, the court reviewed their application to a partnership interest. The court noted that the Texas Supreme Court has determined that the only partnership-related property that can be awarded on divorce is the partnership interest, not partnership property. A partnership interest is a partner’s right to receive his share of profits and losses and to receive distributions. Partnership property is not property of the individual partners, and a partnership interest does not include an ownership interest in partnership property. A partner does not retain an ownership interest in his capital contribution; the contribution becomes partnership property. Thus, the partner’s right to receive his share of the profits is the only partnership right subject to characterization. Here, the undisputed summary judgment evidence established that Grayson acquired his partnership interest before marriage and purchased no additional units during marriage. A portion of his share of the income earned on his partnership interest was distributed, and a portion was retained by the partnership for operating expenses. During the marriage, the partnership acquired units from retiring or withdrawing partners, thus increasing Grayson’s percentage interest. The court rejected Smith’s argument that the portion of Grayson’s income retained by the partnership constituted community property. Partnership earnings are owned by the partnership prior to distribution and cannot be characterized. The portion of partnership income retained in Grayson’s capital account was thus partnership property and as such was neither separate nor community property of Grayson or Smith. Further, the court concluded that, assuming the funds in Grayson’s capital account were used in purchasing units of withdrawing partners, the funds and repurchased units were partnership property. The court stated that the summary judgment evidence showed that the only resulting increase in Grayson’s interest was the increase in the proportional percentage of his interest resulting from a reduction in the total number of partnership units and that there was no actual increase in Grayson’s interest. Even if the repurchase somehow were construed to result in an actual increase in Grayson’s interest, the court said that the increase in interest would remain partnership property and would not constitute property acquired after marriage until distributed. Because the portion of partnership income retained in Grayson’s capital account was partnership property, its retention could not result in the commingling of community and separate property. Thus, the trial court did not err in granting the partial summary judgment.

P. Derivative Claims


The defendants in this case were limited partnerships and managing partners that were sued by partnership investors in two successive lawsuits. The same attorney represented the investors in each lawsuit. In Wesolek I, suit was brought in state court, and the case was removed to federal court where the court dismissed the plaintiffs’ direct fraud claims with prejudice and dismissed the plaintiffs’ derivative claims without prejudice. Although the court’s opinion in Wesolek I put the plaintiffs on notice of the need to plead facts capable of establishing that the preconditions for derivative claims were satisfied, the plaintiffs in Wesolek II filed an original petition in state court and an amended complaint in federal court after removal of the action without alleging with particularity facts capable of establishing the preconditions for bringing derivative claims. The defendants sought attorney’s fees and expenses incurred in Wesolek I and Wesolek II from plaintiffs and their counsel, jointly and severally. The defendants based their request on Federal Rule of Civil Procedure 11(b), 28 U.S.C. § 1927, the court’s inherent authority, Texas Business Organizations Code § 153.404, Chapter 10 of the Texas Civil Practice and Remedies Code, and Texas Rule of Civil Procedure Rule 13. The court analyzed the bases relied on by the defendants and concluded that 28 U.S.C. § 1927 and Texas Rule of Civil Procedure Rule 13 supported an award of attorney’s fees and expenses against the plaintiffs’ attorney with respect to Wesolek II, but not Wesolek I. Rule 13 supported sanctions for filing the original petition in state court that initiated Wesolek II, and 28 U.S.C. § 1927 supported sanctions for unreasonably and vexatiously multiplying proceedings by continuing to pursue the claims asserted in Wesolek I following removal of Wesolek II to federal court. The plaintiffs’ attorney argued that there was a good faith argument that the pleadings satisfied the requirements for pleading derivative claims under Texas law based on the allegation that the plaintiffs attempted to get the general partner to act through its attorney. The attorney also argued that Section 153.401(2) of the Texas Business Organizations Code recognizes demand futility with respect to limited partnership derivative actions. The court responded that the problem with these arguments was that the allegations were not only deficient because they failed to allege with particularity the facts required by Texas law for asserting derivative claims, but based on the court’s dismissal of virtually identical claims in Wesolek I, the attorney knew that the derivative claims in Wesolek II were also deficient. Although the court found that sanctions were warranted against the plaintiffs’ attorney, the court concluded that sanctions were not warranted against the plaintiffs individually, relying on an affidavit of one of the plaintiffs stating that the attorney failed to keep the plaintiffs properly informed and did not obtain their authorization to file the second suit.
A limited partner of two limited partnerships brought a derivative suit in 2012 against the limited partnerships’ lender and attorneys. The limited partner plaintiff alleged that an effort to cause the general partner to bring the action was not likely to succeed. The attorney defendants filed a motion to abate on the basis that the limited partner was a foreign entity that had not registered to do business in Texas and the limited partnerships had been involuntarily terminated in 2011. The trial court abated the action based on Sections 9.051 and 153.309 of the Texas Business Organizations Code (BOC). After the trial court denied the limited partner’s motions to reconsider, the limited partner sought mandamus relief.

The court of appeals first addressed Section 153.309(a)(1) of the BOC, which states that a limited partnership whose right to transact business has been forfeited may not maintain an action, suit, or proceeding in a Texas court unless its right to transact business is revived pursuant to Section 153.310. The court concluded that the limited partnership was not maintaining the suit because it was a derivative suit brought by a limited partner on the partnership’s behalf. The court discussed and relied on case law permitting shareholders to bring derivative actions on behalf of an unregistered foreign corporation or a corporation whose charter has been forfeited for failure to pay franchise taxes. In this context, the courts have allowed shareholders to assert claims alleging fraudulent, ultra vires, or negligent acts on the part of the directors as opposed to an ordinary cause of action that accrues to the corporation in the due course of business, which cannot be asserted by a shareholder on behalf of an incapacitated corporation. Based on this case law and the fact that the limited partner had no control over whether the limited partnerships were revived (because the authority to revive the partnerships was vested in the general partners), the court of appeals concluded that the trial court abused its discretion in holding that Section 153.309(a)(1) required abatement of this suit and that the limited partner had no adequate remedy by appeal.

With respect to the trial court’s abatement of the action based on Section 9.051(b) of the BOC, which provides that a foreign filing entity may not maintain an action, suit, or proceeding in a Texas court on a cause of action arising out of the transaction of business in Texas unless the foreign filing entity is registered in accordance with Chapter 9 of the BOC, the court of appeals stated that the limited partner controlled whether it registered to do business in Texas and had shown only that it chose not to register. Thus, the limited partner had a method of challenging an indefinite abatement. Because the limited partner did not show it had no adequate remedy by appeal, it was not necessary for the court of appeals to consider whether the trial court abused its discretion in abating on this basis.

The trustee of a limited partnership’s bankruptcy estate sued Michael Manners, an individual, and his affiliated companies for breach of fiduciary duty, conspiracy to breach fiduciary duty, and aiding breach of fiduciary duty in connection with the buyout of Manners’ limited partnership interest by the other partner. In 1998, Manners, the founder and CEO of the limited partnership’s business, sold 50% of the equity to John Speer and retained a 50% interest as a limited partner through a corporation. An entity owned by Speer became the 1% general partner, and another Speer entity became “Chairman Emeritus” of the limited partnership. The trustee alleged that Manners and Speer devised a scheme to take money out of the limited partnership to finance Speer’s 2006 buyout of Manners without reflecting a loss in equity on the partnership’s balance sheet. The trustee also argued that Manners breached the duties of loyalty and care owed as a limited partner by selling his ownership in the limited partnership to Speer. The trustee relied on the status of Manners as “Chairman Emeritus” of the limited partnership as the position giving rise to fiduciary duties after Manners sold his interest in the limited partnership in 2006. The limited partnership was a Delaware limited partnership, and the court thus applied Delaware law to the claims that Manners breached fiduciary duties to the partnership. The court concluded that Manners did not owe the limited partnership any fiduciary duty under Delaware law because he was a passive limited partner, and the position of Chairman Emeritus did not involve the exercise of discretionary authority or active management of the limited partnership. The court discussed allegations that Speers as well as Manners owed fiduciary obligations to the partnership and noted that the trustee did not allege that Manners or Speers were fiduciaries as to the partnership’s creditors. The court stated that if Manners had discretionary control over the limited partnership, any resulting fiduciary duties would run to Speer as the only other partner, and the Delaware Revised Limited Partnership Act gives only the general partner the right to sue on behalf of the partnership. The statute gives a limited partner the right to bring a derivative suit if the general partner refuses to do so, and the court noted Delaware case law stating that the statute literally prevents creditors, or anyone else other than a partner, from suing on behalf of the partnership. The court stated that to the extent the trustee sued on the partnership’s behalf, he lacked derivative standing.
The plaintiffs purchased units in Texas limited partnerships organized to acquire working and royalty interests in oil and gas properties. After the plaintiffs’ claims in a previously filed action (Wesolek I) were dismissed, the plaintiffs filed this action, asserting claims for common law fraud, conversion, violation of the Texas Theft Liability Act, money had and received, violations of the Texas Securities Act, breach of fiduciary duty, and negligence. The defendants sought dismissal for failure to plead fraud with particularity and failure to state a claim for which relief can be granted. The defendants argued that the plaintiffs’ direct claims were barred by the doctrine of res judicata based on Wesolek I, and that the same claims asserted by the plaintiffs derivatively failed to satisfy the pleading requirements for a derivative suit. In their response to the defendants’ motion, the plaintiffs conceded that they did not have direct claims against the defendants and that all claims were derivative in nature on behalf of the limited partnerships, but the court addressed the direct claims in any event and held that they were barred by res judicata based on Wesolek I. As to the derivative claims, the court held that the plaintiffs failed to satisfy the pleading requirements of Texas and/or federal law, and that the claims should be dismissed with prejudice and without leave to amend because the plaintiffs were placed on notice by the court’s opinion in Wesolek I of the need to plead with particularity facts capable of establishing that the pre-conditions for asserting a derivative suit were satisfied. The Texas Business Organizations Code (BOC) permits a limited partner to bring a derivative action on behalf of the partnership only where (1) all general partners with authority have refused to bring the action, and (2) an effort to cause those general partners to bring an action is not likely to succeed. The complaint must set forth with particularity (1) the effort, if any, of the plaintiff to secure initiation of the action by the general partner, or (2) the reasons for not making the effort. Also, Federal Rule of Civil Procedure Rule 23.1 requires that a complaint in a derivative action be verified and set forth that the action is not a collusive one to confer jurisdiction. The plaintiffs did not dispute their failure to comply with the requirements of the BOC and Rule 23.1 for asserting derivative claims. Instead, without citing any portion of their petition in this action, they asserted that they had attempted to get the general partner, an LLC, to act through its two members, and that no action was taken by the general partner. The court quoted from portions of the plaintiffs’ petition reciting that the plaintiffs had made attempts to initiate action of the general partner, the failure of the general partner to act, and that an effort to cause the general partner to bring an action was not likely to succeed, but the court stated that the plaintiffs failed to allege with particularity the pre-conditions required by Texas law. Also, the plaintiffs did not specifically set forth that the action was not a collusive one to confer jurisdiction as required by Rule 23.1. Thus, the court dismissed the derivative claims. The plaintiffs requested an opportunity to replead, but they did not attach to their response a proposed amended complaint or state what additional facts they would allege or explain why they failed to allege them in the original petition. Since the plaintiffs were on notice of the pleading requirements based on the court’s opinion in Wesolek I, the court was not persuaded that the plaintiffs should be given yet another chance.


The plaintiff, a limited partner in a Texas limited partnership, filed an action in state court against the general partner and other parties seeking damages on behalf of the limited partnership for breach of fiduciary duty, fraud, and other causes of action. The plaintiff nonsuited that action and filed this action in federal court against the same defendants seeking damages on its own behalf for breach of fiduciary duty, fraud, and other causes of action. The plaintiff alleged diversity jurisdiction based on the fact that the plaintiff was a Colorado LLC while the general partner was a Texas corporation, and the other two defendants were a Texas partnership and a Texas individual resident respectively. The plaintiff, individually and on behalf of the limited partnership, also filed another action in state court against the same defendants. The plaintiff sought leave to amend to add the limited partnership as a plaintiff and an indispensable party and, in anticipation of the joinder, sought dismissal based on lack of diversity jurisdiction. The court had previously denied dismissal on the basis that the plaintiff’s complaint did not allege a derivative claim on the limited partnership’s behalf and that the limited partnership’s citizenship did not destroy diversity. The plaintiff argued that the limited partnership was an indispensable party because its interests were implicated by the relief sought by all of the parties, but the defendants argued that the plaintiff largely sought relief on its own behalf and that joinder of the limited partnership would destroy diversity and should not be permitted. The plaintiff contended that the limited partnership was a required party in an action brought by a limited partner such as the plaintiff to enforce the rights of the partnership. The court stated that it must determine whether the limited partnership was the real party in interest or if the plaintiff’s claims were for the plaintiff’s sole benefit. The inquiry was complicated by the fact that the plaintiff’s complaint purported to assert derivative claims while at the same time referring to the plaintiff as the party seeking relief. The court looked to Texas law, under which an individual shareholder or partner does not have the right to recover personally for injury to the legal entity, to determine whether the plaintiff’s claims must be brought on behalf of the partnership. The plaintiff complained


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that the general partner of the limited partnership misappropriated partnership funds, acted in its own self-interest to the detriment of the partnership, and breached the partnership agreement. These claims alleged harm to the partnership as a whole; therefore, the partnership was the appropriate plaintiff to assert the claims. The court also examined a breach of fiduciary duty claim asserted by the plaintiff arising out of the partnership’s purchase of a tract of land. The plaintiff argued that this claim was a derivative claim, but the defendants cited well-settled case law that a general partner owes a fiduciary duty to the limited partners for the proposition that the limited partner plaintiff could assert this claim on its own behalf and that amendment of the pleadings was thus not necessary. The court concluded that this claim alleged harm to the value of the partnership and must be brought in a derivative capacity. Because the limited partnership was a required party, the plaintiff lacked standing individually and could not obtain relief without adding the limited partnership as a derivative party-plaintiff. Because the limited partnership’s citizenship would defeat diversity jurisdiction, the court turned to the question of whether the limited partnership was indispensable, i.e., whether the case should proceed in the absence of the limited partnership or should be dismissed. One factor the court was required to consider was whether a judgment in the limited partnership’s absence might prejudice its interest. The court concluded that the relief sought, which included the plaintiff’s request for removal of the general partner and the defendants’ claims for indemnity and attorney’s fees recoverable from the assets of the partnership, would prejudice the partnership and weigh in favor of dismissal. Further, the court considered the fact that the plaintiff would have an adequate remedy in its state-court action if the action here were dismissed. The court acknowledged the defendants’ arguments regarding forum shopping by the plaintiff in its repeated filings and dismissals of actions involving almost identical claims, but the court stated that it could not overlook the law that required these claims to be brought derivatively.

The plaintiffs in this case were limited partners of a hedge fund organized as a Delaware limited partnership. The plaintiffs’ suit arose out of the total loss of their investments in the hedge fund, but the plaintiffs did not sue the primary actors. The plaintiffs sued The Perot Family Trust, Hill Air Company I, L.L.C. (d/b/a Perot Investments), and Petrus Securities, L.P. (collectively, “the Perot Entities”) and two individuals, Blasnik and Karmin, who were employed by the hedge fund’s general partner (and also held positions in various other non-defendant entities and the Perot Entities). The plaintiffs alleged that the defendants owed fiduciary duties to the hedge fund and the limited partners by virtue of control over the hedge fund and its general partner. The plaintiffs alleged breach of fiduciary duty claims based on mismanagement, misrepresentations, and nondisclosure by the defendants. The plaintiffs also alleged aiding and abetting and vicarious liability for breach of fiduciary duty on the part of certain defendants. In a previous opinion, the court dismissed the plaintiff’s claims subject to an opportunity to replead. This opinion addressed motions to dismiss filed by the Perot Entities and the two individual defendants after the plaintiffs amended their complaint. In its previous opinion, the court determined that the mismanagement claim was a derivative claim under Delaware law and that the plaintiffs failed to plead facts demonstrating that demand had been made on the general partner of the hedge fund or the reasons for not making a demand. In their amended complaint, the plaintiffs asserted that demand would be futile because demand would be made on Blasnik, as president and sole manager of the general partner, and The Perot Family Trust, as owner of the general partner, and both participated in and approved of the alleged wrongdoing and were thus incapable of making an impartial decision about suing the defendants. The court found that these allegations adequately pled demand futility, but the defendants argued that (1) the plaintiffs lacked standing to assert derivative claims on behalf of the hedge fund because the challenged conduct took place at the level of the foreign fund through which the hedge fund invested and the plaintiffs were not shareholders of the foreign fund, and (2) claims for mismanagement of the foreign fund were at that time under the control of liquidators appointed by Bermuda courts so that plaintiffs would have to make demand on the liquidators. The court stated that the evidence might develop to show that the challenged conduct did not take place at the level of the hedge fund, but the court was satisfied at this stage of the litigation that the claims were derivative claims of the hedge fund as to which demand was futile.

The plaintiffs purchased units in Texas limited partnerships organized to acquire working and royalty interests in oil and gas properties. The plaintiffs asserted various claims on behalf of themselves and the limited partnerships based on alleged misrepresentations made before and after the plaintiffs’ purchase of their units by the individuals who promoted and ran the limited partnerships. The defendants sought dismissal of most of the claims based on lack of standing and failure to comply with the requirements of Federal Rule of Civil Procedure 23.1 and applicable state law regarding derivative actions. The defendants sought dismissal of the remaining fraud-based claims based on a failure to plead the claims with the required particularity. The court granted the motion to dismiss, concluding that the plaintiffs lacked standing and had failed to comply with the requirements for a derivative suit with respect to the derivative claims.
and had failed to meet the pleading burden for the direct fraud claims. The court reviewed provisions of the Texas Business Organizations Code and case law addressing the nature and capacity of a partnership and the circumstances under which a limited partner may assert claims against general or controlling partners. The court noted provisions of Chapter 152 providing that a partnership is an entity distinct from its partners with the power to sue and be sued and that each partner has equal rights in the management and conduct of the partnership business absent an agreement otherwise. The court stated that a general partner of a limited partnership acting with authority has the capacity to bring a suit on behalf of the limited partnership only when a majority-in-interest of the partners agree to such action. Under Chapter 153, a limited partner may bring an action to recover a judgment on behalf of a limited partnership if all general partners with authority to bring the action have refused to do so or an effort to cause the general partners to bring the action is not likely to succeed. The plaintiff must be a limited partner when the action is brought, and the complaint must detail the effort, if any, made by the plaintiff to secure initiation of the action by a general partner or the reasons for not making the effort. Federal Rule of Civil Procedure 23.1 contains similar requirements. The court explained that a limited partner may have standing to bring two different types of claims against a general or controlling partner: (1) direct claims on behalf of the limited partner or a class of similarly situated individuals; or (2) derivative claims brought on behalf of the partnership. The nature of the suit is often critical because the limited partnership is an indispensable party in a derivative suit, while the partnership is not an indispensable party in a direct action. The court concluded that the plaintiffs lacked standing to assert claims arising from loss of the value of plaintiffs’ investment in the limited partnerships (i.e., claims for conversion, theft, money had and received, breach of fiduciary duty, negligence, common law fraud, and violation of the Texas Securities Act arising from misrepresentations made after the plaintiffs invested in the limited partnerships) because those claims belonged to the limited partnerships and must be brought derivatively rather than individually. The only claims that the plaintiffs had standing to bring directly were claims for common law fraud and violation of the Texas Securities Act arising from misrepresentations arising before the plaintiffs purchased their units. Because the plaintiffs failed to comply with the pleading requirements of the Texas Business Organizations Code and Rule 23.1, had already amended their complaint once, did not provide a proposed second amended complaint, and did not explain what, if any, additional facts plaintiffs would allege and why they were not alleged in the first amended complaint, the court denied the plaintiffs’ request for leave to amend and dismissed the derivative claims. The court went on to conclude that the plaintiffs’ direct claims for common law fraud and violation of the Texas Securities Act were subject to dismissal because the plaintiffs failed to plead the claims with the required particularity.


The plaintiffs, a limited partner in a limited partnership and an investor in the limited partnership who had not yet been admitted as a limited partner, asserted claims based on the defendant’s refusal to honor a loan commitment. The court concluded that the plaintiffs could not assert the claims because the claims belonged to the limited partnership’s bankruptcy estate. Although the plaintiffs asserted that they suffered direct damages, including the loss of funds invested by one of the plaintiffs in reliance on the loan commitment, the court concluded that the plaintiffs’ injuries were only indirect injuries resulting from the direct injury suffered by the limited partnership as a result of the defendant’s alleged breach of contract with the limited partnership.


The plaintiff was a limited partner in Rough Creek Capital, LP, a Texas limited partnership. The plaintiff sued the limited partnership’s general partner, but not the limited partnership itself. The plaintiff alleged numerous causes of action related to whether the plaintiff’s ownership interest in the limited partnership was diluted properly due to and following the plaintiff’s election not to fund a required capital contribution requested by the defendant on behalf of the limited partnership. The defendant filed a motion to dismiss based on the plaintiff’s failure to join a required party (i.e., the limited partnership), which would destroy diversity of citizenship and cause the court to dismiss for lack of subject matter jurisdiction. The defendant argued that the limited partnership was required to be a party because the claims in the suit were derivative in nature.

The threshold question for the court was whether the plaintiff’s action was a direct or derivative claim. (A limited partnership is an indispensable party to a derivative action brought by a limited partner to enforce the rights of the partnership whereas a limited partnership need not be joined in an action brought by a limited partner directly against a general partner. Here, if the plaintiff brought derivative claims, the action must be dismissed for failure to join the limited partnership, a non-diverse required party.) The determination of whether the claims were direct or derivative depended on the nature of the wrongs alleged in the complaint. To bring a direct action against a general partner, a limited partner must demonstrate that it has been injured directly or independently of the partnership. In a derivative
action, a limited partner sues on behalf of the partnership for harm done to the partnership. When a limited partner alleges wrongs to a limited partnership that indirectly damaged a limited partner by rendering its interest in the partnership of lesser value, that partner must bring the claim derivatively. The court concluded that the plaintiff’s claims for breach of contract, breach of fiduciary duty, and declaratory judgment belonged to the limited partnership and thus were derivative in nature based on Fifth Circuit precedent holding that the only direct lawsuit a limited partner may bring against a general partner is an action for an accounting. See Bankston v. Burch, 27 F.3d 164, 167-68 (5th Cir. 1994).

Because the plaintiff’s claims were derivative claims brought on behalf of the limited partnership, the limited partnership was a necessary party to the action, and joining the limited partnership would destroy diversity of citizenship because citizens of Texas would be on both sides of the dispute. The court thus lacked subject matter jurisdiction, and the action was subject to dismissal.


Terrill Horton, a successful and wealthy businessman who was a principal in D.R. Horton Homes, wanted to invest in a tax shelter that would reduce his income tax liability. In furtherance of that goal, Horton invested in a limited partnership promoted by American Housing Foundation (“AHF”) and its founder/president, Steve Sterquell. AHF was a nonprofit organization involved in HUD projects, and this particular limited partnership was formed to invest in properties damaged by Hurricane Ike. Horton made a contribution and received a 99.99% interest as a limited partner in the limited partnership. AHF obtained a .01% interest as general partner in the limited partnership. Horton also made a loan of $1.4 million to the partnership, which was guaranteed by AHF on the guaranty. Horton understood that the partnership would generate $15 million in losses that would result in a $3 million tax refund for him. A tax expert testified that the transaction was an abusive tax shelter and that Horton’s claimed reliance on Sterquell was unreasonable. The bankruptcy court concluded that the guaranty was constructively fraudulent and disallowed Horton’s claim against AHF. The court also rejected a breach of fiduciary duty claim by Horton against AHF. Horton argued that AHF, as general partner of the limited partnership, breached its fiduciary duty by employing and permitting Sterquell to use funds and assets of the limited partnership to the benefit of AHF and not the limited partnership, causing Horton the loss of his $1.4 million loan, interest, and attorney’s fees. The court stated that the claim ignored the big picture in which Horton knew the loan funds were to be used in Sterquell’s “housing fund” and Horton’s primary objective was obtaining tax relief in the form of a $3 million tax refund. The court did not understand how such circumstances gave rise to a breach of fiduciary duty. The other problem identified by the court was Horton’s lack of standing to assert his claim on behalf of the limited partnership. The court discussed the ability of a limited partner to bring against a general partner a direct claim, derivative claim, or class action, depending upon the alleged cause of harm and alleged harm suffered. The court noted the authority conferred on a limited partner to assert a claim on behalf of the limited partnership under Section 153.401 of the Texas Business Organizations Code when the general partner has failed to do so or is unlikely to do so (and characterized the situation as one in which Horton would have qualified given the unlikelihood of AHF suing itself). The court discussed how Horton’s injury stemmed from injury to the partnership and thus was not a “personal” claim. Further, if Horton were to recover on his claim, he would be collecting proceeds that properly belong to the partnership. The court acknowledged that it was tempting to argue that characterizing Horton’s relief as indirect does not make sense where Horton is the 99.99% owner of the partnership, and the only other owner is AHF. However, the court pointed out that a partnership is a separate legal entity formed by the partners to shift responsibility, risk, and liability to the entity. The court stated that partners are not the only ones with an interest in litigation involving “incestuous” partnerships; creditors of the partnership have an interest in the partnership’s ability to pursue claims properly belonging to the partnership without being undercut by “bogus” direct suits by the partners. The court stated that the partnership was still a partnership for purposes of this analysis, even if the partnership was set up as a shell, possibly fraudulent, partnership. Horton could have sued derivatively but chose not to do so; he was “attempting to have his partnership cake and eat it too.” Although the court “generously” construed Horton’s pleadings to state a direct fraud claim against AHF in Horton’s capacity as a lender (noting that the Texas Business Organizations Code recognizes that partners may make a loan to the partnership and retain direct claims under Section 152.201), the court concluded that the fraud claim failed on the merits. The evidence showed that the partnership was established for the very purpose of losing money. Horton did not, in entering the deal, rely on specific financial information of AHF. At most, Horton made a loan to the partnership in reliance on financial information of AHF, but it was not fraudulently induced to accept a guaranty from AHF. The court further concluded, as another basis for denying the fraud claim, that the fraud claim was an attempt to enforce a contract that the court had found to be an illegal contract.
Q. Creditor Remedies: Charging Order, Turnover Order


Elgohary, an employee whose employment was terminated by a limited partnership (Herrera Partners, L.P. or the “LP”) in May 2007 obtained an arbitration award in his favor and a judgment confirming the award against the LP in 2010. In 2011, Elgohary obtained a turnover order to pursue collection of the judgment against the LP, and the trial court appointed a receiver to pursue the collection of the judgment. In 2012, the receiver sent Amegy Bank a letter invoking the receiver’s power under the turnover order and requesting the bank to place a hold on all accounts of “Herrera Partners, L.P. FEIN 20-4056583.” The bank responded that it maintained no funds in the name of the LP but held funds of Herrera Partners, a Texas general partnership. An account for the LP listing its federal employer identification number had been opened at the bank in June of 2007. Twelve days later, Herrera Partners formed as a general partnership, and on that date the LP transferred $100,000 from another bank to the Amegy account. Twenty days after the account was opened, the general partnership applied for and received its federal employer identification number from the IRS. On June 28, 2007, the LP filed its certificate of termination with the Texas Secretary of State. The evidence showed that the form of business was changed from a limited partnership to a general partnership to avoid the new margin tax that was applicable to limited partnerships and, to avoid tax consequences, the transaction had to be completed by July 1, 2007. Thus, the Amegy account had been temporarily set up in the name and under the employer identification number of the LP, but after the LP terminated, the account could only be accessed using the general partnership’s employer identification number. There was evidence that the $100,000 deposited in the account was used to pay existing liabilities of the LP at the time and that thereafter all deposits in the account were for services provided by the general partnership. A commercial lender with Amegy Bank testified that the general partnership was the owner of the account since early August 2007 but that a new signature card was not executed by the general partnership until July 2010. When the receiver sent the letter requesting the hold on all accounts of the LP in 2012, Amegy Bank filed an interpleader stating that the LP had no accounts but that the general partnership did. The general partnership intervened in the interpleader and contended that the money belonged to it and not the LP. Elgohary and the receiver filed a motion requesting release of the funds to them in satisfaction of the judgment against the LP, and the trial court denied the request. In this appeal, the general partnership argued that the turnover statute cannot be used to resolve disputes as to ownership of property or to adjudicate the rights of someone not a party to the judgment. The court of appeals agreed that the turnover statute does not authorize the issuance of an order to a person who is not the judgment debtor or under the judgment debtor’s control. It was undisputed that the general partnership was not a party to the underlying judgment, but Elgohary argued that Gilbert Herrera controlled the entities and had complete and unfettered discretion to move funds in the accounts. Elgohary also argued that all of the companies were mere alter egos of Gilbert Herrera and that courts should disregard the corporate fictions when they are being used to perpetrate fraud or injustice. The court of appeals stated that Elgohary could not use the turnover statute to determine ownership of disputed funds or to litigate issues of alter ego. Thus, the trial court did not abuse its discretion in determining the turnover statute could not be used to adjudicate substantive rights, and issues of successor liability, alter ego, or ownership of disputed property may not be resolved in a turnover proceeding.


Two judgment creditors sought a charging order on a judgment debtor’s interest in a family limited partnership (the “FLP”), and the trial court entered an agreed charging order signed by counsel for the judgment creditors, the judgment debtor, and the FLP. The charging order stated that the FLP would not make any distributions to the judgment debtor but would instead distribute to the judgment creditors all funds and assets that would have been distributed to the judgment debtor by virtue of her interest in the FLP until the judgments were fully paid. Before the entry of the charging order, the IRS filed federal tax liens on the judgment debtor’s assets, and after the entry of the charging order an irrevocable living trust issued a check to the IRS in the amount of the value of the judgment debtor’s interest in the FLP as determined in separate litigation and set by the IRS. The IRS released the FLP from the tax liens on the judgment debtor’s interest, and the judgment debtor assigned her entire interest in the FLP to the irrevocable trust. The FLP filed a motion seeking discharge and release of the agreed charging order, and the judgment creditors responded by filing an application for turnover order and appointment of a receiver to facilitate their attempts to collect on the judgments. At that point, the FLP intervened in the lawsuit and asked the trial court to reject the application for turnover order and receiver or, if the court granted the application, to limit the powers of the receiver and the judgment creditors from directing any post-judgment discovery or subpoenas to the FLP or otherwise interfering with the FLP’s business. The
trial court denied the FLP’s motion to release the charging order without explanation and without mention of the plea in intervention or of any requests for affirmative relief or defenses of any party. The FLP appealed the order denying release of the charging order, and the court of appeals held that the trial court’s order was not a final judgment and was not appealable. The court of appeals first explained that the charging order is a creation of statute in Texas, the sole purpose of which is to facilitate collection of a judgment from a judgment debtor who owns an interest in a business entity. The court quoted the charging order statute in the limited partnership context found in Tex. Bus. Orgs. Code § 153.256. The court commented that appellate courts have had relatively few opportunities to review charging orders, and some of these have been in mandamus proceedings. When presented on appeal, most decisions involved orders or judgments granting or denying both a charging order and other forms of relief. The court of appeals discussed at some length Dispensa v. University State Bank, 951 S.W.2d 797 (Tex. App.–Texarkana 1997, pet. denied), the one appellate decision considering whether an order that relates solely to a charging order is final for purposes of appeal. In Dispensa, the court of appeals held that the charging order was not final and appealable because it neither disposed of all issues raised at that stage nor did it act as a mandatory injunction. The court of appeals rejected various arguments by the FLP and reached the same conclusions regarding the order denying release of the charging order in this case as the court in Dispensa did regarding the charging order in that case. Because the court held that it did not have jurisdiction over the appeal due to the absence of a final judgment, it was not necessary for the court to reach the judgment creditors’ argument that the FLP lacked standing or arguments by the parties on the merits.


After a judgment entered in the Northern District of Texas was registered in the Southern District, this court issued an order for turnover relief and appointment of a receiver requiring the judgment debtors, Gary Kornman and various related entities, to turn over all nonexempt property to the receiver. Kornman executed a conveyance of interest on behalf of himself and all judgment debtors in which the judgment debtors conveyed all of their right, title, and interest to property identified in the conveyance. Kornman objected to the court’s ruling as to the effect of the conveyance in certain respects. With respect to several limited partnerships, the court ruled that the receiver owned all of the limited partnerships and that the receiver was the sole person in control of the limited partnerships. Kornman stipulated to the receiver’s 100% ownership interest but contested that the receiver was the sole person in control of the limited partnerships. A corporation that was wholly owned by Kornman was the 1% general partner of each limited partnership, and the 99% limited partner of each partnership was a trust that was also a judgment debtor. Because he was the 100% shareholder of the corporate general partner, Kornman’s assignment of his stock to the receiver resulted in the receiver’s obtaining the ability to manage the business and affairs of the corporation and thus act as general partner. With respect to the trust’s assignment of its 99% interests in the partnerships, the court concluded that the assignments caused the trusts to cease to be a limited partner. The court relied on withdrawal provisions in Chapter 152 of the Texas Business Organizations Code, which governs general partnerships, because Chapter 153, which governs limited partnerships does not define events of withdrawal for a limited partner. Section 153.003(a) specifies that the provisions of Chapter 152 govern limited partnerships in a case not provided for by Chapter 153. The court stated that Section 153.110 (which allows withdrawal of a limited partner only as provided by the partnership agreement) only deals with voluntary withdrawal and that there is no provision of Chapter 153 superseding the provisions of Chapter 152 dealing with withdrawal as a matter of law. The court relied upon Sections 152.501(a) (specifying that a person ceases to be a partner on an event of withdrawal) and 152.501(b)(6)(B) (specifying that an assignment for the benefit of a creditor is an event of withdrawal) to conclude that the trust’s assignment of its limited partnership interests constituted an event of withdrawal that caused the trust to cease to be a limited partner. As assignee of the trust’s limited partnership interests, the receiver could become a limited partner with the consent of all partners under Section 153.253(a)(2). Since the receiver owned and managed the affairs of the 99% limited partner and could admit himself as limited partner, the receiver was the sole person in control of the partnerships.


Houston Baseball Partners, LLC sued Comcast Corporation, Drayton McLane, and others in state court for fraud, fraudulent inducement, fraud by nondisclosure, negligent misrepresentation, and civil conspiracy based on alleged misrepresentations that the plaintiff claimed caused it to pay an inflated purchase price for the Houston Astros and its interest in the Houston Regional Sports Network, L.P. (the “Network”). Comcast removed the action, and the plaintiff sought remand. The court’s analysis of its jurisdiction revolved around indemnification provisions in two agreements.
Deferred consideration owed from the acquisition and the unpaid $1 million loan because the claims were a debt owed personally aggrieved. The defendants also claimed that the trial court erred in refusing to dismiss Richey's claims for injury to his character, and mental anguish. Thus, his pleadings did not affirmatively negate that he was a partner who is “personally aggrieved” may bring claims for injuries suffered directly. The court pointed out that the indemnification provisions did not cover the defendants because Comcast was not performing its duties under the services agreement and the McLane parties’ acts were not taken on behalf of the Network. Additionally, even if the defendants’ alleged conduct was performed on behalf of the Network or under the services agreement, the plaintiff argued that the alleged conduct fell within the exclusions of gross negligence, fraud, or willful misconduct. The court concluded that the factual allegations underpinning the plaintiff’s claims alleged conduct within the scope of the duties of the services agreement or conduct on behalf of the Network. Further, there was the possibility that the defendants would be entitled to indemnification since the plaintiff’s claims included negligent misrepresentation. If the plaintiff failed on the fraud, fraudulent inducement, fraud by nondisclosure, and civil conspiracy claims but succeeded on the negligent misrepresentation claim, the Network would be obligated to indemnify the defendants. Under the broad test that required only a finding of a conceivable effect on the Network’s estate, the court concluded that it had related-to jurisdiction. The court concluded that it did not have jurisdiction over a claim that a McLane entity breached the purchase agreement with the plaintiff because the McLane entity was not acting on behalf of the Network when it entered into the purchase agreement with the plaintiff, and the Network could not be required to indemnify it with respect to this cause of action. The court remanded that cause of action to state court and stated that it would hold a hearing to determine whether the remaining claims should be remanded for reasons other than an absence of subject matter jurisdiction.


The bankruptcy court in this adversary proceeding determined that the debtor, Edelman, was liable for trespass, breach of fiduciary duties, theft, and fraud based on actions he took while serving as vice president of the LLC general partner of a limited partnership that developed and operated a condominium project. The liability included exemplary damages as well as actual damages and was nondischargeable. The court concluded that all of Edelman’s liabilities in this action were nondischargeable under one or more provisions of Section 523 of the Bankruptcy Code, i.e., Sections 523(a)(2)(A), (a)(4), and/or (a)(6).


The plaintiff, a limited partner of Nighthawk Oilfield Service, Ltd. (“Nighthawk”), sued two executives of Nighthawk for fraud, breach of fiduciary duty, and other causes of action after Nighthawk and its wholly owned subsidiary, Richey Oilfied Construction, Inc. (“Richey Oil”), filed for bankruptcy. The plaintiff was the founder of Richey Oil and was its sole owner until he sold Richey Oil to Nighthawk for cash, a promissory note, and limited partnership units in Nighthawk. The defendants moved the trial court to transfer venue or dismiss the suit based on a forum selection clause in the acquisition documents and also argued that the plaintiff lacked standing because his claims belonged to Nighthawk and could only be brought by the bankruptcy trustee. The trial court denied the motions, and the defendants sought mandamus. With respect to the standing challenge, the defendants relied on case law holding that a limited partner does not have standing to sue for injuries to the partnership that merely diminish the value of a partner’s interest. The defendants argued that the plaintiff’s claims related to mismanagement of Nighthawk’s affairs and that he did not have standing to assert them. The supreme court noted that the case law relied on by the defendants recognized that a partner who is “personally aggrieved” may bring claims for injuries suffered directly. The court pointed out that the plaintiff’s pleadings, which are to be construed liberally in the context of a plea to the jurisdiction, alleged that the plaintiff made a $1 million payment to Nighthawk after the acquisition, that other limited partners failed to make similar payments, and that the plaintiff suffered a loss of earning capacity, lost profits, loss of income, damage to credit reputation, injury to his character, and mental anguish. Thus, his pleadings did not affirmatively negate that he was personally aggrieved. The defendants also claimed that the trial court erred in refusing to dismiss Richey’s claims for deferred consideration owed from the acquisition and the unpaid $1 million loan because the claims were a debt owed

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by Nighthawk that must be filed against Nighthawk in bankruptcy court. The supreme court stated that whether these claims were claims that should have been brought against another party was not a question of jurisdiction requiring dismissal but rather was a question of liability. The defendants did not argue that they were the incorrect parties and did not show themselves entitled to mandamus on this ground. The defendants also argued that the debt claims against Nighthawk in this suit violated the automatic stay, but Nighthawk was not a defendant in the suit, and the automatic stay does not extend to non-debtors. The court stated that the defendants had not shown that there was “such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party defendant will in effect be a judgment or finding against the debtor.”


In this opinion, the bankruptcy court denied a motion to dismiss the involuntary Chapter 11 petition and made a preliminary determination that the directors of the LLC general partner of the limited partnership debtor owed fiduciary duties to the bankruptcy estate notwithstanding the provisions of the partnership agreement that disclaimed fiduciary duties. The debtor was a Delaware limited partnership with an LLC as the sole general partner. The LLC had four directors, each of whom was selected by an owner of the LLC (two by Comcast, one by the Rockets, and one by the Astros). Certain decisions required unanimity of the directors. The Astros argued that the Chapter 11 bankruptcy petition should be dismissed as futile because the Astros’ exercise of its veto right through its appointed director rendered any hope of reorganization futile. The court rejected this argument, concluding that the directors owed fiduciary duties to the bankruptcy estate and would not act in breach of their duties. The court acknowledged that the limited partnership was structured in such a way as to disclaim any state-law fiduciary responsibilities by the partners, but the court rejected the Astros’ contention that the parties created a bankruptcy-remote structure that absolved its directors of fiduciary responsibilities. The court reasoned that fiduciary duties to the estate rest with a debtor-in-possession’s directors in a Chapter 11 case where no trustee is appointed. The court stated that “[t]he individuals who manage the Estate’s affairs—whether ‘officers and managing employees’ [citation omitted] or puppeteers acting through a general partner—must respect the fiduciary sanctity of the operation of a bankruptcy estate.” The court stated that the Astros could choose to leave its seat on the board vacant, but that any individual who chose to serve on the board of the general partner would be required to honor fiduciary responsibilities. The court explained that the fiduciary duties to the estate were owed by the director selected by the Astros and not by the Astros themselves, leaving the Astros free to participate in hearings and oppose actions and defend contractual rights possessed under its media rights agreement with the debtor. In a footnote, the court stated that it was making only a preliminary determination that the directors owed fiduciary duties for purposes of the threshold determination of whether the case was futile. The court characterized its belief that the directors owed fiduciary responsibilities as “strongly” held, but noted that the parties had not fully briefed the issue of the directors’ fiduciary responsibilities and found it unnecessary to reach any final conclusion on the matter unless and until an alleged breach of duty occurred.


In this adversary action, the court set forth findings of fact and conclusions of law after trial of the trustee’s claims to avoid guaranties of the debtor as fraudulent obligations, subordinate allowed claims, and avoid and recover payments made by the debtor with respect to guaranties by the debtor of Templeton’s investment in various limited partnerships. The court described the Templeton deals as frustrating legal analysis. In each of the deals, Templeton was a major investor and received a defined partnership interest in a newly created limited partnership. For those investment dollars, he also received a guaranty of repayment of the amount of the investment from the debtor. The deals were “wildly beneficial” to Templeton, and the product received by Templeton was “not based on economic reality.” The court looked to Texas state law to determine whether the Templeton deals were investments that created, at most, an equity interest or debt subject to treatment as an unsecured claim. The court identified a number of factors that were relevant to this analysis and examined them in the context of the Templeton deals. The intent of the parties as determined at the time of each deal was that Templeton receive a range of benefits far in excess of the value of his investment and thus not limited to the amount of his investment. The court addressed the identity and relationship of the contracting parties, the amount of capital (i.e., whether thinly capitalized) of the limited partnerships at the time of the transactions, the risk involved based on the absence or presence of security, the arrangement’s formal indicia, and Templeton’s position relative to other creditors regarding repayment of principal and interest. Though Templeton obtained certain rights as a limited partner, he never manifested any desire to exercise them, so this factor was not helpful. The deals involved returns denominated as interest, but the rates were “absurdly beneficial.” There were no terms concerning the
consequences of the debtor’s or partnership’s failure to return the amount of the investment. The evidence was not clear regarding the redemption rights of either Templeton or the limited partnerships, but Templeton’s interests may have been redeemed to accommodate the “rolling” of investments from one partnership to another. The timing of the investments was at the formation of each partnership and issuance of the partnership interests and guaranties. As a whole, the deals involved millions of dollars and huge passed-through tax write-offs and lacked economic substance. Templeton trusted the debtor’s principal and turned a blind eye to the strangeness of the deals. The court concluded that Templeton’s investments were equity investments and must be treated as such under the Bankruptcy Code. Templeton’s unliquidated fraud claim arose from the purchase of these equity interests and fell within the broad residual category of other equity interest holders in the debtor. Assuming the facial integrity of the deals, Templeton argued that he owned interests in various limited partnerships, not the debtor, but the court pointed out that a limited partnership agreement can serve to meet the requirements of an affiliate relationship. The debtor, or a wholly owned subsidiary of the debtor, was the general partner of each limited partnership. The debtor exercised total control of the partnerships, and the partnerships were affiliates of the debtor. According to the court, Templeton’s participation in a nonsensical deal required him to bear the risk in the deal, and it would be inherently unfair to place an investor like Templeton at the same priority level as true creditors. The court acknowledged that Templeton gave value in the amount of his investments, but the court stated that his participation in the illegitimate tax schemes defeated his good faith claim. Payments made by the debtor to Templeton within ninety days of the bankruptcy were voidable, preferential transfers.

A state district court in Harris County entered a summary judgment against Wyckoff in her suit against Buggs. The judgment awarded Buggs damages and ordered that KLAR Collections, L.P. (“KLAR”) be wound up and terminated. KLAR had inventory, fixtures, and other assets, and Wyckoff transferred KLAR’s assets to an entity of which Wyckoff was the sole shareholder and used them in her business, claiming she had never been in partnership with Buggs. Buggs filed an adversary proceeding in Wyckoff’s bankruptcy, seeking an exception to discharge. Wyckoff sought summary judgment on Buggs’ claim for exception to discharge. The court stated that the state court’s order established the existence of a partnership regardless of Wyckoff’s belief, and she had a duty to comply with the order. Wyckoff offered no explanation of why her disposition of the assets was not a defalcation. The court held that there was at least a genuine issue of fact regarding whether Wyckoff’s failure to comply with the state court’s order was a defalcation of Wyckoff’s fiduciary duty.

The trustee and certain creditors of the limited partnership debtor sought dismissal of this Chapter 11 bankruptcy case, and unsecured creditors and the limited partnership’s general partner, which had also filed bankruptcy, sought substantive consolidation of this case and the bankruptcy of the general partner. The court found cause for dismissal, noting that the limited partnership had never filed a monthly operating report; there had been no corporate or partnership resolution authorizing the partnership’s bankruptcy filing; the partnership had never mailed notice of the bankruptcy or meeting of creditors to anyone; the partnership had no known business purpose or employees; and there was no reasonable likelihood that the partnership would file a plan of reorganization. The parties stipulated that the partnership agreement was subject to interpretation as to whether the partnership dissolved upon the bankruptcy of its sole general partner. The court stated that the facts demanding dismissal likewise supported, at least in part, the motions for substantive consolidation. The court discussed evidence of an alter-ego type relationship between the partnership and its general partner, including domination of the entities by a common individual who essentially used the partnership as a bank account in his various dealings with investors, massive commingling of funds, failure to follow recognized corporate formalities, and terrible books and records. After analyzing the effect of the equitable remedy of substantive consolidation of the two bankruptcy cases and the generally mandated remedy of dismissal, the court concluded that dismissal was the appropriate choice in this case.

In re Pegasus Funds TFN Trading Partnership, LP, 345 S.W.3d 175 (Tex. App.–Dallas 2011, no pet.).
A limited partnership and two individuals alleged that a trial court’s judgment against them was void and sought to stop post-judgment discovery and collection attempts against them on the basis of the bankruptcy filing of the limited partnership. The court held that the judgment was void as to the limited partnership because the automatic stay that was triggered by the bankruptcy filing deprived the trial court of jurisdiction over the limited partnership. However, the court held that the automatic stay did not extend to the individual relators because the stay does not extend to actions against nondebtors merely because of their relationship to the debtor. The court cited Texas case law holding that the stay does not extend to “separate legal entities such as corporate affiliates, partners in debtor partnerships or to codefendants in
pending litigation.” Thus, the judgment as to the individual relators was not shown to be void, and the trial court did not abuse its discretion in determining that the judgment could be enforced as to them.


The plaintiffs in an adversarial proceeding against a Chapter 7 debtor argued that the debtor should be denied a general discharge pursuant to Sections 727(a)(2), (4), or (5) of the Bankruptcy Code. One of the plaintiffs also argued that her claim should be specifically excepted from discharge pursuant to Section 523(a)(4). Prior to the debtor’s bankruptcy, the plaintiffs, who were married at the time, embarked on a business venture with the debtor. The venture was structured as a limited partnership to which Mike Mullin (“Mr. Mullin”) lent money and in which Tiffany Mullin ("the ex-Mrs. Mullin") invested as a limited partner by providing services. The general partner was a corporation of which the debtor was a director, president, and 51% shareholder. The ex-Mrs. Mullin was also a shareholder in the corporate general partner.

The ex-Mrs. Mullin claimed that the debtor committed fraud or defalcation while acting in a fiduciary capacity and breached fiduciary duties owed to the corporate general partner, the limited partnership, and the ex-Mrs. Mullin as an equity owner of these entities. According to the ex-Mrs. Mullin, the debtor treated the limited partnership as his own personal “piggy bank,” using limited partnership funds for many personal expenses. In determining whether the debtor owed a non-dischargeable debt to the ex-Mrs. Mullin under Section 523(a)(4) of the Bankruptcy Code, the court first examined whether the debtor was acting in a fiduciary capacity vis-s-vis the ex-Mrs. Mullin. After noting that the debtor, as an officer and director of the corporate general partner, stood in a fiduciary relationship to the corporation and its shareholders under Texas corporate law, the court proceeded to analyze the nature of the relationship of the corporate general partner to the partnership and the limited partners under Texas partnership law. The court discussed the development of Texas partnership law regarding duties of partners and concluded that the changes in Texas statutory partnership law in recent years expunged the concept of a partner as a per se fiduciary but did not eliminate the fiduciary status of a managing general partner because of the control exercised by such a partner. The court reasoned that the new statutory language, which makes clear that a partner is not per se a fiduciary, puts partners and partnerships on a parity with shareholders and corporations in that shareholders do not generally owe fiduciary duties to other shareholders. Based on the roles in which fiduciary duties are owed in the corporate context and longstanding case law regarding the fiduciary duties of a managing partner in the partnership context, the court concluded that control is the key to determining whether a partner is a fiduciary. Thus, the court held that Texas case law holding that there is an express trust that satisfies the strict test for “fiduciary capacity” under Section 523(a)(4) is still good law in the context of a managing general partner. The court then looked at the two-tiered structure of the limited partnership to determine how it affected the fiduciary duties owed by the debtor. As noted above, the debtor was a director, president, and 51% shareholder of the corporate general partner. The court concluded that the debtor owed the ex-Mrs. Mullin fiduciary duties through at least two avenues: (1) in his capacity as officer and director of the corporate general partner (since the ex-Mrs. Mullin was a shareholder); and (2) in his capacity as the control person/manager of the general partner (since the ex-Mrs. Mullin was a limited partner). The court then concluded that the debtor committed defalcation while acting in his fiduciary capacity by repeatedly spending partnership funds for his own personal use and allowing others involved in the business to do the same. Finally, the court determined the amount of the “debt” to the ex-Mrs. Mullin that had arisen as a result of the debtor’s defalcation based on the amount of the misappropriated partnership funds. Since the ex-Mrs. Mullin primarily contributed “sweat equity” to the limited partnership, loss of partnership investment was not a practical measure. The court also awarded exemplary damages.

The plaintiffs also alleged that the debtor should be denied a general discharge based on Section 727(a)(2)(A) (concealment of property) and 727(a)(4)(A) (material omissions in his sworn schedules). The court found that the debtor’s unilateral dissolution or discontinuance of the limited partnership and funneling of its goodwill, intellectual property, other assets, and business model to a company owned by the debtor’s domestic partner was a basis to deny the debtor a general discharge under Section 727(a)(2)(A). Further, the court found that the debtor’s omission of information regarding his domestic partner’s company and its receipt of the assets of the limited partnership were intentional and material omissions from his sworn statements that support a denial of discharge under Section 727(a)(4).

In re Harwood, 637 F.3d 615 (5th Cir. 2011).

The Fifth Circuit Court of Appeals affirmed the district court’s judgment affirming the bankruptcy court’s judgment that the debtor’s debts arising from loans obtained from a limited partnership managed by the debtor in his capacity as officer and director of the general partner were nondischargeable under Section 523(a)(4). The court of appeals agreed with the lower courts that Harwood, who was president, a director, and a 50% shareholder of the corporate general partner of a limited partnership, owed a fiduciary duty to the partnership and that he engaged in a
defalcation in such capacity in connection with loans he obtained from the limited partnership. The court relied upon In re Bennett, 989 F.2d 779 (5th Cir. 1993) and McBeth v. Carpenter, 565 F.3d 171 (5th Cir. 2009) to conclude that an officer of a corporate general partner who is entrusted with the management of the limited partnership and who exercises control over the limited partnership in a manner analogous to those cases owes a fiduciary duty to the partnership that satisfies Section 523(a)(4). The court emphasized that it is not only the control that the officer actually exerts over the partnership, but also the trust and confidence placed in the hands of the controlling officer, that leads to a finding of a fiduciary relationship for purposes of Section 523(a)(4). Thus, the court examined the evidence regarding the control entrusted to and exercised by Harwood to ascertain whether he owed a fiduciary duty to both tiers of the organization.

Harwood did not dispute that he owed a fiduciary duty to the corporate general partner as an officer and director of the corporation but contended he owed no duty to the partnership since he was not a partner and did not exercise a level of control over its affairs to justify recognition of fiduciary obligations to the partnership. The court rejected Harwood’s attempt to distinguish the cases relied upon by the court. Harwood relied on the fact that he was not the sole shareholder and sole director of the corporate general partner, whereas In re Bennett involved an individual who was managing partner of a limited partnership that was general partner of the limited partnership, and McBeth v. Carpenter involved the president and sole owner of the general partner of the limited partnership. The court focused on Harwood’s control and agreed with the bankruptcy and district courts that the board’s entrustment in Harwood of the management of the partnership’s affairs combined with the practically complete control that Harwood actually exercised over the partnership’s management compelled the conclusion that Harwood stood in the same fiduciary capacity to the limited partners as a trustee to beneficiaries of a trust. Thus, Harwood acted in a fiduciary capacity within the meaning of Section 523(a)(4). The court also agreed with the bankruptcy court’s conclusion that Harwood’s debt resulted from a defalcation (i.e., a willful neglect of duty based on a recklessness standard) based on Harwood’s failure to record deeds of trust securing two notes representing personal loans Harwood caused the partnership to make to him. The bankruptcy court found the evidence insufficient to show that the making of the loans themselves was a willful neglect of duty (noting that the loans were not made surreptitiously and that the board was at least generally aware of and approved their existence), but concluded that the failure to record the deeds of trust did constitute a willful neglect of duty to the partnership. Harwood argued that the responsibility for recording the deeds of trust rested with the other shareholder/officer of the corporate general partner and that he could not be denied a discharge for taking additional, incomplete steps to secure the loans if the loans did not amount to a defalcation. The court rejected both of these arguments. Harwood was an experienced banker, and he knew the other shareholder/officer had no banking expertise and no particular knowledge of sound lending practices. Further, Harwood knew that failure to properly record the deeds of trust worked to his benefit (by allowing him to pledge the property to obtain additional funds from a bank) and could have a devastating effect on the partnership’s ability to collect. Thus, the court concluded that the bankruptcy court did not err in concluding that Harwood recklessly breached his duty to the partnership by failing to perfect the liens even if the existence of the loans themselves was not a defalcation.

In re Harwood, 427 B.R. 392 (E.D. Tex. 2010), aff’d, 637 F.3d 615 (5th Cir. 2011).

The district court affirmed the bankruptcy court’s determination that an individual who was president and a 50% shareholder of the corporate general partner of a limited partnership owed a fiduciary duty to the partnership and that he engaged in a defalcation in such capacity such that the debt arising from the defalcation was non-dischargeable in the individual’s bankruptcy. The court held that Harwood owed a fiduciary duty to the limited partnership, even though his relationship with the partnership was indirect, because he controlled the daily operations of the partnership. The court stated that the law imposes a fiduciary duty in a two-tiered business model such as this just as Harwood would have had a duty if he had a direct relationship with the partnership, such as serving as the president of the partnership. The distinction between the cases relied upon by the court (In re Bennett (involving an individual who was managing partner of a limited partnership that was general partner of another limited partnership) and McBeth v. Carpenter (involving the president of the LLC general partner of a limited partnership) and this case was the fact that Harwood was president, but not the sole shareholder, of the corporate general partner. However, the key issue was Harwood’s control, and the court concluded that the evidence relied upon by the bankruptcy court was sufficient to support its finding of control. The court also agreed with the bankruptcy court’s conclusion that Harwood’s debt resulted from a defalcation (i.e. a willful neglect of duty based on a recklessness standard) based on Harwood’s failure to ensure that deeds of trust were recorded securing more than $800,000 in personal loans which Harwood caused the partnership to make to him. Harwood argued that the responsibility for recording the deeds of trust rested with the other shareholder of the corporate general partner and that Harwood placed the partnership in a better position by executing the deeds of trust even if they were not recorded. The court rejected both of these arguments. Harwood was an experienced banker, and he willfully neglected his duty by handing off responsibility for recording to the other shareholder and not ensuring that he did so. The court
was not swayed by the argument that Harwood placed the partnership in a better position when he executed the deeds of trust even if they were not properly recorded. His duty to protect the partnership from financial harm included properly securing the loans, and he was well-aware of the impact of his failure to properly record the deeds of trust. Thus, his debt arose from a defalcation while acting in a fiduciary capacity and, as such, was non-dischargeable.

S. Securities Laws


Limited partner unitholders brought a securities fraud class action and sought to enjoin a unitholder vote on a proposed acquisition that they claimed did not adequately compensate the unitholders, was negotiated in an unfair process, and involved an Form S-4 Registration Statement containing material misrepresentations. In this opinion, the court addressed the plaintiffs’ request for expedited discovery. The defendants argued that the plaintiffs’ request lacked merit because the plaintiffs’ claims for violation of the Exchange Act and Rule 14a-9 (the proxy anti-fraud rule) were subject to the mandatory stay of discovery imposed by the Private Securities Litigation Reform Act (PSLRA) and that, in any event, the plaintiffs had neither shown a need for expedited discovery nor demonstrated a sufficient probability of irreparable harm to justify expedited discovery. The plaintiffs argued that the PSLRA’s mandatory stay of discovery did not apply because the expedited discovery they sought was particularized and necessary to prevent undue prejudice. The court examined the plaintiffs’ request and concluded that it was neither limited nor particularized and that the plaintiffs failed to show expedited discovery was needed to prevent undue prejudice. Thus, the court was not persuaded that the PSLRA’s mandatory stay should be lifted. The court went on to conclude that the plaintiffs did not satisfy the standards for expedited discovery applied in non-PSLRA cases and that the plaintiffs’ motion would be denied even if their claims were not subject to the PSLRA’s stay.

T. Constitutionality of Margin Tax


A natural-person limited partner of a limited partnership challenged the constitutionality of the Texas franchise tax (a/k/a “margin” tax) on the basis that it was an impermissible income tax on the income of the limited partner. The Texas Supreme Court held that the franchise tax was not prohibited by the state constitutional provision requiring a statewide referendum before imposing an income tax on the net income of a natural person.

Article VIII, Section 24 of the Texas Constitution (referred to as the “Bullock Amendment”) was adopted by voters in 1993. The Bullock Amendment provided in part that a general law enacted by the legislature that imposed a tax on the net income of natural persons, including a person’s share of partnership income, must provide that the portion of the law imposing the tax not take effect until approved by a majority of the registered voters voting in a statewide referendum held on the question of imposing the tax. A decade later, as Texas faced a crisis in how to fund the public school system, one of the proposed solutions offered by the Texas Tax Reform Commission was to increase the number of business forms subject to the franchise tax. In 2006, the Texas Legislature amended Chapter 171 of the Texas Tax Code to expand the scope of the franchise tax to include additional forms of business, and for the first time partnerships were required to pay a franchise tax. These amendments and their application were the subject of this case against the Comptroller and the Attorney General (collectively, the “Comptroller”).

Allcat Claims Service, L.P. (the “partnership”) was a Texas limited partnership that provided adjusting services to property insurers. John Weakly, the relator, was one of the limited partners. For the 2008 and 2009 tax years, the partnership paid franchise taxes under protest. The partnership and Weakly (collectively “Allcat”) filed suit in Travis County and an original proceeding in the Texas Supreme Court seeking an order to refund the portion of the franchise taxes paid that were referable to the partnership’s natural-person partners’ shares of partnership income, a declaration that the franchise tax was unconstitutional to the extent it taxed partnership income allocable to its natural-person partners, and an injunction directing the Comptroller not to assess, enforce, or collect the franchise tax to the extent it applied to the partnership’s income allocated to its natural-person partners.

First, Allcat alleged a facial challenge asserting that the amendment to the franchise tax statute violated the Texas Constitution because the effect of the amendment was to impose a tax on the net incomes of natural persons absent approval in a statewide referendum. The court analyzed whether it had original jurisdiction over the suit and held that it did and that it had the power to issue mandamus. The bill amending the franchise tax provided the Texas Supreme Court exclusive and original jurisdiction over a facial challenge to the constitutionality of the tax and authorized the court to issue injunctive or declaratory relief in connection with the challenge. Mandamus was a proper or necessary process for enforcement of the right.
After determining jurisdiction was proper, the court examined the constitutionality of the new franchise tax. Allcat argued that the franchise tax is an income tax. According to Allcat, the income of a partnership is allocated to each partner according to the partner’s partnership interest, and the franchise tax taxes each partner’s allocated share of the partnership’s income. The Comptroller countered by arguing that Texas has adopted the entity theory of partnership law and that a tax imposed on a limited partnership entity does not constitute a tax on the net income of the partnership’s individual partners. The court agreed with the Comptroller. Texas formerly followed the aggregate theory of partnership law under which the partnership was not an entity separate and distinct from its individual partners. When the Texas Uniform Partnership Act was enacted in 1961, Texas adopted the entity theory of partnership law under which the partnership is an entity separate and distinct from its partners. The entity theory was unequivocally embraced in 1993 with the enactment of the Texas Revised Partnership Act, which explicitly stated that a partnership is an entity distinct from its partners. The provision stating that a partnership is an entity distinct from its partners was recodified in the Texas Business Organizations Code. Partnership income thus remains property of the partnership entity until it is distributed, and allocated but undistributed partnership income is not personal income of the partners. The franchise tax imposed on a partnership consequently is not a tax on the income of natural persons. Allcat urged the court to apply the Bullock Amendment to instances in which a natural person’s partnership income is taxed “indirectly” by the imposition of the franchise tax. Again, the court reasoned that Texas utilizes the entity theory of partnership law and explained that, while a partner’s interest in the partnership represents the right to receive a share of the partnership’s income or profits when distributed, individual partners do not own any of the partnership income or profits that remain in the partnership before being distributed to the partners. Texas does not follow the federal flow-through approach for taxing partnerships, which adheres to the aggregate theory of partnership law. The court held that the franchise tax constitutes a tax on the partnership as an entity and does not constitute a tax on the net income of the partnership’s natural-person partners within the meaning of the Bullock Amendment.

Allcat also made an “as-applied” challenge to the amendment, arguing that the Comptroller’s interpretation and application of the tax violated the constitution under the equal and uniform taxation clause. That is, Allcat alleged that the Comptroller’s assessment, enforcement, and collection of the tax violated the constitution. The court concluded that the bill amending the franchise tax did not confer original jurisdiction on the court over challenges as to how the Comptroller assessed, enforced, or otherwise collected the franchise tax. The court also disagreed with Allcat’s assertion that Section 22.002(c) of the Government Code gave the court original jurisdiction. In this case, the Tax Code expressly provided which courts had jurisdiction to provide relief in taxpayer challenges (i.e., the district courts of Travis County) and whether those courts were authorized to provide mandamus or other similar relief, and the specific provisions of the Tax Code applied over the general provisions and limitations of the Government Code.

U. Property Tax Exemption


Like **AHF-Arbors at Huntsville I, LLC v. Walker County Appraisal District**, 410 S.W.3d 831 (Tex. 2012), this case concerned the ad valorem tax exemption available under Section 11.182 of the Texas Tax Code for property owned by a community housing development organization (CHDO). The court decided in **AHF-Arbors** that equitable title is sufficient “ownership” for this exemption. In this case, a limited partnership acquired legal title to an apartment complex. A nonprofit corporation was formed and became the sole member of an LLC, which in turn acquired the limited partnership by acquiring the limited partners’ 99% interest and acquiring the general partner, which owns 1% of the limited partnership. The nonprofit corporation is a CHDO, but the LLC and limited partnership are not CHDOs. The CHDO’s equitable title pursuant to this arrangement qualifies for the exemption under Section 11.182(b) of the Texas Tax Code. The remaining issue in the appeal related to the timeliness of the application for exemption. The appraisal district argued that the relevant occurrence for determining the timeliness of the application was the limited partnership’s acquisition of the apartment complex years earlier, but the court rejected this argument because it was based on the appraisal district’s position that the exemption must be based on legal title, which the court rejected. Because the CHDO applied within 30 days of acquiring equitable title to the apartment complex, the application was timely under the statute in effect at that time.


McLennan County Appraisal District (MCAD) denied two limited partnerships’ applications for exemption from ad valorem taxes for two low-income and moderate-income housing apartment complexes. The trial court ruled that the
partnerships were entitled to the exemption. On appeal, MCAD asserted that the limited partnerships did not qualify because they were 99.98% or more owned by purely for-profit entities for purely profit motives. The court of appeals first noted that the Texas Constitution permits the legislature to provide for exemptions for buildings used exclusively and owned by institutions engaged primarily in public charitable functions. Under Section 11.1825 of the Tax Code, an organization that owns property used to provide low-income housing can qualify for an exemption if certain requirements are met. A limited partnership can qualify for the exemption if a qualifying charitable organization owns 100% of the general partner interest in the limited partnership. MCAD asserted that the partnership was not engaged primarily in public charitable functions because of the for-profit entities that owned 99.98% of the limited partnerships and the for-profit motives of these investors. However, the court of appeals agreed with the trial court’s analysis that the general partners (who were 100% controlled by a community housing development organization/Section 501(c)(3) entity) operated, managed, and controlled the properties, and that the focus of the analysis should be how the property is actually used and not the financial interest of the limited partner. The court of appeals agreed with the trial court that the partnership was engaged exclusively in the charitable function of providing low-income or moderate-income housing. The court stated that the fact that persons or entities with a profit motive had invested resources in the limited partnership was irrelevant. The limited partners had no control over the operation of the limited partnership, and the court likened the limited partners to persons or entities that make a donation to a charitable organization. Because the limited partnership itself was engaged exclusively in providing low-income or moderate-income housing, a public charitable function, and the organizational structure satisfied the requirements of Section 11.1825, the court held the limited partnership was entitled to the tax exemption.

V. Standing or Capacity to Sue


The appellant filed a restricted appeal after a default judgment against it. The appellant argued that it was improperly served. The notice of appeal stated that the appellant was “Greystar Management, L.P.,” incorrectly named as “Greystar, LLC.” The appellee sought dismissal of the appeal on the basis that the appellant’s general partner was not registered to conduct business in Texas. The appellant responded that it was a properly registered limited partnership and that the Texas Business Organizations Code required nothing more of it. Section 9.001(a) of the Business Organizations Code requires a foreign filing entity to register with the Secretary of State in order to transact business in Texas. The appellee argued that the appellant violated Section 9.001(a) because a limited partnership can only conduct business through its general partner, relying on Section 153.152. The court agreed with the appellant that Section 153.152 had no bearing on whether or how a limited partnership conducts business in Texas, particularly with regard to whether the appellant could maintain this appeal. As a Delaware limited partnership, the appellant was a “foreign entity.” Under Section 9.051 of the Business Organizations Code, a foreign filing entity is prevented from maintaining an action, suit, or proceeding in a Texas court unless the foreign filing entity is registered. The appellant was registered and thus was not in violation of the statute and was not prohibited from maintaining this appeal. Furthermore, even if the court were to conclude that the general partner’s failure to register impacted the appellant’s ability to maintain suit, Section 9.051 does not prevent an entity that has failed to register from defending an action in Texas, and the court said that the appellant would not be prevented from bringing this appeal since it was not prevented from defending the underlying action.

**In re Fisher.** __ S.W.3d __, 2014 WL 801160 (Tex. 2014).

The plaintiff, a limited partner of Nighthawk Oilfield Service, Ltd. ("Nighthawk"), sued two executives of Nighthawk for fraud, breach of fiduciary duty, and other causes of action after Nighthawk and its wholly owned subsidiary, Richey Oilfield Construction, Inc. ("Richey Oil"), filed for bankruptcy. The plaintiff was the founder of Richey Oil and was its sole owner until he sold Richey Oil to Nighthawk for cash, a promissory note, and limited partnership units in Nighthawk. The defendants moved the trial court to transfer venue or dismiss the suit based on a forum selection clause in the acquisition documents and also argued that the plaintiff lacked standing because his claims belonged to Nighthawk and could only be brought by the bankruptcy trustee. The trial court denied the motions, and the defendants sought mandamus. With respect to the standing challenge, the defendants relied on case law holding that a limited partner does not have standing to sue for injuries to the partnership that merely diminish the value of a partner’s interest. The defendants argued that the plaintiff’s claims related to mismanagement of Nighthawk’s affairs and that he did not have standing to assert them. The supreme court noted that the case law relied on by the defendants recognized that a partner who is "personally aggrieved" may bring claims for injuries suffered directly. The court pointed out that the plaintiff’s pleadings, which are to be construed liberally in the context of a plea to the jurisdiction, alleged that the
plaintiff made a $1 million payment to Nighthawk after the acquisition, that other limited partners failed to make similar payments, and that the plaintiff suffered a loss of earning capacity, lost profits, loss of income, damage to credit reputation, injury to his character, and mental anguish. Thus, his pleadings did not affirmatively negate that he was personally aggrieved. The defendants also claimed that the trial court erred in refusing to dismiss Richey’s claims for deferred consideration owed from the acquisition and the unpaid $1 million loan because the claims were a debt owed by Nighthawk that must be filed against Nighthawk in bankruptcy court. The supreme court stated that whether these claims were claims that should have been brought against another party was not a question of jurisdiction requiring dismissal but rather was a question of liability. The defendants did not argue that they were the incorrect parties and did not show themselves entitled to mandamus on this ground. The defendants also argued that the debt claims against Nighthawk in this suit violated the automatic stay, but Nighthawk was not a defendant in the suit, and the automatic stay does not extend to non-debtors. The court stated that the defendants had not shown that there was “such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party defendant will in effect be a judgment or finding against the debtor.”

In re Immobiliere Jeuness Establissement, 422 S.W.3d 909 (Tex. App.--Houston [14th Dist.] 2014, no pet. h.). A limited partner of two limited partnerships brought a derivative suit in 2012 against the limited partnerships’ lender and attorneys. The attorney defendants filed a motion to abate on the basis that the limited partner was a foreign entity that had not registered to do business in Texas and the limited partnerships had been involuntarily terminated in 2011. The trial court abated the action based on Sections 9.051 and 153.309 of the Texas Business Organizations Code (BOC). After the trial court denied the plaintiff limited partner’s motions to reconsider, the limited partner sought mandamus relief.

The court of appeals first addressed Section 153.309(a)(1) of the BOC, which states that a limited partnership whose right to transact business has been forfeited may not maintain an action, suit, or proceeding in a Texas court unless its right to transact business is revived pursuant to Section 153.310. The court concluded that the limited partnership was not maintaining the suit because it was a derivative suit brought by a limited partner on the partnership’s behalf. The court discussed and relied on case law permitting shareholders to bring derivative actions on behalf of an unregistered foreign corporation or a corporation whose charter has been forfeited for failure to pay franchise taxes. In this context, the courts have allowed shareholders to assert claims alleging fraudulent, ultra vires, or negligent acts on the part of the directors as opposed to an ordinary cause of action that accrues to the corporation in the due course of business, which cannot be asserted by a shareholder on behalf of an incapacitated corporation. Based on this case law and the fact that the limited partner had no control over whether the limited partnerships were revived (because the authority to revive the partnerships was vested in the general partners), the court of appeals concluded that the trial court abused its discretion in holding that Section 153.309(a)(1) required abatement of this suit and that the limited partner had no adequate remedy by appeal.

With respect to the trial court’s abatement of the action based on Section 9.051(b) of the BOC, which provides that a foreign filing entity may not maintain an action, suit, or proceeding in a Texas court on a cause of action arising out of the transaction of business in Texas unless the foreign filing entity is registered in accordance with Chapter 9 of the BOC, the court of appeals stated that the limited partner controlled whether it registered to do business in Texas and had shown only that it chose not to register. Thus, the limited partner had a method of challenging an indefinite abatement. Because the limited partner did not show it had no adequate remedy by appeal, it was not necessary for the court of appeals to consider whether the trial court abused its discretion in abating on this basis.

ART Midwest, Inc. v. Atlantic Limited Partnership XII, 742 F.3d 206 (5th Cir. 2014).

The parties in this case sued one another after a real estate transaction between the parties collapsed, and this appeal was the second appeal in the case. The real estate transaction at issue involved an agreement by the plaintiffs to acquire eight apartment complexes from the defendants and was structured so that a limited partnership intermediary would be the nominal buyer. (For ease of reference, the court in this opinion referred to the “patchwork of contracts” governing the transaction collectively as “the agreement.”) The plaintiffs purported to terminate the deal on behalf of the partnership because of a title problem, but the defendants contended that they did not default in their obligations and that the plaintiffs did not have the right to terminate the agreement. The plaintiffs sued for fraud on the basis that the defendants misrepresented matters regarding the title to the property and seeking a declaratory judgment that the plaintiffs properly terminated the deal. The defendants countersued the plaintiffs for breaching the agreement by improperly terminating it. The jury found that the plaintiffs properly terminated the deal but that the defendants did not commit fraud. In the first appeal, a panel of the Fifth Circuit held that there was no failure by the defendants to render marketable title and thus no default by the defendants entitling the plaintiffs to terminate. On remand, the district court
To the partnership's creditors. The court stated that if Manners had discretionary control over the limited partnership, fiduciary obligations to the partnership and noted that the trustee did not allege that Manners or Speers were fiduciaries passive limited partner, and the position of Chairman Emeritus did not involve the exercise of discretionary authority concluded that Manners did not owe the limited partnership any fiduciary duty under Delaware law because he was a court thus applied Delaware law to the claims that Manners breached fiduciary duties to the partnership. The court sold his interest in the limited partnership in 2006. The limited partnership was a Delaware limited partnership, and the Manners as "Chairman Emeritus" of the limited partnership as the position giving rise to fiduciary duties after Manners as a limited partner by selling his ownership in the limited partnership to Speer. The trustee relied on the status of connection with this transaction in 1998. In 2006, Speer bought out the remaining 50% owned by the founder, and Speer became the sole owner of the limited partnership through entities he controlled. Speer sought summary judgment on the breach of fiduciary duty claims on the basis that, as the limited partnership’s sole owner, he could not be liable for breaching a fiduciary duty to himself. The court noted that it had stated in a prior opinion that Speer was in effect the only owner of the limited partnership after the 2006 buyout and that Delaware limited partnership law is clear that a company’s sole owner cannot breach a fiduciary duty to the wholly owned company. The trustee did not cite a case finding that a sole partner of a limited partnership can be liable for breaching a fiduciary duty to the partnership, but the trustee argued that a limited partnership may assert a claim for breach of fiduciary duty against its general partner. The trustee reasoned that if the limited partnership could assert a claim for breach of fiduciary duty against Speer, then the trustee may assert the claim in its capacity as trustee of the bankruptcy estate. However, the court stated that Delaware does not allow a limited partnership to assert claims on its own behalf. The court stated that the purpose of the Delaware “common name” statute, which allows partnerships to sue and be sued in the partnership name, is to permit a plaintiff to file a suit against an unincorporated association using a common name without having to identify all the members, but it does not allow a limited partnership to assert on its own behalf a claim against a general partner. The court distinguished cases such as *In re USACafes* in which Delaware courts rejected the notion that directors of a corporation owe no fiduciary duty to a partnership or LLC controlled by that corporation. The court stated that these cases do not hold that a partnership may assert claims on its own behalf but rather stand for the established proposition that a parent corporation may owe duties to a subsidiary corporation that it controls and may be liable for self-dealing transactions. For example, the court stated that a corporate general partner could be liable to the limited partnership and its limited partners if the corporate general partner formed a new entity and then caused the general partner to sell partnership assets to the new entity at an unfairly low price. The court distinguished the trustee’s claims because the trustee did not claim that Speer intentionally injured the limited partnership to benefit another corporate entity that Speer owned or controlled.


The trustee of a Delaware limited partnership’s bankruptcy estate sued John Speer for breach of fiduciary duties owed to the limited partnership based on distributions made to Speer to make payments on loans that financed Speer’s purchase of a 50% interest in the partnership. The founder of the limited partnership’s business sold 50% of the equity to entities owned by Speer in 1998. In 2006, Speer bought out the remaining 50% owned by the founder, and Speer became the sole owner of the limited partnership through entities he controlled. Speer sought summary judgment on the breach of fiduciary duty claims on the basis that, as the limited partnership’s sole owner, he could not be liable for breaching a fiduciary duty to himself. The court noted that it had stated in a prior opinion that Speer was in effect the only owner of the limited partnership after the 2006 buyout and that Delaware limited partnership law is clear that a company’s sole owner cannot breach a fiduciary duty to the wholly owned company. The trustee did not cite a case finding that a sole partner of a limited partnership can be liable for breaching a fiduciary duty to the partnership, but the trustee argued that a limited partnership may assert a claim for breach of fiduciary duty against its general partner. The trustee reasoned that if the limited partnership could assert a claim for breach of fiduciary duty against Speer, then the trustee may assert the claim in its capacity as trustee of the bankruptcy estate. However, the court stated that Delaware does not allow a limited partnership to assert claims on its own behalf. The court stated that the purpose of the Delaware “common name” statute, which allows partnerships to sue and be sued in the partnership name, is to permit a plaintiff to file a suit against an unincorporated association using a common name without having to identify all the members, but it does not allow a limited partnership to assert on its own behalf a claim against a general partner. The court distinguished cases such as *In re USACafes* in which Delaware courts rejected the notion that directors of a corporation owe no fiduciary duty to a partnership or LLC controlled by that corporation. The court stated that these cases do not hold that a partnership may assert claims on its own behalf but rather stand for the established proposition that a parent corporation may owe duties to a subsidiary corporation that it controls and may be liable for self-dealing transactions. For example, the court stated that a corporate general partner could be liable to the limited partnership and its limited partners if the corporate general partner formed a new entity and then caused the general partner to sell partnership assets to the new entity at an unfairly low price. The court distinguished the trustee’s claims because the trustee did not claim that Speer intentionally injured the limited partnership to benefit another corporate entity that Speer owned or controlled.


The trustee of a Delaware limited partnership’s bankruptcy estate sued Michael Manners, an individual, and his affiliated companies for breach of fiduciary duty, conspiracy to breach fiduciary duty, and aiding breach of fiduciary duty in connection with the buyout of Manners’ limited partnership interest by the other partner. In 1998, Manners, the founder and CEO of the limited partnership’s business, sold 50% of the equity to John Speer and retained a 50% interest as a limited partner through a corporation. An entity owned by Speer became the 1% general partner, and another Speer entity became a 49% limited partner. The partners entered into an amended and restated limited partnership agreement in connection with this transaction in 1998. In 2006, Speer bought out the remaining 50% owned by Manners, and Manners became “Chairman Emeritus” of the limited partnership. The trustee alleged that Manners and Speer devised a scheme to take money out of the limited partnership to finance Speer’s 2006 buyout of Manners without reflecting a loss in equity on the partnership’s balance sheet. The trustee also argued that Manners breached the duties of loyalty and care owed to the new entity at an unfairly low price. The court distinguished the trustee’s claims because the trustee did not claim that Speer intentionally injured the limited partnership to benefit another corporate entity that Speer owned or controlled.
any resulting fiduciary duties would run to Speer as the only other partner, and the Delaware Revised Limited Partnership Act gives only the general partner the right to sue on behalf of the partnership. The statute gives a limited partner the right to bring a derivative suit if the general partner refuses to do so, and the court noted Delaware case law stating that the statute literally prevents creditors, or anyone else other than a partner, from suing on behalf of the partnership. The court stated that to the extent the trustee sued on the partnership’s behalf, he lacked derivative standing.


The appellant filed a petition in intervention in a case in which a judgment had been entered against a limited partnership and its LLC general partner and a receiver of the property of the limited partnership and general partner had been appointed. The appellant was a limited partner and member of the judgment debtors, and the appellant sought to appeal a modified order of the trial court appointing receiver and an order severing the limited partnership from the underlying cause. The judgment creditor argued that the appellant lacked standing to appeal because the appellant was not a party to the underlying judgment or to the trial court’s subsequent severance or modified order appointing a receiver. The appellant argued that it had standing under the virtual representation doctrine. In connection with the first element of the virtual representation doctrine, the appellant argued that it was bound to the judgment as the sole limited partner of the limited partnership and sole member of the LLC general partner. The court stated that the appellant mischaracterized the liability of a limited partner or LLC member for judgments against the entity. Under Section 153.102(a) of the Business Organizations Code, a limited partner is not liable for the obligations of the limited partnership unless the limited partner is also a general partner or, in addition to the exercise of the limited partner’s rights and powers, it participates in the control of the business. Under Section 153.102(b), even if the limited partner participates in the control of the business, the limited partner is liable only to persons who transact business with the limited partnership reasonably believing, based on the limited partner’s conduct, that the limited partner is a general partner. The appellant was not a general partner of the limited partnership and had made no showing that any party in the underlying cause believed that the limited partner was a general partner based on its conduct. Thus, the limited partner was not bound by the judgment against the limited partnership by virtue being a limited partner. Neither was there any showing that the appellant was liable for the underlying judgment by virtue of its role as a member of the LLC general partner. Furthermore, the appellant did not show that it was an insurer or other party having a duty to pay all or part of the judgment, and there was no showing that the limited partnership and LLC general partner were not able to adequately represent their own interests, and thus those of their limited partners or members. The appellant argued that it had a privity of interest and a strong identity of interest with the entities such that the trial court’s post-judgment rulings directly harmed the appellant, but the court stated that any harm flowed from the appellant’s role as a limited partner and LLC member and that individual stakeholders in a legal entity do not have a right to recover personally for harms to the entity. Thus, the appellant was not a proper party to challenge the trial court’s orders, and the appeal was dismissed.


A limited partnership appealed from a summary judgment against it, and the plaintiff argued that the limited partnership lacked standing to attack the trial court’s summary judgment because the limited partnership was forfeited when the plaintiff sued it. The limited partnership had moved for an extension of deadlines under Rule 306a and for a new trial based on its failure to get notice of the judgment, and the trial court denied the requests. Section 153.309 of the Business Organizations Code provides that, when a limited partnership’s right to do business in Texas is forfeited, the partnership “may not maintain an action, suit, or proceeding in a court of this state,” but the forfeiture does not “prevent the limited partnership from defending an action, suit, or proceeding in this state.” The plaintiff argued that the latter exception applied only when the forfeiture was remedied within 120 days, but the court pointed out that the statute contains no such condition. Further, the court stated that the partnership’s effort to attack the judgment against it was part and parcel of its effort to defend against an action, suit, or proceeding. Thus, the partnership had standing to invoke Rule 306a.


Limited partners who purchased their limited partnership interests in 2005 sued the accountants who prepared financial statements and reports for the limited partnership before and after the limited partners purchased their interests. The plaintiffs’ alleged claims for negligence, negligent misrepresentation, fraudulent inducement and conspiracy, violations of the Texas Securities Act, statutory fraud, and exemplary damages. The trial court granted summary judgment in favor of the defendants on all the claims. The court of appeals affirmed. The court of appeals first pointed
out that the primary legal right to pursue a personal cause of action against the accountants for harms done to the limited partnership belonged to the limited partnership. Thus, the plaintiffs, as limited partners, were without standing to pursue legal relief for breach of any legal right belonging to the limited partnership, and the court lacked subject matter jurisdiction to consider the plaintiffs’ personal causes of action based upon their partnership interests for harms allegedly accruing to them or the limited partnership. The court then considered the plaintiffs’ pre-investment claims and concluded that summary judgment was properly granted on each of the claims. Among the reasons were a lack of justifiable reliance (an element of the negligent misrepresentation and fraudulent inducement claims) because of disclaimer letters accompanying the accountants’ reports, and a failure to show a legal duty owed by the accountants to the plaintiffs as non-client pre-investors (as would be required for their negligence claim).


A limited partner, Hall, sued the other partners, the partnership, and a mortgage company alleging breach of the partnership agreement and breach of fiduciary duty based on the partnership’s use of partnership funds to pay non-partnership debts. Hall relied on Section 152.210 of the Texas Business Organizations Code (BOC) for the proposition that a partner is liable to the partnership and other partners for any breach of the partnership agreement. The defendants countered that the BOC provides that “a partnership may maintain an action against a partner for breach of the partnership agreement or for the violation of a duty to the partnership causing harm to the partnership.” Tex. Bus. Orgs. Code § 152.211(a). The court concluded that the alleged harm was to the partnership rather than Hall because he alleged that the defendants misappropriated funds of the partnership. A limited partner does not have standing to sue for injuries to the partnership that merely decrease the value of the partner’s interest. The damages for these claims belong to the partnership alone. Thus, Hall lacked standing to bring a claim for breach of the partnership agreement. With respect to his breach of fiduciary duty claim, he argued that using the partnership’s funds to pay non-partnership debts was a breach of fiduciary duty for which Hall had an individual claim against the other partners. Hall attempted to characterize the damages he was seeking as personal damages, but the court failed to see how Hall was personally aggrieved because the money misappropriated belonged to the partnership. Hall also asserted that he suffered damages due to wrongful distributions made to the other partners without a pro rata distribution to Hall. The court stated that Hall likewise could not sue directly for “distributions, profits, or benefits” he allegedly lost because of harms suffered by the partnership. Thus, Hall lacked standing to bring his claims for breach of fiduciary duty.


Tandan, the defendant, argued for the first time on appeal that the court lacked jurisdiction because the plaintiff limited partnership “is not the proper party to bring suit and thus, it lacks standing, which warrants dismissal.” Tandan pointed out that the contract at issue was with “Affordable Power Plan” rather than “Affordable Power, L.P.” He attached to his appellate brief a copy of a certificate of conversion that converted “Affordable Power, Inc.” to “Affordable Power, L.P.” and a certificate of formation for “Affordable Power, L.P.” Tandan contended that the entity named “Affordable Plan, L.P.” appeared to be the party with standing to bring the claims. Affordable Power, L.P. contended that the issue was one of capacity rather than standing and that the issue was waived because it was not raised by a verified pleading. The court explained that standing focuses on whether a party has a sufficient relationship with the lawsuit so as to have a justiciable interest, whereas the issue of capacity is a procedural issue dealing with personal qualifications to bring suit. The court further explained that a person has standing when it is personally aggrieved, regardless of whether it is acting with legal authority; a party has capacity when it has the legal authority to act regardless of whether it has a justiciable interest. The court agreed that the issue raised by Tandan was a challenge to capacity that was required to be raised by a verified pleading in the trial court, and the issue was thus waived by Tandan’s failure to raise it in the trial court.


The plaintiffs purchased units in Texas limited partnerships organized to acquire working and royalty interests in oil and gas properties. The plaintiffs asserted various claims on behalf of themselves and the limited partnerships based on alleged misrepresentations made before and after the plaintiffs’ purchase of their units by the individuals who promoted and ran the limited partnerships. The defendants sought dismissal of most of the claims based on lack of standing and failure to comply with the requirements of Federal Rule of Civil Procedure 23.1 and applicable state law regarding derivative actions. The defendants sought dismissal of the remaining fraud-based claims based on a failure to plead the claims with the required particularity. The court granted the motion to dismiss, concluding that the plaintiffs lacked standing and had failed to comply with the requirements for a derivative suit with respect to the derivative claims and had failed to meet the pleading burden for the direct fraud claims. The court reviewed provisions of the Texas Business Organizations Code and case law addressing the nature and capacity of a partnership and the circumstances
under which a limited partner may assert claims against general or controlling partners. The court noted provisions of
Chapter 152 providing that a partnership is an entity distinct from its partners with the power to sue and be sued and that
each partner has equal rights in the management and conduct of the partnership business absent an agreement otherwise.
The court stated that a general partner of a limited partnership acting with authority has the capacity to bring a suit on
behalf of the limited partnership only when a majority-in-interest of the partners agree to such action. Under Chapter
153, a limited partner may bring an action to recover a judgment on behalf of a limited partnership if all general partners
with authority to bring the action have refused to do so or an effort to cause the general partners to bring the action is
not likely to succeed. The plaintiff must be a limited partner when the action is brought, and the complaint must detail
the effort, if any, made by the plaintiff to secure initiation of the action by a general partner or the reasons for not making
the effort. Federal Rule of Civil Procedure 23.1 contains similar requirements. The court explained that a limited partner
may have standing to bring two different types of claims against a general or controlling partner: (1) direct claims on
behalf of the limited partner or a class of similarly situated individuals; or (2) derivative claims brought on behalf of the
partnership. The nature of the suit is often critical because the limited partnership is an indispensable party in a
derivative suit, while the partnership is not an indispensable party in a direct action. The court concluded that the
plaintiffs lacked standing to assert claims arising from loss of the value of plaintiffs’ investment in the limited
partnerships (i.e., claims for conversion, theft, money had and received, breach of fiduciary duty, negligence, common
law fraud, and violation of the Texas Securities Act arising from misrepresentations made after the plaintiffs invested
in the limited partnerships) because those claims belonged to the limited partnerships and must be brought derivatively
rather than individually. The only claims that the plaintiffs had standing to bring directly were claims for common law
fraud and violation of the Texas Securities Act arising from misrepresentations arising before the plaintiffs purchased
their units. Because the plaintiffs failed to comply with the pleading requirements of the Texas Business Organizations
Code and Rule 23.1, had already amended their complaint once, did not provide a proposed second amended complaint,
and did not explain what, if any, additional facts plaintiffs would allege and why they were not alleged in the first
amended complaint, the court denied the plaintiffs’ request for leave to amend and dismissed the derivative claims. The
court went on to conclude that the plaintiffs’ direct claims for common law fraud and violation of the Texas Securities
Act were subject to dismissal because the plaintiffs failed to plead the claims with the required particularity.


The court of appeals held that the forfeiture of a limited partnership’s right to transact business and cancellation
of its certificate for failure to file the limited partnership’s periodic report under Chapter 153 of the Business
Organizations Code did not prevent the limited partnership from filing objections to a special commissioners’ award
in a condemnation proceeding initiated by the county because the partnership was the defendant. Section 153.309(b)(2)
of the Business Organizations Code precludes a partnership that has forfeited its right to transact business from
maintaining an action, suit, or proceeding in a court in Texas but does not prevent a limited partnership from defending
an action, suit, or proceeding in Texas.


The plaintiffs, a limited partner in a limited partnership and an investor in the limited partnership who had not
yet been admitted as a limited partner, asserted claims based on the defendant’s refusal to honor a loan commitment.
The court concluded that the plaintiffs could not assert the claims because the claims belonged to the limited
partnership’s bankruptcy estate. Although the plaintiffs asserted that they suffered direct damages, including the loss
of funds invested by one of the plaintiffs in reliance on the loan commitment, the court concluded that the plaintiffs’
injuries were only indirect injuries resulting from the direct injury suffered by the limited partnership as a result of the
defendant’s alleged breach of contract with the limited partnership.

**Heston Emergency Housing, L.P. v. Texas Department of Housing and Community Affairs**, Civil Action

A limited partnership in the business of providing emergency housing and its limited partner alleged that
employees of the Texas Department of Housing and Community Affairs (“TDHCA”) engaged in retaliatory acts against
them based on the defendants’ belief that the plaintiffs had provided information in a Congressional investigation of
TDHCA’s handling of federal funding in the aftermath of the 2005 hurricane season. The defendants argued that the
court did not have subject matter jurisdiction over free speech retaliation claims asserted by the plaintiff limited partner
because the only injury alleged in the complaint was the termination of the contract between the limited partnership and
TDHCA, and any damages to the limited partnership as a result were not personal to the limited partner and could not
be sued to give him standing. The plaintiffs did not controvert this argument, and the court cited cases holding that a
partner, employee, shareholder, or officer does not have standing to sue on his own behalf when the only alleged injury
was to the partnership or corporation and not to the individual personally. The court stated that the Fifth Circuit has
considered this principle in the context of free speech retaliation and has determined that it did not matter whether the
individual bringing suit made the constitutionally protected speech if the only alleged injury was to the company and not
the individual. Because the plaintiffs did not identify any damages individually attributable to the limited partner or
challenge the defendants’ standing argument, the court concluded that the limited partner failed to meet his burden to
establish he had standing to bring the free speech retaliation claim.


The landowner in a condemnation action argued that the limited partnership that brought the action lacked the
capacity to receive the award and writ of possession because its right to do business was forfeited during the pendency
of the proceeding for failure to file a periodic report with the Secretary of State. The condemnation petition was filed
before the forfeiture, and the limited partnership had revived its right to transact business, but the special commissioners’
award and original writ of possession issued after the forfeiture and before the revival of its rights. The court discussed
the provisions of Chapter 153 that provide for the filing of periodic reports by limited partnerships and forfeiture of a
limited partnership’s right to transact business if the partnership fails to file the report (and eventual termination of the
partnership’s certificate of formation if it fails to revive its right to transact business). The court analogized these
provisions to the provisions of the Tax Code under which a corporation’s privileges are forfeited if the corporation fails
to pay its franchise tax. Under the provisions of both Chapter 153 and the Tax Code, a forfeited entity may not sue in
a Texas court. The court relied upon case law involving tax forfeitures in which courts have held that reinstatement
revives a corporation’s rights retroactively as if the disability had never occurred, and the court held that the limited
partnership’s temporary lack of capacity was moot because its right to transact business had been restored.

**W. Personal Jurisdiction**

**United States Small Business Administration v. Cottonwood Advisors, LLC**, Civil Action No. 3:12-CV-1222-

The SBA, as receiver for a limited partnership, made a capital call on Brooks Trust, a limited partner,
demanding that the Donald R. Brooks Trust pay all of its unpaid capital commitment under the limited partnership
agreement and subscription agreement between the Brooks Trust and the partnership. The SBA alleged that the Brooks
Trust failed to honor its commitment and was in default under the agreements. The Brooks Trust argued that the court
did not have personal jurisdiction over it because the obligations established under the agreements were not “property”
within the plain meaning of the federal receivership statute (28 U.S.C. § 754). The court stated that the SBA’s
allegations, taken as true, established that the Brooks Trust was currently in possession of $125,000 owed to the limited
partnership, and the only question was whether money owed under a contractual obligation is personal property of the
entity to which it is owed. The court held that, similar to an account for receivables, which a bankruptcy court has held
to be property of the entity that provided the services or property for the right to be paid, the outstanding obligation to
the limited partnership was an asset owned by the limited partnership under the terms of the agreements between the
parties. Because the court’s in personam personal jurisdiction extended to all districts where property believed to be that
of the receivership estate could be found, the court had jurisdiction over the Brooks Trust.


Two individual residents of Florida asserted that the court lacked personal jurisdiction over them in the
plaintiff’s suit arising out of the sale of a home to the plaintiffs by a limited partnership. The individuals claimed that
they acted only in their representative capacities for the partnership, but the court determined that the manner in which
the individuals signed the documents relating to the purchase and sale of the home constituted sufficiently purposeful
contacts to support the exercise of jurisdiction. First, the contract by which the partnership acquired the lot on which the
home was built identified the buyer as the partnership and was signed by one of the individual defendants without indicating his representative capacity. Second, the contract the plaintiffs signed when they purchased the home from the partnership identified the seller as the partnership and was signed by an individual other than the defendants on behalf of the partnership but was signed by the individual defendants without indicating their representative capacity. Three addenda to the contract were similarly signed. Finally, another document, referred to as the “punch list,” was initialed by the individual defendants with no reference to the partnership. The court concluded that the individual defendants undertook a purposeful act that engendered a relationship between the individuals, the Texas forum, and the subject matter of the litigation by failing to indicate their representative capacities when signing the

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contracts and initialing the punch list. In addition, the court characterized the contract at issue as involving continuous
contacts rather than a single contract for an isolated sale of a product to a Texas resident. Thus, the individual defendants
availed themselves of the privilege of conducting business in Texas and subjected themselves to jurisdiction. In addition
to contract claims, the plaintiffs asserted tort claims of misrepresentation and fraudulent inducement against the
individuals. The individuals relied on the fiduciary shield doctrine, arguing that they acted exclusively in their corporate
capacity. The court concluded that the individuals were not protected by the fiduciary shield doctrine because a corporate
officer or employee is not shielded from specific jurisdiction as to torts for which the individual officer or employee may
be held personally liable. Corporate agents are personally liable for fraudulent or tortious acts committed while in the
service of the corporation. Because this specific jurisdiction case included allegations sounding in tort for which the
individuals could be held individually liable, the fiduciary shield doctrine did not apply.

w.r.m.).

The court held that a Delaware limited partnership was subject to general jurisdiction in Texas because its
partnership agreement identified its principal place of business in Texas and identified its only asset as a Texas general
partnership with assets of a value exceeding $164 million. The limited partnership relied upon an affidavit stating that
its principal place of business was in Tennessee, but the court stated that the record was sufficient to support the trial
court’s finding that the partnership’s principal place of business was in Texas. Based on the record, the limited
partnership’s only function was to manage the valuable assets of a Texas general partnership, an activity that required
it to utilize Texas-based assets. Also, the corporate general partner’s principal place of business was identified as the
same Texas address as that for the limited partnership. In light of the significant evidence connecting the limited
partnership with Texas, it did not appear to the court that the listing of the principal place of business in Texas was
merely fortuitous, and the trial court’s decision to base general jurisdiction on the principal place of business was not
erroneous.

X. Sufficiency of Pleadings and Service of Process on Partners or Limited Partnership

Atrium Medical Center, L.P. v. Lange Mechanical Services, L.P., No. 14-12-00364-CV, 2013 WL 269037
(Tex. App.–Houston [14th Dist.] Jan. 24, 2013, no pet.) (mem. op.).

The plaintiff obtained a default judgment against a limited partnership, and the limited partnership sought to
set aside the default judgment based on improper service of process. The plaintiff identified the registered agent in the
plaintiff’s petition, but the return of service showed that another individual was served as CEO of the limited partnership.
The court pointed out the Business Organizations Code (like the predecessor Texas Revised Limited Partnership Act)
provides that the registered agent and each general partner of a limited partnership are its agents for service of process,
subject to certain exceptions for service on the Secretary of State that were not applicable in this case. The plaintiff pled
and citation was issued for service on the registered agent of the partnership. Since the return showed it was not the
registered agent identified in the pleadings but another individual who was served, and the pleadings and record did not
indicate that the individual served was a registered agent or general partner of the partnership, the record failed to show
compliance with the applicable rule of service, and the default judgment was reversed.

Y. Recovery of Attorney’s Fees

12, 2012, no pet.) (mem. op.).

A limited partner sued the limited partnership to collect on a note executed by the partnership in favor of the
limited partner. The partnership argued the note violated a provision of the partnership agreement. The trial court agreed
and found that the limited partner breached the partnership agreement and his duty of loyalty, and the trial court
reformed the terms of the note. On appeal, the court of appeals concluded that the note did not violate the terms of the
partnership agreement, but the only relief requested by the limited partner was reformation on different terms than the
trial court employed. The court of appeals reversed the trial court’s award of attorney’s fees to the limited partnership
because the limited partnership was only awarded equitable relief and did not recover damages. Although Section
38.001(8) of the Civil Practice and Remedies Code provides that a party may recover reasonable attorney’s fees from
an individual or corporation in a suit on an oral or written contract, the Texas Supreme Court has held that a party must
recover damages to recover attorney’s fees under Section 38.001(8). The limited partnership urged that it gained
something of value through the reformation, but reformation is an equitable remedy. Finally, the court of appeals rejected
the limited partnership’s claim for attorney’s fees under the Uniform Declaratory Judgments Act in the Civil Practice and Remedies Code. In its amended petition, the limited partnership recast its request for reformation of the contract as a request for declaratory judgment, but the court said it was obvious the limited partnership “simply repackaged” its cause of action for reformation, and a party may not plead for declaratory relief simply to pave the way to recover attorney’s fees.

Z. Issue Preclusion


The trustee’s claims against an entity was barred by res judicata because the trustee alleged that the entity was the general partner of a limited partnership that was a party to a prior proceeding brought by the trustee. The court stated that general partners are in privity with the partnership for preclusive purposes. The entity’s interests were closely aligned with the partnership’s, and the entity was alleged to have engaged in the same conduct. Thus, the entity’s interests were adequately represented by the partnership in the prior litigation. The court concluded that it was apparent from the face of the complaint that res judicata barred the claim against the entity that could have been litigated as part of the prior proceeding.

AA. Diversity Jurisdiction

[The citizenship of a partnership, including a limited partnership, is determined by the citizenship of each of its partners. Carden v. Arkoma Associates, 494 U.S. 185 (1990). There are many district court opinions applying this principle; they are too numerous to include in this paper. Some recent decisions of the Fifth Circuit Court of Appeals applying this rule are noted below as well as a recent district court decision addressing a question not yet directly addressed by the Fifth Circuit.]


One of the two members of the LLC defendant in this case was a master limited partnership (MLP), and the plaintiff argued that the citizenship of an MLP should be determined like a corporation rather than an unincorporated entity because an MLP is publicly traded and is more like a corporation than a partnership. (As an unincorporated entity, the LLC’s citizenship was determined by the citizenship of its two members.) The court noted that the question of whether an MLP should be given jurisdictional citizenship tantamount to a corporation has not yet been directly addressed by the Fifth Circuit, but the court concluded that the United States Supreme Court’s decision in Carden v. Arkoma Associates compels the conclusion that an MLP’s citizenship is determined by the citizenship of all its members rather than by the MLP’s state of formation and principal place of business like a corporation. The plaintiff argued that an MLP, which has thousands of investors who regularly enter and exit the partnership and generally do not participate in management, is not a real partnership and should not be treated as such. The plaintiff also argued that fundamental fairness dictated treating an MLP as a corporation. The court pointed out that similar arguments were raised and rejected in Carden, and the Supreme Court identified Congress as the appropriate source for aligning the law on federal diversity jurisdiction with the changing realities of commercial organizations. Because the MLP’s citizenship was based on the citizenship of all its unit holders, diversity of citizenship was lacking, and the court dismissed the case for lack of subject matter jurisdiction.

Mullins v. TestAmerica Inc., 300 Fed. App’x 259 (5th Cir. 2008).

The court held that allegations of diversity were deficient where the notice of removal and complaint failed to disclose the citizenship of the partners of a limited partnership defendant. The absence of a dispute between the parties regarding the existence of diversity citizenship was irrelevant because subject matter jurisdiction cannot be created by waiver or consent.


The Fifth Circuit Court of Appeals upheld the district court’s award of attorney’s fees based on a finding that an LLC’s argument regarding citizenship for diversity purposes was frivolous. The LLC argued that it was a corporation for diversity purposes although it was undisputed that it was an LLC. The district court found that it had diversity jurisdiction because the LLC and a limited partnership of which the LLC was a partner were not citizens of Texas. In analyzing the limited partnership’s citizenship, the district court necessarily had to analyze the citizenship of its partners,
including the LLC. The district court ruled that the limited partnership was not a citizen of Texas even though one of its partners, the LLC, had its principal place of business in Texas. The district court found that the LLC’s argument to the contrary was frivolous because *Carden* establishes that corporations are treated differently than unincorporated associations for purposes of determining diversity of citizenship.

**BB. Attorney Liability**


The defendants in this case were limited partnerships and managing partners that were sued by partnership investors in two successive lawsuits. The same attorney represented the investors in each lawsuit. In *Wesolek I*, suit was brought in state court, and the case was removed to federal court where the court dismissed the plaintiffs’ direct fraud claims with prejudice and dismissed the plaintiffs’ derivative claims without prejudice. Although the court’s opinion in *Wesolek I* put the plaintiffs on notice of the need to plead facts capable of establishing that the preconditions for derivative claims were satisfied, the plaintiffs in *Wesolek II* filed an original petition in state court and an amended complaint in federal court after removal of the action without alleging with particularity facts capable of establishing the preconditions for bringing derivative claims. The defendants sought attorney’s fees and expenses incurred in *Wesolek I* and *Wesolek II* from plaintiffs and their counsel, jointly and severally. The defendants based their request on Federal Rule of Civil Procedure 11(b), 28 U.S.C. § 1927, the court’s inherent authority, Texas Business Organizations Code § 153.404, Chapter 10 of the Texas Civil Practice and Remedies Code, and Texas Rule of Civil Procedure Rule 13. The court analyzed the bases relied on by the defendants and concluded that 28 U.S.C. § 1927 and Texas Rule of Civil Procedure Rule 13 supported an award of attorney’s fees and expenses against the plaintiffs’ attorney with respect to *Wesolek II*, but not *Wesolek I*. Rule 13 supported sanctions for filing the original petition in state court that initiated *Wesolek II*, and 28 U.S.C. § 1927 supported sanctions for unreasonably and vexatiously multiplying proceedings by continuing to pursue the claims asserted in *Wesolek I* following removal of *Wesolek II* to federal court. The plaintiffs’ attorney argued that there was a good faith argument that the pleadings satisfied the requirements for pleading derivative claims under Texas law based on the allegation that the plaintiffs attempted to get the general partner to act through its two members. The attorney also argued that Section 153.401(2) of the Texas Business Organizations Code recognizes demand futility with respect to limited partnership derivative actions. The court responded that the problem with these arguments was that the allegations were not only deficient because they failed to allege with particularity the facts required by Texas law for asserting derivative claims, but based on the court’s dismissal of virtually identical claims in *Wesolek I*, the attorney knew that the derivative claims in *Wesolek II* were also deficient. Although the court found that sanctions were warranted against the plaintiffs’ attorney, the court concluded that sanctions were not warranted against the plaintiffs individually, relying on an affidavit of one of the plaintiffs stating that the attorney failed to keep the plaintiffs properly informed and did not obtain their authorization to file the second suit.


A limited partnership sued the lawyers that represented a tenant in lease negotiations with the limited partnership regarding space in the partnership’s shopping center. The partnership argued that the lawyers had a duty to disclose certain facts to the partnership. The lawyers had never represented the partnership but had represented the general partner on a personal matter. The partnership argued that there was a formal or informal fiduciary relationship between the lawyers and the general partner and therefore a fiduciary relationship between the lawyers and the partnership. The court held that a fiduciary duty to the general partner does not automatically inure to the partnership’s benefit because a partnership is a legal entity separate from its partners. There was no evidence of a formal or informal fiduciary relationship between the lawyers and the partnership, and the trial court thus did not err in finding no fiduciary duty between the parties.

**IV. Texas Cases Involving Limited Liability Companies**

**A. Nature of Limited Liability Company**


In this patent infringement action, one of the plaintiffs, a Delaware LLC, was formed by its Delaware parent corporation, one day before this suit was filed. The defendant argued that the LLC lacked standing because Section 9.001
acts of the vice-principal are the acts of the corporation itself. A corporate officer is among the types of corporate agent.

A person’s status as vice-principal of a corporation is sufficient to impute liability to the corporation on the basis that the LLC was a limited liability company that the pleadings and evidence did not support piercing the corporate veil and that the LLC was a limited liability company.

In applying the federal venue statute, the court recognized that 28 U.S.C. § 1391(d) refers only to a “corporation,” but felt compelled to follow the precedent that reads the “corporation” language to refer to unincorporated entities like LLCs. The court noted that basic principles of statutory construction (i.e., to follow the plain language and give meaning to different language in the statute) would seem to require applying Section 1391(d) only to corporations in view of the much broader reference to “an entity with the capacity to sue and be sued in its common name under applicable law” in Section 1391(c). The court explained the history and development of the language in subsections (c) and (d). In the Venue Clarification Act of 2011, Congress codified a judicial interpretation of language in prior subsection (c) (pursuant to which the courts had included unincorporated associations like partnerships and LLCs in the term “corporation”) by adding the phrase “whether or not incorporated” in subsection (c)’s general residence provision, but Congress also moved the multi-district rule into a separate subsection (d), which retained the prior use of “corporation.” The failure to include unincorporated associations in subsection (d) has been characterized by commentators as an oversight.

A Texas LLC argued that it was a “hospital district management contractor” within the meaning of a provision of the Texas Health and Safety Code that treats a hospital district management contractor as a governmental unit for purposes of the Texas Tort Claims Act. The Health and Safety Code defines a “hospital district management contractor” as “a nonprofit corporation, partnership, or sole proprietorship that manages or operates a hospital or provides services under contract with a hospital district that was created by general or special law.” The LLC admitted it was an LLC but argued that the undefined term “partnership” in the statute should be construed broadly to include LLCs that elect to be taxed as partnerships for tax purposes under Texas and federal law. The court concluded that an LLC does not fall within the ordinary meaning of “partnership” even if the LLC elects partnership tax treatment. The court explained that an LLC has some characteristics of a partnership but also has some characteristics of a corporation. The legislature chose to make only nonprofit corporations, partnerships, and sole proprietorships eligible for the protections of a hospital district management contractor, and the court stated that it was not the role of the court to question the wisdom of the statute or rewrite it.

The trial court entered a judgment against an LLC based on the acts of an individual. The appellants argued that the pleadings and evidence did not support piercing the corporate veil and that the LLC was a limited liability corporation rather than a limited liability corporation. The court pointed out that the individual testified that the company was a limited liability corporation and that she was the president and sole stockholder. The court applied the rule that a person’s status as vice-principal of a corporation is sufficient to impute liability to the corporation on the basis that the acts of the vice-principal are the acts of the corporation itself. A corporate officer is among the types of corporate agent.
classified as a vice-principal. Since the undisputed evidence established that the individual was a vice-principal, her acts were imputed to the "corporation."

American Electric Power Company v. Affiliated FM Insurance Company, 556 F.3d 282 (5th Cir. 2009). In this case, the court held that an insurance policy that covered "any subsidiary corporation now existing or hereafter acquired" was unambiguous and did not include LLCs. American Electric Power Company ("AEP") sued its insurer after it discovered losses that occurred in 1999 due to employee theft at two LLC subsidiaries of Central & Southwest Corporation ("CSW"), a conglomerate acquired by AEP in 2000. AEP claimed that the losses were covered under the prior loss clause of its policy with Affiliated FM Insurance Company ("Affiliated"). The Affiliated policy was amended to include CSW and its subsidiaries in 2000 when AEP acquired CSW, and the prior loss clause provided coverage for earlier losses if those losses would have been covered under an insurance policy in existence at the time of the loss. At the time of the theft, CSW was covered by a policy issued by Chubb Insurance Group (the "Chubb policy"), which expressly covered CSW and "any subsidiary corporation now existing or hereafter acquired." The court applied Louisiana contract interpretation principles but noted that the outcome would remain the same under Texas law. The court concluded that the district court did not err in finding that the term "corporation" was unambiguous and excluding parol evidence. The court rejected AEP’s argument that the common understanding of "corporation" extends to unincorporated entities like LLCs. The LLCs in issue were Oklahoma LLCs, and the court cited Oklahoma law defining an LLC as "an unincorporated association or proprietorship." The court also cited the Louisiana LLC statute, which provides that "[n]o limited liability company organized under this Chapter shall be deemed, described as, or referred to as an incorporated entity, corporation, body corporate, [etc.]" AEP pointed to numerous judicial and legal references to "limited liability corporations," but the court stated that these were merely imprecise references that did not alter the fundamental distinction between the two types of entities. The court found nothing "absurd" in interpreting the term "corporation" to cover a particular type of subsidiary and not others. AEP also argued that the district court should have reformed the Chubb policy to include LLCs. Although AEP filed affidavits from both Chubb and CSW stating that LLCs were intended to be covered under the general heading of "corporation" in the Chubb policy, the court found that the district court did not err in refusing to reform the policy because Affiliated assumed the coverage obligations under the unambiguous terms of the Chubb policy and there was no indication that Affiliated knew or should have known of any understanding between Chubb and CSW regarding the meaning of the term "corporation." Further, the court stated that use of the term "corporation" was not the type of clerical error that reformation is intended to remedy, and the court characterized AEP’s argument for reformation as an attempt to make an end-run around the parol evidence rule.

Royal Mortgage Corp. v. Montague, 41 S.W.3d 721 (Tex. App.—Ft. Worth 2001, no pet.). The court rejected the argument that an LLC’s partnership returns established that the LLC was a partnership. The court pointed out that the K-1’s as well as other documentation indicated that the company was an LLC.

B. Pre-Formation Transactions


Lentz Engineering, L.C. ("Lentz") sued Alden Brown for breach of contract and quantum meruit alleging that Brown was liable as a partner in a general partnership with William Wilkins, who contracted for Lentz’s services in June 2005. In 2004 and 2005 (before entering into the contract with Lentz), Wilkins contracted to purchase a piece of property that he and Brown planned to develop, Wilkins and Brown met with an attorney and agreed to form an LLC to develop the property, Brown supplied funds for the purchase, and Wilkins acquired title to the property. In April 2005, one day after the property was acquired by Wilkins, the articles of organization for the LLC were filed. The articles of organization identified Brown and Wilkins as managers. Brown and Wilkins also established a bank account for the LLC. Brown later became suspicious of Wilkins’s conduct and attempted to recover his money and obtain title to the property. Meanwhile, Wilkins contracted with Lentz to provide engineering services on the property. Lentz was never paid and sued Brown and Wilkins. Wilkins defaulted, and after a bench trial, the trial court made findings of fact and conclusions of law that included the following: (1) Brown and Wilkins agreed to establish the LLC for the purpose of owning and developing the property; (2) Brown and Wilkins were never general partners; and (3) Brown could not be personally liable for the contract between Lentz and Wilkins. On appeal, Lentz argued that the trial court erred in finding that there was no general partnership. The court looked at the sufficiency of the evidence with regard to the trial court’s conclusion that there was no partnership between Brown and Wilkins at the time of the contract with Lentz and
concluded that the trial court’s finding was not against the great weight and preponderance of the evidence with respect to the five statutory factors indicating the creation of a partnership. The court noted that an association or organization is not a partnership if it was created under the statute governing the formation of an LLC. The court discussed Lentz’s argument that the conduct of the two men before formation of the LLC formed a partnership and that the formation of an LLC does not displace a preexisting partnership. Lentz pointed to Brown’s transfer of money to Wilkins and the purchase of the property by Wilkins before the LLC was formed. The court acknowledged that promoters have been held liable on contracts made prior to formation of a company as if the promoters were partners but stated that Lentz had not cited any authority suggesting that liability should be imposed on one promoter because of another promoter’s conduct after formation of the company. The court concluded that the mere fact that promoters of a company engage in conduct to further the company’s formation and business does not per se establish a partnership under the Business Organizations Code so that partner-like liability of promoters may extend beyond the date of the company’s formation.


The defendants argued that plaintiff Conceal City, LLC did not have standing to sue in this patent infringement action because it did not exist at the commencement of the suit. The plaintiff argued that it had standing to sue because it was later formed as a Texas “limited liability corporation” and acquired the patent. The court found that Conceal City, LLC did not have standing because the plaintiff must have enforceable title to the patent at the inception of the suit. The court thus dismissed the claim of Conceal City, LLC for lack of standing.

Kahn v. Imperial Airport, L.P., 308 S.W.3d 432 (Tex. App.–Dallas 2010, no pet.).

An individual was personally liable on a lease signed by him as president of “Condom Sense.” The individual claimed that an LLC was really the lessee, but he admitted that the LLC did not exist when the lease was signed and that it was his practice to enter a lease under the dba “Condom Sense” on behalf of an entity to be formed after “everything [is] resolved.” The court stated that a trade name has no legal existence and that one cannot bind a legal entity that does not yet exist. The individual was liable under the rule that a promoter who signs a contract on behalf of an unformed entity is liable unless there is an agreement with the other party that the promoter is not liable. There was no evidence that the lessor agreed not to hold the individual liable, and the lease did not even name the unformed entity. There was conflicting evidence as to whether the representative of the management company who negotiated the lease for the lessor knew the individual was purporting to sign for an unformed entity, and there was no evidence the LLC adopted the lease after its formation. Under these facts, the court concluded the individual was personally liable.

In re JNS Aviation, LLC, 376 B.R. 500 (Bankr. N.D. Tex. 2007).

The court applied corporate promoter liability principles to a contract to purchase an airplane entered in the name of a nonexistent LLC. The court found that the individual who signed the agreement acted as the promoter of the LLC and was obligated as the purchaser under the purchase agreement. The individual was also deemed to be the assignor under a subsequent assignment executed by the individual in the name of the LLC, and the assignment to the individual’s corporation was effective such that the corporation had standing to bring suit on the agreement.


The plaintiff (“Sysco”) sued Judith Miller (“Miller”) for breach of contract after it did not receive payment for food delivered to “Vincent’s at Brushy Creek” (“Vincent’s”). Vincent’s was a restaurant owned by an LLC in which Miller was a member. Vincent Pisa (“Pisa”) filled out a credit application for Vincent’s. Pisa left the ownership line in the application blank, but wrote “Vincent’s at Brushy Creek” on the line for “dba (trade name).” Pisa checked a box indicating that Vincent’s was a corporation and listed Miller and Carol Hall (“Hall”) in the section of the application for “individual proprietors, general partners or corporate officers.” The application was signed by Pisa as the agent of Vincent’s. Hall signed as an individual guarantor. At the time Pisa signed the application, the LLC had not been formed. The LLC was formed the day after the credit application was signed by Pisa. On various dates after the LLC was formed, food was delivered by Sysco’s to Vincent’s. After discovering that the corporation identified in the application never existed, Sysco attempted to hold all persons listed in the application personally liable as partners in a general partnership. The court of appeals affirmed the trial court’s summary judgment in favor of Miller because Sysco could produce no evidence that Miller intended Pisa to act on her behalf, that she intended to be part of a partnership, or that Sysco thought it was dealing with a partnership.
Two parties signed a “Pre-Organization Agreement” in which they agreed to form an LLC and then to form an S corporation or LLP within 60 days of the contract. The contract stated that the LLC would pay specified sums to the S corporation or LLP, and the sums were set out by the names of each party and referred to as “contributions.” Each party was to be issued a certificate to reflect a specified percentage of ownership in the new S corporation or LLP. The contract had a “pullout” clause allowing any member to withdraw and be reimbursed his initial capital contribution. The contract also provided for reorganization of the S corporation or LLP to reflect equal ownership when all initial capital contributions were refunded. The court held that this contract unambiguously obligated the parties to contribute the sums specified to the LLC.

C. Fraud in Formation of LLC


An Oklahoma LLC sought to enforce an agreement to purchase and sell property that was executed on behalf of the LLC prior to filing articles of organization with the Oklahoma Secretary of State. The court applied an Oklahoma statute that provided that a person or corporation may not deny validity of a contract relating to real property if the person or corporation has knowingly received and accepted benefits under the contract. The court concluded that the seller was estopped under this provision to assert the LLC’s lack of capacity. In a subsequent opinion on rehearing, the court determined that there was no fraud on the part of the individual who represented that the LLC was in existence before it was formed because the misrepresentation was unintentional.


Two parties signed a “Pre-Organization Agreement” in which they agreed to form an LLC and then to form an S corporation or LLP within 60 days of the contract. The contract stated that the LLC would pay specified sums to the S corporation or LLP, and the sums were set out by the names of each party and referred to as “contributions.” Each party was to be issued a certificate to reflect a specified percentage of ownership in the new S corporation or LLP. The contract had a “pullout” clause allowing any member to withdraw and be reimbursed his initial capital contribution. The contract also provided for reorganization of the S corporation or LLP to reflect equal ownership when all initial capital contributions were refunded. The court held that this contract unambiguously obligated the parties to contribute the sums specified to the LLC.


Matthew Minnis and Cullen 130, LLC (the “Minnis Parties”) and Jacob Citrin and Citrin Holdings, LLC (the “Citrin Parties”) went into business to acquire and develop industrial properties near airports and seaports. Citrin, Minnis, and their attorneys spent several months negotiating the terms of an operating agreement for an existing LLC (“Cargo Ventures New York”) of Citrin’s. Under this operating agreement, Cullen 130, LLC (“Cullen 130”) was admitted as an additional member with a 45% interest, and Citrin Holdings, LLC (“Citrin Holdings”) held a 55% interest. Citrin was the manager of Cargo Ventures New York. A bank was to lend most of the money to purchase and develop the properties, and Millennium Partners, a company owned by Citrin’s father-in-law, provided the rest of the money. A single-purpose entity would hold title to each property. The members of the single-purpose entities were to be Cargo Investors, LLC (an entity created by Citrin Holdings and Cullen 130) and a Millenium entity. Citrin Holdings and Cullen 130 later formed another entity, Cargo Investors II, LLC, for the purpose of investing in a particular project. The Minnis Parties sued the Citrin Parties after their relationship deteriorated, claiming that the Citrin Parties excluded them from the business and alleging causes of action for breach of fiduciary duty, breach of contract, fraud, minority oppression, conspiracy to breach fiduciary duties, and aiding and abetting breach of fiduciary duties. Minnis alleged that before signing off on the Cargo Ventures New York operating agreement, he and Citrin entered into an oral agreement creating an “overarching” partnership agreement. Citrin denied that he and Minnis had a partnership distinct from their relationship in the Cargo entities and argued that the “partnership” was subsumed into the Cargo Ventures New York operating agreement. The case was tried to a jury, which found for Minnis, Cullen 130, or both on each cause of action submitted. A judgment holding Citrin and Citrin Holdings liable to Cullen 130 for over $28,000,000 in actual damages for breach of fiduciary duty was entered, but the judgment stated that, should the recovery for breach of fiduciary duty become less favorable, the plaintiffs may recover on any one of the other theories found by the jury. On appeal, the court of appeals found that the Minnis Parties’ damage expert’s testimony was unreliable and should have been excluded, and the Minnis Parties were unable to show any other reliable evidence on which their $28,000,000 damage award could be sustained. The damage model for all of the Minnis Parties’ theories of liability was based on the expert’s testimony, so neither Cullen 130 nor Minnis could recover the damages awarded on any of their claims in the trial court’s alternative judgment. The trial court also awarded out-of-pocket damages of $1,000,000 on the alternative claim for fraud and/or fraudulent inducement based on claims that Citrin fraudulently induced Minnis into entering an oral partnership agreement with Citrin and fraudulently induced Cullen 130 into entering the Cargo entities’ operating agreements. The court of appeals concluded that Minnis and Citrin did not form a partnership, so there was no fraudulent inducement to enter into a partnership. As for the remaining fraudulent inducement claim, there was no dispute that Citrin and Cullen 130 entered into the operating agreements of the Cargo entities, but the Citrin Parties asserted that Citrin Holdings’
partial performance under the operating agreements negated Cullen 130's claim for fraudulent inducement. The Minnis Parties' primary contention in support of its claim that Citrin Holdings had no intention of performing under the operating agreements was Citrin Holdings' breach of the agreements by usurping opportunities, failing to liquidate and distribute, ousting the Minnis Parties from the business, and transferring the property, contracts, and cash flows into another Citrin-owned company. In 2003, Citrin and Minnis discussed going into business together, and Citrin owned 100% of Cargo Ventures New York at that time. Cullen 130 was admitted as a 45% member of Cargo Ventures New York. Citrin Holdings and Cullen 130 created Cargo Investors and Cargo Investors II for the purpose of holding interests in single-purpose entities, which held title to the properties. By the time Citrin removed Minnis as president of Cargo Ventures New York at the end of 2006, the Cargo entities had acquired a portfolio of numerous properties, which they were developing. Although "slight circumstantial evidence" of fraud, when considered with the breach of a promise to perform, is sufficient to support a finding of fraudulent intent, partial performance can negate an intent not to keep a promise when made. The court stated that the record contained undisputed evidence of partial performance, thus negating Cullen 130's claim for fraudulent inducement.


An LLC and two of its members sought a determination that debts to them arising from activities of the debtor while he was managing member of the LLC were nondischargeable in bankruptcy. The court found that the debtor had breached fiduciary duties to the LLC and had nondischargeable debts to the LLC arising out of a defalcation in a fiduciary capacity and embezzlement, but the members failed to establish that their initial investments in the LLC were procured by actual fraud or false representations so as to support an exception to discharge with respect to the amount of their investments. The evidence showed the debtor devised his embezzlement scheme subsequent to the original investment solicitations and made no false representations at the time of the investment solicitation.


Jim Sandt, a CPA employed by Enron as vice president of its tax group, became interested in buying Enron assets that had substantial value when he became aware that many Enron assets were being sold in Enron’s bankruptcy. Sandt and his wife became friends with Tim Nesler and his wife, and Jim and Tim began working on a business plan for the purchase and management of an Enron business. Four other individuals joined the group, and Jim formed an LLC to be managed by Jim, Tim, and the other individuals. The group became interested in purchasing the interest of Enron in a limited partnership. Another LLC, Energy Maintenance Services Group I, LLC (“Energy Maintenance”) and a subsidiary LLC were formed. Jim became nervous that he might have a conflict of interest because he was still working at Enron and was also CFO of a group seeking to buy Enron’s interest in the limited partnership. Although Tim sought to provide reassurance to Jim that he did not have a conflict of interest, Jim resigned from his positions at all three LLCs that had been formed by the group. Tim was upset about Jim’s resignation and feared it would jeopardize the deal. Jim continued to work on the deal but played a lesser role. After Jim’s resignation, he and the other five members of the group met at a lawyer's office to sign various documents. Jim tendered his anticipated contribution of $75,000 and signed a subscription agreement. Tim and another member of the group, Art Robbins, signed a written consent of directors in lieu of organizational meeting that reflected Jim contributed $75,000 and was a membership interest unitholder of 75 of 400 units. The documents also included an LLC agreement specifying that Jim was a member of Energy Maintenance and owned 75 of 400 outstanding units based on his capital contribution of $75,000. The LLC agreement provided that all amendments to the agreement must be submitted to all members in writing and approved by members owning an aggregate of more than fifty percent of the outstanding units of Energy Maintenance. The agreement did not address the issuance of additional units beyond the initial 400 units. A few days later, without notice to Jim, the other five members of Energy Maintenance met and approved various amendments to the LLC agreement, including an amendment that gave the board of the LLC the authority to issue units. The next day, Energy Maintenance’s subsidiary signed an agreement to purchase Enron’s interest in the limited partnership. Additional units were issued to members of the group other than Jim without Jim’s knowledge, and the purchase of Enron’s interest was closed. Jim did not learn until over a year later that an additional 1,200 units had been issued. Jim and his wife sued Energy Maintenance, Tim, Art, and another member/officer of Energy Maintenance (the “EMS parties”), alleging various claims for fraud, breach of fiduciary duty, and breach of contract. The jury found that Tim breached a fiduciary duty to the Sandts and found against Tim, Art, and Energy Maintenance on claims for statutory fraud, common law fraud, and negligent misrepresentation. On appeal, the EMS parties argued that the evidence was insufficient to support the findings of statutory fraud by the jury. The statutory fraud claim was based on Chapter 27 of the Texas Business and Commerce Code. [All parties apparently assumed that Section 27.01 of the Texas Business and Commerce Code, which provides
a cause of action for fraud in a transaction involving “stock in a corporation or joint stock company” applied to the purchase of the LLC units in this case.] The court of appeals concluded that the evidence was sufficient for a reasonable and fair-minded jury to find that: (1) Tim made a false, material promise to Jim to do an act with the intention of not fulfilling the promise; (2) Tim made the promise to Jim for the purpose of inducing Jim to enter into an agreement to purchase stock; and (3) Jim relied on the promise in entering into an agreement to purchase stock. The court of appeals reviewed the evidence relating to Jim’s investment in Energy Maintenance and the amendment of the LLC agreement empowering the board to issue additional units and concluded that the jury reasonably could have found Tim falsely promised Jim he would receive an interest of approximately 18.75% in Energy Maintenance, that the promise was material and made for the purpose of inducing Jim to purchase units in Energy Maintenance, that Jim relied upon the promise, that the LLC agreement was amended without Jim’s knowledge although it required amendments to be submitted to all members, that 1,200 additional units were issued to members other than Jim as “sweat equity” within fifteen days after the amendment for no additional consideration, that Tim was furious with Jim for resigning from the management team at a critical time in the transaction, and that Tim promised Jim he would receive an ownership interest of approximately 18.75% with the intent that Jim would receive a significantly lower ownership interest as a result of the issuance of additional units, i.e. with no intention of fulfilling the promise. Because the jury could reasonably have concluded Tim was acting as an agent of Energy Maintenance, the evidence was sufficient to support the jury’s finding that Energy Maintenance committed statutory fraud. The court rejected the argument that the evidence was insufficient to support the jury’s finding that Tim had actual awareness of the falsity of his promise. The court of appeals agreed with the argument that the evidence was insufficient to show statutory fraud against Jim’s wife. She did not sign the subscription agreement, which contained various representations that he was acting on his own behalf and for his own account. Thus, the court concluded that the evidence was insufficient to show that she entered into an agreement to purchase stock. The court rejected the argument that the use of community property funds to purchase the Energy Maintenance units allowed Jim’s wife to assert the fraud claim. The court said that it had not seen any case in which a court has held that a spouse’s interest in community funds expands the substantive law and allows a spouse to recover based on tort claims against third parties that only run in favor of the other spouse. The court found that the evidence was legally insufficient to support the jury’s finding of statutory fraud on the part of Art but upheld the judgment against Art because unchallenged conspiracy findings predicated on the statutory fraud finding against Tim provided a basis for holding Art liable.


Brothers David and Harvey Gartley sued Smith for fraud based on misrepresentations made by Smith to induce the Gartleys to invest in an LLC and for misrepresentations after they invested that induced them to personally guarantee the company’s debt. Smith argued that the Gartleys did not have standing or capacity to bring their claims against Smith. Relying on case law from the corporate context, the court acknowledged that an individual stakeholder in a legal entity does not have a right to recover personally for harms done to the entity, but the court concluded that the Gartley brothers suffered direct harm above and beyond a mere reduction in the value of their “stock” in the LLC. The court held that the Gartleys had standing and capacity to assert their claims for damages flowing from Smith’s misrepresentations that induced them to invest funds and personally guarantee the company’s debt.


Michael Sanderson and Ann Gainous wanted to start their own ice rink business, and they signed a lease for an ice rink (with an option to purchase the property) and formed a corporation, Ridglea Entertainment, Inc. (“Ridglea Entertainment”) to operate the business. After they experienced problems operating the business, they contacted W. Graeme Roustan, an investor in and operator of numerous ice rinks, about Roustan buying a controlling interest in their business. After meeting with Roustan, the parties signed a purchase agreement under which a new entity, Rouston Ridglea, LLC (the “LLC”), agreed to purchase the lease and all of the assets of the ice rink business. The LLC agreed to transfer a 25% ownership interest to Ridglea Entertainment and to pay $75,000 to Gainous and Ridglea Entertainment. Ridglea Entertainment and Roustan, Inc. (a company wholly owned by Roustan) executed an operating agreement for the LLC. Under the operating agreement, Roustan, Inc. owned a 65% interest, Ridglea Entertainment owned a 25% interest, and two trusts each owned a 5% interest. The agreement called for Roustan, Inc. to make a $150,000 capital contribution to the LLC, and Ridglea Entertainment’s capital contribution consisted of its assignment of its interest in the ice rink and the sale of its business assets as set out in the purchase agreement. The parties disputed at trial whether Roustan, Inc. satisfied all of its capital contribution and whether the LLC paid all of the purchase price under the
purchase agreement. After the business fell on hard times and Roustan maneuvered to exclude Sanderson and Gainous from the business, Sanderson, Gainous, and Ridglea Entertainment (the “S&G parties”) filed suit against Roustan, the LLC, and others, alleging claims for fraud and breach of contract. Among the claims asserted by the S&G parties was a claim for fraud involving real estate or corporate stock under Section 27.01 of the Texas Business and Commerce Code. Based on the jury verdict, the trial court entered a judgment against Roustan based on statutory fraud. [The parties apparently assumed without argument that Section 27.01 applied to the transaction. It is not clear whether the claim was based on the transfer of the lease for the ice rink or the purchase of the LLC interest or both.] On appeal, Roustan argued there was no evidence he made any representation that was false; however, he did not argue that there was no evidence that he made a promise with the intention of not fulfilling it. Section 27.01 can be premised on either a false representation of fact or a false promise to act. The court of appeals reviewed evidence in the record that was sufficient to allow the jury to conclude that Roustan told the S&G parties that he could and would provide the $150,000 capital contribution from his own funds or the funds of Roustan, Inc., but that he always intended to and actually did fund the obligation with debt that the LLC would be obligated to repay. Although the jury found that Roustan did not fail to make the agreed $150,000 capital contribution, the court of appeals said that the jury could have found that Roustan’s borrowing the money to fund the LLC and making the LLC liable for the repayment satisfied Roustan’s obligation to make a capital contribution but at the same time violated his promise to the S&G parties that he personally could and would fund the company.


Michael and Lee Flores (the “Flores Brothers”) entered into a Pre-Organization Contract to form a business with Eric Gutschow, and Matthews & Branscomb was retained to prepare the documents to form an LLC. The Pre-Organization Contract obligated Michael Flores to contribute $384,000, but the regulations only required a contribution of $800 and recited that they superseded all prior agreements, including the Pre-Organization Contract. The Flores Brothers claimed that Matthews & Branscomb jointly represented the Flores Brothers and Gutschow in preparing the LLC documents. A few months later, Gutschow and the LLC sued the Flores Brothers asserting various causes of action relating to the ownership and operation of the business. Matthews & Branscomb represented Gutschow in the lawsuit. The Flores Brothers were held liable to Gutschow and the LLC for breach of the Pre-Organization Contract, and the trial court also found that the Flores Brothers committed fraud in the inducement. The Flores Brothers then filed suit against Matthews & Branscomb alleging that fraud and breach of fiduciary duty on the part of Matthews & Branscomb resulted in the judgment against the Flores Brothers in favor of Gutschow and the LLC. Specifically, the Flores Brothers claimed that Matthews & Branscomb failed to disclose the regulations which presented a defense to the claims asserted by Gutschow and the LLC. The court held that the finding of fraud in the inducement against the Flores members precluded them from enforcing the provision in the LLC regulations superseding the Pre-Organization Contract; therefore, assuming the failure to disclose the regulations constituted a fraudulent omission or breach of fiduciary duty, the failure was not the cause of damages to the Flores Brothers.

_D. LLC Property and LLC Membership Interest_


Cherer brought a forcible entry and detainer action against the Barreras and was awarded possession of the property by the justice court and by the county court after the Barreras appealed. The Barreras argued Cherer lacked standing to bring the action because the property was purchased at a tax foreclosure sale by Chererco LLC and the tax deed listed the LLC as the grantees of the property. The tax deed listed Cherer as the member and registered agent of Chererco LLC, and Cherer asserted that this case was a case of misnomer rather than standing because he had “a tendency to use the first person singular pronoun when referring both to himself and to his LLC.” The court of appeals concluded that Cherer was not the correct party to bring the suit, and misnomer did not apply. The court relied on case law recognizing that an LLC is considered a separate legal entity from its members and Section 101.106 of the Texas Business Organizations Code, which provides that a member of an LLC does not have an interest in any specific property of the LLC. Further, the court pointed out that Section 101.113 provides that a member may be named as a party in an action by an LLC only if the action is brought to enforce the member’s right against or liability to the LLC. Here, Cherer did not bring suit for the purpose of enforcing his right against or liability to the LLC. He brought the forcible entry and detainer suit himself and acquired possession of property belonging to the LLC. A member lacks standing to assert a
cause of action that belongs to the LLC. Thus, the court vacated the county court’s judgment and rendered judgment dismissing the suit.


Clark obtained a judgment against Orr, and Orr then gave $225,000 to an LLC owned by Orr and his wife. Clark applied for a post-judgment writ of garnishment to obtain the $225,000 in the LLC’s possession. After a bench trial, the trial court awarded Clark a judgment against the LLC for $225,000. On appeal, the court held that the evidence was insufficient to support the trial court’s finding that the $225,000 belonged to Orr at the time the writ of garnishment was served on the LLC. The $225,000 at issue was received by Orr from a limited partnership in payment for his 25% limited partnership interest. On the day after this sale, Orr deposited the check directly into the LLC’s bank account, and Orr’s wife signed an unsecured 30-year promissory note on behalf of the LLC with an interest rate of 3%. Interest was payable annually, but the principal was not due until the expiration of the 30-year term. Clark then applied for the writ of garnishment against the LLC and later added fraudulent transfer claims. At the bench trial, Orr testified that he made the loan to the LLC because it was in dire need of capital. He testified the loan was structured the way it was because the LLC could not afford to pay more. Evidence showed that the LLC had gross revenue in 2011 of over $900,000. Clark chose not to try his fraudulent transfer claims and nonsuited those at the time of trial to avoid a continuance. The trial court found for Clark, stating on the record that Orr’s maneuvering was for the sole purpose of getting $225,000 out of Clark’s grasp. The trial court found that the LLC had in its possession $225,000 owned by Orr and entered a judgment against the LLC in that amount. The court of appeals noted that it was Clark’s burden to prove Orr’s ownership of the $225,000 at the time of the writ of garnishment. Since Clark nonsuited his fraudulent transfer claims and there was no pleading to support a fraudulent transfer claim, the court said the judgment in the garnishment could not be sustained on the basis of a fraudulent transfer. The court thus found unpersuasive and irrelevant the contentions that the evidence showed, and the trial court found (orally or impliedly), that Orr intended to avoid paying the judgment. The trial court could and apparently did disbelieve Orr’s testimony that the LLC was in dire need of capital, and the court of appeals accordingly disregarded that testimony in its review. But the court of appeals said that disregarding Orr’s testimony did not prove that Orr owned the $225,000 at the time the writ of garnishment was served. The only remaining evidence relied on by Clark was the fact that Orr and his wife were the sole members of the LLC. But Clark acknowledged the general rule that a partnership fund is not subject to garnishment for the individual debt of a member of the firm, and the court stated that this rule applies equally to an LLC, citing Sections 154.001 and 101.106 of the Texas Business Organizations Code, which provide that a partner is not a co-owner of partnership property and a member of an LLC does not have an interest in any specific property of the LLC. The parties agreed that at the time of the writ of garnishment the $225,000 was in a bank account of the LLC, and Clark did not establish that Orr had the right to recover the money regardless of whether the transfer was a bona fide loan. Thus, there was no evidence to support the trial court’s finding that the LLC possessed $225,000 “belonging to” Orr.


Investors of an LLC asserted claims against the managers of the LLC, the LLC’s law firm, and the LLC’s lender in connection with an allegedly fraudulent exchange offering that transformed the investors from equity holders to note holders in order to cover up long-time, ongoing violations of securities laws and liquidity problems in the LLC. The confirmation plan in the LLC’s bankruptcy released the lender from claims that the LLC owned against it, and the lender sought to prevent the investors from asserting their claims against it on the basis that their claims involved recovery of damages derivative of damages to the LLC. The bankruptcy court had previously held that the investors’ claims based on the exchange offering were direct claims owned by the investors and not property of the bankruptcy estate. The court said that the lender appeared to concede that the claims against it arising from the exchange offering (aiding and abetting breach of fiduciary duty, secondary liability for securities fraud, and violation of unfair competition law) belonged to the investors rather than the bankruptcy estate, but the court made clear that these claims are direct and personal to the investors and could not have been brought by the LLC on the date it filed for bankruptcy. The court stated that this conclusion did not end its analysis, however, because the lender argued that the investors were attempting to recover damages that were derivative of damages suffered by the LLC on claims that could have been brought on the bankruptcy petition date. With respect to the investors’ claim against the lender for aiding and abetting breach of fiduciary duty, the court concluded that it would be impossible to know until the conclusion of the trial of the investors’ claim what facts would be proven. Thus, the court said it was impossible to enjoin the investors from pursuing their direct claim against the lender for aiding and abetting the managers’ breach of fiduciary duty owed to them as members of the LLC. But the
court found it appropriate to enjoin the investors from attempting to recover damages attributable to the managers’ post-exchange offering mismanagement of the LLC. The court left it to the California court where the investors’ class action was pending to correctly apportion damages to the extent necessary at trial. With respect to the investors’ claim against the lender for secondary liability for securities fraud, the court was satisfied that the investors were not attempting to recover for harm to the LLC itself. The court said it was theoretically possible that some component of damages proven at trial might be derivative of damage to the LLC based on the managers’ post-exchange offer mismanagement, and the investors would not be entitled to recover such a component of damages but would share as creditors under the plan any recovery for the managers’ post-exchange offer mismanagement. Finally, the court concluded that the investors’ claims under California unfair competition law would only entitle the investors to restitution, not damages; thus, the investors were not seeking to recover damages that would compensate them for the managers’ post-exchange offer mismanagement.


The debtors, John and Deborah Lau, were in the real estate business, and the plaintiffs sought a determination that the Laus’ debts for the plaintiffs’ losses in real estate ventures managed by the Laus were nondischargeable on various grounds, including as debts arising from fraud or defalcation in a fiduciary capacity and embezzlement. The plaintiffs gave John Lau, as managing member of the Laus’ real estate LLC, $600,000 to invest in two real estate ventures. One of the ventures was structured as an LLC. A portion of the plaintiffs’ claims against the Laus related to capital calls issued by John Lau, as managing member of the LLC, based on false representations regarding the LLC. The capital infusions were diverted by John Lau for his own business purposes and those of another entity owned by the Laus. The plaintiffs received no return on their investments in the LLC. Although the court concluded that the Laus’ debts to the plaintiffs were excepted from discharge as debts arising from fraud and defalcation in a fiduciary capacity, the court stated that a claim arising from a manager’s embezzlement of funds intended for the use and benefit of a company would belong to the company rather than the individual shareholders or members. Thus, the court held that the diversion of the funds received in the capital call was embezzlement as to the LLC and not its members, and embezzlement was not a basis for an exception to discharge as to the plaintiffs.


Three individuals each formed new Delaware LLCs to serve as the purchasers of property they sought to acquire. The LLC’s entered into a co-tenancy agreement under which the property would be acquired and managed. The LLC owned by the debtor in this bankruptcy was appointed the “Managing Cotenant” under the agreement, and the other individuals and their LLCs sought to have indebtedness of the debtor arising out of the acquisition and operation of the property excepted from discharge. The court concluded that any misconduct by the debtor pertaining to post-acquisition operation of the property that could constitute fraud or defalcation in a fiduciary capacity was actionable only by the LLCs as the actual co-tenants affected by the misconduct. The court stated that an individual stakeholder does not have a right to recover personally for harms to the LLCs and that this principle applies to the rights of a member of an LLC. The court relied on Section 101.106(b) of the Texas Business Organizations Code, which provides that a member of an LLC does not have an interest in any specific LLC property. Thus, the court concluded that the members of the LLCs had no standing in their individual capacities to litigate claims that arose from the debtor’s misconduct after the acquisition of the property owned by the LLCs as cotenants under the cotenancy agreement.


Ghosh and Grover, through their respective entities of Cinemawalla, Inc. (“Cinemawalla”) and 87 Minutes, LLC (“87 Minutes”), formed an LLC to produce a movie entitled _97 Minutes_. Ghosh and Grover orally agreed that Grover and 87 Minutes would contribute the rights to a screenplay and written commitments for the project along with $600,000 in cash and $400,000 of previous expenditures in exchange for 87 Minutes’ membership interest, and Ghosh and Cinemawalla, in exchange for its membership interest, would obtain the release of $4 million that had been placed in escrow under a contract between Cinemawalla and a third party (“San Luis Cine”) for the production of another movie. Grover and 87 Minutes satisfied their obligations, and Ghosh repeatedly assured Grover that San Luis Cine had agreed to reallocate the escrowed funds to the production of _97 Minutes_, but San Luis Cine never released all the funds. After Ghosh offered various excuses and asserted that various actions needed to be taken before San Luis Cine would release the funds, Grover began to question Ghosh’s credibility and demanded that their agreement be reduced to writing. Ghosh refused to do so, and Grover and 87 Minutes sued Ghosh and Cinemawalla. The plaintiffs’ causes of action included breach of contract, conversion, and fraud, and the jury found in favor of the plaintiffs on each cause of action. On appeal,
Ghosh and Cinemawalla argued, *inter alia*, that the statute of frauds barred the breach of contract claim and that the evidence did not support the jury’s verdict on the conversion claim. The court of appeals first addressed the enforceability of the oral agreement by the defendants to cause the $4 million being held in escrow for production of another movie to be redirected to the LLC’s movie project and concluded the agreement was unenforceable because the Texas LLC statute provides that a promise to make a contribution or otherwise pay cash or transfer property to an LLC is not enforceable unless the promise is in writing and signed by the person making the promise. The plaintiffs’ conversion claim was based on checks Ghosh wrote to herself from the LLC’s bank account. To recover for conversion, a plaintiff must have had legal possession or the right to possession of the money converted. The money in the LLC’s bank account was deposited by 87 Minutes, but 87 Minutes no longer owned, possessed, or controlled the money once it was deposited in the LLC’s account. Grover argued that he had the right to immediate possession of the money because he was entitled to rescind the fraudulently induced contract, but there was no legally enforceable contract due to the statute of frauds provision mentioned above, and thus this argument failed even assuming it otherwise had merit.


A member’s 50% interest in an LLC was awarded to his wife in their divorce. Before the divorce, the other member closed an LLC bank account and transferred $160,000 in the account to another account as a “payment to owner.” After the divorce, the other member caused the LLC to make payments to him for services provided to the LLC. The ex-wife, now an assignee of her husband’s 50% interest, sued the other member and the LLC, asserting claims that included unjust enrichment. The court of appeals agreed with the other member’s challenge to the trial court’s finding on the ex-wifes’s unjust enrichment claim. The trial court found that the other member wrongfully utilized funds and assets of the LLC for his own use and unilaterally obligated the LLC to pay himself for management services that were not performed at all or were performed in a manner that damaged the LLC. A claim for unjust enrichment on these facts belonged to the LLC rather than the ex-wife.


The court held that a foreign corporation that asserted a claim for breach of an agreement to purchase a membership interest in a Texas LLC was entitled to its proposed judgment and rejected the defendants’ argument that the corporation was required to register to do business in Texas under the Texas Business Organizations Code in order to assert its claim. The transaction giving rise to the corporation’s cause of action was an LLC Membership Purchase Agreement that contained a release and covenant not to sue, which the defendants breached. The corporation argued that the agreement did not constitute the “transaction of business in this state” under Section 9.251 of the Texas Business Organizations Code because it fell within two provisions that are expressly excluded from transacting business: (1) transacting business in interstate commerce; and (2) conducting an isolated transaction that is completed within a period of 30 days and is not in the course of a number of repeated, similar transactions. The agreement, which was governed by New York law, was for the sale in interstate commerce to the plaintiff, a Maryland corporation with its principal place of business in New York, of membership interests in a Texas LLC owned by the defendants. Additionally, the transaction was completed in less than 30 days and was not in the course of a number of repeated, similar transactions. The court stated that it fully agreed with the corporation that the defendants’ objections lacked merit and that the corporation was entitled to judgment.

**In re Marriage of Davis,** 418 S.W.3d 684 (Tex. App.–Texarkana 2012, no pet.).

William and Eleanor Davis entered a Rule 11 agreement in their divorce action in which they agreed to the appointment of a receiver to sell the property of their LLC horse farm. William asserted certain complaints about the receiver’s authority and a modified order issued by the trial court after the first order appointing the receiver, but William failed to preserve those issues for appeal. William also complained that the trial court erred in issuing an order placing the LLC’s property into receivership because the LLC was not a party in the divorce proceeding. The LLC was co-owned and managed by Eleanor and William in equal shares. The governing documents stated that the LLC was managed and that Eleanor and William were the managers, but the LLC was operated by them informally “as a partnership” without holding meetings or observing other formalities. Although the court acknowledged that the LLC’s property was owned by the LLC and not Eleanor and William, the court found it sufficient that Eleanor and William agreed to the appointment of the receiver in the Rule 11 agreement given that Eleanor and William enjoyed complete authority over the property as members and managers of the LLC, “especially given that they exercised that control over it informally as a matter of course.” A concurring justice wrote to express his view that the trial court was without authority to enter its first order appointing a receiver for the LLC’s property because the LLC was not a party at that time,
and the Rule 11 agreement was not signed by Eleanor and William in their capacities as managers of the LLC, but rather as individuals who were parties to the divorce action. The concurring justice argued that past mutually agreed informal management of an entity does not forever bar insistence on obedience to the governing documents of the entity, and an agreement in the capacity of an individual does not unwillingly bind that same person in the capacity as manager of an LLC. Because the LLC had been made a party to the divorce proceeding by the time a subsequent order appointing a receiver was entered nunc pro tunc, the concurring justice concurred in the result reached by the majority.


Two LLCs that owned low-income housing apartment complexes asserted that they met the statutory requirements for exemption from ad valorem taxation available to a community housing development organization (“CHDO”) under Section 11.182 of the Texas Tax Code. The principal issue addressed in this opinion was whether a CHDO must have legal title to property to qualify for the exemption, and the Texas Supreme Court held that equitable title is sufficient. The sole member of each of the two LLCs in this case was a nonprofit corporation exempt from federal income taxation under Section 501(c)(3) and certified as a CHDO by the Texas Department of Housing and Community Affairs. Section 11.182(b) of the Texas Tax Code provides a tax exemption to an organization on “property it owns” if it is organized as a CHDO and “owns the property for the purpose of” providing low- or moderate-income housing without profit. The LLCs argued that their apartments were exempt because ownership, within the meaning of the statute, includes equitable title, which the LLCs’ sole member, a certified CHDO, held by virtue of its complete control of the LLCs. The appraisal district argued that ownership means legal title, and that the LLCs were not entitled to an exemption since there was no evidence they themselves were CHDOs. The court looked to Section 11.182(e) of the Tax Code as an indication that ownership in subsection (b) included equitable title. Section 11.182(e) allows property “owned by a limited partnership” to be tax-exempt in certain instances if 100% of its general partner is controlled by a CHDO meeting the requirements of subsection (b). The court was unconvinced that limited partnerships are the one exception to subsection (b)’s requirement of legal ownership by a CHDO and saw no reason to distinguish between a general partner’s control of a limited partnership and other types of corporate control over related entities, such as the CHDO’s complete ownership of its subsidiary LLCs in this case. The court characterized the purpose of subsection (e) as limiting exemptions for limited partnerships to those in which the CHDO wholly owns the general partner rather than as carving out an exception for non-CHDO limited partnerships. The court observed that this construction acknowledges the realities of the commercial housing industry, in which lenders often require that property be purchased by a single-asset entity. The court also noted that tiered ownership allows greater flexibility for investors, encouraging the involvement of private funds in developing low-income housing consistent with the purpose in creating the concept of CHDOs. The court rejected several arguments made by the appraisal district, including an argument that entities that are separate for purposes of imposing liability should not be treated as one for purposes of qualifying for tax exemptions. The court pointed out that federal tax law disregards the separate identity of some entities (e.g., the LLCs in this case, which are disregarded as separate entities from their owner), and the court stated that there was no reason why Section 11.182 should not do the same. The court discussed five cases in which courts of appeals adopted varying constructions of Section 11.182. The court agreed with the reasoning in **TRQ Captain’s Landing v. Galveston Central Appraisal District**, 212 S.W.3d 726 (Tex. App.–Houston [1st Dist.] 2006, pet. granted, appeal abated), in which the court of appeals upheld an exemption for a limited partnership that was wholly owned by an LLC whose only member was a CHDO. Applying the rule that a CHDO’s equitable ownership of property qualifies for an exemption under Section 11.182 to the facts in the instant case, the court concluded that the CHDO had complete control over the LLCs and equitable title to the property—the power to compel the transfer of legal title. The court acknowledged that each of the LLCs had managers, which were the governing authority of the entities, but concluded that the member CHDO had complete control over the LLCs because managers serve at the pleasure of the members. The court noted that it was not addressing and expressed no view on numerous other issues raised by the parties, including the appraisal district’s arguments that the LLCs were not charitable organizations, that their apartments were not used for low- and moderate-income housing, and that other requirements of Section 11.182 and of federal law were not met.

Justice Willet dissented from the majority’s opinion, pointing out that the companies were asking the court to pierce the corporate veil that they themselves created. He argued that Texas law respects corporate formalities and usually limits piercing to circumstances of fraud or other malfeasance. He pointed out that the legal and business communities would be astounded if taxing authorities could routinely look to the parent to pay taxes on property of a subsidiary, and the granting of a tax exemption to a subsidiary struck Justice Willet as equally untenable. Justice Willet viewed the legislature’s failure to provide a provision similar to the one provided for limited partnerships in Section 11.182(e) as reason enough to disagree with the majority. Though he found it unnecessary to consider why the legislature would treat the two entities differently, he pointed out various differences between limited partnerships and LLCs that
might provide plausible reasons for drawing a statutory distinction. In sum, Justice Willet stated that he would respect what he viewed as the legislature’s policy choice to treat LLCs and limited partnerships differently.


Yammine purchased property at a sheriff’s sale and then sold the property to an LLC. Six months later, Yammine filed suit against Wise County due to a discrepancy in the acreage conveyed. The court held that Yammine lacked standing to pursue the relief he sought under the Tax Code because he no longer owned the property. The court noted that LLCs are separate legal “persons” under the Tax Code based on the definition of a “person” in the Code Construction Act. Thus, to the extent Yammine argued that he remained an owner because he was one of the members of the LLC, his argument failed.

**Storguard Investments, LLC v. Harris County Appraisal District**, 369 S.W. 3d 605 (Tex. App.–Houston [1st Dist.] 2012, no pet.).

A corporation filed a suit for judicial review of an order determining the corporation’s protest of taxes assessed for 2008, and the appraisal district filed a plea to the jurisdiction on the basis that the corporation lacked standing to pursue judicial review because it did not own the property on January 1, 2008. The corporation moved to add the LLC record owner of the property as a plaintiff, but the trial court granted the plea to the jurisdiction. On appeal, the LLC argued that the trial court erred because the corporation amended its petition to cure a misnomer, the LLC had standing to pursue the petition for judicial review, and the LLC satisfied the requirements for Rule 28 substitution. The court of appeals affirmed the trial court’s judgment. The corporation conveyed its interest in the property to the LLC in 2003, and the corporation had no legal right to protest the valuation or seek judicial review. Under the Tax Code as in effect at the time of the proceeding, the LLC, as record legal owner of the property, had standing to protest the valuation, but it never became involved in the administrative protest, and there was no protest determination brought by the LLC on which it could premise a suit for judicial review. The court reviewed other provisions of the Tax Code, including certain amendments to the Tax Code in 2011, and determined that they did not avail the corporation and the LLC. In the course of rejecting the misnomer argument, the court noted that the corporation—the party that completed the administrative protest and initiated the judicial review—had an ownership interest in the LLC, and the LLC—the property owner and substituted plaintiff—were separate and distinct entities. The court cited case law for the proposition that parent and subsidiary corporations are separate and distinct “persons” and Section 101.106 of the Business Organizations Code for the proposition that a member of an LLC does not have an interest in any specific property of the LLC. Because the corporation and LLC were distinct entities with separate existences, the LLC record owner could not rely on the corporation’s conduct to satisfy the jurisdictional prerequisites of completing the administrative protest process and timely filing a suit for review. The court rejected the substitution argument because there was no showing that the LLC was doing business under the corporation’s name, held itself out as the corporation, or requested the appraisal district to refer to it as the corporation in its records. Rule 28 allows an entity doing business under an assumed or common name to sue or be sued in that name and for the true name to be substituted on the motion of any party or the court. Under these facts, Rule 28 was not applicable and did not permit substitution of the “true name” of the LLC for the “common name” of the corporation.


The court of appeals held that the sole member of an LLC that owned property at issue in the case was qualified to testify regarding the value of the property. The court relied upon the “Property Owner Rule,” under which the testimony of a property owner as to the value of the property is admissible even if the owner is not an expert and would not be qualified to testify as to the value of other property. The court distinguished the Texas Supreme Court’s opinion in **Reid Road Municipal Utility District No. 2 v. Speedy Stop Stores, Ltd.**, 337 S.W.3d 846 (Tex. 2011), in which the supreme court held that testimony of the vice president of the corporate general partner of a limited partnership was not admissible under the Property Owner Rule with respect to property owned by the limited partnership. In **Speedy Stop**, the court limited the category of witnesses who could testify on behalf of an organization that owns property to officers of the entity in managerial positions or employees of the entity with substantially similar positions and duties. Based on the witness’s status as the “sole member” of the LLC property owner, the court in this case applied the Property Owner Rule and its presumption that the witness as owner of the property was familiar with it and its value.
The court noted that a membership interest in an LLC is personal property and that a member has no interest in specific LLC property and held that the trial court in a divorce action abused its discretion when it awarded to the husband all interest in an entity variously referred to as a corporation and LLC where a mediated settlement agreement did nor divide or mention the entity and alter ego was neither pled nor tried.

E. Fiduciary Duties and Oppression


The bankruptcy court in this adversary proceeding determined that the debtor, Edelman, was liable for trespass, breach of fiduciary duties, theft, and fraud based on actions he took while serving as vice president of the LLC general partner of a limited partnership that developed and operated a condominium project. The liability included exemplary damages as well as actual damages and was nondischargeable. With respect to the breach of fiduciary duty claim, Edelman admitted that he owed a duty to the LLC general partner as vice president of the LLC, and he admitted that the LLC owed a fiduciary duty to the limited partnership as its general partner, but Edelman denied that he owed a fiduciary duty to the limited partnership. The court concluded that Edelman owed a fiduciary duty to the limited partnership based on his control of the limited partnership’s operations through his position as vice president of the LLC general partner. The court concluded that the LLC’s claim for breach of fiduciary duty failed because the facts underlying the LLC’s claim were the same as the limited partnership’s, and the allegations and evidence focused on injury to the limited partnership or benefit to Edelman at the limited partnership’s expense. The LLC failed to prove it suffered any damage from Edelman’s breaches of fiduciary duty to it. Although Edelman argued that he owed no fiduciary duty to the limited partnership, the limited partnership agreement and LLC regulations as well as the evidence at trial showed that Edelman controlled all aspects of the limited partnership’s business operations during the relevant period of time. Edelman argued that Wiggins, the sole member of the general partner LLC, had a superior right to manage the limited partnership, but the evidence showed that Wiggins chose not to exercise his right to control and paid little attention to the day-to-day operations of the LLC and limited partnership until he discovered Edelman’s wrongdoing and removed Edelman as vice president of the LLC. Under Fifth Circuit precedent (In re Bennett and In re Harwood), the type of control exercised by Edelman as an officer of the general partner was sufficient to give rise to a fiduciary relationship with the limited partnership. The court found that Edelman breached his fiduciary duties of loyalty and care by: (1) occupying a condominium unit owned by the limited partnership without a lease and without paying rent; (2) authorizing the payment of illegal commissions to his wife (who was not a licensed real estate broker or sales person) for her efforts on the sale of condominium units by the limited partnership; and (3) improperly authorizing and directing certain draws on the limited partnership’s line of credit and deposit of the funds into the account of another entity.


The debtors, John and Deborah Lau, were in the real estate business, and the plaintiffs sought a determination that the Laus’ debts for the plaintiffs’ losses in real estate ventures managed by the Laus were nondischargeable on various grounds, including as debts arising from fraud or defalcation in a fiduciary capacity. The plaintiffs’ claims related to their investments in the acquisition of a tract of land in Melissa, Texas (the “Melissa Property”) and the development of a tract of land in Denton County, Texas (the “Craver Ranch”). John Lau, as managing member of JNC Partners, LLC (“JNC”), accepted $600,000 from the plaintiffs and agreed to hold the funds until it was determined how to allocate and apply the funds between the Melissa Property and the Craver Ranch. Deborah Lau was also a manager of JNC and was active in its business operations. Once it was determined how much the plaintiffs were investing in each property, Melissa Fourteen, Ltd., a limited partnership, was formed for the acquisition of the Melissa Property. JNC became the general partner of the limited partnership, and the plaintiffs became limited partners. The limited partnership agreement provided that title to the Melissa Property would be taken in the limited partnership, but John Lau, as managing member of JNC, acquired the Melissa Property in the name of JNC. Thereafter, John Lau, as managing member of the managing general partner of the limited partnership, issued capital calls to the plaintiffs based on false representations regarding the partnership and its financial needs. The capital infusions were diverted by John Lau for his own business purposes and those of JNC. JNC eventually sold the Melissa Property and satisfied JNC’s indebtedness and that of the Laus on their guaranties. The plaintiffs received no return on their investments in the Melissa Property. The court discussed the fiduciary duty of a general partner to the limited partnership and its limited partners under Texas law, relying on opinions of Texas courts.
of appeals and federal courts applying Texas law. The court went on to address fiduciary duties in a “two-tiered partnership arrangement,” concluding that John Lau stood in a fiduciary relationship with Melissa Fourteen, Ltd. and its limited partners because he was the managing member of the managing general partner. The court concluded that the amount of the plaintiffs’ initial investment designated for investment in the Melissa Property and the amounts provided by the plaintiffs pursuant to the capital calls made by John Lau were debts for both fraud and defalcation by John Lau while acting in a fiduciary capacity and as such were excepted from discharge. Additionally, the court concluded that Deborah Lau knowingly participated in her husband’s breach of fiduciary duty and ratified the breach of duty by knowingly accepting the benefits derived from the breach. Thus, Deborah Lau’s liability for these debts was excepted from discharge as well.

John and Deborah Lau were the sole members of JNC Partners Denton, LLC (“JNC Denton”), which owned and sought to develop Craver Ranch. Part of the $600,000 investment of the plaintiffs was used to purchase interests in JNC Denton, and the plaintiffs became members of JNC Denton. John Lau exercised complete control over JNC Denton as the sole managing member. As the managing member of JNC Denton, John Lau issued capital calls, which were promptly paid by the plaintiffs. When the capital calls were made, John Lau supplied false information to the plaintiffs regarding the LLC, and the capital infusions made by the plaintiffs were diverted by John Lau for his own business purposes and those of JNC. The plaintiffs received no return on their investments in JNC Denton. The court concluded that John Lau breached his fiduciary duties to the LLC and its members. The court noted that Chapter 101 of the Texas Business Organizations Code, like the predecessor Texas Limited Liability Company Act, does not directly address the duties owed by LLC managers and members but provides that the company agreement of an LLC may expand or restrict duties, including fiduciary duties, and related liabilities that a member, manager, officer or other person has to the company or to a member of manager. The court stated that the statute thus implies that certain duties may be owed without defining them and allows the contracting parties to specify the breadth of those duties in the company agreement. The regulations of JNC Denton conferred on John Lau as the manager-member the power and authority to act on behalf of the company subject to limitations set forth in the regulations and “the faithful performance of the Managers’ fiduciary obligations to the Company and the Members.” Thus, the court concluded that John Lau stood in a fiduciary relationship to the plaintiffs as members of the LLC. The court stated that recognition of this fiduciary duty was consistent with the degree of control exercised by John Lau as the managing member. The court also concluded that John Lau’s representations and acts in connection with the capital calls were acts of fraud and constituted defalcations. The court noted that, for purposes of a “defalcation” under Section 523(a)(4) of the Bankruptcy Code, the United States Supreme Court recently rejected an objective recklessness standard in favor of a heightened culpability standard requiring “‘knowledge of, or gross recklessness in respect to, the improper nature of the relevant fiduciary behavior.’” Because John Lau’s debts to the plaintiffs arose from fraud and defalcation in a fiduciary capacity they were excepted from discharge. Additionally, the court concluded that Deborah Lau knowingly participated in her husband’s breach of fiduciary duty and ratified the breach of duty by knowingly accepting the benefits derived from the breach. Thus, Deborah Lau’s liability for these debts was excepted from discharge as well.


The plaintiff, a litigation trust, alleged claims against the CEO of the debtor LLC for approving a wrongful distribution and for breach of fiduciary duty. The CEO sought summary judgment on the wrongful distribution claim on the basis that it was barred by the Georgia two-year statute of limitations, but the court concluded that North Carolina had the most significant relationship to the transaction at issue even though the LLC was a Georgia LLC. The LLC had no apparent relationship to Georgia other than being formed under Georgia law, and the CEO admitted that the LLC’s principal place of business was in North Carolina where he worked and that the injury flowed from an agreement executed in North Carolina with another party that was headquartered in North Carolina. The CEO also sought summary judgment on the plaintiff’s breach of fiduciary duty claims. The court stated that both Georgia and North Carolina appear to have followed the lead of Delaware in adopting the standard theories of corporate director liability, including the duties of loyalty, care, and good faith, and the business judgment rule. The court also noted that North Carolina follows the traditional rule that the business judgment rule does not apply to self-dealing or conflicted directors. The CEO contended that he was protected by both an exculpation clause in the LLC agreement and the business judgment rule. The exculpation clause provided that the board members, officers, and directors of the LLC were not liable for damages for actions taken on behalf of the LLC unless those actions were performed fraudulently or constituted gross negligence or willful misconduct. Thus, he argued he could not be liable for making a reasonably informed decision to approve the transaction at issue on behalf of the LLC. The CEO argued that he was at most negligent and did not act with the heightened state of mind required under the exculpation clause to hold him liable. The court concluded, however, that the summary judgment record raised substantial questions as to whether the CEO, a self-interested director with a
financial stake in the transaction, could even take advantage of the exculpation clause or the business judgment rule. Assuming he could, the court said there were factual disputes as to whether he was merely negligent or something more. The CEO was not entitled to summary judgment on the breach of fiduciary duty claims by simply professing in an affidavit that he acted in good faith.


[Note regarding the oppression doctrine relied upon in this case: On June 20, 2014, the Texas Supreme Court issued its opinion in _Ritchie v. Rupe, _ S.W.3d __ (Tex. 2014), in which the court (1) rejected the “reasonable expectations” and “fair dealing” tests for oppression, (2) held that a rehabilitative receivership is the only remedy for oppression under Section 11.404 of the Texas Business Organizations Code, and (3) declined to recognize a common-law cause of action for oppression.]

In 1996, Jacob Kohannim (“Jacob”) and Mike Khosravikatoli (“Mike”) formed an LLC to purchase and hold real property on which a corporation owned by them operated a restaurant. Jacob and Mike were the managers and each owned a 50% interest in the LLC. The member agreement contained transfer restrictions that provided the LLC and the other member the opportunity to purchase a member’s interest in the event of a proposed sale of the interest or a transfer to a member’s spouse in a divorce. In 2003, Mike’s wife, Parvenah, filed for divorce, and the divorce court issued temporary orders prohibiting Mike and Parvenah from transferring assets. During the pendency of the divorce, Mike purported to transfer a 5% interest in the LLC to Jacob. In 2005, the divorce decree was entered. In the divorce decree, the district court found the transfer was void because it was an attempt to transfer community property in violation of the court’s order enjoining such a transfer. The divorce decree further awarded to Parvenah “[o]ne hundred percent (100%) of the husband’s interest” in the LLC, “which interest is equivalent to a fifty percent (50%) interest in such company.” The decree required the husband to execute and deliver to the wife’s attorney a stock transfer certificate and/or assignment of interest. Before the divorce decree was entered, Jacob closed an LLC bank account and transferred $160,000 in the account to the restaurant’s bank account as a “payment to owner.” After the divorce decree was entered, Parvenah’s attorney raised with Jacob the issue of the $160,000 payment and demanded a meeting for an accounting and to discuss management of the LLC. The following month, Jacob advised Parvenah that he intended to start the process of determining the value of the LLC for purposes of the buyout provision in the member agreement. Jacob never consented to Parvenah’s admission as a member. At the end of 2005, Jacob’s attorney informed Parvenah that she had no right to vote at an upcoming meeting regarding Jacob’s compensation and that Jacob intended to vote his 55% interest in favor of a $50,000 payment to him as compensation for his services in 2005. Jacob received the $50,000 payment over Parvenah’s objections. In 2006, Parvenah sued Jacob and the LLC, seeking a declaration of her rights with respect to the LLC and the validity of the member agreement and asserting claims based on constructive fraud, breach of fiduciary duty, oppression, waste, gross mismanagement and abuse of control, and unjust enrichment. The trial court appointed a receiver for the LLC and ordered the receiver to sell the LLC’s assets. The trial court eventually approved a sale of the LLC’s property for $1,300,100. The trial court’s final judgment contained findings as to the amount of assets held by the receiver and how the assets should be divided based on the court’s finding that Jacob and Parvenah each held a 50% beneficial interest in the assets. The trial court also found that Jacob, with malice and intent to defraud, engaged in wrongful acts and omissions that damaged Parvenah by decreasing the value of Parvenah’s interest in the LLC, and the trial court awarded Parvenah actual and punitive damages based on the wrongful acts and omissions. Jacob appealed on numerous issues but did not challenge the trial court’s division of the LLC’s assets.

The court of appeals sustained Jacob’s challenge to Parvenah’s recovery for breach of fiduciary duty. Although the trial court’s conclusions of law stated that Jacob owed a fiduciary duty to the LLC and breached that duty, the trial court did not make Parvenah’s requested findings that Jacob owed Parvenah a fiduciary duty or that he breached that duty. Thus, the court of appeals held that Parvenah could not recover for her breach of fiduciary duty cause of action.

The court of appeals also held that Parvenah could not recover on her fraud and constructive fraud claims. She failed to plead a cause of action for actual fraud, and the court concluded the issue of actual fraud was not tried by consent. With respect to Parvenah’s constructive fraud claim, the court of appeals held that Parvenah could not recover because constructive fraud is premised upon the existence of a breach of fiduciary duty, and the trial court refused to find that Jacob owed Parvenah a fiduciary duty and that he breached that duty.

The court of appeals rejected Jacob’s challenge to the legal sufficiency of the evidence to support Parvenah’s oppression claim. The court of appeals stated that “a member oppression claim may exist when: (1) a majority shareholder’s conduct substantially defeats the minority’s expectations that objectively viewed, were both reasonable under the circumstances and central to the minority shareholder’s decision to join the venture; or (2) burdensome, harsh, or wrongful conduct, a lack of probity and fair dealing in the company’s affairs to the prejudice of some members, or a visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts
his money to a company is entitled to rely." Jacob contended that an oppression claim can only be asserted by a minority member or shareholder, and Jacob conceded that Parvenah owned a 50% interest. The court of appeals rejected the argument that only a minority owner may assert an oppression claim because the receivership provisions of the Texas Business Organizations Code provide for appointment of a receiver for a Texas entity based on oppression by the directors or "those in control" of the entity. The court of appeals went on to examine whether there was any evidence of oppressive acts. Jacob argued that there was no evidence that he oppressed Parvenah’s rights by refusing to allow her to participate in management given that she was not a member. The court explained that a membership interest is personal property and that Mike’s 50% membership interest was community property awarded in its entirety to Parvenah under the divorce decree. Mike executed a document transferring and assigning the membership interest to Parvenah as required by the divorce decree, but the assignment of the interest did not include the right to participate in management under the Texas Business Organizations Code. Under the LLC provisions of the Texas Business Organizations Code, the right to participate in management is not community property, and assignment of a membership interest does not entitle the assignee to participate in the management and affairs of the LLC, become a member, or exercise any rights of a member. An assignee is entitled to become a member only with the approval of all of the members, and Jacob never consented to Parvenah becoming a member. Thus, she did not have any right to participate in the management of the LLC. Jacob next contended that there was no evidence that he oppressed Parvenah’s rights by failing to make distributions to her. The LLC’s regulations (i.e., company agreement) provided for quarterly distributions to members of "available cash" provided available cash was not needed for reasonable working capital reserves. The Texas Business Organizations Code provides that an assignee is entitled to receive any distribution the assignor is entitled to receive to the extent the distribution is assigned. Because the district court awarded the entire community interest to Parvenah, she had a right to receive distributions. The district court found that Jacob paid himself for services that were not performed and that he failed to make any distributions to Mike or Parvenah even though $250,000 in undistributed profits had accumulated since the mortgage on the LLC’s property was paid off. The court of appeals concluded this was some evidence supporting the trial court’s finding that Jacob failed to make profit distributions. The court also agreed that the established facts demonstrated that Jacob engaged in wrongful conduct and exhibited a lack of fair dealing to the prejudice of Parvenah.

Jacob challenged the legal sufficiency of the evidence to support the actual and punitive damages award. Because the court of appeals sustained Jacob’s challenges to Parvenah’s other causes of action, the only viable cause of action to support a damage award was the shareholder/member oppression claim. The court of appeals stated that the standard of review on this issue was not the traditional sufficiency analysis as asserted by Jacob, but rather was abuse of discretion because the receivership provision of the Texas Business Organizations Code that provides for an oppression action authorizes a court to fashion an equitable remedy if the acts of those in control of an entity are oppressive. The court of appeals concluded that the trial court’s methodology for finding actual damages was not an abuse of discretion. The trial court calculated Parvenah’s damages by calculating the difference between the value of the LLC’s assets at the time of the trial court's judgment in this case and the value of the LLC at the time of the divorce, increased by the amount taken from the LLC’s bank account by Jacob before the divorce decree. The court of appeals rejected Jacob’s argument that the trial court erred by adding back the amount taken from the LLC’s bank account prior to the divorce. Because Jacob’s removal of the LLC’s funds reduced the value of Parvenah’s interest, the court of appeals concluded the trial court did not err by adding that amount back into the value of the LLC. Next the court of appeals rejected the argument that the member agreement required the LLC to be valued as of the date of the divorce petition. The court of appeals stated that the trial court found that the member agreement did not apply to Parvenah. Assuming it did apply to Parvenah, the court of appeals stated that it was inapplicable here because Jacob did not comply with the provision addressing a buyout on divorce by intervening in the divorce proceeding to enforce the provision. Mike had agreed to the intervention, but Jacob did not do so. Jacob next argued that the LLC regulations provided that the valuation of Parvenah’s interest must be based on book value because the regulations contained a provision for purchase of a member’s interest at book value or appraised value on request of a party who deems the book value to vary from market value by more than 20%. The provision of the regulations relied upon by Jacob addressed death, dissolution, retirement, or bankruptcy of a member. The court stated that the provision did not address how damages are calculated in a lawsuit based on oppression, and the court relied on other case law in which the court in an oppression action concluded that it was not an abuse of discretion to order a buyout for fair value when a buy-sell agreement provided for redemption at book value. The court of appeals pointed out that receivership is one remedy for shareholder/member oppression and that the trial court ordered a receivership and authorized a sale of the LLC’s assets. Jacob did not complain concerning the receivership or sale. However, the court concluded that Parvenah was not limited to a recovery of her proportionate share of the sale proceeds and that courts have equitable powers to fashion appropriate remedies for oppressive conduct, including a buyout. Here, the court concluded that sufficient evidence supported the values found.
by the trial court and that Jacob did not argue, and the court of appeals did not perceive, that the trial court’s methodology constituted an abuse of discretion. The court of appeals sustained Jacob’s challenge to punitive damages because the only causes of action that could support a punitive damages award were actual fraud and breach of fiduciary duty.


Sumer Pinglia sued Jaikishin and Nanik Bhagia alleging various wrongful acts in connection with two transactions involving certain apartment complexes. Pinglia and the Bhagias formed Woodbridge Properties, LLC (“Woodbridge”) in connection with the acquisition of the Taft Circle Apartments, which Pinglia and the Bhagias acquired at a tax foreclosure sale and then transferred to Woodbridge. Woodbridge sold the Taft Circle Apartments a few years later, and Pinglia alleged that the Bhagias withheld a portion of the purchase price owed to Pinglia in addition to overcharging Pinglia for his share of property taxes and failing to remit to Pinglia a portion of a payment received when the former owner redeemed a portion of the property. Pinglia and the Bhagias were also involved in another transaction involving the Sandalwood Apartments. Pinglia was the managing member and general partner of Heritage Gulf Coast Properties, Ltd. (“Heritage Ltd.”), which acquired the Sandalwood Apartments from Sandalwood Apartments, Inc. (“Sandalwood Inc.”). The Bhagias were officers, directors, and shareholders of Sandalwood Inc., and Pinglia and Heritage asserted claims against the Bhagias and Sandalwood Inc. based on an alleged promise by Sandalwood Inc. to subordinate its first lien on the property and alleged fraudulent misrepresentations and omissions about the property. The trial court granted summary judgment against Pinglia on certain claims, including a claim by Pinglia for breach of fiduciary duty in connection with the Sandalwood Apartments. After trial, the court signed a final judgment in which Pinglia was awarded damages from the Bhagias for breach of fiduciary duty pertaining to the Taft Circle Apartments but took nothing on all other claims. On appeal, Pinglia argued that the trial court erred in rendering summary judgment against him on his breach of fiduciary duty claim against the Bhagias in connection with the Sandalwood Apartments transaction. Pinglia conceded that there was no formal fiduciary relationship created with the Bhagias in the Sandalwood Apartments transaction but argued there was evidence of an informal fiduciary relationship. Pinglia argued that he and the Bhagias had a pre-existing and contemporaneous fiduciary relationship relative to the Taft Circle Apartments and that they were partners at all times with respect to the Taft Circle Apartments because they initially agreed to share equally in the purchase price, profits, and losses, and this arrangement continued when they transferred the property to Woodbridge, although it was an LLC. Pinglia pointed out that the jury found the Bhagias and Pinglia were fiduciaries as to the Taft Circle Apartments, but the court of appeals noted that this finding was not relevant to whether the trial court erred in granting summary judgment on the breach of fiduciary duty claim relative to the Sandalwood Apartments based on the summary judgment evidence before the court at that time. Regardless of any fiduciary relationship with respect to the Taft Circle Apartments, the court of appeals stated that Pinglia failed to present any evidence that the circumstances surrounding the Sandalwood Apartments transaction justified imposing a fiduciary relationship. It was undisputed that the nature of the relationship in the Taft Circle Apartments transaction was different from that in the Sandalwood Apartments transaction. The court stated that Pinglia and the Bhagias worked together as partners in the Taft Circle Apartments transaction to purchase and develop the property and share in expenses, profits, and losses. In contrast, the Sandalwood Apartments transaction involved a buyer-seller and financing relationship. The parties structured the transaction between two entities, Heritage Ltd. and Sandalwood Inc., that were not involved in the Taft Circle Apartments. The court rejected Pinglia’s suggestion that a fiduciary relationship will necessarily be imposed in a transaction if a fiduciary relationship existed before and apart from the transaction in question. “[W]here evidence that Pinglia and the Bhagias may have had a fiduciary relationship in connection with the Taft Circle Apartments was insufficient to create a fiduciary relationship between any of the parties in the Sandalwood Apartments transaction.” Thus, the trial court did not err in determining that Pinglia presented no evidence of a fiduciary relationship with respect to the Sandalwood Apartments transaction and granting summary judgment on his claim for breach of fiduciary duty.


In this adversary proceeding, an LLC and two of its members sought a determination that debts to them arising from activities of the debtor, Hardee, while he was managing member of the LLC were nondischargeable in Hardee’s bankruptcy. The plaintiffs alleged that Hardee’s debts to them were nondischargeable on the basis that the debts were obtained by actual fraud or false representations or as debts arising from a defalcation by a fiduciary and/or embezzlement. The court granted a partial summary judgment in favor of the LLC on the basis that the summary judgment evidence established that Hardee owed a debt to the LLC arising from the unauthorized diversion of corporate funds and that the debt was nondischargeable as a debt arising out of a defalcation by a fiduciary or embezzlement. The
issue of the amount of the debt was reserved for trial. After the trial, the court concluded that a debt to the LLC representing over $250,000 in embezzled funds was nondischargeable as a debt arising from a defalcation and embezzlement, and a debt to the LLC of approximately $248,000 arising from Hardee’s failure to tender employment taxes owed to the IRS was nondischargeable as a debt arising from a defalcation by a fiduciary. The court concluded, however, that the two members who sought an exception to Hardee’s discharge failed to establish that Hardee was in a formal or informal fiduciary relationship with them as would be required to render the debt to them for the unpaid tax liabilities nondischargeable as arising out of a defalcation by a fiduciary, and the members failed to establish that their initial investments in the LLC were procured by actual fraud or false representations so as to support an exception to discharge with respect to the amount of their investments.

The court’s opinion consists of findings of fact and conclusions of law after the trial in the adversary proceeding. The parties agreed to the basic facts of the case. ETRG Investments, LLC was a Texas limited liability company formed in 2005 for the purpose of owning and operating restaurants in Arkansas. Tomlin and Scott were individuals who resided in Georgia and invested as members in the LLC. Hardee, the debtor in this bankruptcy proceeding, was also a member of the LLC and resided in Texas. Although Hardee invested no money in the LLC, he held the title of “Managing Member” of the LLC from its inception until December 2008. The LLC paid Hardee a yearly salary. In September 2006, the LLC obtained a loan in the amount of $350,000. Hardee sent falsified financial statements via email to the LLC investors to conceal his taking of LLC funds in excess of his compensation for personal purposes. In December 2010, the LLC, Tomlin, and Scott filed a lawsuit against Hardee. The lawsuit was stayed when Hardee filed for relief under Chapter 7 of the Bankruptcy Code in March 2011. In October 2011, Hardee was charged with and pled guilty to the federal crime of wire fraud. Hardee listed the LLC, Tomlin, and Scott as creditors in his bankruptcy filings. Hardee admitted that he was responsible for the LLC’s tax matters, wrote checks on behalf of the LLC, and sent letters to potential investors of the LLC, and that the LLC’s regulations (i.e., company agreement) required him to obtain unanimous consent from the LLC’s members prior to incurring any indebtedness of $100,000 on behalf of the LLC.

In additional findings of fact, the court determined that Hardee embezzled significant sums of money from the LLC and that his breaches of fiduciary duty included entering into an unauthorized lending relationship, not properly managing the LLC’s affairs by diverting funds, and not tendering required tax payments to the IRS on behalf of the LLC. The failure to tender the required tax payments also clearly breached the regulations (i.e., company agreement) of the LLC. The court determined the amount of the debt arising from Hardee’s embezzlement of money from the LLC to pay personal expenses, obtain excessive expense reimbursements, and otherwise receive compensation in amounts in excess of what he was authorized to receive was $253,331. The court found that the tax debt owed by the LLC to the IRS remained in flux but was at least $248,000. The court found that Hardee, as the sole person authorized to transact business and direct the financial activities of the LLC, including the payment of tax obligations, acted as an agent of the LLC and as such had a formal fiduciary relationship. The failure to tender the tax payments was a willful breach of duty and thus a defalcation while acting in a fiduciary capacity. As for Hardee’s relationship to the other plaintiffs, Tomlin and Scott, the court found that these members failed to establish that Hardee had a formal fiduciary relationship with them. The company agreement governing the LLC did not impose or even address any fiduciary duties owed by and among the LLC members. Furthermore, the court found that Tomlin and Scott failed to establish that Hardee had an informal fiduciary relationship with them or a trust relationship that existed prior to the creation of the tax obligations at issue that would create fiduciary duties to the members.

In its conclusions of law, the court addressed the nondischargeability of debts arising from breach of fiduciary duties. The court addressed the concept of a fiduciary under federal bankruptcy law and the requirement that the relationship amount to a “technical” or “express” trust. The court then proceeded to set forth numerous conclusions of law regarding fiduciary duties as they related to this proceeding. The Texas Business Organizations Code, which governs LLCs, does not directly address or define the duties owed by managers and members but implies that certain duties may be owed and allows the contracting parties to specify the breadth of those duties in the LLC agreement. One type of fiduciary relationship recognized under Texas law is a formal fiduciary relationship that arises as a matter of law and includes relationships between principal and agent. An agent has authority to transact business or manage some affair for another person or entity and owes a duty of care. Texas law also recognizes that a fiduciary relationship exists between corporate officers or directors and the corporation they serve, and one of the duties imposed on corporate management is a duty of care that requires diligence and prudence in the management of the corporation’s affairs. Although LLCs are not corporations in the strictest sense, Texas law implies that the fiduciary status of corporate officers and directors and their corresponding duties of care, loyalty, and obedience apply to managers and/or members governing the activities of an LLC. Thus, imposition of fiduciary duties on the management of an LLC under Texas law is appropriate and warranted, and Hardee acted in a fiduciary capacity as to the LLC. Breach of Hardee’s fiduciary duties required a willful neglect of duties owed, which is measured objectively by reference to what a reasonable person in the
exist when fiduciaries have become adverse parties in litigation, and the court did not foreclose the possibility that, under ordinarily accompany a fiduciary relationship, but the court stated that it need not parse out what, if any duties, may still acknowledged that the very nature of litigation dictates that adverse litigants cannot be saddled with all duties that might parties were adverse litigants when they executed the release also supported its enforceability. In a footnote, the court same respect as that of other parties. Although not expressly a Forest Oil factor, the court stated that the fact that the parties were adverse litigants when they executed the release also supported its enforceability. In a footnote, the court acknowledged that the very nature of litigation dictates that adverse litigants cannot be saddled with all duties that might ordinarily accompany a fiduciary relationship, but the court stated that it need not parse out what, if any duties, may still exist when fiduciaries have become adverse parties in litigation, and the court did not foreclose the possibility that, under


The managing member of a Delaware LLC sued the other members for rescission of a settlement agreement that contained broad mutual release provisions relative to various claims, including “fraud in the inducement” of the agreement. The trial court instructed the jury that the fraudulent inducement claim was not barred by the release, and the jury found that at least one of the defendant members fraudulently induced the managing member into signing the settlement agreement. The trial court concluded the fraudulent-inducement release was unenforceable because the parties were fiduciaries under Delaware law and the settlement agreement was not an arm’s length transaction. The trial court further concluded that a fraudulent-inducement release is only enforceable between fiduciaries if they first contractually disavow their respective fiduciary duties. Thus, the trial court ordered rescission of the settlement agreement. On appeal, the defendant members argued that the trial court erred by excluding the parties had a fiduciary relationship and by rescinding the settlement agreement because the fraudulent-inducement release was enforceable even if the parties were fiduciaries. The court of appeals analyzed the release at issue and concluded that it met the “clear and unequivocal intent” requirement relative to extra-contractual fraud and that there was no misrepresentation in the settlement agreement. With respect to the extrinsic Forest Oil factors that must be considered in determining enforceability of a fraudulent-inducement release, the managing member contended, among other arguments, that the release did not satisfy the “arm’s length” factor. In analyzing this factor, the court of appeals assumed, without deciding, that the parties had a fiduciary relationship relative to the operation of the LLC and performance of a related agreement involved in the dispute. (The defendant members argued that a provision in the related agreement contractually disclaimed a fiduciary relationship among the members.) The parties also disputed whether they still owed each other any fiduciary duties during the negotiation and execution of the settlement agreement and thus whether it was an arm’s length transaction. The defendant members argued that the parties no longer owed each other any fiduciary duties because they had become adverse litigants. The managing member cited Delaware and Texas cases for the proposition that fiduciaries continue to owe each other duties even when their relationship becomes adverse. The court of appeals refused to adopt a blanket rule that a fraudulent-inducement release in a settlement agreement between fiduciaries is unenforceable. Thus, even if execution of the settlement agreement was not entirely an arm’s length transaction because some fiduciary duty to disclose was owed by the defendant members, the fiduciary relationship did not automatically vitiate the release. The court stated that fiduciaries, like other business associates, might wish to ensure finality to their disputes and that their expressed intent to do so by means of a fraudulent inducement release or disclaimer of reliance should be accorded the same respect as that of other parties. Although not expressly a Forest Oil factor, the court stated that the fact that the parties were adverse litigants when they executed the release also supported its enforceability. In a footnote, the court acknowledged that the very nature of litigation dictates that adverse litigants cannot be saddled with all duties that might ordinarily accompany a fiduciary relationship, but the court stated that it need not parse out what, if any duties, may still exist when fiduciaries have become adverse parties in litigation, and the court did not foreclose the possibility that, under
certain circumstances, existence of a fiduciary relationship may vitiate a fraudulent-inducement release even if the parties have become adverse litigants. The court stated that it was merely concluding that, under the circumstances in this case, the managing member could not reasonably rely on the defendant members to protect its interests relative to the fraudulent-inducement release. The court of appeals rejected the trial court’s reasoning that the parties were required to contractually disavow their fiduciary duties to execute an enforceable fraudulent-inducement release. Rather, a court should focus on determining whether the fraudulent-inducement release is enforceable, notwithstanding the existence of a fiduciary relationship, based on all the circumstances. Considering all the *Forest Oil* factors, the court of appeals concluded that, despite any fiduciary relationship, sophisticated parties, represented by their own counsel, negotiated and voluntarily agreed to clear and unequivocal mutual release provisions releasing any claim for fraudulent inducement of the settlement agreement. Thus, the fraudulent-inducement release in this case was enforceable, and the trial court erred by granting rescission.


The debtor brought this action against her ex-husband and others to recover her share of royalty payments on royalties owned by Artist Rights Foundation L.L.C., a California LLC of which she was a 25% owner. Jackson, another member, joined the debtor in this action. In a previous opinion, the bankruptcy court concluded that the ex-husband, Raul Galaz, lacked authority to transfer the royalties on behalf of the LLC and that the transfer was thus void and unenforceable. The court also determined that the transfer was a fraudulent transfer made with actual fraudulent intent and that Galaz breached his fiduciary duties owed to the LLC and Jackson. (Because the debtor was only an assignee, the court determined that fiduciary duties were not owed to her.) In this opinion after remand on the damages issue, the court determined that exemplary damages were appropriate in connection with Galaz’s breach of fiduciary duty to the LLC and Jackson. The California LLC statute provides that a managing member owes fiduciary duties of loyalty and care to the other members and the LLC. Galaz breached his fiduciary duties of loyalty and care through his failure to account for the property and profits derived from the business of the LLC, the perpetration of an intentional fraud to secure royalties for his own benefit, and the wrongful dissolution of the LLC after making the transfer. In breaching his fiduciary duties of loyalty and care, he acted with malice. As a law school graduate, convicted felon, and disbarred attorney with experience in entertainment law, he knew the impropriety of his actions. By acting with full knowledge of the impropriety of his actions, he acted with a specific intent to harm Jackson and the LLC. Thus, an award of exemplary damages for Galaz’s malice in connection with his breach of fiduciary duty was proper under the provisions of the Texas Civil Practice and Remedies Code.


Vejara and another individual formed a company to create and distribute an energy drink called “Bulls Eye.” Vejara secured the start-up capital to produce the drink as well as additional assets, such as two company vans to be used to distribute the drink. Vejara and her co-founder each owned a 50% interest in the company. Needing additional funding, Vejara sought investors. In December 2009, Vejara met Gama, managing member of Levior International, LLC (collectively “Levior”). Levior wanted to become a distributor of Bulls Eye. On March 25, 2010, Vejara became the sole owner of the company by acquiring the 50% interest owned by her co-founder. On April 21, 2010, Vejara and Levior entered into a company agreement relating to the ownership of the company, which became Bulls Eye Beverages, LLC. Under the agreement, Vejara owned 30% and Levior owned 70% of the LLC. On April 30, 2010, LeVior removed Vejara as president of the LLC, and Gama appointed himself as the LLC’s president. The energy drinks and two company vans were stored in a warehouse. When Vejara was removed as president of the LLC, the warehouse owners denied Levior access to the merchandise and vans in storage on the basis that the warehouse signed a lease agreement with Vejara and past due rent was owed. Vejara refused to assist Levior in obtaining access to the merchandise in the warehouse and retained possession of the keys to the two company vans. In 2012, Vejara and Levior entered into a settlement agreement regarding their dispute over the LLC, which stipulated that the company agreement was operative and that Vejara would give Levior complete and unrestricted access to the LLC’s records and inventory, including the vehicles used for distributing the energy drink. Vejara later repudiated the settlement, claiming it was obtained by fraud. Levior filed suit against Vejara alleging Vejara breached the settlement agreement and her fiduciary duty to Levior. Vejara counterclaimed for fraud. The jury returned a verdict in favor of Levior on its breach of contract and breach of fiduciary duty claims and awarded Levior damages on the breach of contract finding, on which the trial entered judgment. The jury found in favor of Vejara on her fraud claim, but the trial court granted Levior’s motion for judgment notwithstanding the verdict on this issue.
Appearing pro se on appeal, Vejara alleged that the jury erred in finding that she breached a fiduciary duty and that the trial court abused its discretion by not reversing the jury’s decision on Levior’s breach of fiduciary duty claim. The appellate court construed Vejara’s complaint as a challenge to the existence of a fiduciary duty as a matter of law and as a legal and factual sufficiency challenge to the jury’s finding that she breached her fiduciary duty to Levior. To recover for breach of fiduciary duty, a party must typically show the existence of a fiduciary relationship, the breach of a fiduciary duty, and resulting injury. Vejara argued that she owed no fiduciary duty to Levior because she was only a minority “shareholder” of the LLC. (The court referred to the owners or members of an LLC as “shareholders” throughout its opinion.) In the jury charge, the trial court asked the jury if Vejara complied with her fiduciary duty to Levior and then went on to instruct the jury that in order to find Vejara breached her fiduciary duty, Levior had to show one of a list of actions by Vejara that constituted a breach. The first part of the jury question presupposed the existence of a fiduciary relationship between Vejara and Levior, and Vejara failed to object to the charge or request additional instructions. Because Vejara did not object to the omission of a question or instruction on the existence of a fiduciary duty or to the court’s presupposition of the existence of a fiduciary duty, the appellate court held that Vejara waived her right to raise this complaint on appeal. The court of appeals went on to hold that the record showed the existence of a fiduciary duty on Vejara’s part even if Vejara did not waive her right to complain about the existence of a fiduciary duty. The appellate court agreed that Vejara, as a minority shareholder of the LLC, did not owe a formal fiduciary duty to Levior as a matter of law since Texas does not recognize a broad formal fiduciary relationship between majority and minority shareholders in closely held companies. However, the court pointed out that Texas courts have recognized that the nature of the relationship between shareholders of an LLC may give rise to an informal fiduciary duty between the shareholders. The court characterized Allen v. Devon Energy as holding that a majority shareholder owed a fiduciary duty to a minority shareholder due to the operating control the majority shareholder had over the company, which gave him intimate knowledge of the company’s daily affairs and plans. Here, although not a majority shareholder, Vejara exhibited the same type of control and had intimate knowledge of the LLC’s business affairs. Vejara created the company, entered leases on behalf of the company, held keys to the company’s vans, and had exclusive access to the company’s inventory held in storage. The appellate court concluded that Vejara’s control and intimate knowledge of the LLC’s affairs and plans gave rise to the existence of an informal fiduciary duty to Levior. Vejara argued that if a fiduciary relationship existed, there was insufficient evidence to show she breached her fiduciary duty to Levior. The court of appeals stated that the record reflected that Vejara failed to act in the utmost good faith toward Levior when she refused to facilitate Levior’s gaining access to the LLC’s inventory in the warehouse and withheld the keys to the company’s vans. Vejara’s actions prevented Levior from selling the energy drink, entering into contracts, and fulfilling the LLC’s obligations to distributors. Thus, the court of appeals concluded there was sufficient evidence to support the jury finding that Vejara breached her fiduciary duty to Levior and that the breach caused Levior injury. Vejara did not properly preserve her issues for appeal regarding the breach of contract claim, so the court of appeals overruled her issues in that regard. The court of appeals affirmed the judgment notwithstanding the verdict against Vejara on her fraud claim as there was no evidence that Levior committed fraud. Thus, the appellate court affirmed the judgment against Vejara.


The bankruptcy court found that the defendant in this adversary proceeding breached a fiduciary duty to the debtor LLC. The LLC was a family-owned LLC in which the defendant was not formally issued a membership interest or given an office to avoid entangling the family business with unrelated legal problems of the defendant and to protect the family from any negative ramifications that might arise from any known association with the defendant. The formal members of the LLC were a family limited partnership, the defendant’s sister, and his sister’s two sons, and the family was willing to provide the defendant a covert income stream. When the defendant’s sister was injured and could no longer provide day-to-day supervision of the business, the plan to conceal any involvement of the defendant was altered, and the defendant’s father (who served as chairman of the LLC) and sister requested that the defendant take direct managerial control of the business. The defendant had no written employment or consulting agreement but received authorized compensation for his management services. Eventually, the defendant was terminated by his sister after an internal audit revealed he had misappropriated a significant amount of funds from the LLC in her absence. The court found that the defendant owed a formal fiduciary duty to the LLC because he was an agent of the LLC. A principal-agent relationship is a fiduciary relationship, and the critical element of an agency relationship is the principal’s right to control the agent. An agency relationship may be established by circumstantial evidence. In addition, the court found that the circumstances giving rise to the managerial control gave rise to an informal fiduciary duty pursuant to which the defendant was required to place the interest of the LLC above his own. An informal fiduciary relationship is a confidential relationship that may arise from moral, social, domestic, or personal relationships in which one person trusts
in and relies on another. Based on the defendant’s repeated breaches of fiduciary duty, the trustee was entitled to actual damages and a constructive trust over a residence obtained by the defendant with funds he unlawfully diverted from the LLC.


Haut, a minority shareholder of a corporation and minority member of an LLC, was found liable for breach of fiduciary duty to the companies, and the trial court ordered equitable forfeiture of his ownership in the companies. On appeal, Haut argued that he owed no formal or informal fiduciary duty to the companies as a matter of law and that the trial court erred in ordering the remedy of equitable forfeiture. The court of appeals affirmed the judgment of the trial court.

The dispute in this case centered around Haut’s participation in the organization and operation of Green Café Management, Inc. (“GCM”), a corporation formed to franchise “Ruggles Green” restaurants, and Alabama Green, LLC (“Alabama Green”), an LLC to whom a Ruggles Green franchise was sold. Marques, Molzan, and Guillerman developed the concept of the first green restaurant in Houston, and Marques discussed the business plan with Haut, whom he had known as a business acquaintance and friend for about ten years. Haut participated in discussions with the group about the structure and operation of the business as the concept took shape, and Haut eventually drafted legal documents, including a GCM shareholders’ agreement, franchise agreement between GCM and Alabama Green, and operating agreement for Alabama Green. All the parties knew that Haut was in law school at the time and was not a licensed lawyer, and Haut claimed Marques told him an attorney would review the documents when they were finalized. Marques disputed this and testified that Haut was very insistent about what the law required and how things should be done. Marques testified that Haut insisted the business should be structured as a franchise although the others were opposed to that approach initially. Haut characterized his advice as “business” or “financial” rather than legal advice. He claimed that he paid $300 for this shares in GCM and $100 for his membership interest in Alabama Green, but he acknowledged that his interests were increased from 3% in each company to 10% in GCM and 5% in Alabama Green because he was “working so hard” to provide financial and legal services to the companies. Haut also acknowledged at trial that the others wanted to make sure they had exclusive control over the operation and management of the business, and Haut sent an email reassuring the group that there were “any number of legal maneuvers available to management to stifle investor interference” and the ‘law is on your side.’” Haut denied that this could properly be described as legal advice. He admitted that the final signed documents did not give Marques, Molzan, and Guillerman, the directors of GCM, exclusive authority over the management of Alabama Green. Marques testified that, among other things, Haut drafted the GCM shareholders’ agreement and the Alabama Green operating agreement to give Haut veto rights. After the restaurant opened for business, it lost money and Haut secretly contacted another investor who owned a 50% membership interest (which combined with Haut’s 3% interest would constitute a majority interest) and encouraged the investor to replace Molzan and Guillerman as managers. The investor did not agree and instead informed Molzan and Guillerman what Haut had said. Haut chose to cease participating in the business and informed the shareholders of GCM and members of Alabama Green that he would consider selling his interests in the companies. After the parties failed to reach an agreement to buy out Haut’s interests, Haut filed a lawsuit seeking access to books and records of the companies and damages for breach of contract by Alabama Green based on an agreement to issue him a “VIP Card” with a specified monthly amount of credit at the restaurant. The companies filed counterclaims, including claims for breach of fiduciary duty. The jury found a relationship of trust and confidence existed between Haut and the companies and that Haut breached his fiduciary duties to the companies. The trial court ordered that Haut forfeit his 10% share ownership in GCM and his 5% membership interest in Alabama Green.

On appeal, Haut first argued that the companies lacked standing to assert breach of fiduciary duty claims against him because the claims arose from the shareholders’ agreement and operating agreement among the owners and the companies suffered no injury. The court stated that Haut argued “without citation to authority that corporations ‘are indifferent to how shareholders divide rights among themselves,’ and therefore ‘any breach of fiduciary duty giving Haut more rights than co-shareholders harmed only co-shareholders,’ not the companies.” The court discussed the general rule that causes of action for injury to the corporation are vested in the corporation rather than individual shareholders and concluded that the companies’ allegations that they relied on Haut to perform legal services in exchange for equity in the companies, that Haut gave legal advice and drafted documents in a manner contrary to the companies’ interests and detrimental to their operations, and that Haut wrongfully attempted to oust the founders and managers shortly after the restaurant opened were sufficient to assert claims on behalf of the companies. The companies alleged that Haut’s wrongful acts impaired GCM and its ability to manage the franchise and thus directly harmed both companies. Additionally, GCM and Alabama Green were the parties to the franchise agreement, and GCM was a signatory to the
shareholders’ agreement. The claims included allegations regarding Haut’s legal advice concerning the structure of the business as well as the drafting of the agreements, and the companies were thus entitled to assert their claims directly against Haut.

Haut next argued that he owed no formal or informal fiduciary duty to either company as a matter of law. The only argument Haut made regarding informal fiduciary duty was that there was no trial evidence that Haut had a special relationship of trust and confidence prior to and apart from the agreements that were the basis of the suit. Because Haut designated only a partial record for appeal, the court of appeals said that it must presume the omitted evidence was relevant and supported the trial court’s judgment on the jury’s findings. Furthermore, the court stated that Haut’s argument lacked merit even if the partial record did not require the court to presume that the evidence supported the jury’s finding because Haut did not timely object to the trial court’s failure to include in the charge an instruction that a pre-existing relationship of trust and confidence was necessary to find a fiduciary relationship. The court also rejected Haut’s argument that the evidence did not support a finding that Haut breached his fiduciary duty.

Finally, Haut argued that the equitable remedy of forfeiture of his interests in the companies was inappropriate because he paid $100 for his interest in Alabama Green and $300 for his stock in GCM and because forfeiture is only applied in exceptional circumstances. The court of appeals stated that the Texas Supreme Court has made it clear that the standard from Burrow v. Arce applies even to fiduciaries who are not attorneys. The court held that payment for the membership interest and stock did not preclude the trial court as a matter of law from determining under the Burrow standard that Haut’s conduct was a clear and serious breach of fiduciary duty and that Haut’s interests in the companies should be forfeited. On the partial record, the court stated that it must presume the evidence supported the trial court’s determination that equitable forfeiture was warranted. A dissenting justice disagreed with the majority’s presumption of an incomplete record and would have held that Haut had no fiduciary duty as a matter of law. The dissent pointed out that it was undisputed that Haut was not a director, officer, or manager of either GCM or Alabama Green, nor was he an accountant or attorney for either company. The companies argued that representations Haut made about his competence to draft legal documents and give legal advice, the tasks he undertook, and his history with Marques resulted in a role that went well beyond a simple arm’s-length transaction, but the dissenting justice concluded that the companies failed to demonstrate that Haut owed them a duty based on the existence of a relationship prior to and apart from the agreements that were the basis of the suit and would have held that there was no evidence in the record that Haut owed the companies an informal fiduciary duty based on a relationship of trust and confidence.

Allen v. Devon Energy Holdings, L.L.C., 367 S.W.3d 355 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgm’t vacated w.r.m.).

This case dealt with a dispute arising from the redemption of a minority interest owned by Allen in a closely held limited liability company. Allen alleged that the LLC and Rees-Jones, the LLC’s manager and majority owner, fraudulently induced him to redeem his interest. In addition to common law and statutory fraud claims, Allen brought claims for breach of fiduciary duty, shareholder oppression, and violations of the Texas Securities Act. In a lengthy opinion analyzing numerous issues bearing on the various claims, the court held that some, but not all, of the statements relied upon by Allen were actionable, that release and disclaimer provisions in the redemption agreement did not bar Allen’s claims based on the actionable statements, that there was a formal fiduciary duty owed by Rees-Jones as the majority member/sole manager of the LLC to Allen as a passive minority member in the context of the redemption of Allen’s interest, that Rees-Jones did not conclusively establish that he owed no duty of loyalty to members individually under the terms of the exculpation clause in the LLC’s articles of organization, that summary judgment was properly granted on Allen’s shareholder oppression claim, that the defendants conclusively established that Allen had certain knowledge that barred his fraud claims relating to the value of the LLC or its assets or the appropriateness of the redemption price, that the defendants did not otherwise disprove justifiable reliance or establish a “knowledge” defense, and that the defendants did not establish that Allen’s claims under the Texas Securities Act were barred by limitations or that Allen had no recoverable damages.

The factual backdrop for this case was the redemption of Allen’s minority interest in an LLC engaged in natural gas exploration and development. The LLC redeemed Allen’s interest in 2004 based on a $138.5 million appraisal of the LLC performed in 2003. In 2006, the LLC was sold for $2.6 billion. The increase in value of the LLC was essentially due to advancements made in horizontal drilling. Allen claimed that Rees-Jones and the LLC made misrepresentations and failed to disclose facts regarding the LLC’s future prospects and that he would not have sold his interest in 2004 if he had known these material facts.

Based on an alleged fiduciary relationship between Allen and Rees-Jones, Allen alleged that the redemption was a breach of fiduciary duty by Rees-Jones. Allen asserted that Rees-Jones owed Allen a formal fiduciary duty on two
bases: (1) a fiduciary duty owed to minority shareholders by a majority shareholder who dominates control over a business, and (2) a fiduciary duty owed by a closely held company’s officers and shareholders to a shareholder who is redeeming stock. The court acknowledged that the entity at issue was an LLC, but the court discussed and applied case law addressing closely held corporations because Allen relied on these cases and the LLC was a closely held LLC that operated much like a closely held corporation.

The court noted that the vast majority of intermediate appellate courts in Texas have declined to recognize a formal fiduciary duty by a majority shareholder to a minority shareholder in a closely held corporation while recognizing that an informal fiduciary duty could exist under particular circumstances. Given “this overwhelming weight of authority,” the court did not agree with Allen that Texas recognizes a broad formal fiduciary relationship between majority and minority shareholders in closely held companies that would apply to every transaction among them, and the court thus declined to recognize such a fiduciary relationship between members of an LLC on this basis. The court concluded, however, that “there is a formal fiduciary duty when (1) the alleged-fiduciary has a legal right of control and exercises that control by virtue of his status as the majority owner and sole member-manager of a closely-held LLC and (2) either purchases a minority shareholder’s interest or causes the LLC to do so through a redemption when the result of the redemption is an increased ownership interest for the majority owner and sole manager.” The court noted that the scope of the fiduciary duty is not necessarily the same as for other fiduciary duties, and the court did not decide the scope of the duty. The court based its conclusion on the fact that Rees-Jones had essentially the powers and responsibilities of a general partner, a role in which the law imposes fiduciary obligations. Furthermore, the court relied upon corporate case law applying the “special facts” doctrine and concluded that the “special facts” doctrine supports recognizing a formal fiduciary relationship when an LLC’s member-manager communicates a redemption offer to the minority members that may benefit the member-manager individually.

The court also discussed Rees-Jones’s fiduciary duty under the LLC’s articles of organization. The articles of organization contained a provision largely tracking Section 7.001 of the Texas Business Organizations Code. Since the LLC was an LLC rather than a corporation, the LLC was excepted from the restrictions under Section 7.001 on the limitation and elimination of liability for governing persons, and the court stated that the LLC’s members were free under the LLC statute “to expand or eliminate, as between themselves, any and all potential liability of [the LLC’s] manager, Rees-Jones, as they saw fit.” In the articles, rather than completely eliminate Rees-Jones’s potential liability to the LLC or its members, the members eliminated the managerial liability of Rees-Jones except for the categories of liability for which Section 7.001 of the Business Organizations Code does not permit elimination or limitation of liability. One of these categories was expressed in the articles of organization as “a breach of [Rees-Jones’s] duty of loyalty to [the LLC] or its members.” Allen relied upon this provision in arguing that Rees-Jones owed him a fiduciary duty. Rees-Jones argued that the articles listed the exact duties owed by Rees-Jones as manager and created duties but that the duties ran to the LLC and the members collectively rather than to individual members. The court disagreed with Rees-Jones’s argument that the word “members” was intended to refer only to the members as a whole and not to include members individually or in groups of less than all. Furthermore, the court stated that the reference to the LLC or its members was ambiguous at best, thus creating a fact question for the jury. Thus, Rees-Jones did not conclusively establish that he did not owe a duty of loyalty to Allen under the articles, nor did he conclusively establish that his duty of loyalty was not implicated since the redemption resulted in an increase in his ownership percentage and the duty of loyalty places restrictions on a governing person’s ability to participate in transactions on behalf of the company when the person has a personal interest in the transaction. The court noted that the LLC did not define or limit Rees-Jones’s duty of loyalty in the LLC documents and that the Business Organizations Code does not define the duty of loyalty in the LLC context. The court stated that it typically looks to the common law when the statutes are silent.

The court of appeals upheld the trial court’s summary judgment on Allen’s shareholder oppression claim. The court stated that the doctrine of shareholder oppression protects a minority shareholder of a closely held corporation from the improper exercise of majority control, citing the two alternative definitions of shareholder oppression commonly relied upon by Texas courts, i.e., (1) majority shareholders’ conduct that substantially defeats the minority’s expectations that, objectively viewed, were both reasonable under the circumstances and central to the minority shareholder’s decision to join the venture; and (2) burdensome, harsh, or wrongful conduct; a lack of probity and fair dealing in the company’s affairs to the prejudice of some members; or a visible departure from the standard of fair dealing and a violation of fair play on which each shareholder is entitled to rely. The court concluded, however, that the alleged “wrongful conduct” of fraud by misrepresentations and omissions and breach of fiduciary duty was not similar to the typical wrongdoing in shareholder oppression cases, i.e., termination of employment, denial of access to books and records, wrongful withholding of dividends, waste of corporate funds, payment of excessive compensation, lock-out from corporate offices, or squeeze-out. Further, the court stated that there is little necessity for the oppression cause of action when the minority
shareholder has nondisclosure and breach of fiduciary duty claims. The court noted that it was expressing no opinion as to whether a member of an LLC may assert a claim for shareholder oppression.


This case involved a dispute over the existence and breach of fiduciary duties in a business venture that operated by means of a limited liability company and limited partnership. An individual who was both a minority member of the LLC and a limited partner of the limited partnership sued the individual who was both the controlling member of the LLC and a fellow limited partner to recover withheld profit distributions. The trial court entered a judgment on the jury verdict that found the controlling member breached his fiduciary duties to the minority member. The court of appeals reversed and remanded holding: (1) the LLC agreement imposed fiduciary duties on the controlling member; (2) the limited partner relationship by itself did not give rise to a direct fiduciary duty between the individuals; (3) the trial court committed harmful error by commingling valid and invalid theories in instructing the jury that the controlling member had fiduciary duties with respect to operations of both the LLC and the limited partnership; and (4) any withheld profit distributions originated from the operations of the limited partnership in which the controlling member’s fiduciary duties had been contractually disclaimed.

In February 2003, John Wimberly and Douglas Strebel went into business together. They formed a limited liability company that came to be known as Black River Capital, LLC (the “LLC”). Wimberly, Strebel, and their spouses executed an amended and restated LLC agreement effective January 2004 in which they memorialized terms and provided specifics as to the business. Under the amended agreement, Strebel and Wimberly were the members, with 60% and 40% sharing ratios, respectively; Strebel, Wimberly, and their spouses comprised a board of managers who had to be consulted on certain major decisions; and Strebel was designated as the “Managing Manager and CEO” of the LLC with broad decision making and management powers. In addition, the agreement provided that the managers had fiduciary duties to the LLC and the members equivalent to the fiduciary duties of directors of Delaware corporations, and members had fiduciary duties to the LLC comparable to stockholders of Delaware corporations. Wimberly, Strebel, and their spouses also formed Black River Capital Partners, LP (the “limited partnership”) in 2005. Under the limited partnership agreement, the LLC was designated as the general partner with broad authority to control the limited partnership, and Wimberly, Strebel, and their spouses became limited partners who agreed not to act for the limited partnership. The limited partnership agreement provided that the general partner had no duties except those expressly set forth in the agreement, and no provision in the agreement imposed fiduciary duties on the general partner.

In 2007, Wimberly and Strebel had a disagreement regarding the profit distributions related to their business ventures. Wimberly sued Strebel to recover profit distributions Strebel allegedly withheld. Wimberly asserted numerous causes of action contending essentially that Strebel acted in bad faith and breached his fiduciary duties to deprive Wimberly of distributions by retroactively reducing Wimberly’s distribution percentages and shifting money from profit to bonuses to reduce funds available for profit distributions. The trial court instructed the jury that Strebel owed Wimberly fiduciary duties based on their relationship as co-owners of the LLC (with Strebel as the majority owner and managing manager) and their relationship as partners in the limited partnership. The jury found that Strebel breached his fiduciary duties to Wimberly. Strebel appealed arguing that he did not owe Wimberly any fiduciary duties and that any acts allegedly depriving Wimberly of distributions were permitted based on the parties' contractual agreements. The court of appeals analyzed the existence and application of fiduciary duties Strebel owed Wimberly.

The parties agreed that whether Strebel owed Wimberly fiduciary duties based on their limited liability company relationship depended on the interpretation of the language in the LLC agreement. The LLC agreement was governed by Delaware law. Under the Delaware LLC Act, parties are given broad freedom to contract. The existence and scope of fiduciary duties thus must be determined by reference to the LLC agreement. Here, the LLC agreement stated that managers shall have fiduciary duties to the LLC and the members equivalent to the fiduciary duties of directors of Delaware corporations except as otherwise provided in the agreement. Strebel contended that as the managing manager he owed fiduciary duties to the LLC and its members collectively rather than to Wimberly individually. Wimberly responded that such an interpretation was illogical as it was contrary to the plain meaning of the language of the agreement, which included fiduciary duties to members. Wimberly also asserted that, unless default fiduciary duties are specifically disavowed by contract, Delaware courts have treated LLC members as owing each other the traditional fiduciary duties that directors owe a corporation. The court of appeals sided with Wimberly and held that the trial court correctly interpreted the LLC agreement as imposing fiduciary duties on Strebel as the managing manager to Wimberly as an individual member. The court viewed the reference in the agreement to the duties of corporate directors as describing the type of duties owed, not limiting those to whom the duties are owed. The language of the LLC agreement specified that the managers shall have fiduciary duties to members. Any other interpretation would render the phrase
superfluous. Thus, the trial court did not err in instructing the jury that Strebel owed Wimberly fiduciary duties as the managing manager of the LLC.

In the remainder of the opinion, the court analyzed whether Strebel owed Wimberly fiduciary duties based on their limited partnership relationship, which depended on whether limited partners owe each other fiduciary duties under Texas law. The limited partnership agreement was governed by the Texas Revised Limited Partnership Act, and the agreement here was silent as to any fiduciary duties owed between and among the limited partners. The court concluded that the mere status as a limited partner does not give rise to fiduciary duties despite some broad language in some of the cases to that effect. However, a party’s status as a limited partner does not insulate that party from the imposition of fiduciary duties that arise when a limited partner also takes on a nonpassive role by exercising control over the partnership in a way that justifies recognition of such duties or by contract. In this case, the relationship between Strebel and Wimberly as limited partners in the limited partnership did not give rise to a direct fiduciary duty to each other. The trial court’s instruction that Strebel owed Wimberly fiduciary duties as partners in the limited partnership was thus erroneous. Furthermore, the instructions were erroneous to the extent they conveyed that Strebel owed Wimberly fiduciary duties in Strebel’s capacity as the managing manager of the LLC that served as the general partner of the limited partnership because the limited partnership agreement expressly disclaimed any fiduciary duties owed to the limited partners by the general partner itself. The trial court’s jury instruction failed to account for the legal effect of this disclaimer. Thus, the trial court wrongly included in its jury instructions the existence of fiduciary duties owed by Strebel to Wimberly in relation to the limited partnership.

Strebel argued that the trial court committed harmful error in the jury instructions by commingling valid and invalid theories. The trial court instructed the jury that Strebel owed Wimberly fiduciary duties based on the LLC agreement, which was correct, and because of the limited partnership relationship, which was incorrect. Because of the commingling, it was impossible to determine if the jury finding that Strebel breached his fiduciary duties was based on a valid or invalid theory. Furthermore, the court of appeals concluded that Wimberly’s recovery under the improper jury question failed on causation grounds. The damages alleged by Wimberly were caused by the actions of the limited partnership’s general partner (i.e., the LLC) in exercising its exclusive authority to run the limited partnership and Strebel’s alleged control of the general partner. Courts have recognized that general partners in a limited partnership owe fiduciary duties to limited partners, but courts have also acknowledged the importance of honoring parties’ contractual terms defining the scope of their obligations and agreement, including limiting fiduciary duties that may otherwise exist. In this case, there was an express contractual disclaimer in the limited partnership agreement of fiduciary duties owed by the Strebel-controlled general partner to the limited partners, and there was no jury question regarding breaches by the general partner. Because Wimberly sought recovery based on actions that were all taken in Strebel’s capacity as managing manager of the general partner, the court held that the waiver of fiduciary duties in the limited partnership agreement foreclosed Wimberly’s recovery on his breach of fiduciary duty claim. Applying the fiduciary duties owed Wimberly in the LLC relationship, as Wimberly urged, would render meaningless the express disclaimer of fiduciary duties in the limited partnership agreement under which the parties were operating. Since Wimberly failed to demonstrate that Strebel took actions that caused Wimberly’s lost distribution damages while acting within the scope of any fiduciary duties that existed between the parties (inasmuch as the parties had contractually disclaimed the fiduciary duties related to the actions by Strebel at issue) the judgment, which was based on the jury’s finding of breach of fiduciary duty, was reversed. The case was remanded for consideration of alternative liability and damages findings.


Cardwell appealed a bankruptcy court’s order granting summary judgment on Gurley’s claim that Cardwell was not entitled to discharge of his debt owed to Gurley under exceptions to discharge provided by Section 523(a)(2)(A) (false pretenses, false representation, or fraud) and 523(a)(4) (fraud or defalcation in a fiduciary capacity). In previous litigation in state court between Cardwell and Gurley, the state district court found that Cardwell and Gurley formed a Texas LLC of which they were equal members and Cardwell was designated the managing member. The state court also found that Cardwell made numerous materially false and misleading statements and promises and failed to disclose material facts which led Gurley to agree to certain transactions. The state court’s conclusions of law included conclusions that Cardwell, as managing member of the LLC, owed fiduciary duties of loyalty, care, and disclosure to the LLC, and that Cardwell also owed such duties to Gurley directly, as the only other member of the LLC, as a matter of law. The court concluded that Cardwell breached these duties and that Cardwell and the LLC were damaged while Cardwell profited by his breach. The federal district court in this case held that the bankruptcy court did not err in giving preclusive effect to the state court’s findings and conclusions and further held that the fiduciary duty owed by a managing
member to his fellow LLC member was similar to the trust-type obligation owed by partners and corporate officers and thus sufficient to support an exception to discharge under Section 523(a)(4) of the Bankruptcy Code. The court discussed the requirement that a fiduciary capacity for purposes of Section 523(a)(4) must constitute a technical or express trust. The court relied on Fifth Circuit case law recognizing that persons exercising control of a business such as general partners and corporate officers owe trust-type obligations to partners and shareholders who do not control the business and that breach of such obligations is sufficient to except such persons from discharge under Section 523(a)(4). Cardwell argued that there is no authority for imposing a fiduciary duty between LLC members, but the court reasoned that the Fifth Circuit has likely not had occasion to address Section 523(a)(4) in the context of an LLC since the LLC is a relatively new form of business entity. The court noted that an LLC is a business entity that has certain characteristics of both a corporation and a partnership and that managing partners of a partnership and officers and directors of a corporation owe fiduciary duties. The court stated that the Texas Business Organizations Code does not directly address the duties owed by LLC managers to members, but the court cited Section 101.401 (permitting the company agreement to expand or restrict duties, including fiduciary duties, that a member, manager, officer, or other person has to the company or to a member or manager of the company) as an example of certain provisions that are premised on the assumption that such duties exist. Because the state court found that Cardwell, as managing member of the LLC, owed Gurley direct fiduciary duties of loyalty, care, and full disclosure as a matter of law, the federal district court saw no reason to distinguish this case, simply because the entity was an LLC, form prior Fifth Circuit precedent concluding that managing partners of partnerships and officers of corporations were not entitled to discharge under Section 523(a)(4). (The court noted that the state court had also found that Cardwell owed Gurley fiduciary duties as a result of a long-standing relationship of trust and confidence, but the court acknowledged that this type of relationship is too broad to satisfy the federal standard for fiduciary duty in a bankruptcy case.) Having concluded that Cardwell owed Gurley a fiduciary duty sufficient to meet the standard required for Section 523(a)(4), the district court next concluded that the state court’s findings regarding Cardwell’s materially false and misleading statements and promises and failures to disclose material facts met the “willful neglect” standard for a “defalcation” under Section 523(a)(4). In sum, the court held that the bankruptcy court did not err in giving preclusive effect to the state court findings and in entering judgment that Cardwell’s debt to Gurley was nondischargeable under Section 523(a)(2)(A) and 523(a)(4).


Vilhauer asserted claims against Rich, Vilhauer’s co-member in an LLC that had run into financial difficulty. Vilhauer’s claims included breach of fiduciary duty. Vilhauer alleged that Rich owed Vilhauer and the LLC a fiduciary duty as an owner of the LLC and based on the trust relationship between Vilhauer and Rich. The court discussed formal and informal fiduciary relationships under Texas law. The court stated that there is no formal fiduciary relationship created as a matter of law between members of an LLC, but the court recognized that an informal fiduciary relationship may arise under particular circumstances where there is a close, personal relationship of trust and confidence. The existence of an informal fiduciary relationship is ordinarily a question of fact. Based on Vilhauer’s allegations of a long-standing friendship for more than 20 years, the court concluded that Vilhauer had sufficiently pled the existence of an informal fiduciary relationship with Rich. The court found that allegations of Rich’s conduct that left the LLC unable to pay creditors alleged breach of fiduciary duties to the LLC that could not be raised by Vilhauer, but allegations that Rich failed to perform his obligations under a separation agreement for the buyout of Rich’s interest, thus eliminating the benefit to Vilhauer of the buyout of Rich’s interest and resulting in Vilhauer’s personal liability on the LLC debts, sufficiently pled that Rich breached his fiduciary duties to Vilhauer.


In this adversary proceeding in the bankruptcy cases of a limited partnership and two LLCs (the “debtors”), the Chapter 7 trustee and certain creditors of the debtors asserted claims for breach of fiduciary duty and aiding and abetting breach of fiduciary duty in connection with the alleged usurpation of “corporate” opportunities of the debtors. The court stated that the usurpation of corporate opportunities doctrine only applies to officers, directors, and major shareholders who are fiduciaries. One of the defendants, Charles Cheatham, was alleged to be an officer or director of the debtors, and the plaintiffs alleged that Cheatham “ceded operating control” of the debtors to another defendant, Dave Morgan. The plaintiffs did not allege that Dave Morgan actually held a position with the debtors and did not allege that Morgan was a de facto officer of the debtors. The court stated that there is no case law addressing whether a de facto officer may be sued for usurpation of corporate opportunity, but the court concluded that the plaintiffs could state a claim against Morgan for usurpation of corporate opportunities only if they alleged facts independent of his misconduct showing he was a de facto officer or director of one or more debtors. The plaintiffs thus failed to state a claim for breach of fiduciary
duty by usurpation of corporate opportunity against any defendant except Cheatham, but the plaintiffs were given leave to amend their pleadings to allege that Morgan was a de facto officer or director of one or more debtors. The court said that the plaintiffs stated a claim against Morgan for aiding and abetting Cheatham’s breach of fiduciary duty by usurpation of corporate opportunities, citing case law for the proposition that a third party becomes a joint tortfeasor with a fiduciary when the third party knowingly participates in a breach of duty by the fiduciary.


LeBlanc and Lange were long-time friends and business associates. Lange, a lawyer who had worked for a hospital management company that LeBlanc had co-founded, later assisted LeBlanc with the acquisition of a health care facility after LeBlanc was terminated by the company he co-founded. With Lange’s assistance, LeBlanc acquired the health care facility through a limited partnership. Eventually Lange left his law firm and joined LeBlanc in the health care business. LeBlanc and Lange formed various LLCs in connection with their plans to develop their long-term acute-care health care business. LeBlanc was presented with an opportunity to sell his interest in the hospital management company he co-founded, but the proposed deal raised various conflicts with his new business arrangement. Because of LeBlanc’s conflict of interest, Lange became involved in the negotiations. Ultimately, a settlement agreement was reached allowing LeBlanc to sell his interest in his former business and resolve the issues with his current business, but, after receiving payment for his stock in his former business, LeBlanc filed suit to set aside the settlement agreement and alleged various claims against Lange. One of LeBlanc’s claims was for fraud based on an alleged material misrepresentation by Lange with respect to the reason for replacing the general partner of the health care facility acquired by LeBlanc. In discussing and rejecting this claim, the court noted that the evidence showed that Lange represented to LeBlanc that LeBlanc could not sign a lease extension on behalf of their health care facility because the other party to the lease was LeBlanc’s former employer in which he still held a substantial interest, and this interest in the transaction disabled him, as an interested principal, from entering into the agreement on behalf of their company as a matter of law. The court stated that LeBlanc produced no evidence that this statement was false and that the law supported the statement, citing Article 2.17 (addressing interested manager/interested member transactions) of the Texas Limited Liability Company Act (noting that the Act is now expired but applied to the transaction in question) and the current version at Section 101.255 of the Texas Business Organizations Code.


The plaintiff in an adversarial proceeding against a Chapter 7 debtor sought to have her claim against the defendant debtor excepted from discharge under Section 523(a)(4) of the Bankruptcy Code, which excepts from discharge a debt from fraud or defalcation while acting in a fiduciary capacity. The court discussed at length the current state of Texas partnership law with respect to fiduciary duties of general partners. In the course of that discussion, the court noted that shareholders of a corporation do not generally owe other shareholders fiduciary duties and further noted that the law also seems to be developing toward the notion that members of a limited liability company do not necessarily owe other members fiduciary duties.


The debtor brought this action against her ex-husband, her ex-father-in-law, and the ex-father-in-law’s LLC to recover her share of royalty payments on royalties owned by an LLC, Artist Rights Foundation L.L.C. (“ARF”), a California LLC of which she was a 25% owner. Another member of ARF, Jackson, joined the debtor in her claims. The defendants claimed that they alone had the rights to the royalty payments because the rights were purchased from ARF by the ex-father-in-law’s LLC. The court concluded that the ex-husband, Raul Galaz (“Raul”), lacked authority to transfer the royalties on behalf of ARF and that the transfer was thus void and unenforceable. The court also determined that the transfer was a fraudulent transfer made with actual fraudulent intent. The debtor and Jackson also asserted breach of fiduciary duty claims against Raul. First, the court examined to whom Raul owed a fiduciary duty. The California LLC statute states that a manager of an LLC owes a fiduciary duty to the members and the LLC in the same manner that a partner in a partnership owes duties to the other partners and the partnership. ARF’s articles of organization stated that it was to be managed by its members, and statements of information filed with the California Secretary of State represented that Raul was a managing member. Thus, the court concluded that Raul owed a fiduciary duty to Jackson and the LLC. The debtor, however, was only an economic interest holder because she had obtained her interest in the LLC pursuant to a divorce from Raul and did not become a full member in accordance with the operating agreement. Because the California LLC statute explicitly equated the fiduciary duty of a manager of an LLC to that of a partner, the court found it appropriate to look to case on partnerships in analyzing whether Raul owed a fiduciary duty to the debtor.
The court concluded that Raul did not owe the debtor a fiduciary duty based on California partnership case law holding that an assignee cannot maintain an action for breach of fiduciary duty against a partner. The court next determined that Raul owed Jackson and the LLC a duty of loyalty and care as described in the California partnership statute and that the evidence proved conclusively that Raul breached those duties. The court pointed to Raul’s purported transfer of ARF’s royalty rights for no consideration to his father’s LLC (prior to the actual creation of his father’s LLC) along with Raul’s spending the royalty income received without accounting to Jackson, the debtor, or the LLC. Raul claimed that he was owed money for legal services rendered to ARF, but he provided no specific information regarding the services provided and time spent. Furthermore, as a result of a felony conviction for mail fraud, he was not licensed to practice law for much of the time he claimed to be providing legal services. The court concluded that Raul was not entitled to any compensation for such services in light of his breach of fiduciary duty. The court characterized his failure to account for the property and profits derived from the conduct of ARF’s business and his dissolution of ARF as a breach of the duty of loyalty. Additionally, the court concluded Raul breached his duty of care through his intentional misconduct. The court characterized the “sale” of ARF’s assets to an LLC owned by Raul’s father, a “straw man,” as an intentional fraud to secure the valuable royalties for Raul’s own benefit. In addition to actual damages, the court awarded exemplary damages for the breach of fiduciary duty and intentional fraud committed with malice.


Several individuals began to work on a gaming system invention, and an LLC was formed after discussions among them as to formation of an entity that would have some involvement with the invention. The defendant contacted a patent attorney and engaged the attorney on behalf of the LLC. After the defendant obtained a patent for the invention naming the defendant as the sole inventor, the plaintiffs brought an action for a declaratory judgment that they were the co-inventors and co-owners of the invention and asserting various state law causes of action, including breach of fiduciary duty. The plaintiffs argued the defendant owed a fiduciary duty based on his capacity as an officer of the LLC “analogous to the fiduciary relationship between partners or corporate officers and shareholders.” The court stated that no Texas court has held that fiduciary duties exist between members of an LLC as a matter of law and that whether such a fiduciary relationship exists is typically a question of fact. The court concluded that, whether or not a fiduciary duty arose out of any position defendant held with the LLC, the four-year statute of limitations barred the breach of fiduciary duty claim. Thus, the court granted summary judgment in favor of the defendant on the claim.


The plaintiff in this adversary proceeding formed an LLC with the debtor to operate a gas station. The plaintiff provided funds to be spent on the gas station and alleged that the debtor promised to repay the plaintiff from funds held in their 401(k) plan if the gas station failed. The debtor closed the gas station and absconded with the funds. The plaintiff got a judgment against the debtor in state court and sought to have the debt excepted from discharge in the debtor’s bankruptcy. With respect to the exception from discharge under Section 523(a)(4) for a debt arising from a defalcation by a fiduciary, the court stated that the plaintiff failed to plead facts relating to the debtor’s fiduciary status. The court stated that members of an LLC are not generally considered fiduciaries as to each other for purposes of Section 523(a)(4) unless specific facts, other than the mere existence of the LLC, create a fiduciary relationship. The court noted that the plaintiff did not plead whether the debtor was a manager or director or officer of the LLC.


The bankruptcy trustee brought an action to avoid payments that were made from an account funded by the debtor LLC’s business operations. The payments challenged by the trustee were payments on mortgage debts of Ortega, and the court held that they were avoidable as fraudulent transfers. The court also stated that Ortega, as president of the LLC, had a fiduciary relationship with the LLC’s creditors since the LLC was insolvent at the time of the mortgage payments. The court relied on corporate case law for the proposition that corporate officers have fiduciary duties to creditors when the corporation is insolvent. The court rejected the trustee’s claim for breach of fiduciary duty against the mortgage company, however, because there was no evidence the mortgage company knew Ortega was breaching a fiduciary duty. The court stated that the transferee of a fraudulent transfer is liable for breach of fiduciary duty only where the transferee knew the transferor was breaching a fiduciary duty. Because the trustee sued only the mortgage company, and not Ortega, for breach of fiduciary duty, the trustee could not pursue any claim for breach of fiduciary duty.
In 2005, the plaintiff and Societe Captrade ("Captrade") formed an LLC with the plaintiff owning 35% and Captrade owning 65%. From 2005 until 2008, the plaintiff managed the LLC, and relations with Captrade and its principals were cordial. In 2008, Captrade hired an outside manager. The plaintiff alleged that there was an attempt to purchase his membership interest at an under-valued price, that he was forced to resign from the LLC, and that Captrade and its principals took clients, records, and financial information from the LLC. The plaintiff brought claims for breach of fiduciary duty, minority member oppression, and an accounting. Captrade sought dismissal of the breach of fiduciary duty claim on the basis that the plaintiff failed to state facts showing that a member of an LLC owes another member a fiduciary duty or that there was more than a subjective trust by the plaintiff in Captrade so as to support an informal fiduciary relationship. The plaintiff responded that he used his personal credit, business contacts, and name in order to fund the start-up and business operations of the LLC and that he relied upon the representations by Captrade and its principals that his investment of time and resources would make his stake in the LLC profitable. The court reviewed the formal and informal types of fiduciary relationship under Texas law and noted that the Texas Limited Liability Company Act does not directly address the duties owed by managers and members. The court stated that Texas courts have not yet held that a fiduciary duty exists as a matter of law among members in an LLC and noted that, where fiduciary duties among members have been recognized in other jurisdictions, the duties have been based on state-specific statutes. The court denied Captrade’s motion to dismiss “[b]ecause the existence of a fiduciary duty is a fact-specific inquiry that takes into account the contract governing the relationship as well as the particularities of the relationships between the parties.” The court noted that Captrade’s motion to dismiss did not address the plaintiff’s claim for minority member oppression.


Prior to filing bankruptcy, the debtor, a Delaware LLC, provided estate and tax planning strategies to extremely wealthy individuals. The trustee filed this action against two individuals, Kornman and Walker, and numerous entities affiliated in some way with Kornman. Kornman was the former CEO and president of the manager of the LLC, and Walker was a long-time employee of various Kornman-controlled entities. Various defendants sought summary judgment on fraudulent transfer, preference, breach of fiduciary duty, and veil piercing claims asserted by the trustee.

Based on the provisions of the LLC operating agreement, the court granted summary judgment in favor of Kornman and Walker, who were officers of the managing member of the LLC as well as officers of the LLC, on the trustee’s breach of fiduciary duty/gross negligence claims against them. The operating agreement contained a broad excusal clause as follows:

The Manager shall not be required to exercise any particular standard of care, nor shall he owe any fiduciary duties to the Company or the other Members. Such excluded duties include, by way of example, not limitation, any duty of care, duty of loyalty, duty of reasonableness, duty to exercise proper business judgment, duty to make business opportunities available to the company, and any other duty which is typically imposed upon corporate officers and directors, general partners or trustees. The Manager shall not be held personally liable for any harm to the Company or the other Members resulting from any acts or omissions attributed to him. Such acts or omissions may include, by way of example but not limitation, any act of negligence, gross negligence, recklessness, or intentional misconduct.

Walker and Kornman argued that they were protected by this clause as agents of the manager; however, the court found that there were fact issues as to the capacity in which Kornman and Walker acted (i.e., whether as officers of the LLC or as agents of the LLC’s manager), and it therefore was not possible on the summary judgment record to conclude that they were protected by the excusal clause applicable to the manager. The court thus proceeded to analyze other provisions of the operating agreement bearing on the duties imposed on the LLC’s officers. The court reviewed various provisions of the operating agreement and concluded that, taken together, the operating agreement set up a duty delegation structure beginning with the LLC’s manager. The operating agreement expressly eliminated the duties and liabilities of the manager, and the operating agreement expressly limited the duties of the officers of the LLC to those provided in the agreement. While the operating agreement conferred on the LLC’s president the same duties granted to the manager, the court characterized that provision as “hollow” given the express exclusion of duties of the manager. The officers of the LLC other than the president had only those duties that were prescribed or delegated by the president or the manager, and there was no evidence in the summary judgment record regarding either the manager’s grant of duties to the president or the president’s or manager’s delegation or prescription of duties to any other officer. Faced with an operating agreement that provided only for duties as delegated or prescribed by the manager or president, and no evidence of any delegation or prescription, the trustee argued that the officers owed common law fiduciary duties to the
LLC. The court rejected this argument, noting that Delaware LLCs are creatures of contract and that the Delaware LLC statute allows the LLC agreement to expand, restrict, or eliminate any duties a person owes to the LLC. The court stated that the LLC agreement clearly contemplated that the LLC’s officers owed only those duties that were either delegated or prescribed by the LLC’s manager or president, and, absent any delegation or prescription evident in the summary judgment record, the trustee failed to demonstrate the existence of any fiduciary duties by Kornman or Walker.


In this case, Global Orthopedic Solutions, Inc. (“Global”) asserted breach of fiduciary duty claims against its former president. In the course of the opinion, the court revealed that Global was originally formed as an LLC and later converted to a corporation. The jury was instructed that the president owed the company a fiduciary duty, and the jury found that he breached his duty. The trial court entered a judgment for the corporation. On appeal by the former president, the court of appeals found that the evidence was sufficient to establish a breach of fiduciary duty and affirmed.

A group of doctors formed Global in July 2001 to design and produce orthopedic surgical devices. Dr. Masson, the founding member of Global, interviewed and hired Lundy to be the president of Global. Business was not profitable, and the relationship between Lundy and the others involved in Global deteriorated. In August 2003, Masson filed suit against Lundy on numerous causes of action and requested that the court appoint a receiver for Global. The receiver assessed Global’s financial condition and determined that the business could no longer operate. The receiver concluded that Global’s problems were the result of Lundy’s malfeasance rather than simply bad business judgment, and he filed suit on behalf of Global against Lundy for, among other actions, breach of fiduciary duty. At the conclusion of trial, the jury found in favor of Global on its breach of fiduciary duty claim and awarded both actual and punitive damages. Lundy appealed arguing that the evidence was legally and factually insufficient to support the jury verdict.

Lundy argued in his supplemental brief on appeal that the court must determine what duties, if any, a non-managing member owes to a managing member or to the LLC itself. (A footnote at this point in the opinion states that Global was formed in July 2001 as a “limited liability corporation” and converted to a corporation in May 2003.) On appeal, Lundy first argued that the trial court erred in instructing the jury that Lundy had a fiduciary duty to Global as a matter of law. The court of appeals noted that Lundy did not object to the trial court instructing the jury that a fiduciary duty existed and even acknowledged in court that there was some evidence that Lundy owed a duty to Global. Thus, Lundy failed to preserve error on this point. Next, Lundy alleged that the evidence was insufficient to support the jury’s finding that he breached his fiduciary duty to Global, but the court concluded that the record revealed ample evidence to support such a finding. For example, the receiver testified that Global could no longer be run due to the problems caused by Lundy’s malfeasance. Lundy manipulated Global’s books, failed to keep Global’s owners and officers informed of Global’s financial condition, executed a full-time employment agreement with another company while he was supposed to be working full-time for Global, and misled Masson about his prior partnership with a company that owned the patent on the main product that Global manufactured, marketed, and sold. Lundy contended that the jury charge did not identify the specific transaction which constituted the breach, but the court stated that no such specificity is required. In addition, Lundy argued that his actions such as falsifying the financial records were intended only to help Global and not hurt it. The court of appeals found that nothing in the record supported Lundy’s assertion. Thus, the court concluded that there was more than a scintilla of evidence to support the jury’s finding that Lundy breached his fiduciary duty to Global, and the jury’s finding was not so contrary to the overwhelming weight of the evidence as to be clearly wrong and unjust.

**Kira Inc. v. All Star Maintenance Inc.**, 267 Fed. App’x 352 (5th Cir. 2008).

A minority member of a Nevada LLC asserted direct and derivative claims against the other two members of the LLC. The plaintiff’s claims were based on the alleged improper use by the defendant members of the LLC’s name and the payment of management fees to affiliates of the defendants. The court of appeals agreed with the district court that there was insufficient evidence to create a jury question on the service mark claim. The evidence showed the operating agreement expressly permitted all three members to compete with each other and with the LLC, even to the exclusion of the LLC from business the LLC was capable of performing. The operating agreement did not reserve the name to the LLC or otherwise prohibit its use. The evidence also showed that the chairman of one of the defendant members had been using some form of the name for many years prior to the formation of the LLC. Thus, the district court correctly determined that the plaintiff had failed to meet its threshold burden of showing the LLC had a protectible interest in the service mark. The court of appeals also rejected the plaintiff’s argument that the district court should have entered judgment in its favor in connection with payment of management fees. The plaintiff argued that the district court should have entered judgment rescinding the contracts and requiring disgorgement of the fees to the LLC based on the jury’s finding that the defendant members breached the operating agreement and their duties of good faith and fair
dealing. The court of appeals rejected this argument because the jury found that the plaintiff suffered no harm. The jury also found the defendants did not breach any fiduciary duties. Under the controlling Nevada law, rescission is an equitable remedy that seeks to place the parties in the same position they occupied before the contract. A judgment returning the fees would have effectively ignored the jury’s determination that the plaintiff suffered no harm. The court stated that the jury’s verdict was understandable given the evidence that necessary services were performed at a rate that was substantially below market rate. Thus, the plaintiff’s argument that it was entitled to equitable relief was without merit.


An LLC member asserted various claims against the LLC and his co-members in connection with the withdrawal and buyout of the member. The member argued that the buyout of his interest did not become effective and that he was still entitled to receive membership distributions because the buyout violated transfer restrictions in the LLC membership regulations (i.e., the operating agreement). The court found that the buyout did not violate the transfer restriction because the transfer did not involve a transfer to a non-member. The court also concluded that the LLC had complied with provisions of the membership regulations governing distributions to a withdrawing member. The court found that the LLC’s offer to purchase the member’s interest substantially complied with the requirement that a withdrawing member receive the fair value of his interest as of the first day of the month following the date of the occurrence giving rise to the member’s withdrawal. The court rejected the member’s claims that the other owners of the LLC breached a fiduciary duty to him in connection with the repurchase of his interest. The member couched his argument in terms of duties owed in the context of a closely held corporation and argued that the defendants had the burden to establish the fairness of the transaction. The court stated that the member’s breach of fiduciary duty claim regarding the voiding of his interest depended upon his argument that the transfer restrictions applied to the purchase of his interest, and the claim thus failed as a matter of law. The court stated that another breach of fiduciary duty claim based on alleged fraudulent transfers of ownership in the LLC related to transactions that occurred after the member’s withdrawal and that the LLC owed him none of the duties owed members after that date.


The court found that transfers from the debtor LLC to a commonly controlled LLC were fraudulent under the constructive and actual fraud provisions of the Texas Fraudulent Transfer Act and Bankruptcy Code; however, the trustee failed to prove fraud or breach of fiduciary duty on the part of the individuals who owned and controlled the LLCs because there was insufficient evidence of actual damages arising from any fraud or breach of fiduciary duty distinct from a failure to transfer reasonably equivalent value to the debtor as alleged under the fraudulent transfer cause of action. The court acknowledged the trustee’s arguments that fiduciary duties arise in favor of creditors when a debtor approaches a “zone of insolvency,” but noted the cogent analysis and rejection of this theory by Judge Harmon in **Floyd v. Hefner,** 2006 WL 2844245 (S.D. Tex. Sept. 29, 2006).


The plaintiffs, a minority member of an LLC and his wife (Mr. and Mrs. Doonan), brought suit against the LLC’s lender for breach of fiduciary duty. The lender made a loan to the LLC secured by the LLC’s assets. The loan was guaranteed by the two members, Mr. Moore and Mr. Doonan, and their spouses, and the members also granted the lender an option to purchase a 34% membership interest in the LLC. The lender exercised its option to purchase the membership, and the lender later acquired Mr. Moore’s membership interest. Mr. Moore’s guaranty was extinguished when he withdrew as an officer. Eventually Mr. Doonan, the LLC’s chief operating officer, quit, and a year later the lender foreclosed its security interest and purchased the LLC’s assets in a private sale. The Doonans brought suit against the lender, alleging, inter alia, claims for breach of fiduciary duty. The court of appeals affirmed the trial court’s summary judgment on the breach of fiduciary duty claim on the basis that there was no evidence of breach of fiduciary duty. With respect to Mrs. Doonan, the court of appeals held there was no evidence of the existence of a fiduciary duty. The court stated that fiduciary duties arise either from certain formal relationships that are recognized as fiduciary as a matter of law or from the existence of an informal, confidential relationship between the parties. The plaintiffs failed to present any evidence regarding a fiduciary duty owed to Mrs. Doonan and did not point to any case law that would establish such a relationship. Furthermore, assuming Mr. Doonan was owed a fiduciary duty, the court held the plaintiffs did not raise a material fact issue as to the breach of a fiduciary duty. The plaintiffs argued that the lender breached its fiduciary duty by (1) enforcing the personal guaranties in violation of the regulations of the LLC, (2) excluding Mr. Doonan from a meeting at which Mr. Moore was released from his personal guaranty and Mr. Moore’s interest was conveyed to the
lender, (3) removing Mr. Doonan as authorized signer on the LLC’s bank account, (4) telling Mr. Doonan to “get out or you’ll be taken out of here in handcuffs,” and (5) foreclosing on the LLC’s assets and Mr. Doonan’s interest. The court found this evidence did not raise a genuine issue of material fact of a breach of fiduciary duty. The court concluded such actions were taken for legitimate business reasons rather than for the fiduciary to profit by taking advantage of its position.

**Pinnacle Data Services, Inc. v. Gillen**, 104 S.W.3d 188 (Tex. App.—Texarkana 2003, no pet.).

Four individuals formed a Texas LLC designated as member-managed by its articles of organization. Two of the individuals, Gillen and Baldridge, each owned a 25% interest, and an entity owned and operated by the other two individuals (Max and Morris Horton) owned the other 50% of the LLC. (The court noted in a footnote that the Hortons were apparently under the impression that they had the right to participate in management although they were not technically members of the LLC.) As the LLC became more profitable, the individuals began to disagree over how it should be managed. Gillen proposed amending the LLC’s articles of organization to change it to a manager-managed LLC and then electing Gillen as manager. The regulations provided that amendment of the articles of organization required the affirmative vote of at least 66 2/3% of the ownership interest while the articles of organization provided for amendment by the affirmative vote of two-thirds of the members. Gillen and Baldridge voted for the proposed changes and relieved the Hortons of their duties with the LLC. The entity member brought suit for declaratory relief, unjust enrichment, and member oppression. The trial court granted summary judgment to Gillen, Baldridge, and the LLC. The declaratory relief hinged on the determination of whether the voting provisions of the articles of organization or the regulations controlled. Under the Texas Limited Liability Company Act, the regulations may contain any provisions for the regulation or management of the LLC not inconsistent with law or the articles of organization. Thus, the court determined that the articles of organization controlled, and the amendment received the requisite vote. The entity member claimed that it was not given a copy of the articles until two years after the regulations were signed, but the court stated that there was no evidence that it sought to obtain a copy (even though it signed regulations that were expressly subordinate to the articles of organization), and the articles were on file with the Secretary of State. The court stated that the regulations, the articles of organization, and the Texas LLC Act are not rendered inoperative by the failure to exercise diligence in obtaining a copy of the articles before agreeing to their terms. The court also found that the entity member had not set forth any evidence that Gillen, Baldridge, or the LLC obtained any benefit through fraud, duress, or taking undue advantage of the entity, and thus the trial court did not err in granting summary judgment on the unjust enrichment claim. The court cited shareholder oppression cases for the definition of “member oppression,” but held that the entity did not set forth any evidence in support of its member oppression claim. The court found the determination that the articles of organization control disposed of the breach of contract claim but not the remaining reformation and breach of fiduciary duty-based claims. The defendants claimed that the claim for breach of fiduciary duty was without merit because the action taken complied with the articles of organization, but the court concluded that compliance with the articles was not dispositive of such claims. The court’s opinion implies that the duties of the LLC members are analogous to those of corporate officers and directors, but the opinion is not entirely clear in this regard.


The Chapter 7 trustee brought an adversary proceeding to set aside alleged fraudulent transfers. The court held that certain distributions to the members were fraudulent transfers. The court also addressed breach of fiduciary duty claims against members of the LLC who were officers. The court discussed the fiduciary duties of the LLC’s officers as if they were officers of a corporation. The court stated that the officers of a corporation owe a fiduciary duty to the corporation and its shareholders. Further, the court stated that the officers owe a fiduciary duty to the creditors of the corporation when the corporation is insolvent. According to the court, “[o]fficers of an insolvent corporation breach their fiduciary duty by transferring funds to themselves, in effect, as equity holders, to the detriment of the corporation’s creditors.” The court determined, however, that the trustee and the LLC’s major creditor were estopped from pursuing the breach of fiduciary duty claim. The noteholder was a “sophisticated player” and understood companies in the LLC’s business. It conducted its own assessment of the LLC’s assets and concluded that the LLC’s assets supported its debt structure. The excess cash distributions were permitted under the terms of the note. The court thus applied the equitable estoppel doctrine to the fiduciary duty claim related to the excess cash distributions. The court also concluded that the officers of the LLC did not breach a fiduciary duty when they resigned from the LLC, formed another LLC, and transferred some business to the new LLC. The court stressed that the officers did not have a non-competition or non-solicitation agreement. Additionally, the agreement under which the LLC was acquired from the noteholder recognized that the officers had fiduciary duties to other interest holders in real estate controlled by them and permitted the officers
to exercise discretion regarding property management contracts when their fiduciary duty to other interest holders required.


The plaintiff LLC obtained a default judgment against one of its members for injunctive relief and damages for breach of fiduciary duty. The pleadings alleged that the defendant instructed an LLC customer to make payments totaling $70,000 to the member rather than to the LLC’s lender as required by the LLC’s loan agreement. The LLC alleged that such action would irreparably damage the goodwill of the LLC, prevent the LLC from fulfilling its obligations to its customer, impair the LLC’s ability to finance the acquisition of additional goods to fill future orders, and impair the LLC’s ability to obtain or satisfy future orders. The petition further alleged that the member, “as a director” of the LLC, owed the LLC fiduciary duties which were breached by the acts described above. The court held that the petition was sufficient to put the member on fair notice that the LLC claimed a breach of fiduciary duty, and there was no error in entering a default judgment for breach of fiduciary duty. The court reversed and remanded for a new trial on the issue of unliquidated damages because the record lacked evidence to support the trial court’s award of damages.


The minority member of a Texas LLC claimed that the majority member owed it a fiduciary duty as a matter of law. The case does not state whether the LLC was member-managed or manager-managed, but the articles of organization provided as follows: “Members of this Company have a duty of undivided loyalty to this Company in all matters affecting this Company’s interest.” The Texas LLC Act provides: “To the extent that at law or in equity, a member, manager, officer, or other person has duties (including fiduciary duties) and liabilities relating thereto to a limited liability company or to another member or manager, such duties and liabilities may be expanded or restricted by provisions in the regulations.” The court noted the absence of Texas case law on fiduciary duties of LLC members and looked to case law regarding fiduciary duties of shareholders of closely held corporations. In prior cases, the court had held that co-shareholders of closely held corporations are not necessarily in a fiduciary relationship. Rather, the existence of a fiduciary relationship is a question of fact. The court applied the same reasoning and stated that its conclusion was not affected by the fact that the defendant was the majority member. The court pointed out that the provision in the LLC’s articles of organization provided for a duty of loyalty to the LLC rather than between members. The court said that neither the statute nor the provision in the articles authorized the court to find that there was a fiduciary relationship between the members as a matter of law, and the issue was remanded for determination by the factfinder.

F. Limited Liability of Members; Personal Liability of Members Under Agency or Other Law


Two individual defendants in an action under the Fair Labor Standards Act (FLSA) sought summary judgment as to their liability for the plaintiffs’ claims for overtime wages. Magdaleno worked as a driver for an LLC in the business of construction debris removal. The action was an opt-in collective action, and numerous employees joined as plaintiffs. The individual defendants argued that they were not liable because the Texas Business Organizations Code provides that they are not liable for the debts, obligations, and liabilities of the LLC and that they may not be named as a party in an action against the LLC unless the action is to enforce a member’s right against or liability to the LLC. The court stated that these provisions were irrelevant to the liability of the individuals under the FLSA, which defines an employer for purposes of an action like this to include “any person acting directly or indirectly in the interest of an employer in relation to an employee.” The Fifth Circuit uses the “economic reality” test set forth in **Gray v. Powers**, 673 F.3d 352 (5th Cir. 2012). Under this test, the court considers whether the alleged employer: (1) possessed the power to hire and fire the employees; (2) supervised and controlled employee work schedules or conditions of employment; (3) determined the rate and method of payment; and (4) maintained employment records. There may be more than one employer, and the court must apply the economic realities test to each individual or entity alleged to be an employer. Each must satisfy the four-part test. The individual defendants cited no evidence and thus did not meet their summary judgment burden of demonstrating that no dispute existed. The court reviewed the plaintiffs’ summary judgment evidence and characterized it as “ample” support of each of the **Gray** factors to raise a fact issue on whether the individual defendants were plaintiffs’ employers.

Kennebrew founded a private security company as an LLC, and Kennebrew was initially the sole manager and member. The parties executed a management agreement under which Harris obtained a 40% interest in the LLC in exchange for a capital contribution of $10,000. After a short time, the parties became dissatisfied with their relationship, and Harris notified Kennebrew of his intent to withdraw. The LLC accepted Harris’s withdrawal, and the parties could not agree on the amount that Harris was owed. Harris sued Kennebrew and the LLC. The trial court appointed an accountant who reviewed the LLC’s records and determined the value of the LLC’s assets, liabilities, and member equity. The trial judge entered a judgment rescinding the management agreement, concluding there was an oral loan agreement between the parties, and holding Kennebrew and the LLC liable to Harris for damages and attorney’s fees. All parties appealed. The court of appeals analyzed the trial court’s rescission of the management agreement and concluded that rescission was improper. The court of appeals found no evidence in the record to support the trial court’s finding of an oral loan agreement, but Harris argued that the management agreement entitled him to be repaid the amount he was owed for goods and services purchased for the LLC. The court of appeals agreed. Two provisions of the management agreement addressed loans by members, and these provisions entitled Harris to recover the amount the trial court found he spent on the LLC’s behalf. The court of appeals also agreed with Harris that he was entitled to recover the value of his interest in the LLC in addition to repayment of the loans. Under the Business Organizations Code, an LLC member may withdraw only if permitted by contract, but a member who validly exercises a right of withdrawal provided by the company agreement is entitled to be paid the fair value of the member’s interest in the LLC as determined as of the date of withdrawal. Both the management agreement and the company agreement expressly permitted a member to withdraw, and the evidence showed that Harris validly exercised that right. The trial court found that the value of Harris’s interest on the date of withdrawal was $44,849, which was 40% of the members’ total equity as found by the court-appointed accountant, and the court of appeals held that Harris was entitled to recover this amount. Kennebrew argued that there was no basis to hold him personally liable for the amounts owed to Harris, and the court of appeals agreed. The Business Organizations Code provides that a member or manager is not liable for the LLC’s debts, obligations, or judgments unless the company agreement specifically provides otherwise. Tex. Bus. Orgs. Code § 101.114. Further, the company agreement in this case expressly provided that no member or manager shall be liable for the debts, obligations, or liabilities of the company. Both the funds advanced by Harris to the LLC and the distribution owed for the value of his interest were liabilities only of the LLC. The attorney’s fees were based on Harris’s recovery for breach of contract under Section 38.001(8) of the Texas Civil Practice and Remedies Code. Because Harris was entitled to damages for breach of contract only from the LLC, the court concluded there was no basis to hold Kennebrew jointly and severally liable for attorney’s fees. Harris argued that the trial court properly held Kennebrew jointly and severally liable because he refused to give Harris access to the LLC’s books and records thereby breaching the management agreement and committing shareholder oppression, but the trial court did not find that this conduct caused Harris any damages. Thus, the court of appeals held that the trial court erred in holding Kennebrew jointly and severally liable with the LLC for its debts, obligations, or liabilities.


The plaintiff brought an anti-piracy action under the Federal Communications Act against the owners and operators of a bar that intercepted and broadcast a closed-circuit telecast of a fighting event without paying the license fee. To prove vicarious liability under this statute, the plaintiff was only required to show that the defendants had the right and ability to supervise the infringing activities and an obvious and direct financial interest. The statute is a strict liability statute, and intent or knowledge of infringement is not required. The plaintiff showed that most of the defendants had the right and ability to supervise. A limited partnership and its LLC general partner admitted they did not have a valid defense because both had the right to supervise the bar and the limited partnership held the liquor license. Two individual defendants were managers of the bar, limited partners of the limited partnership, and members of the limited partnership’s LLC general partner and also had a financial interest in the activities of the bar. The plaintiff conceded, however, that it did not yet have proof that two other individual defendants had the right and ability to supervise the activities of the bar. At one point in the opinion, the court states that these individuals admitted that they were limited partners in the limited partnership but denied having the right or ability to supervise the activities at the bar. The plaintiff explained that these individuals were not limited partners but members of the LLC general partner and that an LLC can be managed by its members. Because the plaintiff had not yet furnished records of the Texas Secretary of State and Comptroller establishing that these two individuals were members of the LLC general partner, the court stated that judgment should not be granted against them at that time, and the court granted the plaintiff leave to determine whether it could locate proof that these individuals had the right and ability to supervise the activities of the bar.

Nwokedi and an LLC appealed a judgment against them in favor of a company that provided restoration services to the LLC’s property after it was damaged in Hurricane Ike. The plaintiff’s claims included claims for fraud, breach of contract, and fraudulent transfer, and the jury found in favor of the plaintiff on all its theories. The judgment awarded compensatory and punitive damages, voided four fraudulent transfers by Nwokedi and the LLC, imposed a constructive trust on fraudulently transferred insurance proceeds, and enjoined Nwokedi and the LLC from transferring any assets not subject to execution.

The plaintiff’s common-law fraud claim was based on the plaintiff’s contention that Nwokedi and the LLC intended to keep the insurance proceeds for themselves when they promised to pay for the plaintiff’s work with the insurance proceeds. The court of appeals concluded that the evidence supported the jury’s finding that Nwokedi and the LLC did not intend to pay the plaintiff as promised. Nwokedi argued on appeal that the evidence was insufficient to support a finding of individual liability on his part. The court recited the rule that a corporate officer who knowingly participated in tortious or fraudulent acts may be held individually liable to third persons even though the officer was acting as an agent of the corporation. The evidence showed that Nwokedi, who owned a controlling interest in the LLC, knowingly participated in its fraud. Nwokedi participated in the contract negotiations with the plaintiff and personally reassured representatives of the plaintiff that the insurance company was acting on the LLC’s behalf and that the plaintiff would be receiving payments from the insurance company. Nwokedi sent several emails to the insurance company instructing it not to issue checks to the plaintiff. Thus, the court concluded there was evidence that Nwokedi knowingly participated in the fraud.

The fraudulent transfer claims were based on several transfers of funds from the LLC’s bank account to various other accounts. The plaintiff alleged that these transfers were made with the intent to hinder, delay, or defraud the plaintiff. Nwokedi and the LLC argued on appeal that there was insufficient evidence to support the jury’s finding that Nwokedi and the LLC fraudulently transferred property with the intent to hinder, delay, or defraud creditors. Based on the jury’s finding, the trial court set aside four transfers of insurance proceeds, amounting to $618,000, from the LLC’s account to other accounts. The court of appeals discussed each transfer and concluded the evidence supported a finding...
that the transfers were fraudulent. The court pointed to evidence of several badges of fraud, including that Nwokedi was an “insider,” that the accounts to which the transfers were made were held in the name of or controlled by Nwokedi, that Nwokedi attempted to conceal the transfers, and that the transfers were made after the plaintiff sued the LLC. The court also rejected the argument that a creditor is required to trace specific funds under the Texas Uniform Fraudulent Transfer Act. A constructive trust could only be imposed on traceable funds, but the other funds could be included in an award of damages. Nwokedi argued that he could not be held individually liable for the fraudulent transfers because there was no evidence that the assets transferred were his assets. The court rejected this argument on the basis that a corporate officer who knowingly participates in tortious or fraudulent conduct may be held individually liable to third persons even though the officer performed the act as an agent of the corporation.


The appellant filed a petition in intervention in a case in which a judgment had been entered against a limited partnership and its LLC general partner and a receiver of the property of the limited partnership and general partner had been appointed. The appellant was a limited partner and member of the judgment debtors, and the appellant sought to appeal a modified order of the trial court appointing receiver and an order severing the limited partnership from the underlying cause. The judgment creditor argued that the appellant lacked standing to appeal because the appellant was not a party to the underlying judgment or to the trial court’s subsequent severance or modified order appointing a receiver. The appellant argued that it had standing under the virtual representation doctrine. In connection with the first element of the virtual representation doctrine, the appellant argued that it was bound to the judgment as the sole limited partner of the limited partnership and sole member of the LLC general partner. The court stated that the appellant mischaracterized the liability of a limited partner or LLC member for judgments against the entity. The court discussed the statutory provisions addressing liability of a limited partner in a limited partnership and concluded that there was no showing that the appellant had liability for the judgment against the limited partnership. Likewise, the court concluded that the appellant had no liability for the judgment against the LLC general partner because Section 101.106(b) of the Business Organizations Code states that a member has no interest in any specific property of the LLC, and Section 101.114 states that a member has no liability for a debt, obligation, or liability of the LLC unless the company agreement specifically provides otherwise.


An LLC member sought dismissal of a patent infringement claim brought by Braun against the member personally. The member relied on Section 101.114 of the Texas Business Organizations Code, which protects a member from personal liability for the debts, obligations, and liabilities of the LLC, and Section 101.113, which provides that a member may be named in an action against an LLC only if the action is brought to enforce the member’s right against or liability to the LLC. The member argued that Braun had not alleged that the member took any actions separate and distinct from her representative capacity on behalf of the LLC and had made no alter-ego argument or otherwise alleged any basis to pierce the veil of the LLC. Braun responded that Texas corporate law was not relevant and that cases applying 15 U.S.C. § 1125(a), on which Braun’s patent infringement claim was based, have found personal liability for officers and directors who knowingly act in a manner that causes confusion, mistake, or deception. The court agreed that an officer or director who actively and knowingly causes confusion, mistake, or deception can be personally liable under 15 U.S.C. § 1125(a), and the court denied the member’s motion for dismissal based on the standard for dismissal, which required a liberal reading of Braun’s complaint viewing the well-pleaded facts in a light most favorable to Braun.


The dependent administrator of the estate of a sole proprietor who did business as Southern Manufacturing filed an application with the probate court and received approval to form a limited liability company, Southern Manufacturing Co., L.L.C, to carry on the business of the deceased sole proprietor. The LLC was formed in 2007. Before the formation of the LLC, the general manager of the business submitted a credit application to a supplier under the company name of Southern Manufacturing. Invoices from December 2009 to June 2010 were never paid, and the supplier sought to recover from the estate. The administrator claimed that all orders after the formation of the LLC were made by the LLC, but the jury found that the supplier had an agreement with the administrator in her representative capacity and that she was liable for the purchases in her representative capacity for the estate. The court of appeals concluded that the evidence was sufficient to support the jury’s verdict because the LLC did not exist when the supplier agreed to sell materials on credit to the sole proprietorship, and the supplier was unaware that the LLC had been formed. The checks used to pay
the supplier all bore the name of the sole proprietorship, Southern Manufacturing, and the supplier believed it was doing business with Southern Manufacturing. The record did not reflect the filing of a new assumed name certificate or a statement of abandonment for the sole proprietorship. The jury could reasonably reject some or all of the testimony of any witness, including those testifying in favor of the administrator. The jury could reasonably conclude that the business was carried on under the same name, that the supplier had no knowledge of the LLC, and that the supplier believed it was dealing with the sole proprietorship when it advanced credit. Under the circumstances, the court said the formation of the new entity did not release the estate of its liability under the contract.

**Broemer v. Houston Lawyers Referral Service.** 407 S.W.3d 477 (Tex. App.– Houston [14th Dist.] 2013, no pet.).

The court held that it was not error for the trial court to modify an arbitration award and enter a judgment confirming the award against an LLC law firm in the firm’s legal name (“W. Fulton Broemer & Associates, L.L.C.”) and two assumed names (“Broemer & Associates” and “Broemer & Associates, L.L.C.”) although the arbitration award was only entered against Broemer & Associates, L.L.C. Broemer & Associates, L.L.C. was not a registered assumed name, and the law firm argued that this name was not an entity or a registered assumed name of the law firm. Before entering the judgment, however, the trial court held an evidentiary hearing and heard evidence that established the law firm conducted business under the name Broemer & Associates, L.L.C. even though the name was not registered. The court of appeals pointed out that failure to register an assumed name does not impair the validity of any act or contract, and an entity may be held liable under an assumed name if the evidence shows it is doing business under that name regardless of whether it filed an assumed name certificate. Thus, it was not error for the trial court to add the law firm’s legal name and its registered assumed name to the unregistered name in the judgment. The plaintiff argued alternatively that Broemer, the sole owner of the LLC law firm, did business individually under the unregistered name Broemer & Associates, L.L.C., but the court of appeals concluded that the evidence showed that the LLC law firm, not Broemer individually, did business as Broemer & Associates, L.L.C. Broemer also complained on appeal that the trial court erred in making him jointly and severally liable for the entire award in contravention of the arbitration award and the arbitrator’s finding that Broemer was not personally liable for the entire award. The arbitrator expressly found no reason to pierce the veil and hold Broemer personally liable with respect to certain claims, and the court of appeals thus agreed with Broemer that the trial court erred in the modification making Broemer jointly and severally liable for the entire award.


In this action to determine dischargeability of a debt, the plaintiff argued that Higgs obtained materials on credit by falsely representing that he made purchases on behalf of an LLC when the LLC had forfeited its charter and could not do business in Texas. The plaintiff alleged that Higgs made this representation with intent to deceive and that the plaintiff relied on the representation to its detriment. Higgs denied that he purchased materials from the plaintiff on behalf of his LLC and asserted that the plaintiff extended credit to him personally. It was undisputed that Higgs executed the plaintiff’s credit application in 2004 in which he listed the type of business as “Construction LLC.” For several years, Higgs made purchases, presumably acting through “RH Construction.” Two invoices in 2012 were not paid. It was also undisputed that “RH Construction” was an assumed name of RHC Consultants, LLC, and that the LLC forfeited its right to do business in Texas in 2009. The court concluded that the plaintiff failed to show that Higgs made a false representation. The court said it was unclear from the complaint what representation was at issue—whether it was the statement on the credit application that Higgs would make purchases for an LLC or the representation on the two unpaid invoices that the materials were ordered for RH Construction. The representation on the credit application was not false in 2004 when it was made because RH Construction was a valid assumed name for an existing LLC at that time. At trial, the plaintiff contended the false representation was Higgs writing “RH Construction” on the invoices when the LLC had lost its charter. However, Higgs did not write “RHC Consultants, LLC” on the invoice; he wrote “RH Construction.” Further, there was no evidence that Higgs no longer did business as “RH Construction” after the LLC lost its charter. In his answer, Higgs stated that the purchases were made for RH Construction and that it still existed. The question was whether Higgs had a duty to tell the plaintiff that RHC Consultants, LLC (of which RH Construction was an assumed name) forfeited its charter and lost its status as an LLC. The plaintiff did not establish that Higgs had such a duty. In addition, the evidence did not establish that Higgs intended to deceive the plaintiff. Statements by Higgs at a meeting of creditors indicated that he did not know or understand the significance of the name of the buyer on the invoice. His statements suggested that he did not differentiate between himself and RH Construction. According to the court, if Higgs did not differentiate between himself and his company or his assumed name, or understand the significance of a name
Nicholas Gray sued his employer, an LLC that owned a nightclub, and one of its owners, Michael Powers, for alleged violations of minimum wage standards under the Fair Labor Standards Act (FLSA). Gray alleged that Powers was personally liable with the LLC for the FLSA damages as an “employer” under the FLSA. The court applied the “economic reality” test to determine whether there was an employer/employee relationship between Powers and Gray. Under this test, the court considers whether the alleged employer: (1) possessed the power to hire and fire employees; (2) supervised and controlled employee work schedules or conditions of employment; (3) determined the rate and method of payment; and (4) maintained employment records. Applying this test, the court held that Powers was not Gray’s employer. With respect to the power to hire and fire, Gray argued that Powers had the inherent power to fire Gray as a member and officer of the LLC. The only evidence Powers cited was the collective power of the LLC members to hire and fire the general manager, but the court stated that this participation in a joint decision with co-owners proved nothing about whether Powers had the authority individually to control employment terms of lower-level employees. In the absence of specific facts in this regard, Gray argued that the court should infer such authority from the position of member and officer. The court rejected this argument and stated that a status-based inference of control alone cannot suffice to create a fact question on the issue of whether Powers had the power to hire and fire bartenders. Similarly, the court found no evidence upon which a reasonable jury could find that Powers controlled employee work schedules or conditions of employment, determined the employees’ rate or method of pay, or maintained employment records. In sum, Powers was not sufficiently involved in the operation of the nightclub to be an employer.


The president of an LLC argued that he could not be held personally liable for tortiously interfering with the plaintiff’s contract because he was acting in his representative capacity when he performed the acts complained of by the plaintiff. The court stated that he could still be liable for the tortious acts even if he was acting in his capacity as president because a corporate agent is personally liable for his own fraudulent or tortious acts. The court distinguished cases relied on by the president in which the particular situations involved exceptions to the rule that an agent is personally liable for tortious acts directed or participated in by the agent.


The court reviewed the record and concluded that there was substantial evidence that a limited partnership and its indirect LLC subsidiary constituted a “single employer” for purposes of the National Labor Relations Act.


Freeman Decorating Services, Inc. filed suit on a sworn account against an LLC and Larry Bruce, an individual who was alleged to be an officer or director of the LLC, for amounts owed for services provided by the plaintiff. The plaintiff alleged that Bruce was liable for the LLC’s debt under Section 171.255 of the Tax Code because the LLC had been forfeited for failure to pay franchise taxes. After a bench trial, the court rendered judgment for the plaintiff against the LLC and Bruce, jointly and severally, and Bruce appealed. The court of appeals explained that Section 171.255(a) provides that each director and officer of a corporation whose corporate privileges are forfeited for the failure to file a report or pay a tax or penalty is liable for each debt of the corporation created or incurred in Texas after the date on which the report, tax, or penalty is due and before the corporate privileges are revived. The plaintiff presented evidence that the LLC’s privileges had been forfeited as of February 10, 2006, that the privileges had not been revived, and that the plaintiff provided the services at issue to the LLC in February 2007. First, Bruce argued that Section 171.255 imposes liability on directors and officers of corporations, not LLCs. The court explained that Section 171.001, as in effect when the LLC forfeited its charter and incurred the debt at issue, provided that a franchise tax was imposed on each “corporation” and “limited liability company” doing business in Texas and defined “corporation” for purposes of Chapter 171 of the Tax Code to include a limited liability company. Thus, Section 171.255 applied to an LLC under the former version of Chapter 171. In 2006, the legislature revised some provisions of Chapter 171, including Section 171.001, effective January 1, 2008. The definition of “corporation” was deleted, but a definition of “taxable entity” was added and includes an LLC. Additionally, the legislature added Section 171.2515, which expressly makes the provisions of Subchapter F, including Section 171.255, applicable to forfeiture of the right of a taxable entity to transact business in Texas. Therefore, under the current version of Chapter 171, Section 171.255 remains applicable to LLCs. The court stated that it need not resolve any issues relative to the effective date of the amendments because the result in this case was the same even if the amended version applied, i.e., Bruce is personally liable under Section 171.255 for the LLC’s debt to the plaintiff if he was an officer or director at the time the debt was incurred. To prove Bruce’s status as an officer or director of the LLC at the time it incurred the debt, the plaintiff presented the Texas Franchise Tax Information Reports prepared for the LLC in 2003, 2004, and 2006. On the 2003 and 2004 reports, Bruce was listed as an officer and director. On the 2006 report, Bruce was listed as the only director. Bruce was also shown as the person signing the 2006 report and certifying that the information in the report was true and correct to the best of his knowledge. Bruce denied that he was a director in 2006 and claimed he did not sign the report, but the fact finder was free to disbelieve his testimony. The 2006 report did not include an expiration date of Bruce’s terms as director as required to be included for each officer and director listed, and there was no evidence that the report was amended during the year following its filing on June 8, 2006. Therefore, the court said that the trial court could have reasonably inferred that Bruce remained a director in February 2007, only eight months after the filing of the report. The court of appeals acknowledged that Section 171.255(c) contains two exceptions to the personal liability of a director or officer under subsection (a). Under Section 171.255(c), a director or officer is not liable for a debt if the director or officer shows that the debt was created or incurred over the director’s objection or without the director’s knowledge and the exercise of reasonable diligence to become acquainted with the affairs of the corporation would not have revealed the intention to create the debt. Bruce waived any appellate contention that he met his burden to prove an exception by failing to adequately brief the contention. Finally, the court reviewed the evidence relating to the debt of the LLC and rejected Bruce’s argument that the plaintiff failed to prove the LLC incurred a debt to the plaintiff.

The debtor was the president, sole shareholder, and sole decision maker of a corporation and the sole member and sole decision maker of an LLC. The plaintiff in this adversary proceeding sought to hold the debtor individually liable in connection with fraudulent misrepresentations made on behalf of his corporation and LLC. The court held that the debtor was personally liable for the damages caused by the misrepresentations because a corporate agent is personally liable for his own fraudulent and tortious acts even when the agent is acting in the scope of employment.


Basurto sued Watkins for personal injuries suffered in an assault by bouncers at a bar known as The Tavern. Two LLCs (which were not defendants) were involved in the operation of The Tavern. One managed the operations, money, and income of The Tavern, and the other held the liquor license and employed the staff. Watkins was the registered agent and a member of both LLCs. The two bouncers involved in the fight with Basurto had several criminal convictions, but it was not the practice of Watkins to run background checks when hiring employees, and he did not run background checks on the bouncers. After a bench trial, the trial court entered a judgment against Watkins, and Watkins appealed. Watkins argued that the evidence was insufficient to support the finding that Watkins owed and breached a duty to Basurto that caused Basurto’s injuries. The court recognized the general duty of an employer to appropriately hire, train, and supervise employees to prevent injuries to third parties that are reasonably foreseeable. The court further stated that an employer has a duty to take reasonable steps to prevent harm to third parties, which may include conducting an appropriate background investigation, if the employer places its employees in a position where it is foreseeable that the employees could cause harm. The court noted that a corporate officer generally is liable for his or her own negligence, but a corporate officer is only liable for the breach of a duty of care owed to third parties independent of the business’s duty. The court further noted that Texas law is unsettled as to whether the agent of a corporation or LLC can be held individually liable for the tort of negligent hiring or supervision, i.e., whether the agent owes a duty to third parties to properly hire or supervise other agents of the principal. Ultimately, the court dodged this question because it concluded that there was insufficient evidence as to proximate cause. There was insufficient evidence that a breach of duty (i.e., failure to run a background check on the bouncers and failure to train and supervise the bouncers) proximately caused Basurto’s injuries because there was no evidence that a background check would have revealed any violent tendencies of the bouncers, no evidence that these bouncers had shown violent tendencies on the job, and no evidence that training would have prevented the injuries.


Hajdasz signed a lease as operations manager of an LLC. The lease identified the LLC as the tenant, and the lessor filed suit against Hajdasz after the LLC defaulted on the lease. The jury found Hajdasz personally liable on the lease, and Hajdasz appealed on the basis that the evidence was insufficient to show he was personally liable. The court of appeals noted that the defaulting tenant was identified in the lease as a limited liability company and stated that managers are not individually liable for the debts of the LLC as a general rule, citing Section 101.114 of the Business Organizations Code. The court further noted that an agent who contracts for a disclosed principal, as did Hajdasz when he signed the lease, is not liable on the contract. In this case, Hajdasz would only be liable for the plaintiff’s breach of contract claim if the plaintiff proved he agreed to be individually liable. The record revealed that he signed the lease only in the capacity as operations manager, and there was no evidence he agreed to be individually liable. Thus, the court held the evidence was insufficient to support the finding of individual liability on the lease.


Smith appealed a post-answer default judgment entered against him for rent owed on a storage building. Smith argued on appeal that he signed the lease only in his official capacity as a member of an LLC and that the trial court erred in entering a judgment against him personally. The court held that Smith was required to file a verified denial to raise the issue of capacity. Since the record contained no verified pleading complaining about capacity the court overruled this point of error.
Two individual members of an LLC were liable for fraud based on the principle that agents are personally liable for fraudulent or tortious acts committed while in the service of their LLC.


Weatherford International, Inc. ("Weatherford") sought to hold an LLC and its two member/managers, Bennett and Donaho, liable for breach of contract and copyright infringement. Bennett and Donaho argued that they were not personally liable because they did not act in their individual capacities. Weatherford argued that Bennett and Donaho were personally liable because the LLC's charter had been forfeited under the Tax Code at the time the negotiations for the contract took place, and the Tax Code provides that a corporate officer of an LLC whose charter has been revoked is liable for a debt that is incurred after the date on which the tax is due. However, the LLC was reinstated after its forfeiture, and Weatherford's complaint did not indicate when the contract with the LLC was signed. Because Texas case law holds that a debt created by a contractual obligation is created when the contract is signed for purposes of the Tax Code provision imposing personal liability on corporate officers and directors, the court could not determine as a matter of law whether the individuals were personally liable. The court also concluded that it did not have sufficient information to determine whether the individuals could be liable under an alter ego theory or for directing the acts of copyright infringement.

The court cited LLC statutory provisions regarding management of an LLC and sharing of profits and losses in concluding that an individual owner of a corporation was liable for the corporation’s copyright infringement.


The plaintiffs sought to hold an LLC member liable for the LLC’s breach of contractual obligations on the basis that the LLC had forfeited its status as a Texas LLC. The court stated the general rule that members are not individually liable for the debts of a limited liability company. The court then stated that the LLC was a “limited liability corporation,” to which state law principles for piercing the corporate veil apply, and that the plaintiffs could hold the member liable for the LLC’s alleged breach of contract only to the extent they pierced the corporate veil. The plaintiffs relied only upon provisions of the Texas Tax Code regarding forfeiture and brought forth no evidence of fraud that would entitle them to hold the member individually liable; therefore, the court concluded that the trial court properly granted summary judgment in favor of the member on the breach of contract claim. However, the court of appeals stated that the trial court erred in rendering summary judgment in the member’s favor with respect to certain non-contract claims. The court stated that the plaintiffs’ allegations of the member’s own tortious and fraudulent actions, including alleged Deceptive Trade Practices Act violations, did not depend upon veil piercing because a corporation’s agent is personally liable for his own fraudulent or tortious acts, even when acting within the scope of employment.


Micaela and Omar Alvarado owned and operated an LLC which they sold to the plaintiff. The Alvarados signed the purchase and sale agreement in their individual capacities, and Omar signed in his capacity as president and duly authorized representative of the LLC. The plaintiff obtained a summary judgment against the LLC and the Alvarados, and the Alvarados argued that they were not liable in their individual capacities. The court of appeals affirmed the summary judgment against the Alvarados because they did not raise the issue of capacity or file a verified plea challenging capacity in the trial court, and they both signed the agreement selling the LLC in their individual capacities. The court rejected the assertion that the Texas Limited Liability Company Act protected the Alvarados from individual liability because the record showed that the Alvarados sold their ownership in the LLC and thus were not members of the LLC when the suit was brought.


The president of an LLC filled out and signed a credit application for the LLC that contained a “personal guarantee” paragraph at the bottom of the second page of the application. After the LLC filed for bankruptcy, the creditor sued the president for unpaid invoices based on the personal guaranty. The president sought summary judgment and filed an affidavit with the second page of the credit application attached and swore that he signed the guaranty in his capacity as president of the LLC and was not individually bound. The court stated that a personal guaranty is not transformed into a corporate guaranty by the fact that a corporate title follows an individual signature because corporate designations appearing after signatures on personal guaranties are considered only to identify the person and not as proof that the person is acting in any particular capacity. The court could not conclude that the president was entitled to judgment as a matter of law based on only the second page of the credit application and the applicable law.


An attorney was sanctioned for filing a frivolous pleading, and the attorney argued that the trial court erred in imposing a sanction on him personally rather than his professional LLC. The attorney argued that he signed the pleading on behalf of the LLC and that the Texas LLC statute protected him from personal liability. The court rejected this argument and stated that the attorney could be sanctioned as the “person who signed” the pleading under the provisions of the Texas Rules of Civil Procedure regarding sanctions. The court noted that an attorney may also subject his firm to liability for a sanction in certain circumstances.


The court recognized that an LLC member has limited liability under either Texas or Delaware law but held that a Delaware LLC member had not shown there was no basis for liability to the plaintiff (who was suing on behalf of
a decedent’s estate for injuries the decedent suffered in a nursing home owned by the LLC) since the member did not show it acted solely in the capacity of an LLC member.


The court stated that the truism that a business entity may only breach a contract through the actions of its officers, employees, and agents does not create individual liability on the part of those agents under Texas law, nor does it make such an agent of an LLC a party to the LLC’s contract.


The plaintiff sued an LLC and its member under a contractual indemnity agreement with the LLC. The court concluded that the LLC member was not personally liable for the LLC’s contractual indemnity obligation in the absence of any evidence that the regulations provided that its members were individually liable for the LLC’s debts.


The defendants, three individuals, were held personally liable on a contract executed on behalf of “Reo Harvest” without any language or abbreviation indicating that Reo Harvest was an LLC. On appeal, the defendant complained of the trial court’s exclusion of evidence that Reo Harvest was a New Mexico LLC and that the plaintiff had notice of that fact prior to the signing of the contract. The appeals court held that it was not error to exclude the evidence because the defendants did not properly plead the defenses that would support their claim of non-liability as members of an LLC. The applicable defenses required verified pleas which the defendants failed to present.

G. Authority of Member, Manager, or Officer


An Iowa LLC challenged the trial court’s exercise of personal jurisdiction over the LLC, and the court of appeals affirmed the trial court. The question was whether the actions of Cox, a Texas resident and member of the LLC, were attributable to the LLC for purposes of specific jurisdiction. Under the Iowa LLC statute, a person is not necessarily an agent simply because the person is a member, but the statute provides that a person’s status as a member does not prevent other law from imposing liability on the LLC because of the person’s conduct. The court of appeals relied heavily on an Iowa court of appeals decision, Three Minnows, LLC v. CREAM, LLC, which explained that an Iowa LLC is presumed to be managed by its members unless the members agree that the LLC will be managed by managers. As the court in Three Minnows further explained, the party asserting an agency relationship must prove its existence, and an agency results from manifestation of consent by a principal that an agent shall act on the principal’s behalf and subject to the principal’s control and consent by the agent to do so. In Three Minnows, where the LLC was manager-managed, a member did not have authority to bind the LLC to a contract. The LLC’s articles of organization in that case expressly provided that no member, agent, or employee of the LLC had any power to bind the LLC unless authorized by the operating agreement or the managers of the LLC. Here, by contrast, the LLC’s operating agreement provided that the LLC’s business and management was to be exercised by the members. Although the members were permitted to delegate to officers, the officers remained subject to the direction and control of the members. Thus, the court concluded that Cox had express authority to act on behalf of the LLC. The LLC argued that it did not control Cox and that Cox was not its agent for purposes of the jurisdictional analysis, but the operating agreement expressly provided that the management of its business would be conducted solely by its members. Cox was recruiting dealers to contract with the LLC, and the court relied on the general rule that the actions of a corporate agent are generally deemed the corporation’s acts. As a member of a member-managed LLC with express authority to conduct the LLC’s business, Cox was the LLC’s agent. As an agent, he recruited dealers to contract with the LLC, and the LLC contracted with recruited dealers, evidencing both the LLC’s consent for Cox to act and Cox’s consent to do so. The LLC, not Cox, controlled the terms of the contractual relationships with the recruited dealers. Thus, the court concluded that Cox’s contacts with Texas were attributable to the LLC for purposes of the specific jurisdiction analysis. The court went on to find the other requirements for the exercise of specific jurisdiction were met as well, i.e., that the contacts were purposeful and were done to obtain a benefit for the LLC, and the exercise of jurisdiction would not offend notions of fair play and substantial justice.

The bankruptcy of the debtor LLC was dismissed because the member who filed the case did not have authority to do so. A Chapter 11 petition was filed August 13, 2012, and the decision to file was made solely by Hellman, who claimed to do so as the sole manager of the LLC. Hellman was a one-third member, and there were two other members at the time of the filing. The other two members, Whitten and Schuil, were not consulted regarding the filing, but Hellman knew they were opposed to putting the company in bankruptcy. The three members had approved an amended operating agreement on August 3, 2011, under which Whitten was named as manager and all significant decisions concerning the company were required to be made by a majority of the members. The filing was clearly in contravention of the amended operating agreement, but Hellman raised several technical arguments that the amended operating agreement should be set aside and that the original operating agreement should be consulted to determine whether he had authority to file the bankruptcy. Hellman argued that he had authority to file the case as sole manager of a manager-managed LLC and under the general powers granted the manager under the original operating agreement. The court examined the provisions of the original operating agreement and characterized them as ambiguous at best. The agreement granted extensive powers to the manager but also referred to decisions of members. The agreement contained no specific direction concerning the filing of a bankruptcy. Hellman admitted during his testimony that as manager he could not force the liquidation of the company, and the court pointed out that the New Mexico Limited Liability Company Act provides for majority consent or vote of members in the analogous circumstance of filing suit. The court stated that it defied common sense to conclude that a one-third owner of an LLC has authority to place the company in Chapter 11 when he knew that the majority of members were opposed to the action. The court went on to discuss how Whitten used his financial muscle to gain majority control of the LLC and force the amendments to the operating agreement. In multiple instances, Hellman acknowledged, at least implicitly, the validity of the amended operating agreement. The court commented that Whitten’s tactics and actions might provide Hellman with a cause of action against Whitten but did not cure Hellman’s lack of authority. In essence, said the court, this case involved a dispute among the owners of the LLC. Whitten used his financial leverage to orchestrate a liquidation of the LLC on his terms. Hellman vehemently disagreed with the terms of a sale that was proposed by Whitten and Schuil on August 9, 2012, and Hellman filed the Chapter 11 case a few days later. He withheld from his own attorneys the amended operating agreement. The court stated that even if it sustained the filing, the rift among the members, with Hellman in the minority, made a reorganization impossible. Concluding that Hellman lacked authority to file the case, that cause existed for dismissal, and that the case did not present the type of “unusual circumstances” sufficient to condone the filing, the court dismissed the case.


Rim Golf Club LLC (“Rim LLC”), an Arizona LLC, made a loan to Chaparral Pines LLC (“Chaparral LLC”), an Arizona LLC, secured by a deed of trust between Chaparral LLC as trustor and Rim LLC as beneficiary. Chaparral LLC was the manager of Rim LLC. At issue was the validity of a deed of release that recited that the beneficiary released the deed of trust and was signed by Jess R. Gift, immediately under the name of Rim LLC, as manager of Chaparral LLC. The bankruptcy court first determined that Gift was the manager of Chaparral LLC (the manager of Rim LLC) and then addressed the question of whether Gift had authority as manager of Chaparral LLC to release the deed of trust. The court relied on provisions of the Arizona LLC statute to conclude that Gift had such authority. Under the Arizona LLC statute, a manager is an agent of the LLC for the purpose of carrying on its business in the usual way, and a manager’s act, including execution of an instrument in the LLC name, for apparently carrying on the business of the LLC in the usual way binds the LLC unless the manager has no authority and the person with whom the manager is dealing knows that the manager has no authority. No argument was made that execution of the deed of release did not constitute execution of an instrument in the name of the LLC in the usual way, and there was no evidence offered to suggest that any party involved in the transaction had knowledge that Gift lacked authority to execute the deed of release. The court noted that because Gift was an agent of both Chaparral LLC and Rim LLC, the person with whom he was dealing was himself. Thus, the court concluded that Gift had the requisite authority to release the deed of trust as agent of both Chaparral LLC and Rim LLC. The bankruptcy court next considered and rejected the argument that the deed of release was ineffective because it listed no capacity for Gift other than manager of Chaparral LLC, who was the trustor, not the beneficiary. Based on the statutory authority of a manager of an LLC and the fact that Chaparral LLC was the manager of Rim LLC, Chaparral LLC had the authority to release the deed of trust and bind Rim LLC by signing as manager of the LLC. Because Gift signed directly under the name Rim LLC, the court stated that the deed of release was technically signed by the beneficiary. The court also noted that the deed of release stated that the recorded document was to be mailed to Rim LLC, and no party disputed the authority of Gift or Chaparral to bind Rim LLC at any time. Thus, the court concluded the deed of release was valid and binding.
William and Eleanor Davis entered a Rule 11 agreement in their divorce action in which they agreed to the appointment of a receiver to sell the property of their LLC horse farm. William asserted certain complaints about the receiver’s authority and a modified order issued by the trial court after the first order appointing the receiver, but William failed to preserve those issues for appeal. William also complained that the trial court erred in issuing an order placing the LLC’s property into receivership because the LLC was not a party in the divorce proceeding. The LLC was co-owned and managed by Eleanor and William in equal shares. The governing documents stated that the LLC was manager-managed and that Eleanor and William were the managers, but the LLC was operated by them informally “as a partnership” without holding meetings or observing other formalities. Although the court acknowledged that the LLC’s property was owned by the LLC and not Eleanor and William, the court found it sufficient that Eleanor and William agreed to the appointment of the receiver in the Rule 11 agreement given that Eleanor and William enjoyed complete authority over the property as members and managers of the LLC, “especially given that they exercised that control over it informally as a matter of course.” A concurring justice wrote to express his view that the trial court was without authority to enter its first order appointing a receiver for the LLC’s property because the LLC was not a party at that time, and the Rule 11 agreement was not signed by Eleanor and William in their capacities as managers of the LLC, but rather as individuals who were parties to the divorce action. The concurring justice argued that past mutually agreed informal management of an entity does not forever bar insistence on obedience to the governing documents of the entity, and an agreement in the capacity of an individual does not unwillingly bind that same person in the capacity as manager of an LLC. Because the LLC had been made a party to the divorce proceeding by the time a subsequent order appointing a receiver was entered nunc pro tunc, the concurring justice concurred in the result reached by the majority.

The debtor brought this action against her ex-husband, her ex-father-in-law, and the ex-father-in-law’s LLC to recover her share of royalty payments on royalties owned by an LLC, Artist Rights Foundation L.L.C. (“ARF”), of which she was a 25% owner. The defendants claimed that they alone had the rights to the royalty payments because the rights were purchased from ARF by the ex-father-in-law’s LLC. The court concluded that the ex-husband, Raul Galaz (“Raul”), lacked authority to transfer the royalties on behalf of ARF and that the transfer was thus void and unenforceable. The defendants argued that Raul was the only full member of ARF, a member-managed LLC, at the time of the transfer and was the only person with authority to act on behalf of ARF. However, the court determined that there was another member and that the failure to obtain approval of members holding a majority of the membership interests for the sale or disposition of substantially all the assets as required by the operating agreement deprived Raul of authority to transfer the royalties since it was undisputed that the royalties constituted substantially all of ARF’s assets.

The trial court entered a judgment against an LLC based on the acts of an individual. The appellants argued that the pleadings and evidence did not support piercing the corporate veil and that the LLC was a limited liability company rather than a limited liability corporation. The court pointed out that the individual testified that the company was a limited liability corporation and that she was the president and sole stockholder. The court applied the rule that a person’s status as vice-principal of a corporation is sufficient to impute liability to the corporation on the basis that the acts of the vice-principal are the acts of the corporation itself. A corporate officer is among the types of corporate agent classified as a vice-principal. Since the undisputed evidence established that the individual was a vice-principal, her acts were imputed to the “corporation.”

The plaintiff sought to hold an LLC liable on a transaction by the manager (Marks) on the LLC’s behalf. The LLC argued that Marks had been removed as manager at a meeting of the members and lacked authority to bind the LLC. The LLC was designated as manager-managed in its articles of organization and Marks was named the initial manager in the articles of organization. The court reviewed the statutory provisions dealing with actual and apparent authority of managers of manager-managed LLCs as well as the provisions of the articles of organization and regulations of the LLC and concluded that the evidence conclusively established that Marks was the initial manager with actual authority to act for the LLC. The question was whether Marks continued to have actual authority at the time in question. The court noted that there was evidence that proper notice required under the regulations had not been given to all members of the meeting at which Marks was removed. The court stated that the plaintiff did not have standing to directly challenge the
irregularity in the meeting, but the failure to give notice of the meeting to Marks, who was also a member of the LLC, did impact the analysis of his authority. The court stated that an agent has actual authority where a principal intentionally confers it or intentionally or negligently allows the agent to believe he has authority. Since Marks was not dispossessed of the belief that he was authorized to continue to act on the LLC’s behalf, he continued to have actual authority to bind the LLC.

H. Admission of Member


After a judgment entered in the Northern District of Texas was registered in the Southern District, this court issued an order for turnover relief and appointment of a receiver requiring the judgment debtors, Gary Kornman and various related entities, to turn over all nonexempt property to the receiver. Kornman executed a conveyance of interest on behalf of himself and all judgment debtors in which the judgment debtors conveyed all of their right, title, and interest to property identified in the conveyance. Kornman objected to the court’s ruling as to the effect of the conveyance with respect to the control of an LLC and several limited partnerships. The LLC at issue had two members: Kornman, who owned 95% of the LLC, and a corporation, which owned the remaining 5%. Kornman owned 100% of the stock of the corporation. As a result of the conveyance executed by Kornman to the receiver, the court had previously entered an order stating that the receiver owned 100% of the LLC and that the receiver was the sole member and could exercise control of the LLC. Kornman stipulated to the receiver’s ownership of 100% of the membership interest but contested that the receiver was the sole member in control of the LLC. The court recognized that the receiver, as an assignee, did not automatically become a member because Section 101.108(b)(2)(B) of the Texas Business Organizations Code provides that an assignee of a membership interest is entitled to become a member on the approval of all the members. With respect to Kornman’s assignment of his 95% interest in the LLC, the court stated that Kornman did not merely assign his 95% membership interest, but all of his rights as a member. The court stated that this distinction is recognized in Section 101.111(a) of the Texas Business Organizations Code, which provides: “An assignor of a membership interest in a limited liability company continues to be a member of the company and is entitled to exercise any unassigned rights or powers of a member of the company until the assignee becomes a member of the company.” (Emphasis added by court). The court stated that Kornman assigned all of his rights as a member, including the ability to approve the admission of new members, in addition to the assignment of his membership interest. The only member of the LLC other than Kornman was a corporation owned by Kornman. Because Kornman was the 100% shareholder of the corporation, Kornman’s assignment of his stock to the receiver resulted in the receiver’s obtaining the ability to manage the business and affairs of the corporation and thus exercise the corporation’s rights as a member. The court stated that one of the two members of the LLC, Kornman, was no longer entitled to object to the admission of the receiver as a member, and Kornman’s approval thus need not be sought. The other member of the LLC, the corporation now owned and controlled by the receiver, could approve the admission of the receiver as a member. Thus, the receiver, in addition to owning 100% of the LLC, could exercise control over the LLC because the receiver managed the business and affairs of both members, i.e., the corporation’s and his own. The court stated that it would amend the previous order to reflect that the receiver is the “sole owner” rather than “sole member” since the receiver and a corporation owned by the receiver were both members.


The court determined that the debtor’s receipt of a 25% interest in a California LLC pursuant to a divorce did not result in her becoming a member; rather, she was only an economic interest holder. The debtor’s community property interest in her husband’s 50% interest terminated upon the divorce, and she received her ownership share through an agreement incident to divorce. The agreement was silent as to the nature of the interest, stating only that it was a 25% interest in the LLC. The LLC’s operating agreement prohibited transfer of membership interests except with the prior approval of all members. The ex-wife argued that the ex-husband gave his approval by signing the divorce agreement, but there was no evidence that the other member of the LLC gave his approval. The LLC operating agreement provided that a transfer of an interest in violation of the provision requiring approval of all members entitled the transferee to receive a share of the net profits and losses, but not to vote or participate in the management. Because a valid transfer of a full membership interest required the prior approval of all members, the debtor held a purely economic interest rather than a full voting membership interest.

A judgment debtor sought a turnover order and receiver for ownership interests in businesses of the judgment debtors, but the court held that the evidence relied upon by the judgment creditor failed to show that the judgment debtors owned non-exempt property that cannot be readily attached or levied on by ordinary process. The judgment debtor relied upon records obtained from the Secretary of State listing one of the judgment debtors as a director, member, or officer of various businesses. The court cited provisions of the Business Organizations Code for the proposition that a person’s right to manage a company is not an “ownership interest.” Specifically, the BOC provides that a person need not be a shareholder to be a director of a corporation. With respect to an LLC, the court cited provisions of the BOC stating that the right to participate in management of an LLC is not a membership interest and a person may be a member of an LLC without acquiring a membership interest. The court also held that county records showing an LLC as owner of the residence of the judgment debtors, and a deed conveying the residence from another company to the LLC, were not evidence that the judgment debtors owned the LLC.


The court concluded that the Texas Lottery Commission failed to establish that the appellant, Jongebloed, was an “officer, director, or owner” of an LLC licensed by the Commission to sell lottery tickets. The Commission relied upon Jongebloed’s status as such to hold him personally liable under the lottery statute for lottery sales proceeds owed to the Commission by the LLC. The court reviewed the evidence and found that the Commission’s findings, on their face, did not support its legal conclusion that Jongebloed was a member of the LLC when the lottery proceeds became due. The court stated that membership in an LLC is an interest in personal property akin to stock ownership or a partnership interest. Although the Commission made findings that Jongebloed had been identified in LLC filings as a vice president (i.e., an officer) and manager (which the court characterized as “essentially the equivalent of a director”), the Commission made no findings that he was ever a member. The court stated that being a manager or officer of an LLC does not mean one is also a member. Managers and officers may, but need not be, members, and managers and officers do not by that status alone have a membership interest in the entity.

KMG Kanal-Muller-Gruppe Deutschland GmbH & Co. KG v. Davis, 175 S.W.3d 379 (Tex. App.—Houston [1st Dist.] 2005, no pet.).

The plaintiff’s employment contract with an LLC contained a provision in which the LLC agreed to grant the plaintiff a 5% membership interest in the LLC. The plaintiff was never granted the membership interest, and the court held that there was sufficient evidence to support a finding by the jury in favor of the plaintiff on the plaintiff’s negligent misrepresentation claim. Although a representative of one of the defendants testified that the plaintiff was required to make a $5,000 capital contribution to become a member, the court noted that the employment agreement made no mention of such a requirement. Further, the initial regulations, although never executed, referred to the plaintiff as an initial member of the LLC, and there was no amount set forth opposite the plaintiff’s name in the provision of the regulations containing a column labeled “Initial Capital Contribution.” The regulations provided that the plaintiff’s total commitment over an unspecified period of time was to be $5,000. The court concluded that the employment contract and regulations constituted evidence from which the jury could infer the defendants made a representation to the plaintiff that he would become a member with a 5% interest without payment of $5,000 as a condition precedent. The plaintiff testified he relied on the representations regarding his membership interest, and there was evidence of economic loss sustained when he did not receive the interest. Thus, the court concluded there was evidence to support each element of negligent misrepresentation.

1. **Conflict Between Regulations/Company Agreement and Articles of Organization/Certificate of Formation**

   Pinnacle Data Services, Inc. v. Gillen, 104 S.W.3d 188 (Tex. App.—Texarkana 2003, no pet.).

   The articles of organization of an LLC provided that the articles of organization (which provided for member-management) could be amended by the vote of two-thirds of the members while the regulations provided that amendment of the articles of organization required the vote of 66 2/3% in interest. Two of the three members (constituting 50% in interest) voted to amend the articles of organization to change the LLC to a manager-managed LLC. The court held that the provision in the articles of organization controlled because the Texas LLC Act provides that the regulations may contain any provisions for the regulation or management of the LLC not inconsistent with law or the articles of
organization. (The court held, however, that compliance with the articles of organization did not dispose of the breach of fiduciary duty claim.)

J. Transfer Restrictions and Buyout Provisions


In 1996, Jacob Kohannim (“Jacob”) and Mike Khosravikatoli (“Mike”) formed an LLC to purchase and hold real property on which a corporation owned by them operated a restaurant. Jacob and Mike were the managers and each owned a 50% interest in the LLC. The member agreement contained transfer restrictions that provided the LLC and the other member the opportunity to purchase a member’s interest in the event of a proposed sale of the interest or a transfer to a member’s spouse in a divorce. In 2003, Mike’s wife, Parvenah, filed for divorce, and the divorce court issued temporary orders prohibiting Mike and Parvenah from transferring assets. During the pendency of the divorce, Mike purported to transfer a 5% interest in the LLC to Jacob. In 2005, the divorce decree was entered. In the divorce decree, the district court found the transfer was void because it was an attempt to transfer community property in violation of the court’s order enjoining such a transfer. The divorce decree further awarded Parvenah “[o]ne hundred percent (100%) of the husband’s interest” in the LLC, “which interest is equivalent to a fifty percent (50%) interest in such company.” The decree required the husband to execute and deliver to the wife’s attorney a stock transfer certificate and/or assignment of interest. After the divorce decree was entered, Jacob advised Parvenah that he intended to start the process of determining the value of the LLC for purposes of the buyout provision in the member agreement. In 2006, Parvenah sued Jacob and the LLC, seeking a declaration of her rights with respect to the LLC and the validity of the member agreement and asserting other claims based on constructive fraud, breach of fiduciary duty, oppression, waste, gross mismanagement and abuse of control, and unjust enrichment. The trial court appointed a receiver for the LLC and ordered the receiver to sell the LLC’s assets. The trial court eventually approved a sale of the LLC’s property for $1,300,100. The trial court’s final judgment contained findings as to the amount of assets held by the receiver and how the assets should be divided based on the court’s finding that Jacob and Parvenah each held a 50% beneficial interest in the assets. The trial court also found that Jacob, with malice and intent to defraud, engaged in wrongful acts and omissions that damaged Parvenah by decreasing the value of Parvenah’s interest in the LLC, and the trial court awarded Parvenah actual and punitive damages based on the wrongful acts and omissions. Jacob appealed on numerous issues but did not challenge the trial court’s division of the LLC’s assets.

The court of appeals rejected Jacob’s challenge to the legal sufficiency of the evidence to support Parvenah’s oppression claim. Jacob argued that there was no evidence that he oppressed Parvenah’s rights by refusing to allow her to participate in management given that she was not a member. The court explained that a membership interest is personal property and that Mike’s 50% membership interest was community property awarded in its entirety to Parvenah under the divorce decree. Mike executed a document transferring and assigning the membership interest to Parvenah as required by the divorce decree, but the assignment of the interest did not include the right to participate in management under the Texas Business Organizations Code. Under the statute, the right to participate in management is not community property, and assignment of a membership interest does not entitle the assignee to participate in the management and affairs of the LLC, become a member, or exercise any rights of a member. An assignee is entitled to become a member only with the approval of all of the members, and Jacob never consented to Parvenah becoming a member. Thus, she did not have any right to participate in the management of the LLC. Jacob next contended that there was no evidence that he oppressed Parvenah’s rights by failing to make distributions to her. The LLC’s regulations (i.e., company agreement) provided for quarterly distributions to members of “available cash” provided available cash was not needed for reasonable working capital reserves. The LLC statute provides that an assignee is entitled to receive any distribution the assignor is entitled to receive to the extent the distribution is assigned. Because the district court awarded the entire community interest to Parvenah, she had a right to receive distributions. The district court found that Jacob paid himself for services that were not performed and that he failed to make any distributions to Mike or Parvenah even though $250,000 in undistributed profits had accumulated since the mortgage on the LLC’s property was paid off. The court of appeals concluded this was some evidence supporting the trial court’s finding that Jacob failed to make profit distributions. The court also agreed that the established facts demonstrated that Jacob engaged in wrongful conduct and exhibited a lack of fair dealing to the prejudice of Parvenah.

The court addressed a challenge by Jacob to the legal sufficiency of the evidence to support the actual and punitive damages award. Because the court of appeals sustained Jacob’s challenges to Parvenah’s other causes of action, the only viable cause of action to support a damage award was the shareholder/member oppression claim. The court of appeals stated that the standard of review on this issue was not the traditional sufficiency analysis as asserted by Jacob, but rather was abuse of discretion because the receivership provision of the Texas Business Organizations Code that
provides for an oppression action authorizes a court to fashion an equitable remedy if the acts of those in control of an entity are oppressive. The court of appeals concluded that the trial court’s methodology for finding actual damages was not an abuse of discretion. The trial court calculated Parvenah’s damages by calculating the difference between the value of the LLC’s assets at the time of the trial court’s judgment in this case and the value of the LLC at the time of the divorce. The court of appeals rejected the argument that the member agreement required the LLC to be valued as of the date of the divorce petition. The court of appeals stated that the trial court found that the member agreement did not apply to Parvenah. Assuming it applied to Parvenah, the court of appeals stated that it was inapplicable here because Jacob did not comply with the provision addressing a buyout on divorce by intervening in the divorce proceeding to enforce the provision. Mike had agreed to the intervention, but Jacob did not do so. Jacob next argued that the LLC regulations provided that the valuation of Parvenah’s interest must be based on book value because the regulations contained a provision for purchase of a member’s interest at book value or appraised value on request of a party who deems the book value to vary from market value by more than 20%. The provision of the regulations relied upon by Jacob addressed death, dissolution, retirement, or bankruptcy of a member. The court stated that the provision did not address how damages are calculated in a lawsuit based on oppression, and the court relied on other case law in which the court in an oppression action concluded that it was not an abuse of discretion to order a buyout for fair value when a buy-sell agreement provided for redemption at book value. The court of appeals pointed out that receivership is one remedy for shareholder/member oppression and that the trial court ordered a receivership and authorized a sale of the LLC’s assets. Jacob did not complain concerning the receivership or sale. However, the court concluded that Parvenah was not limited to a recovery of her proportionate share of the sale proceeds and that courts have equitable powers to fashion appropriate remedies for oppressive conduct, including a buyout. Here, the court concluded that sufficient evidence supported the values found by the trial court and that Jacob did not argue, and the court of appeals did not perceive, that the trial court’s methodology constituted an abuse of discretion. The court of appeals sustained Jacob’s challenge to punitive damages because the only causes of action that could support a punitive damages award were actual fraud and breach of fiduciary duty, and Jacob’s challenges to these claims were sustained by the court of appeals.


An LLC member asserted various claims against the LLC and his co-members in connection with the withdrawal and buyout of the member. The member cashed a check tendered by the LLC for his interest but did not sign a letter accompanying the check. The letter contained a release of liability and stated that the member’s signed acceptance of the terms constituted the member’s agreement that his ownership was relinquished. The member argued that the buyout of his interest did not become effective and that he was still entitled to receive membership distributions because the buyout violated transfer restrictions in the LLC membership regulations (i.e., the operating agreement). The transfer restrictions prohibited a member from disposing of all or any portion of his membership interest without complying with specified conditions and stated that any attempted disposition in violation of the agreement was void. The transfer restriction provision referred to the “Person” to whom the membership interest was transferred, and the agreement defined “Person” as having the meaning given in the Texas LLC statute. The statute defined the term broadly to include individuals and entities. The court concluded, however, that the transfer restriction only applied to a transfer to a person who was not a member. The court stated that a plain reading of the provision demonstrated that its purpose was to provide rules for disposition of a member’s interest to a non-member. In support of this interpretation, the court pointed to the fact that the phrase “Person to be admitted” was used in various subsections of the transfer restriction provision. The court found that the buyout did not violate the transfer restriction because the transfer did not involve a transfer to a non-member. The court also concluded that the LLC had complied with provisions of the membership regulations governing distributions to a withdrawing member. The court found that the LLC’s offer to purchase the member’s interest substantially complied with the requirement that a withdrawing member receive the fair value of his interest as of the first day of the month following the date of the occurrence giving rise to the member’s withdrawal. The letter stated that the purchase price would be calculated based on the retained earnings of the LLC as of the last day of the month of the member’s withdrawal. Although the member did not sign the letter accompanying the check, the court found that the member accepted the buyout of his interest by signing and depositing the check and completed his withdrawal effective as of the date specified in the letter. The court rejected the member’s claims that the other owners of the LLC breached a fiduciary duty to him in connection with the repurchase of his interest. The member couched his argument in terms of duties owed in the context of a closely held corporation and argued that the defendants had the burden to establish the fairness of the transaction. The court stated that the member’s breach of fiduciary duty claim regarding the voiding of his interest depended upon his argument that the transfer restrictions applied to the purchase of his interest, and the claim thus failed as a matter of law. The court stated that another breach of fiduciary duty claim
based on alleged fraudulent transfers of ownership in the LLC related to transactions that occurred after the member’s withdrawal and that the LLC owed him none of the duties owed members after that date.


The court interpreted LLC operating agreement transfer restrictions requiring unanimous member approval for transfer of an interest.


Two groups of entities, Lone Star and Eikon, were members of an LLC with a push-pull buy-sell provision. Either party could invoke the provision by notice to the other member in which the invoking member set forth an amount (the “Stated Amount”) which represented the price at which the invoking member would be willing to purchase all the assets of the LLC as if the invoking member were a hypothetical third party proposing to purchase the assets of the LLC. The agreement set forth a formula for calculating the value of each member’s interest based on the Stated Amount. After the invoking member gave notice to the other member, the other member could elect to buy the invoking member’s interest or sell its own interest to the invoking member. Eikon invoked the buy-sell provision, and Lone Star accepted the Stated Amount proffered by Eikon but believed that Eikon had miscalculated the price. Lone Star agreed to buy Eikon’s interest and tendered a check for the full amount claimed by Eikon for its interest, but reserved its right to contest the amount. While the LLC agreement required Lone Star to provide a 10% cash deposit on acceptance of the offer, Lone Star placed a cashier’s check in escrow for a portion of the deposit and a letter of credit for the remainder of the deposit. Eikon brought suit alleging that Lone Star had breached the agreement by failing to deliver the cash deposit and seeking liquidated damages under the agreement. Lone Star counterclaimed for declaratory judgment requiring Eikon to sell its interest pursuant to the agreement. The court concluded that Lone Star’s interpretation of the purchase price provisions of the agreement was correct and that Lone Star had the right to accept the offer and reserve its rights as it had done. The court concluded that Eikon did not have the right to liquidated damages. With respect to the deposit requirement, the court determined that questions regarding compliance with this requirement were only relevant in the event that the purchase of the interest did not close. Since the closing occurred, the question did not need to be addressed.


Ghosh and Grover, through their respective entities of Cinemawalla, Inc. (“Cinemawalla”) and 87 Minutes, LLC (“97 Minutes”), formed an LLC to produce a movie entitled _97 Minutes_. Ghosh and Grover orally agreed that Grover and 87 Minutes would contribute the rights to a screenplay and written commitments for the project along with $600,000 in cash and $400,000 of previous expenditures in exchange for 87 Minutes’ membership interest, and Ghosh and Cinemawalla, in exchange for its membership interest, would obtain the release of $4 million that had been placed in escrow under a contract between Cinemawalla and a third party (“San Luis Cine”) for the production of another movie. Grover and 87 Minutes satisfied their obligations, and Ghosh repeatedly assured Grover that San Luis Cine had agreed to reallocate the escrowed funds to the production of _97 Minutes_, but San Luis Cine never released all the funds. After Ghosh offered various excuses and asserted that various actions needed to be taken before San Luis Cine would release the funds, Grover began to question Ghosh’s credibility and demanded that their agreement be reduced to writing. Ghosh refused to do so, and Grover and 87 Minutes sued Ghosh and Cinemawalla. The plaintiffs’ causes of action included breach of contract, conversion, and fraud, and the jury found in favor of the plaintiffs on each cause of action. On appeal, Ghosh and Cinemawalla argued, _inter alia_, that the statute of frauds barred the breach of contract claim, and the court of appeals addressed the enforceability of the oral agreement by the defendants to cause the $4 million being held in escrow for production of another movie to be redirected to the LLC’s movie project. The Texas Business Organizations Code provides that a promise to make a contribution or otherwise pay cash or transfer property to an LLC is not enforceable unless the promise is in writing and signed by the person making the promise. “Contribution” is broadly defined in the statute to include any tangible or intangible benefit that a person transfers to an entity for an ownership interest or otherwise in the capacity as an owner or member. The benefit includes cash, services rendered, a contract for services to be performed, a promissory note or other obligation to pay cash or transfer property, or securities or other interests in or obligations of an entity. The plaintiffs argued that the defendants did not promise to contribute anything directly to the LLC, but rather to obtain the release of the escrowed funds to Cinemawalla, who would then use the funds
to pay vendors and others providing services needed to make the movie *97 Minutes*. The court stated that the statutory language is not limited to direct contributions. Here it was clear that the oral agreement to access the $4 million in escrow and invest it to fund the production of the LLC’s movie project constituted a promise to make a contribution to the LLC and was unenforceable because it was not in writing and signed as required by the statute. The defendants made several arguments attacking the damages awarded on the fraud claim. With respect to the measure of recovery, the court of appeals held that the plaintiffs were not permitted to recover based on the benefit of their bargain with the defendants because the oral agreement was unenforceable as discussed above. Thus, the plaintiffs could not recover the lost profits they sought. The plaintiffs could, however, recover out-of-pocket damages incurred as a result of the defendants’ misrepresentations. The evidence regarding the expenses incurred by the plaintiffs did not support the amount of expenses found by the jury, but there was evidence that the plaintiffs suffered some out-of-pocket damages, and the court thus remanded for a new trial on the fraud claim.


The court determined that a member’s status as a member did not terminate in connection with the member’s failure to respond to a letter requesting the member to remit funds to cover his half of expenses and taxes incurred by the LLC. The operating agreement had a provision that gave a member 10 days to respond to a written notice of request for capital contributions. Failure to respond resulted in a member’s having only the rights of a transferee under another section of the agreement, which provided that a transferee who acquired a membership interest without approval of all members had only an economic interest and no voting or management rights. The court found that the letter sent to the member (“Jackson”) by the other member (“Galaz”) did not terminate Jackson’s membership for several reasons. First the letter did not detail with any particularity the charges for services or capital contributions Jackson allegedly owed at the time, nor did it account for the capital contributions provided by Jackson at the time of formation of the LLC. It only said that Galaz had incurred certain expenses and tax debt and that he had not been paid for his services. The letter then demanded that Jackson remit a specified amount to Galaz personally plus an amount for several hundred hours of services at a rate of $250 per hour. The court stated that this letter was not a legitimate demand for capital contributions or an accounting of the LLC’s expenses, but merely a pretext in Galaz’s scheme to defraud the LLC and its interest holders. The court stated that its finding was supported by the fact that Galaz sent the letter to the address listed for Jackson in the operating agreement, which Galaz was aware would not result in Jackson’s actually receiving the notice since the two men were involved in litigation against each other. The court stated that Galaz’s actions showed that he purposed to abide by the letter of the law while committing outright fraud (the unauthorized and fraudulent transfer of substantially all of the LLC’s assets, which was the subject of the adversary proceeding).


An LLC sued Potter, one of its members, to enforce a capital call. Potter argued that the regulations did not obligate him to make additional capital contributions without his consent. The trial court submitted the issue of whether Potter was obligated to make the capital contribution to the jury. The jury found Potter was obligated to make the capital contribution. The court of appeals examined the provisions of the regulations and concluded they were susceptible to two interpretations regarding additional capital contributions. On the one hand, they could be read to require members to contribute if requested by the manager and agreed to by a majority in interest of the members. On the other hand, as Potter argued, they could be read as providing that additional contributions were not mandatory on members who objected. Since the regulations were ambiguous, the trial court properly submitted the issue of their interpretation to the jury. The court reviewed the evidence and found there was sufficient evidence to support the jury’s finding that the regulations obligated Potter to make the contribution that the other two members had approved. Additionally, the court concluded that the jury’s damages finding was supported by the evidence because it fell within the range of damages presented to the jury.

I. Financial Rights


Kennebrew founded a private security company as an LLC, and Kennebrew was initially the sole manager and member. The parties executed a management agreement under which Harris obtained a 40% interest in the LLC in exchange for a capital contribution of $10,000. After a short time, Harris became unhappy with Kennebrew’s financial reporting and the LLC’s failure to reimburse Harris for amounts expended on behalf of the LLC, and Kennebrew was
unhappy that Harris did not become licensed or registered under the Private Security Act. Less than a year after joining
the LLC, Harris notified Kennebrew of his intent to withdraw. The LLC accepted Harris’s withdrawal, and the parties
could not agree on the amount that Harris was owed. Harris sued Kennebrew and the LLC. The trial court appointed
an accountant who reviewed the LLC’s records and determined the value of the LLC’s assets, liabilities, and member
equity. Harris’s evidence on these matters differed only with respect to the amount of an outstanding loan balance owed
by the LLC to Harris. The trial judge entered a judgment rescinding the management agreement, concluding there was
an oral loan agreement between the parties, and holding Kennebrew and the LLC liable to Harris for damages and
attorney’s fees. All parties appealed.

The court of appeals analyzed the trial court’s rescission of the management agreement and concluded that
rescission was improper. (Although Kennebrew and the LLC presented all their arguments jointly, and the trial court
made no distinction between the rights and obligations of Kennebrew and the LLC, the court of appeals referred to the
contract claims and arguments as those of the LLC alone because the court determined that the contractual obligations
at issue ran solely between Harris and the LLC.) Because the LLC did not prevail on its counterclaims, it established no
wrong on the part of Harris to support rescission. Further, even if the LLC had prevailed on its counterclaims, the LLC
failed to establish that it satisfied the preconditions for rescission because it did not notify Harris that the contract was
being rescinded, did not return or offer to return Harris’s capital contribution and loans, and did not offer to pay Harris
interest representing the value of the benefit derived from the use of his money. The LLC argued that rescission was
nevertheless appropriate because the management agreement was unenforceable. The LLC argued that the management
agreement never became effective based on a provision requiring execution of all documents necessary to effectuate
the provisions of the agreement. The LLC argued that this provision required Harris to register with the Texas Department
of Public Safety-Private Security Bureau as required by the Private Security Act. Assuming Harris was required to
register, which the court did not decide, the court held that Harris’s failure to register did not render the management
agreement unenforceable. The Private Security Act does not provide that a contract with a person who fails to register
as required by the statute is void or unenforceable, and the statute provides other means of encouraging compliance in
the form of criminal and civil penalties.

The court of appeals found no evidence in the record to support the trial court’s finding of an oral loan
agreement, but Harris argued that the management agreement entitled him to be repaid the amount he was owed for goods
and services purchased for the LLC. The court of appeals agreed. Two provisions of the management agreement
addressed loans by members. One provision stated that a member with the managers’ consent may advance needed funds
to pay obligations of the LLC if the LLC lacked sufficient to pay its obligations. Another provision stated that if a
member made a loan to the LLC or advanced money on the LLC’s behalf, the amount of such loan or advance was a debt
due from the LLC and not a capital contribution. These provisions entitled Harris to recover the amount the trial court
found he spent on the LLC’s behalf.

The trial court’s judgment awarded Harris the return of his capital contribution (as a result of rescission of the
management agreement) and repayment of his loans, but Harris argued that he was entitled to recover the value of his
interest in the LLC (not merely the return of his capital contribution) in addition to repayment of the loans. The court of
appeals agreed that Harris was entitled to recover the value of his 40% interest. Under the Business Organizations
Code, an LLC member may withdraw only if permitted by contract, but a member who validly exercises a right of
withdrawal provided by the company agreement is entitled to be paid the fair value of the member’s interest in the LLC
and the company agreement expressly permitted a member to withdraw, and the evidence showed that Harris validly
exercised that right. The trial court found that the value of Harris’s interest on the date of withdrawal was $44,849, which
was 40% of the members’ total equity as found by the court-appointed accountant. The LLC did not argue that
subtracting the LLC’s liabilities from its assets was an inappropriate means of determining the members’ equity, but
asserted that Harris was not entitled to 40% of the entirety of the members’ equity. Based on a provision of the
management agreement that provided a member was not entitled to return any portion of his capital contribution or
to be paid interest on his capital account or capital contribution, the court said that the LLC reasoned that the sum of
the capital contributions of the two members “should be subtracted from the total members’ equity before calculating
the value of Harris’s share— but not before calculating the value of Kennebrew’s share.” The court characterized this
argument as conflating two different concepts, stating that “a distribution to a withdrawing member of the value of his
interest is not the same as a return of capital.” The court stated that there was no testimony in the record supporting the
LLC’s argument and that it contradicted the trial court’s finding and the statute. Thus, the court of appeals held that
Harris was entitled to recover the value of his membership interest as found by the trial court.

Kennebrew argued on appeal that there was no basis to hold him personally liable for the amounts owed to
Harris, and the court of appeals agreed. The Business Organizations Code provides that a member or manager is not
liable for the LLC’s debts, obligations, or judgments unless the company agreement specifically provides otherwise. Tex. Bus. Orgs. Code § 101.114. Further, the company agreement in this case expressly provided that no member or manager shall be liable for the debts, obligations, or liabilities of the company. Both the funds advanced by Harris to the LLC and the distribution owed for the value of his interest were liabilities only of the LLC. The attorney’s fees were based on Harris’s recovery for breach of contract under Section 38.001(8) of the Texas Civil Practice and Remedies Code. To recover attorney’s fees under that provision, a party must prevail on a breach-of-contract claim and recover damages. Because Harris was entitled to damages for breach of contract only from the LLC, the court concluded there was no basis to hold Kennebrew jointly and severally liable for attorney’s fees. Harris argued that the trial court properly held Kennebrew jointly and severally liable because he refused to give Harris access to the LLC’s books and records thereby breaching the management agreement and committing shareholder oppression, but the trial court did not find that this conduct caused Harris any damages. Thus, the court of appeals held that the trial court erred in holding Kennebrew jointly and severally liable with the LLC for its debts, obligations, or liabilities.


Ghosh and Grover, through their respective entities of Cinemawalla, Inc. (“Cinemawalla”) and 87 Minutes, LLC (“87 Minutes”), formed an LLC to produce a movie entitled _97 Minutes_. Ghosh and Grover orally agreed that Grover and 87 Minutes would contribute the rights to a screenplay and written commitments for the project along with $600,000 in cash and $400,000 of previous expenditures in exchange for 87 Minutes’ membership interest, and Ghosh and Cinemawalla, in exchange for its membership interest, would obtain the release of $4 million that had been placed in escrow under a contract between Cinemawalla and a third party (“San Luis Cine”) for the production of another movie. Grover and 87 Minutes satisfied their obligations, and Ghosh repeatedly assured Grover that San Luis Cine had agreed to reallocate the escrowed funds to the production of _97 Minutes_, but San Luis Cine never released all the funds. After Ghosh offered various excuses and asserted that various actions needed to be taken before San Luis Cine would release the funds, Grover began to question Ghosh’s credibility and demanded that their agreement be reduced to writing. Ghosh refused to do so, and Grover and 87 Minutes sued Ghosh and Cinemawalla. The plaintiffs’ causes of action included breach of contract, conversion, and fraud, and the jury found in favor of the plaintiffs on each cause of action. On appeal, Ghosh and Cinemawalla argued, _inter alia_, that the statute of frauds barred the breach of contract claim, and the court of appeals addressed the enforceability of the oral agreement by the defendants to cause the $4 million being held in escrow for production of another movie to be redirected to the LLC’s movie project. The Texas Business Organizations Code provides that a promise to make a contribution or otherwise pay cash or transfer property to an LLC is not enforceable unless the promise is in writing and signed as required by the statute. “Contribution” is broadly defined in the statute to include any tangible or intangible benefit that a person transfers to an entity for an ownership interest or otherwise in the capacity as an owner or member. The benefit includes cash, services rendered, a contract for services to be performed, a promissory note or other obligation to pay cash or transfer property, or securities or other interests in or obligations of an entity. The plaintiffs argued that the defendants did not promise to contribute anything directly to the LLC, but rather to obtain the release of the escrowed funds to Cinemawalla, who would then use the funds to pay vendors and others providing services needed to make the movie _97 Minutes_. The court stated that the statutory language is not limited to direct contributions. Here it was clear that the oral agreement to access the $4 million in escrow and invest it to fund the production of the LLC’s movie project constituted a promise to make a contribution to the LLC and was unenforceable because it was not in writing and signed as required by the statute. The defendants made several arguments attacking the damages awarded on the fraud claim. With respect to the measure of recovery, the court of appeals held that the plaintiffs were not permitted to recover based on the benefit of their bargain with the defendants because the oral agreement was unenforceable as discussed above. Thus, the plaintiffs could not recover the lost profits they sought. The plaintiffs could, however, recover out-of-pocket damages incurred as a result of the defendants’ misrepresentations. The evidence regarding the expenses incurred by the plaintiffs did not support the amount of expenses found by the jury, but there was evidence that the plaintiffs suffered some out-of-pocket damages, and the court thus remanded for a new trial on the fraud claim.


In 1996, Jacob Kohannim (“Jacob”) and Mike Khorasavikatoli (“Mike”) formed an LLC to purchase and hold real property on which a corporation owned by them operated a restaurant. Jacob and Mike were the managers and each owned a 50% interest in the LLC. The member agreement contained transfer restrictions that provided the LLC and the other member the opportunity to purchase a member’s interest in the event of a proposed sale of the interest or a transfer to a member’s spouse in a divorce. In 2003, Mike’s wife, Parvenah, filed for divorce, and the divorce court issued temporary orders prohibiting Mike and Parvenah from transferring assets. During the pendency of the divorce, Mike
purported to transfer a 5% interest in the LLC to Jacob. In 2005, the divorce decree was entered. In the divorce decree, the district court found the transfer was void because it was an attempt to transfer community property in violation of the court’s order enjoining such a transfer. The divorce decree further awarded to Parvenah “[o]ne hundred percent (100%) of the husband’s interest” in the LLC, “which interest is equivalent to a fifty percent (50%) interest in such company.” The decree required the husband to execute and deliver to the wife’s attorney a stock transfer certificate and/or assignment of interest. After the divorce decree was entered, Jacob advised Parvenah that he intended to start the process of determining the value of the LLC for purposes of the buyout provision in the member agreement. In 2006, Parvenah sued Jacob and the LLC, seeking a declaration of her rights with respect to the LLC and the validity of the member agreement and asserting other claims based on constructive fraud, breach of fiduciary duty, oppression, waste, gross mismanagement and abuse of control, and unjust enrichment. The trial court appointed a receiver for the LLC and ordered the receiver to sell the LLC’s assets. The trial court eventually approved a sale of the LLC’s property for $1,300,100. The trial court’s final judgment contained findings as to the amount of assets held by the receiver and how the assets should be divided based on the court’s finding that Jacob and Parvenah each held a 50% beneficial interest in the assets. The trial court also found that Jacob, with malice and intent to defraud, engaged in wrongful acts and omissions that damaged Parvenah by decreasing the value of Parvenah’s interest in the LLC, and the trial court awarded Parvenah actual and punitive damages based on the wrongful acts and omissions. Jacob appealed on numerous issues but did not challenge the trial court’s division of the LLC’s assets.

The court of appeals rejected Jacob’s challenge to the legal sufficiency of the evidence to support Parvenah’s oppression claim. Jacob contended that there was no evidence that he oppressed Parvenah’s rights by failing to make distributions to her. The LLC’s regulations (i.e., company agreement) provided for quarterly distributions to members of “available cash” provided available cash was not needed for reasonable working capital reserves. The Texas Business Organizations Code provides that an assignee is entitled to receive any distribution the assignor is entitled to receive to the extent the distribution is assigned. Because the district court awarded the entire community interest to Parvenah, she had a right to receive distributions. The district court found that Jacob paid himself for services that were not performed and that he failed to make any distributions to Mike or Parvenah even though $250,000 in undistributed profits had accumulated since the mortgage on the LLC’s property was paid off. The court of appeals concluded this was some evidence supporting the trial court’s finding that Jacob failed to make profit distributions. The court also agreed that the established facts demonstrated that Jacob engaged in wrongful conduct and exhibited a lack of fair dealing to the prejudice of Parvenah.

The court addressed a challenge by Jacob to the legal sufficiency of the evidence to support the actual and punitive damages award. Because the court of appeals sustained Jacob’s challenges to Parvenah’s other causes of action, the only viable cause of action to support a damage award was the shareholder/member oppression claim. The court of appeals stated that the standard of review on this issue was not the traditional sufficiency analysis as asserted by Jacob, but rather was abuse of discretion because the receivership provision of the Texas Business Organizations Code that provides for an oppression action authorizes a court to fashion an equitable remedy if the acts of those in control of an entity are oppressive. The court of appeals concluded that the trial court’s methodology for finding actual damages was not an abuse of discretion. The trial court calculated Parvenah’s damages by calculating the difference between the value of the LLC’s assets at the time of the trial court’s judgment in this case and the value of the LLC at the time of the divorce. The court of appeals rejected the argument that the member agreement required the LLC to be valued as of the date of the divorce petition. The court of appeals stated that the trial court found that the member agreement did not apply to Parvenah. Assuming it applied to Parvenah, the court of appeals stated that it was inapplicable here because Jacob did not comply with the provision addressing a buyout on divorce by intervening in the divorce proceeding to enforce the provision. Mike had agreed to the intervention, but Jacob did not do so. Jacob next argued that the LLC regulations provided that the valuation of Parvenah’s interest must be based on book value because the regulations contained a provision for purchase of a member’s interest at book value or appraised value on request of a party who deems the book value to vary from market value by more than 20%. The provision of the regulations relied upon by Jacob addressed death, dissolution, retirement, or bankruptcy of a member. The court stated that the provision did not address how damages are calculated in a lawsuit based on oppression, and the court relied on other case law in which the court in an oppression action concluded that it was not an abuse of discretion to order a buyout for fair value when a buy-sell agreement provided for redemption at book value. The court of appeals pointed out that receivership is one remedy for shareholder/member oppression and that the trial court ordered a receivership and authorized a sale of the LLC’s assets. Jacob did not complain concerning the receivership or sale. However, the court concluded that Parvenah was not limited to a recovery of her proportionate share of the sale proceeds and that courts have equitable powers to fashion appropriate remedies for oppressive conduct, including a buyout. Here, the court concluded that sufficient evidence supported the values found by the trial court and that Jacob did not argue, and the court of appeals did not perceive, that the trial court’s
methodology constituted an abuse of discretion. The court of appeals sustained Jacob’s challenge to punitive damages because the only causes of action that could support a punitive damages award were actual fraud and breach of fiduciary duty, and Jacob’s challenges to these claims were sustained by the court of appeals.

Finally, the court concluded that Jacob’s challenges to the trial court’s declarations that the member agreement was void or inapplicable to Parvenah did not impact the judgment given that: Jacob did not challenge the declaration that Parvenah owned a 50% interest or the 50/50 allocation of the LLC’s assets; the court of appeals sustained Jacob’s contentions that an award of damages could not be based on Parvenah’s breach of fiduciary duty, constructive fraud, and unjust enrichment claims; and attorney’s fees under the Declaratory Judgment Act were supported by the unchallenged declarations of the trial court.


Sumer Pinglia sued Jaikishin and Nanik Bhagia alleging various wrongful acts in connection with two transactions involving certain apartment complexes. One of the transactions involved the acquisition and development by Pinglia and the Bhagias of an apartment complex which was held by them in an LLC formed for that purpose. Pinglia sued the Bhagias for breach of fiduciary duty and sued the LLC seeking access to its books. In a post-trial motion, the LLC sought to recover one-third of its litigation expenses from Pinglia under the LLC’s regulations (i.e., company agreement). According to the LLC, the regulations provided that all allocations of income, gain, deduction, loss, and credit were made in accordance with the interest of each member. The LLC contended that Pinglia, a 1/3 member, was thus responsible for one third of the LLC’s litigation expenses. The court of appeals stated that it was unclear what expenses the LLC sought. In Pinglia’s post-trial filings, Pinglia indicated that he was successful in obtaining relief on his claim for access to the LLC’s books. At a hearing on attorney’s fees, the evidence and argument apparently focused on another defendant’s claim for attorney’s fees against Pinglia as sanctions. The LLC presented no evidence of any expenses it incurred for which Pinglia was purportedly responsible under the regulations. In the absence of evidence or argument by the LLC at the hearing on attorney’s fees, the trial court did not err in denying the LLC’s request.


In 1996, two cardiologists, Guniganti and Pokala, opened an out-patient laboratory known as East Texas Cardiovascular Labs, L.L.C., and they signed regulations (i.e., a company agreement) governing operation of the LLC. Guniganti owned 65% of the LLC, and Pokala owned 35%. Pokala had worked for Guniganti since 1984 at Guniganti’s clinic, and in 1999, Pokala bought into the clinic. In 2006, after a dispute about a patient, Guniganti decided that Pokala could no longer work for the clinic, and litigation ensued over a buy-sell agreement and covenant not to compete relating to the clinic. In the litigation, Pokala also sought to recover distributions from the LLC for 2006 until the date of trial. The regulations of the LLC provided for “Net Cash Flow” for each fiscal year to be distributed to Guniganti and Pokala in proportion to their “Sharing Ratios.” The regulations defined “Net Cash Flow” as “all cash funds derived by the [LLC] (including interest received on reserves, borrowings, and capital transactions), without reduction for any non-cash charges, but less cash funds used to pay current operating expenses, debt payments, capital improvements, replacements, and establish reasonable reserves for future expenses and costs as determined by a Majority interest.” The jury found that the LLC failed to distribute to Pokala his share of net cash flow for 2009. The court refused to submit a jury question on Pokala’s breach of contract claim for failure to distribute his portion of net cash flow for the years 2006 through 2008. The court of appeals concluded that there was sufficient evidence to support the jury’s finding that the LLC failed to distribute to Pokala his share in 2009 and that the issue of Pokala’s entitlement to a distribution for 2006-2008 was conclusively established against him as a matter of law. With respect to the jury’s finding awarding Pokala a share of the net cash flow for 2009, the LLC agreed that Pokala retained an interest in the LLC and was entitled to share in any distribution of net cash flow, but the LLC argued that there was no evidence that the LLC made a distribution. Both Pokala’s and Guniganti’s experts testified that there were years in which all payments to the doctors were in the form of guaranteed payments for services and no distributions were made. Guniganti’s expert explained that the regulations provided that Guniganti could determine whether to make a distribution, and if he decided to do so, it had to be in proportion to the doctors’ sharing ratios consistent with their ownership interests. The 2009 tax return showed a distribution to Guniganti in the amount of $131,162 and no distribution to Pokala. Pokala’s expert testified that the records showed total net cash flow for 2009 in the amount of $143,827 and that the records did not indicate what happened to the difference of $12,665 not distributed to Guniganti. Thus, Pokala’s expert testified Pokala was entitled to 35% of $143,827, or $50,339. Guniganti’s expert testified that the $131,162 paid to Guniganti in 2009 was a guaranteed payment and that the 2009 tax return was in error in showing the amount as a distribution. The court of
appeals stated that the tax return was some evidence that there was a 2009 distribution and that there was sufficient
evidence to support the jury’s finding that Pokala was entitled to 35% of $131,162, or $45,906. With respect to Pokala’s
breach of contract claim based on failure to distribute amounts to him in the years 2006-2008, Pokala had to prove that
there was net cash flow in those years that was not distributed. Pokala’s expert testified that there were guaranteed
payments made to Guniganti in those years, and the tax returns showed that no distributions were made in those years.
The court of appeals stated that the material facts were not disputed and that the issue was established against Pokala
as a matter of law. Pokala complained about the exclusion of portions of his expert’s testimony in which she opined as
to how much the LLC owed Pokala for distributions and stated her opinion that payments to Guniganti were incorrectly
characterized as guaranteed payments rather than distributions. The trial court excluded the expert’s testimony on the
amount of distributions owed because the expert did not include in her calculations any amount credited for Guniganti’s
management services. The court of appeals explained that the expert’s calculations did not include a reasonable amount
of compensation for Guniganti’s services as called for by the LLC regulations. The absence of the guaranteed payment
amount resulted in a speculative amount for distributions and rendered the calculations incomplete and unreliable.
Likewise, the court of appeals characterized the expert’s testimony that payments to Guniganti were incorrectly
characterized as guaranteed payments as mere conjecture. Thus, the court of appeals upheld the trial court’s exclusion
of this portion of the expert’s testimony. Because LLC regulations are a contract and Pokala prevailed on his claim for
payment of a distribution for 2006 under the LLC regulations, the court of appeals upheld the award of attorney’s fees
to Pokala with respect to that issue under Texas Civil Practice and Remedies Code § 38.001(8).

M. Record Keeping Requirements and Access to Books and Records

The bankruptcy court in this adversary proceeding determined that the debtor (Edelman) was liable for trespass,
breach of fiduciary duties, theft, and fraud based on actions he took while serving as vice president of the LLC general
partner of a limited partnership that developed and operated a condominium project. Certain claims by the LLC general
partner, the LLC general partner’s sole member (Wiggins), and the limited partnership failed. Claims based on
Edelman’s wrongful transfer and personal use of the limited partnership’s funds and Edelman’s personal use of a
condominium unit without a lease and without paying rent failed as to all plaintiffs because the evidence did not establish
that the plaintiffs did not have an equal opportunity to learn the truth about Edelman’s actions through access to books
and records of the partnership and another entity. Edelman’s knowledge was not imputed to the LLC general partner
and the limited partnership since Edelman was acting adversely to them, but knowledge that Wiggins had an equal
opportunity to discover could be imputed to the LLC general partner and the limited partnership. The court relied on
the fact that the limited partnership agreement gave partners the right to access to all of the partnership’s records.
Wiggins testified that he demanded access and that Edelman blocked his efforts, but there was no evidence Wiggins took
any steps beyond asking Edelman. The court stated that Wiggins had a legal right to the information under the limited
partnership agreement and the evidence did not show that Wiggins could not have obtained access had he done more than
merely ask Edelman. With respect to knowledge of the improper use of the limited partnership’s funds by a related LLC,
the related LLC was owned 50% by Wiggins and 50% by Edelman, and Wiggins had a right under that LLC’s regulations
to access its books and records, which would have revealed how the funds were being used. Thus, the fraud by
nondisclosure claims failed as to the matters that could have been discovered by Wiggins in the limited partnership’s
books and records and the books and records of a related LLC to which he had access.

A former member of an LLC and former partner of a limited partnership sued for a declaratory judgment that
he was entitled to access the books and records of the LLC and limited partnership for the period of time during which
he was member and partner. The plaintiff alleged that he had requested access to the books and records and that he was
refused access. The limited partnership and LLC filed special exceptions asserting that the plaintiff did not allege facts
establishing a justiciable controversy. The plaintiff did not amend his petition, and the defendants filed a plea to the
jurisdiction and asked for dismissal, which the trial court granted. The court of appeals held that the trial court erred in
granting the plea and dismissing the cause. A person whose rights are affected by a statute or contract may have a trial
court determine a question arising under the statute or contract and obtain a declaration of the person’s rights. A
declaratory judgment is appropriate if there is a justiciable controversy as to the rights and status of the parties and the
controversy will be resolved by the declaration. A justiciable controversy is a real and substantial controversy and not
merely a theoretical dispute. Section 3.151 of the Texas Business Organizations Code lists the books and records a filing entity must keep, and Section 3.153 provides that each owner or member of a filing entity may examine the books and records required to be maintained under Section 3.151 along with other books and records required for that particular type of filing entity. A “filing entity” includes a limited partnership and LLC. Tex. Bus. Orgs. Code § 1.002(22). More specific provisions regarding the rights of an LLC member and a partner in a limited partnership to examine the entity’s books and records are set forth in Sections 101.502 and 153.552, respectively. The plaintiff’s petition alleged that he requested and was denied access to the books and records of the defendant LLC and defendant limited partnership. The crux of the parties’ dispute was whether the Business Organizations Code and the governing documents of the entities allowed the plaintiff ongoing access to the books and records for the period of time he was a member and partner even after he ceased to be a member or partner. The court of appeals stated that this was a real and substantial controversy, that the plaintiff’s petition provided fair notice of his claim, and that a declaration of the plaintiff’s rights to examine the books and records at issue would resolve the controversy. Thus, it was error for the trial court to grant the special exceptions and plea to the jurisdiction. The LLC and limited partnership argued that the plaintiff’s claim for declaratory relief was improper because the plaintiff could have sought access to the books and records by filing a mandamus or Rule 202 deposition, but the court stated that the existence of another adequate remedy does not bar the right to maintain a declaratory judgment action. The plaintiff properly sought a declaratory judgment because he sought a declaration of his rights to examine the books and records under the Business Organizations Code and the governing documents of the entities.

N. Forum Selection Clause

The court concluded that a forum selection clause in an LLC operating agreement was binding in a patent infringement action brought against an LLC with respect to patents assigned to the plaintiff by an LLC member (General Nanotechnology or “GN”). The operating agreement required the members to assign to the LLC the exclusive rights to a broadly defined category of intellectual property but specified certain narrow areas in which GN retained its rights, labeled in the agreement as “Reserve Areas.” The plaintiff brought this infringement action alleging that the LLC was infringing on patents included in the Reserve Areas and for which the LLC did not have a license. The court concluded that the plaintiff was bound by the forum selection clause as a successor in interest to GN because the plaintiff’s claims to the patents in question were based solely on GN’s ownership and rights as a predecessor in interest, GN and the LLC agreed that the operating agreement would be binding on future successors and assigns, and the express language of the operating agreement showed that it was foreseeable that a third-party successor would be bound by the operating agreement.

O. Dissolution/Winding Up

In re HRM Holdings, LLC, 421 B.R. 244 (Bankr. N.D. Tex. 2009).
The bankruptcy trustee sought to pierce the veil of the debtor limited liability company and hold several affiliated LLCs liable as a single business enterprise based on actual fraud consisting of the debtor LLC’s failure to notify creditors that it was terminating its business operations. The court concluded that the failure to give the statutorily required notice of winding up could constitute actual fraud under the Texas veil piercing statutes, but the court found that the amended complaint failed to specify who the perpetrators of the fraud were and how the fraud benefitted the defendants. The court gave the trustee a final opportunity to further amend its complaint.

Gale v. Carnrite, 559 F.3d 359 (5th Cir. 2009).
In 1999, the Gales bought all of the membership interest in a Nevada LLC that owned a condominium unit in Mexico. Because of a legal restriction on non-Mexican ownership of real property, the Gales had to purchase the outstanding membership interest in the LLC. The sole asset of the LLC was beneficial ownership of a leasehold interest in the condominium under a special trust arrangement with a Mexican bank. In the sale agreement between seller, Carnrite, and the Gales, Carnrite included a warranty that as of the date of closing “the LLC has and will have no liabilities of any nature…including without limitation tax liabilities due or to become due.” When the sale was completed in January 2000, no one reported the transaction to the Mexican government and no taxes were paid on the transfer. After the Gales used the condominium for a number of years, the LLC sold the beneficial interest in the condominium to the Vaudagnas. The sale resulted in a substantial Mexican capital gains tax liability. The Gales filed suit against Carnrite for allegedly breaching the contractual warranty he gave to them regarding tax liability when they bought the
LLC. The Gales alleged that Carnrite breached the warranty by failing to report and pay taxes on the sale to the Gales. The district court entered summary judgment in favor of the Gales, finding that Carnrite breached the warranty because the parties’ transaction gave rise to tax liability for the LLC. Carnrite appealed, and the first issue discussed in the opinion on appeal was the whether the Gales had standing to pursue the claim. Carnrite argued that it was the LLC rather than the Gales that were liable for the capital gains tax and that the Gales did not have standing since they suffered no injury. The Gales responded that the LLC assigned the claim to them when they filed the lawsuit in 2007. Carnrite did not dispute the usual propriety of such an assignment, but argued that the assignment was ineffective because Nevada had revoked the LLC’s right to do business in 2004 for failure to pay franchise taxes and fees and file annual reports. The court concluded that the Gales had standing to pursue the claim, however, based on Nevada LLC statutes regarding dissolution and the fact that payment of the taxes ultimately fell on the Gales. The court pointed out that the Nevada LLC statutes provide that the property and assets of an LLC whose charter has been revoked must be held in trust and that dissolution proceedings should be pursued. Another statutory provision provides that dissolution does not impair a remedy or cause of action arising before dissolution and commenced within 2 years after the date of dissolution. Additionally, the Nevada statutes provide that the assets of a dissolved LLC may be distributed to its members. Based on these statutes, the court concluded the assets of the LLC, which included the cause of action against Carnrite, were held by the Gales in trust when its right to transact business was forfeited, and, moreover, the Gales were permitted to transfer those assets to themselves as the LLC’s only members. As the parties ultimately injured and the assignees of the LLC’s claims, the Gales had standing to pursue the action. After analyzing the tax liability, however, the court held that the record did not establish that Carnrite breached the terms of the warranty as worded in the contract he made with the Gales because the record indicated that Carnrite’s failure to pay taxes on the transaction resulted in a tax liability of the Gales rather than the LLC.


Weatherford International, Inc. (“Weatherford”) sought to hold an LLC and its two member/managers, Bennett and Donaho, liable for breach of contract and copyright infringement. Bennett and Donaho argued that they were not personally liable because they did not act in their individual capacities. Weatherford argued that Bennett and Donaho were personally liable because the LLC’s charter had been forfeited under the Tax Code at the time the negotiations for the contract took place, and the Tax Code provides that a corporate officer of an LLC whose charter has been revoked is liable for a debt that is incurred after the date on which the tax is due. However, the LLC was reinstated after its forfeiture, and Weatherford’s complaint did not indicate when the contract with the LLC was signed. Because Texas case law holds that a debt created by a contractual obligation is created when the contract is signed for purposes of the Tax Code provision imposing personal liability on corporate officers and directors, the court could not determine as a matter of law whether the individuals were personally liable.


Gray and Neely entered into a contract for the sale of Neely’s homestead in June 2005. One month later Gray assigned his rights in the contract to Graywest, LLC (“Graywest”), which the court referred to as a “limited liability corporation.” Neely attempted to avoid the contract for sale, and Graywest filed suit to enforce it. Neely filed a motion to abate and alternatively to dismiss the suit arguing that Graywest did not have the capacity to sue because it had forfeited its corporate status by failing to pay franchise taxes. The parties agreed that Graywest had been involuntarily dissolved in March of 2001 for not paying its franchise taxes. The trial court ruled that Graywest lacked the capacity to file suit on the contract at issue because its charter had not been revived within the 36-month window for reinstatement allowed by Article 7.01E of the Texas Business Corporation Act (“TBCA”), and the three year survival period under Article 7.12 of the TBCA had expired. [Note: Although TBCA Articles 7.01E and 7.12 were applicable to LLCs under Article 8.12 of the Texas Limited Liability Company Act, Article 7.01E was not actually applicable in this case. It has long been the Secretary of State’s practice to effectuate forfeitures for failure to pay franchise taxes under the Tax Code provisions, which have their own reinstatement provisions and do not contain a time limitation on reinstatement, rather than to rely on the involuntary dissolution provisions of the TBCA. The successor to Article 7.01 of the TBCA, Section 11.251 of the BOC, does not specify failure to pay franchise taxes as a basis for involuntary termination. Thus, there should be less confusion in this regard under current law.] Since Graywest was not an existing entity and no other proper party was before the court, the trial court dismissed the case with prejudice. The court of appeals affirmed, explaining that the assignment from Gray to Graywest fifty-one months after dissolution was invalid and that Graywest was not an appropriate party to the suit. The court of appeals stated that the trial court could have allowed the litigation to continue.
if the appellant had amended its petition by substituting Gray individually as the plaintiff, but Graywest did not pursue this remedy at the abatement hearing. Thus, dismissal with prejudice as to Graywest was proper.


This case involved a dispute as to whether an LLC’s claim against a deceased member was timely presented to the administratrix of the deceased member’s estate. In the course of the court’s opinion, the court noted that, while the member’s death dissolved the LLC, the LLC had authority to wind up its affairs, including the ability to make payments to creditors required by the deceased member’s actions.


A member of two LLCs claimed that a proposed transfer of funds by one LLC to the other would constitute a fraudulent transfer. The trial court entered a temporary injunction against the payment and ordered the LLCs dissolved under the statutory provision that an LLC may be judicially dissolved if it is not reasonably practicable to carry on the business of the LLC in conformity with its articles of organization or regulations. The trial court appointed a liquidator under another statutory provision authorizing the court to wind up an LLC’s affairs or appoint a person to carry out the liquidation. The liquidator was given control of the two LLCs and had essentially all the powers of a receiver. The court of appeals concluded that the order appointing a “liquidator” was an order appointing a “receiver;” therefore, the court had jurisdiction over the interlocutory appeal. The court held that the order of judicial dissolution and appointment of a liquidator was improper in this case as it did not properly preserve the subject matter of the suit until the trial court could finally determine whether the payment would be a fraudulent transfer. In other words, the court found the trial court’s order was improper because it gave the LLC member its ultimate relief.

p. Withdrawal of Member


Kennebrew founded a private security company as an LLC, and Kennebrew was initially the sole manager and member. The parties executed a management agreement under which Harris obtained a 40% interest in the LLC in exchange for a capital contribution of $10,000. After a short time, Harris became unhappy with Kennebrew’s financial reporting and the LLC’s failure to reimburse Harris for amounts expended on behalf of the LLC, and Kennebrew was unhappy that Harris did not become licensed or registered under the Private Security Act. Less than a year after joining the LLC, Harris notified Kennebrew of his intent to withdraw. The LLC accepted Harris’s withdrawal, and the parties could not agree on the amount that Harris was owed. Harris sued Kennebrew and the LLC. The trial court appointed an accountant who reviewed the LLC’s records and determined the value of the LLC’s assets, liabilities, and member equity. Harris’s evidence on these matters differed only with respect to the amount of an outstanding loan balance owed by the LLC to Harris. The trial judge entered a judgment rescinding the management agreement, concluding there was an oral loan agreement between the parties, and holding Kennebrew and the LLC liable to Harris for damages and attorney’s fees. All parties appealed. The court of appeals held that rescission of the management agreement was improper and that the terms of the management agreement entitled Harris to repayment of the amounts he paid for goods and services for the LLC. The trial court’s judgment awarded Harris the return of his capital contribution (as a result of rescission of the management agreement) and repayment of his loans, but Harris argued that he was entitled to recover the value of his interest in the LLC (not merely the return of his capital contribution) in addition to repayment of the loans. The court of appeals agreed that Harris was entitled to recover the value of his 40% interest. Under the Business Organizations Code, an LLC member may withdraw only if permitted by contract, but a member who validly exercises a right of withdrawal provided by the company agreement is entitled to be paid the fair value of the member’s interest in the LLC as determined as of the date of withdrawal. Tex. Bus. Orgs. Code §§ 101.107, 101.205. Both the management agreement and the company agreement expressly permitted a member to withdraw, and the evidence showed that Harris validly exercised that right. The trial court found that the value of Harris’s interest on the date of withdrawal was $44,849, which was 40% of the members’ total equity as found by the court-appointed accountant. The LLC did not argue that subtracting the LLC’s liabilities from its assets was an inappropriate means of determining the members’ equity, but asserted that Harris was not entitled to 40% of the entirety of the members’ equity. Based on a provision of the management agreement that provided a member was not entitled to the return of any portion of his capital contribution or to be paid interest on his capital account or capital contribution, the court said that the LLC reasoned that
the sum of the capital contributions of the two members “should be subtracted from the total members’ equity before calculating the value of Harris’s share–but not before calculating the value of Kennebrew’s share.” The court characterized this argument as conflating two different concepts, stating that “a distribution to a withdrawing member of the value of his interest is not the same as a return of capital.” The court stated that there was no testimony in the record supporting the LLC’s argument and that it contradicted the trial court’s finding and the statute. Thus, the court of appeals held that Harris was entitled to recover the value of his membership interest as found by the trial court. Kennebrew argued that there was no basis to hold him personally liable for the amounts owed to Harris, and the court of appeals agreed. The Business Organizations Code provides that a member or manager is not liable for the LLC’s debts, obligations, or judgments unless the company agreement specifically provides otherwise. Tex. Bus. Orgs. Code § 101.114. Further, the company agreement in this case expressly provided that no member or manager shall be liable for the debts, obligations, or liabilities of the company. Both the funds advanced by Harris to the LLC and the distribution owed for the value of his interest were liabilities only of the LLC.

Q. Veil Piercing


The plaintiff sued two individuals and four LLCs asserting claims arising out of the sale of allegedly harmful dietary supplements. The plaintiff sought to impose collective liability on all these defendants based on veil piercing. The defendants sought dismissal on the basis that the plaintiff failed to adequately allege that veil piercing was warranted. The court first addressed the law governing the case and applied Texas choice-of-law principles since the events allegedly occurred in Texas. Under Texas choice-of-law rules, whether a corporation, LLC, or individual may be held liable pursuant to veil-piercing theory is governed by the law of the state in which the entity is organized. Three of the LLCs were Wyoming LLCs, and the other LLC and the two individuals were a Texas LLC and Texas residents. The court proceeded to analyze the veil piercing claims as to the Wyoming LLCs under Wyoming law and the claims against the Texas defendants under Texas law and concluded that the complaint was insufficient to allege veil-piercing claims as to both sets of defendants. The court stated that the plaintiff could seek leave to amend.

With respect to the Wyoming LLCs, the court cited Wyoming case law for the proposition that the separate existence of a corporation or LLC can be disregarded when the recognition of its separate existence would lead to injustice. The court listed the relevant factors under Wyoming case law as follows: (1) fraud; (2) inadequate capitalization; (3) failure to observe company formalities; and (4) intermingling of business and assets. The court found the allegations that the LLCs were all owned and controlled by the individual defendants and engaged in a single enterprise of developing, marketing, and selling unsafe and ineffective dietary supplements insufficient to justify disregarding the separate entity status of each Wyoming LLC. The plaintiff did allege fraud in the marketing of the products, and fraud may be sufficient to justify piercing the veil under Wyoming law, but the plaintiff did not allege fraud in the capitalization of the Wyoming defendants or any other circumstance indicating that veil piercing was necessary to avoid the inequitable effects of the LLC’s activities.

The court next considered the sufficiency of the allegations with respect to the Texas defendants. The court stated that there are multiple bases for piercing the corporate veil under Texas law, and each has its own requirements. The court analyzed the veil-piercing allegations separately with respect to the plaintiff’s tort claims and her claims for breach of warranty because a showing of actual fraud is required in the contract context but not the tort context. The court further broke down its analysis in the tort context to separately address alter ego and sham to perpetrate a fraud.

With respect to the sufficiency of the allegations to state a basis to impose liability based on alter ego for the plaintiff’s tort claims (negligence, products liability, and wrongful death), the court stated that alter ego applies when there is such unity between the business entity and the individual or subsidiary that the separateness of the business entity has ceased, and holding only the entity liable would result in injustice. The court listed matters that may be considered: the degree to which the property of the entity and individual have been kept separate; the amount of financial interest, ownership, and control the individual maintains over the entity; whether the entity has been used for personal purposes; whether an individual has paid entity debts using personal checks; whether the individual defendant has represented that he or she will financially back the entity; and whether the entity is adequately capitalized. Again, the court found the allegations that the LLCs were all owned and controlled by the individual defendants and engaged in a single enterprise of developing, marketing, and selling unsafe and ineffective dietary supplements insufficient to justify disregarding the separate entity status. A court may not pierce the veil on a mere showing that an individual served as an officer or director and held an ownership interest in a corporation or LLC, and the plaintiff did not allege any other factor relevant to an alter-ego determination under Texas law. With respect to whether the Texas defendants undertook a sham to perpetrate a fraud, the court held that the heightened pleading requirement of Rule 9(b) applied and that alleging the Texas LLCs
were formed solely to escape liability for selling dangerous products and misleading customers failed to meet the particularity requirement under Rule 9(b). The allegations lumped all the LLC defendants together and did not differentiate or specify each LLC’s specific connection to the alleged fraud. Although the complaint specified that the individuals controlled and managed the LLCs, the complaint contained only minimal allegations as to the individuals’ roles.

Because the plaintiff’s breach of warranty claims sounded in contract, the court stated that the plaintiff was required to sufficiently plead actual fraud for the defendants’ direct personal benefit (see Tex. Bus. Orgs. Code § 21.223). The court stated that actual fraud for this purpose means dishonesty of purpose or intent to deceive and is not equivalent to the tort of fraud. Because of the fraud component, the court stated that the heightened pleading requirement of Rule 9(b) applied. The plaintiff’s allegations of actual fraud, like her allegations of sham to perpetrate a fraud, lumped all the defendants together without differentiating them and thus failed to satisfy Rule 9(b).


The plaintiff contracted to provide various therapy services for a limited partnership engaged in the business of providing home health care services. After the limited partnership stopped paying the plaintiff, the plaintiff sued the limited partnership, numerous related entities (two corporations, a limited partnership, and numerous LLCs), and individuals who were limited partners, officers, and members of these entities. The court in this opinion addressed a motion to dismiss in which the individual defendants argued that the plaintiff failed to state a claim against them. The individuals argued that the plaintiff must meet a heightened pleading standard (requiring particularity) applicable to a fraud claim because the plaintiff must prove “actual fraud” under the Texas Business Organizations Code to pierce the veil of the entities and hold the individuals liable. The court distinguished “actual fraud” for purposes of veil piercing, which simply requires “dishonesty of purpose or intent to deceive” and is less burdensome than a showing of common-law fraud, and the court held that the plaintiff’s veil-piercing claims were not subject to the heightened pleading standard of Rule 9(b). In determining whether the plaintiff stated a claim against the individual defendants under Rule 12(b)(6), the court first addressed the scope of the motion and concluded that it only pertained to the individuals’ liability with respect to one Texas corporation and six Texas LLCs because the individual defendants relied on Section 21.223 of the Texas Business Organizations Code, which the court pointed out applied only to Texas corporations and Texas LLCs. Tex. Bus. Orgs. Code §§ 21.223, 1.102, 1.104, 101.002. Thus, the court said the motion did not relate to the individuals’ liability with respect to the two Texas limited partnerships, a Nevada corporation, two Delaware LLCs, and one Michigan LLC. The court then further discussed the standard imposed by Section 21.223 with respect to a claim to pierce the veil of a Texas corporation or LLC. The court reiterated that “actual fraud” in this context involves “dishonesty of purpose or intent to deceive” and is not equivalent to the tort of fraud. The court stated that courts generally look at the totality of the shareholder’s actions to determine if the shareholder committed fraud. The court analyzed the plaintiff’s complaint and concluded that the allegations were sufficient for a jury to infer actual fraud. The plaintiff alleged that the defendants frequently promised to pay for the plaintiff’s services but continued to make only partial payments. Further, the individuals allegedly used one of their companies, an LLC, as a “back office” to funnel money between their companies. The plaintiff alleged that this LLC received disbursements from government programs, some of which should have been paid to the plaintiff, and funneled them toward improper purposes. The plaintiff also alleged that the price a third party paid to purchase the entities showed that they were operating in an undercapitalized condition when the transactions with the plaintiff were entered into. The court concluded these allegations were sufficient to survive the motion to dismiss. Conclusory allegations of the elements of joint enterprise did not survive the motion for dismissal.


The court relied on previous Texas case law for the proposition that the policies governing corporate veil piercing also apply to LLCs and held that there was no evidence of actual fraud, i.e., no evidence of dishonesty of purpose or intent to deceive, so as to hold a member or manager of the LLC liable. The court noted that the legislature specifically authorized single-member LLCs and limited the liability of a member or manager. The evidence did not establish who the principals of the LLC in this case were, but even if the evidence showed there was only one principal of the LLC, there was no evidence of actual fraud to support holding him liable and thus no basis to hold the sole principal liable for the LLC’s debt.

Spring Street Partners-IV, L.P. v. Lam, 730 F.3d 427 (5th Cir. 2013).

The claimant in this case sought to recover based on a fraudulent transfer of assets to an LLC, and to hold the owners of the LLC personally liable for the value of the transfers. The claimant argued that it was not required to prove
actual fraud to pierce the LLC veil because fraudulent transfer of assets is a tort under Texas law. The court pointed out that the Texas legislature specified that the statutory provisions regulating and restricting veil piercing of corporations in Texas are applicable to LLCs and their members and managers by virtue of an amendment to Chapter 101 of the Texas Business Organizations Code in 2011 and that the Austin Court of Appeals has held that a plaintiff seeking to pierce the veil of an LLC not covered by the amendment to the LLC statute must also meet the same requirements applicable to a corporation. These requirements differ depending upon whether a claimant is seeking to recover based on a tort or a contract. The court concluded that it did not have to determine whether the claimants were required to prove actual fraud or merely constructive fraud because there was “ample evidence” of the members’ actual fraud. This evidence included the formation of an LLC ten days after the members’ brother received notice that his debts were being accelerated, transfer of the brother’s interest in another LLC to the newly formed LLC for no consideration, signing a document transferring an asset of the newly formed LLC to another family member for no consideration, failing to disclose the transfer for over a year during the pendency of litigation against the newly formed entity, attempting to evade the Texas Uniform Fraudulent Transfer Act by allowing the new LLC’s charter to lapse, and attempting to evade individual liability by claiming the charter had been reinstated. The court stated that the members were acting for their direct personal benefit with respect to these actions because they had no other interest to serve.

Metroplex Mailing Services, L.L.C. v. RR Donnelly & Sons Company. 410 S.W.3d 889 (Tex. App.–Dallas 2013, no pet.).

The court held that there was no evidence to support piercing an LLC’s veil to hold the sole member liable for the return of a deposit owed by the LLC. The LLC was a presort mailing company that entered into a mail processing agreement with the plaintiff. The contract was for five years but could be terminated by the plaintiff if the LLC failed to perform as to agreed terms. The contract required the plaintiff to keep a deposit with the LLC. The deposit would be returned less any amounts still owed following expiration or termination of the contract. A few months after entering into the contract, the plaintiff requested a refund of part of the deposit even though the contract had not expired or been terminated. The LLC voluntarily refunded $200,000 of the deposit, but the plaintiff notified the LLC a few months later that it would not pay further invoices until receiving the remaining $386,000 of its requested refund. Less than two weeks later, the LLC ceased operations and was unable to return the remaining deposit. The plaintiff terminated the contract and filed suit against the LLC and its sole member for breach of contract. The jury found that the LLC breached its contract with the plaintiff and that the veil should be pierced to hold the member personally liable for the LLC’s contractual liability. The court of appeals held that the evidence was not sufficient to pierce the LLC veil to hold the member personally liable for the LLC’s debt. The court noted that the Texas legislature specifically authorized single-member LLCs and that the statutory liability protection afforded members and managers only gives way when a plaintiff can show that the LLC was used for the purpose of perpetrating and did perpetrate an actual fraud for the member’s or manager’s direct personal benefit. The court relied on previous Texas case law for the proposition that the policies governing corporate veil piercing also apply to LLCs and equated actual fraud to dishonesty of purpose or intent to deceive. The plaintiff argued that three actions by the member demonstrated the type of dishonesty encompassed by the concept of actual fraud. First, the plaintiff pointed to the member’s use of money wired to the LLC from the sale of a sorting machine to pay off a part of his personal loan. Despite the plaintiff’s characterization of this transaction as a fraudulent diversion of corporate assets for the member’s personal benefit, the court stated that the evidence at trial showed no dishonesty about the use of the sale proceeds. It was undisputed that the member took out a personal loan to buy sorting equipment to be used by the LLC, and the security agreement for the equipment required all proceeds from any sale of the equipment to be used first to pay off the loan. It was also undisputed that the member sold the equipment once the LLC no longer had a use for it and applied the proceeds to the loan balance as required by the security agreement. According to the court, the member’s “use of a single-member LLC, as statutorily authorized by the legislature, combined with an ordinary personal loan to purchase equipment for the company’s use secured by that equipment, amounts to no evidence of actual fraud even in combination with the other facts in this case.” There was no evidence that the member attempted to conceal that the equipment was purchased with money from a loan to him personally or that the equipment was security for the loan. Nor did the evidence show that the member represented that the equipment was a gift to the LLC. In fact, the evidence included a written lease of the equipment from the member to the LLC. The court stated that the bill of sale showing the LLC rather than the member as the purchaser of the equipment might be some evidence that the member treated the LLC as his alter ego but did not show that the member committed fraud against the plaintiff. Next, the plaintiff argued that the LLC used some of the plaintiff’s deposit as operating funds in violation of the contract and without disclosing the fact to the plaintiff. Even if true, the court concluded there was no evidence that the member derived any direct personal benefit from the LLC’s use of the deposit so as to warrant piercing the LLC veil. The court rejected the argument that use of the deposit as operating funds
benefitted the member by relieving him of the obligation to contribute additional capital or incur personal debt to keep the LLC afloat. The court pointed out that the LLC agreement did not obligate him to make additional capital contributions or take on any personal debt. Finally, the plaintiff contended that the member committed fraud by shutting down the LLC when the plaintiff demanded a return of its deposit. The court stated that there was no evidence the member closed the LLC to avoid returning the deposit, which the plaintiff admitted the LLC had no obligation to return at the time of the plaintiff’s demand. Rather, the evidence showed that the LLC ceased operating due to declining business. Further, the plaintiff presented no evidence that the member obtained any direct personal benefit by shutting down the LLC.

*Guarino v. 11327 Reeder Road, Inc.*, No. 05-12-01573-CV, 2013 WL 4478202 (Tex. App.–Dallas Aug. 20, 2013, no pet.) (mem. op.).

The plaintiff argued that Guarino, a nonresident individual, and Guarino’s Rhode Island corporation were subject to personal jurisdiction in Texas on the basis that an LLC tenant that defaulted on a lease with the plaintiff in Texas was the alter ego of Guarino and the Rhode Island corporation. The court of appeals set forth the test for alter ego in the personal jurisdiction context and listed the types of evidence that a court will consider as proof of alter ego. The plaintiff presented no evidence of this type. An individual’s status as an officer, director, or majority shareholder is not alone sufficient to support a finding of alter ego, and there was no evidence that Guarino was an officer, director, or owner of the tenant LLC. The plaintiff did not present any evidence that Guarino or his Rhode Island corporation owned or controlled the LLC to the extent necessary to pierce its veil.


The plaintiff operated a heating and air conditioning business and entered into a master purchase order agreement providing for the sale and purchase of goods with David Powers Homes, the assumed name of DJPH, LLC. Several business entities were affiliated with this LLC. Between 2000 and 2009, it was undisputed that a corporation affiliated with the LLC paid the plaintiff for hundreds of jobs. In 2008, the plaintiff sued the corporation and David Powers individually for unpaid balances from approximately 50 jobs involving the sale of air conditioning equipment and labor. The LLC and its affiliated entities ceased operating in 2009. The affiliated corporation sued by the plaintiff in this case filed a sworn pleading confessing judgment in 2010, and the plaintiff nonsuited the corporation, but the plaintiff continued to sue David Powers individually to recover payment and alleged that Powers was individually liable for breach of contract, fraud, and alter ego. Powers filed a motion for summary judgment, which the trial court granted. On appeal, the plaintiff argued that the trial court erred in granting summary judgment. The court of appeals first rejected the plaintiff’s contract claim. The plaintiff argued that the true identity of David Powers Homes was Powers, or that there at least was a fact question, and that the plaintiff presented evidence establishing an exception to the statute of frauds. Powers argued that he was not a party to the agreement and that the actual party was the LLC for which David Powers Homes was an assumed name. Both parties acknowledged that the contract was subject to the statute of frauds as a contract for the sale of goods over $500 and, as such, not enforceable unless signed by the person against whom enforcement is sought. The court rejected the plaintiff’s arguments that two exceptions applied here: (1) that Powers admitted he had a contract with the plaintiff, and (2) partial performance. The court of appeals examined the evidence and concluded that there were no admissions by Powers that he had a contract with the plaintiff and that the evidence did not show Powers, as opposed to a business entity, performed under the agreement. Summary judgment was thus proper on the breach of contract claim because there was no enforceable agreement against Powers as a matter of law. With respect to the trial court’s summary judgment on the fraud claim, Powers argued that the plaintiff did not plead or offer evidence that the fraud was perpetrated primarily for Powers’ direct, personal benefit, as required under Texas law to pierce the LLC veil. The plaintiff countered that it was seeking to hold Powers individually liable for common law fraud rather than seeking to pierce the LLC veil. The appellate court concluded that the only theory of fraud available to the plaintiff was one characterized as piercing the LLC veil based on the plaintiff’s pleadings, summary judgment response, and evidence. The plaintiff alleged that Powers was individually liable because he used the corporate fiction to commit fraud and contended that Powers misrepresented the identity of David Powers Homes, assured payment of debts, and used an assumed name as a mechanism to escape debt. The plaintiff further alleged that David Powers Homes and Powers were inextricably tied together under an alter ego theory. Together, the allegations were based on the premise that Powers used the LLC and its affiliates in a fraudulent manner, which required proof that Powers perpetrated fraud for his direct, personal benefit. The appellate court concluded that the plaintiff produced no evidence of any acts by Powers in his individual capacity distinct from the LLC and its affiliates, and there was no evidence that Powers abused the entities primarily for his direct, personal benefit. In addition, there was no evidence of acts by Powers to deceive or mislead explicitly or implicitly. The only evidence presented by the plaintiff was evidence that the plaintiff’s employee
worked directly with Powers as representative of “David Powers Homes” and that Powers did not volunteer that this was not an assumed name of Powers individually. The appellate court stated that even viewing this evidence in the light most favorable to the plaintiff, it was no evidence that Powers committed fraud so as to justify piercing the LLC veil.

**K-Solv, LP v. McDonald**, No. 01-11-00341-CV, 2013 WL 1928798 (Tex. App.–Houston [1st Dist.] May 9, 2013, no pet.) (mem. op.).

The plaintiff sought to hold an LLC’s two individual members vicariously liable for the LLC’s breach of contract, and the trial court granted summary judgment in favor of the members. On appeal, the plaintiff did not dispute that the Texas Business Organizations Code (BOC) governs the liability of members of an LLC. The BOC provides that an LLC member may be named as a party in an action by or against an LLC only if the action is brought to enforce the member’s right against or liability to the LLC and further provides that a member or manager is not liable for a debt, obligation, or liability of the LLC. The court noted that the BOC, as amended September 1, 2011, currently provides that LLC member liability is subject to the same statutory limitations and exceptions as corporate shareholder liability, but no party contended that Section 101.002 applied to this appeal. The plaintiff relied on Texas case law applying common-law veil piercing theories in the LLC context. The plaintiff conceded that it must show actual fraud and a direct personal benefit to prevail on its vicarious liability claim against the members, and the court agreed that these requirements must be satisfied. The plaintiff asserted that not paying the amount owed to the plaintiff enabled the members to pay monies toward loan obligations personally guaranteed by them and IRS 941 taxes that would have resulted in personal penalties against them. These facts constituted direct personal benefit to the members according to the plaintiff. However, the court stated that the bank records did not establish any connection between the LLC’s transaction with the plaintiff and the LLC’s payment of debt or tax obligations. Even assuming payment of these types of obligations constitutes “direct personal benefit” for veil-piercing purposes, the court found the absence of any evidence of a connection between the payments and the LLC’s transaction with the plaintiff to be fatal. Thus, the trial court correctly concluded that the summary judgment record contained no evidence of an essential element of the plaintiff’s vicarious liability claim.


The court concluded that personal jurisdiction over the parent of an LLC (previously organized as a corporation) was lacking. Although the subsidiary had extensive contacts with Texas, the evidence did not show that the parent and its subsidiary should be fused for jurisdictional purposes. The court examined the factors relied on by the Texas Supreme Court when determining whether a subsidiary is separate and distinct from its parent corporation for jurisdictional purposes. Although it was undisputed that the parent’s wholly owned subsidiary owned 100% of the LLC’s “stock,” the subsidiaries maintained separate headquarters from the parent. With respect to the extent of observance of corporate formalities and the degree of the parent’s control, the testimony showed a high degree of control, but the court concluded the testimony did not establish that the parent controlled the internal business operations and affairs of the subsidiary such that exercise of jurisdiction over the parent would be necessary to prevent fraud or injustice.


The Estate of Vasquez-Ortiz brought this action seeking a declaratory judgment that an insurance policy issued to a Delaware LLC covered the death of passengers and crew members. The LLC was set up and owned by Hoffman, a broker of aircraft, who advised Vasquez-Ortiz that it would be prudent and advantageous to set up a separate United States entity for airplanes acquired by Vasquez-Ortiz because Vasquez-Ortiz was not a U.S. citizen. The LLC acquired several airplanes, but neither Hoffman nor the LLC paid for the planes; Vasquez-Ortiz negotiated and paid for the planes. The LLC obtained a liability insurance policy, and a plane covered by the policy crashed. Vasquez-Ortiz, who was the pilot, and a passenger died in the crash. The passenger’s estate sued the LLC and the Estate of Vasquez-Ortiz, and the insurer denied coverage when presented with the law suit. The Estate of Vasquez-Ortiz (the “Estate”) then brought this suit alleging various causes of action, including for declaratory judgment. The insurer argued that the Estate had no standing to bring an action on the insurance contract between the LLC and the insurer. The Estate argued that it had standing to bring the suit because Vasquez-Ortiz was the alter ego of the LLC. Because Vasquez-Ortiz purchased all of the LLC’s assets, paid for any maintenance, and controlled the assets of the LLC, the Estate argued that he should be able to step in and sue on the LLC’s behalf. The court acknowledged that Texas courts have recognized the alter ego doctrine for purposes of allowing a party to bring a claim directly against a corporation’s owner as a means of protecting creditors injured by the corporate form. However, the Estate did not cite, and the court did not find, any cases supporting an “alter ego” concept of standing. The court stated that the alter ego doctrine is a sword to be used by creditors against the
corporation rather than a sword to be used by the corporation against those who assumed in good faith that they were dealing with a corporation, and the court declined to derive from this doctrine a novel theory of standing. The court stated that it was not unsympathetic to the Estate’s predicament since it was up to Hoffman, as sole owner of the LLC, to bring the LLC’s claims, and it appeared that Hoffman had a close relationship with family members of Vasquez-Ortiz who were trying to remove assets from the Estate in order to keep them from the rightful heir. Even so, the court stated that it was simply not aware of any doctrine that would allow an individual with no legal ownership of an entity to sue on its behalf. The court noted that the predicament could have been avoided if Vasquez-Ortiz had maintained legal ownership of the LLC, and the court did not see any reason he could not have registered the LLC in his own name under the Delaware LLC statute.

**In re Boyd (Rodriguez v. Four Dominion Drive, LLC),** 2012 WL 5199141 (Bankr. W.D. Tex. 2012).

The bankruptcy trustee of the individual debtor sought to treat the debtor and his law firm, a professional LLC, as a single entity based on reverse veil-piercing principles. The court assumed that the corporate alter ego doctrine applied in this context and held that the trustee’s reverse veil-piercing claim was not a “core” proceeding but conceivably fell within the court’s “related to” jurisdiction.


An employee of a nursing home asserted negligence claims against her employer and numerous related entities based on an alleged workplace injury suffered by the employee. The employee added two individual defendants and alleged claims for conspiracy and alter ego theory against the individuals. The trial court granted special appearances by the individual defendants, and the employee appealed. The court of appeals interpreted the employee’s argument to be that, through a chain of entities, the court could establish jurisdiction over a Delaware LLC, and by reaching the LLC extend jurisdiction to the individuals because they were managing members of the LLC. The court noted that Texas courts have applied to LLCs the same state-law principles for piercing the veil that apply to corporations. Here, the employee sought to use the alter ego theory as a form of “jurisdictional veil piercing.” The Texas Supreme Court has held that, to disregard the corporate fiction and “fuse” a parent and subsidiary, a plaintiff must demonstrate a degree of control by the parent entity exceeding that normally associated with common ownership and directorship by means of evidence showing that the entities ceased to be separate. According to the court, the employee pleaded only that the individuals “were managing members of Canyon Sudar Partners, LLC and Canyon Sudar is the sole member of Svcare Holdings, LLC, which is the sole member of SavaSeniorCare, LLC, which owns 100% of SSC Equity Holdings, LLC, which is the sole member of SSC Submaster Holdings, LLC, which owns 100% of the equity of SSC Greenview Operating Company, GP, LLC, which operates the Waco nursing home where the appellant worked and was allegedly injured on the job.” The court said that this allegation of ownership standing alone was insufficient to establish an alter ego relationship. The employee presented no jurisdictional facts to the district court establishing minimum contacts with Texas, and the individual defendants provided affidavits negating all bases of jurisdiction. Thus, the district court did not err in granting the special appearances.


Doyle contracted with Kontemporary Builders, Inc. (“KBI”) for KBI to install a cover and insulated roof over her patio. The patio cover collapsed, and Doyle refused to pay the balance owed KBI. An engineer suggested by KBI in a mediation between the parties submitted a written report in which he concluded the patio cover had been inadequately designed and installed. The parties failed to reach a settlement in the mediation, and shortly after the failed mediation, the owner of KBI, Bains, formed a new LLC and transferred all of KBI’s assets to the LLC and began operating under the name of the LLC. Doyle added Bains and the LLC to a suit she had filed against KBI, alleging violation of the Texas Uniform Fraudulent Transfer Act (TUFTA) and an “alter ego/sham corporation” claim. Following a bench trial, the court entered a judgment against KBI on Doyle’s DTPA claim, but Doyle did not prevail against Bains and the LLC on her TUFTA and “alter ego/sham corporation” claims. On appeal, the court of appeals reviewed the evidence with regard to the TUFTA claim and concluded that the evidence was sufficient to support the trial court’s findings that Bains did not conspire with the LLC or engage in any fraudulent transfer to the LLC. With respect to Doyle’s challenge to the trial court’s finding that Bains was not the alter ego of the LLC, the court of appeals discussed the fundamental principle that corporations are separate legal entities from their shareholders, officers, and directors and the provisions of Section 21.223 of the Texas Business Organizations Code limiting the liability of a shareholder with respect to contractual obligations of the corporation unless the shareholder causes the corporation to be used to perpetrate an actual fraud for the shareholder’s direct personal benefit. The court stated that the alter ego theory is one theory used
to pierce the corporate veil and may be applied when there is such unity between the corporation and individual that the
corporation’s separateness has ceased and holding only the corporation liable would be unjust. The court listed factors
that may be considered by the court and pointed out that Section 21.223(a)(3) provides that failure to follow corporate
formalities is no longer a factor in considering whether alter ego exists. The court of appeals stated that the trier of fact
in this case could have inferred from the evidence that Bains, as the sole owner of the LLC, had complete control over
it, but mere control and ownership of all the stock of a corporation is not a sufficient basis for ignoring the distinction
between the shareholder and the corporate entity. There was no evidence that the LLC was organized as a mere tool or
conduit of Bains, nor was there evidence that the LLC’s property was not kept separately from Bains’s property or that
the LLC was used for personal purposes. Thus, the evidence was sufficient to support the trial court’s finding.


This case involved a dispute over whether the trial court had personal jurisdiction over a nonresident manager
of a foreign limited liability company when the LLC had forfeited its certificate of authority for failure to pay its Texas
franchise tax. In 2009, ACS Partners, LLC (“ACS”) contracted with two Delaware limited partnerships to perform
improvements on two apartment complexes in Houston. Alleging it did not receive payment under the contracts, ACS
sued GFI Houston Holdings Management, LLC (“GFI”) and Allen Gross. GFI, a general partner of the two limited
partnerships, was a Delaware LLC. Gross was a manager of GFI residing in New York. ACS alleged that GFI was
subject to personal jurisdiction of the court because GFI did business in Texas. As to Gross, ACS contended that
jurisdiction was proper because GFI’s certificate of authority had been forfeited in 2005, and under an alter ego theory
GFI’s jurisdictional contacts were imputed to Gross. Gross filed a special appearance supported by a sworn affidavit
in which he testified that he was an employee of GFI, had a business address in New York, and lived in New York all
his life. Gross denied having sufficient contacts with Texas or the underlying litigation to be subject to personal
jurisdiction in Texas, and he presented affidavits showing that GFI was not the general partner at the time the contracts
were executed. At the hearing on the special appearance, ACS argued that because GFI had failed to satisfy all of its
franchise tax requirements, Section 171.255(a) of the Tax Code – which under certain circumstances makes corporate
directors and officers liable for corporate debts incurred after a tax becomes due but is unpaid – operated to make Gross
personally liable for the debts of GFI and conferred personal jurisdiction over Gross. ACS claimed that personal
jurisdiction could be asserted over Gross by virtue of GFI’s status as the officially registered general partner and the
forfeiture of GFI’s certificate of authority. The trial court granted Gross’s special appearance and dismissed him from
the suit for lack of jurisdiction.

On appeal, the appellate court found that ACS did not allege that Gross performed any actions so as to come
within the Texas long-arm statute, and Gross met his burden of proof to negate personal jurisdiction based on his own
forum contacts by means of his sworn affidavit that he did not and had never lived in Texas. However, ACS also alleged
personal jurisdiction over Gross was proper based on an alter ego theory. The court explained that a presumption of legal
separateness between an LLC and its managers existed, and ACS had the burden to prove facts that would justify
imputing GFI’s contacts with the forum to Gross such that the contacts of GFI and Gross should be fused for
jurisdictional purposes. ACS did not premise its jurisdictional veil-piercing theory on the traditional alter ego doctrine
in which the plaintiff must show that one of two entities exerted a level of control over the other such that in reality they
constituted the same entity. Instead, ACS contended that Gross was subject to personal jurisdiction in Texas based on
Section 171.255(a) of the Texas Tax Code. The Tax Code provides in relevant part that if the corporate privileges are
forfeited for the failure to file a report or pay a tax or penalty, then each director or officer of the corporation is liable
for each debt of the corporation that is created or incurred in Texas after the date on which the report, tax, or penalty is
due and before the corporate privileges are revived. ACS argued that the forfeiture of GFI’s certificate of authority
pursuant to this Tax Code provision meant that GFI’s contacts in Texas were imputable to Gross for jurisdictional
purposes. The appellate court disagreed. The court considered the plain language of the statute and strictly construed
the statute so as to protect those individuals against whom liability was sought. Section 171.255 does not create a basis
for asserting personal jurisdiction over a nonresident officer or director of an entity that enjoyed or once enjoyed
corporate privileges in Texas. The statutory provision does not mention jurisdiction in any way. The court explained
that a crucial distinction existed between liability and personal jurisdiction. Even if ACS proved that GFI’s corporate
privileges had been forfeited, that established the potential liability of GFI’s officers or directors but not personal
jurisdiction over them. A defendant’s potential liability to a plaintiff is not dispositive of the personal jurisdiction
requirement. The appellate court concluded that Section 171.255 of the Texas Tax Code did not provide an independent
basis for personal jurisdiction over Gross, a nonresident defendant. Because ACS failed to suggest any other factual
basis for asserting personal jurisdiction over Gross, the appellate court affirmed the order of the trial court granting Gross’s special appearance and dismissing him from the suit.


The principal issue in this appeal was the appropriate standard for piercing the veil of a limited liability company before the 2011 amendment to the Business Organizations Code extending the statutory standards governing veil piercing of corporations to LLCs. The court concluded that, assuming veil-piercing principles can be applied to LLCs, a claimant seeking to pierce an LLC’s veil with respect to a contractual liability of an LLC must prove (as has long been required by statute when piercing the veil of a corporation) that the person on whom the LLC’s liability is to be imposed used the LLC to perpetuate actual fraud for the person’s direct personal benefit.

The Waldens entered into two contracts with S & J Endeavors, LLC under which the LLC would convey a residential lot to the Waldens and construct a residence on the lot. Disputes relating to the construction work arose, and there was a protracted delay in transfer of the title to the lot. The Waldens sued the LLC, and its two members/managers, Shook and Jaehne, asserting numerous tort and contract theories. The jury found that the LLC breached the construction contract, that Shook and Jaehne were liable for the LLC’s contractual liabilities on the basis of alter ego and single business enterprise, and that the LLC was operated as a sham. The trial court entered judgment against the LLC, Jaehne, and Shook based on these findings. Shook appealed.

On appeal, the Waldens conceded that the single business enterprise finding could not support a judgment against Shook because the single business enterprise theory that was rejected by the Texas Supreme Court in *SSP Partners v. Gladstrong Invs. (USA) Corp.* was materially identical to the version submitted to the jury in this case. Thus, the alter ego and sham theories remained as potential bases for the judgment against Shook. Shook did not dispute that the concept of veil piercing applied to an LLC but argued that the Waldens were required to prove that he used the LLC to perpetrate a fraud for his direct personal benefit in order to impose on him the contractual liability of the LLC. The Waldens argued that the common law veil-piercing principles articulated in *Castleberry v. Branscum*, which only required constructive fraud, applied in the absence of any statutory standards in the LLC context.

The court reviewed the development of Texas veil-piercing law going back to the *Castleberry* case. Prior to 1989, Article 2.21 of the Texas Business Corporation Act mandated that the liability of a shareholder of a Texas corporation was limited to the value of the shareholder’s shares and did not reference any exception under which a shareholder could be held individually liable for the corporation’s obligations. Notwithstanding this statutory language, courts had long held that a corporation’s separate existence could be disregarded as a matter of equity in certain circumstances. In 1989, however, the Texas Business Corporation Act (TBCA) was amended to partially codify and limit judicial application of veil-piercing principles in reaction to the Texas Supreme Court’s 1986 decision in *Castleberry*, in which the court stated that piercing the corporate veil on the basis of “sham to perpetrate a fraud” merely required a showing of constructive fraud regardless of whether the underlying claim arose in tort or contract. Article 2.21 of the TBCA was amended in 1989 to provide that a corporation’s contractual obligation could not be imposed on a shareholder “on the basis of actual or constructive fraud, or a sham to perpetrate a fraud” except on proof that the shareholder “caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud” on the claimant “for the direct personal benefit of the shareholder.” The 1989 amendments also provided that a shareholder had no liability for a contractual obligation of the corporation “on the basis of the failure of the corporation to observe any corporate formality.” Article 2.21 was further amended in 1993 and 1997 in several respects, which included broadening the actual fraud requirement to any obligation “relating to or arising from” a corporation’s contractual obligation and to claims based on alter ego or any other similar theory.

Meanwhile, as these developments regarding corporate veil piercing were taking place, the legislature authorized the creation of LLCs by passing the Texas Limited Liability Company Act (TLLCA) in 1991. The TLLCA was later recodified in the Business Organizations Code (BOC). Article 4.03 of the TLLCA provided that LLC members and managers were not liable for the debts, obligations, or liabilities of the LLC without mention of veil-piercing principles as an exception. This approach was carried forward in the BOC until the legislature added new Section 101.002 of the BOC in 2011 specifying that the BOC provisions applicable to corporate veil piercing (Sections 21.223 and 21.224) also apply to LLCs, their members, and their managers. Shook acknowledged, however, that the 2011 amendment did not impact this case, which was governed by prior law.

Shook relied upon state and federal decisions that have applied corporate veil-piercing standards to LLCs, but the court of appeals pointed out that courts in those cases have done so without analysis of why the corporate standards apply. The Waldens argued that comparison of the corporate and LLC statutes evidenced a legislative intent that the veil-piercing standards applicable to corporations not apply to LLCs (at least prior to 2011) since the legislature conspicuously omitted from the LLC statute the types of restrictions it imposed in the corporate context. In the absence
of any statutory standards for veil-piercing of LLCs, the Waldens reasoned that the equitable principles set forth in
Castleberry applied. The court of appeals noted that its research had revealed a Wisconsin federal district court veil-
piercing decision governed by Texas law in which the court had essentially employed the same reasoning advanced by
the Waldens. The court of appeals noted as an incidental matter that the legislative history of the 2011 amendments to
the LLC statutes reflected that the amendments were in part a response to perceived confusion generated by the
Wisconsin federal court’s decision. The court of appeals agreed with the Waldens that the veil-piercing restrictions and
limitations in the TBCA did not, as a matter of statutory construction, extend to LLCs at any time relevant to this case
and that the veil-piercing remedy in this case would be governed by extra-statutory equitable principles. However, the
court stated that it did not automatically follow that proper application of those principles to the LLC must track
Castleberry as the Waldens presumed.

The court discussed the balancing of competing principles required in the application of veil-piercing principles
and concluded that the legislative policy judgments made in the aftermath of Castleberry and the balancing of interests
must necessarily inform judicial application of equitable veil-piercing principles to LLCs. The court stated that it was
following the example set by the Texas Supreme Court in the context of equitable prejudgment interest. In that context,
the supreme court overruled prior precedent in deference to legislative policy judgments made and conformed preexisting
equitable accrual and compounding methodologies to statutory standards even in cases that the statute did not reach.
Although the Waldens stressed that the legislature did not enact a statute to govern veil piercing of LLCs at times relevant
to this case, the Waldens offered no reason why the relative equities present with respect to claims to pierce the veil of
an LLC with respect to a contract claim would categorically differ from those present in the corporate context. Nor could
the court perceive any, and the court concluded that the courts should be guided by the framework provided by the
legislature in determining equity with respect to veil-piercing claims against LLCs. The court observed that its
conclusion was consistent with the results in other Texas cases although the reasoning was admittedly not made explicit
in those cases. The court also noted that a contrary conclusion was not suggested by the fact that the legislature later saw
fit to amend the LLC statute to explicitly incorporate the veil-piercing standard prescribed in the corporate statutes.

Deffering to and applying the legislative actual fraud standard governing veil-piercing of corporations required
reversal of the judgment against Shook because there were no findings or proof that Shook caused the LLC to be used
to perpetrate actual fraud for his direct personal benefit.

A dissenting justice argued that the equitable standard set forth in Castleberry was the correct approach in this
case given the absence of a statutory standard. Because an actual fraud finding is not required under Castleberry, the
dissenting justice would have affirmed the judgment imposing personal liability on Shook based on the jury’s findings
(which the dissenting justice considered to be supported by the record) that the LLC was operated as the alter ego Shook
and as a sham.

In re Juliet Homes, LP, Bankruptcy No. 07-36424, Adversary No. 09-03429, 2011 WL 6817928 (Bankr. S.D. 

This adversary proceeding was brought in the bankruptcy cases of a limited partnership, the limited partnership’s
LLC general partner, and the individual who owned 100% of the LLC and 28% of the limited partnership. The Chapter 7
trustees for these debtors brought this action to recover preferential and fraudulent transfers and to pierce
the corporate veil of various entities affiliated with the entity debtors. Some of the defendants sought dismissal of claims
that were based on transfers made by non-debtor entities. The defendants argued that the trustees must show that the non-
debtor entities should be substantively consolidated under bankruptcy law with one or more debtors in order to assert
claims for transfers made by the non-debtor entities. The court stated that the trustees did not have to plead substantive
consolidation because they stated claims for state law reverse veil piercing with respect to the entities and thus had
standing to assert fraudulent or preferential transfer claims based on transfers from the non-debtor entities. The court
relied upon ASARCO LLC v. Americas Min. Corp., 382 B.R. 49 (S.D. Tex. 2007) for the proposition that a debtor can
pursue its wholly owned subsidiary’s fraudulent transfer claim where state law veil-piercing requirements are met. The
court explained that traditional veil piercing uses the alter ego doctrine to include the assets of a shareholder as assets
of a corporation while the common law doctrine of reverse veil piercing counts the assets of a corporation or other entity
as the assets of its shareholder. In this case, the trustees sought to count the assets of the non-debtor entities as assets
of the debtors. The court reviewed specific facts alleged by the trustees that supported the allegation that the entities
were a sham and were not truly separate from the debtors and that the sham entities were used to facilitate the fraudulent
diversion of assets. The court concluded that the allegations adequately stated a claim for reverse veil piercing under
Texas law.

The plaintiffs in this adversary proceeding sought to establish that their claim against the debtors, Norman and Joan Williams, was nondischargeable. Norman and Jean Williams were the sole owners, managers, and employees of Williams Building Consultants, LLC, and the plaintiffs’ claim was based on the breach of a construction contract between the LLC and the plaintiffs. The court concluded that the plaintiffs had a breach of contract claim against the debtors even though the contract was with their LLC. The court stated that the debtors completely disregarded the corporate form throughout the negotiations and closing process and that the LLC was “essentially a sham corporation.” The LLC had no employees, no significant assets, and very little money in the bank. Mrs. Williams testified the LLC was created for the sole purpose of building the home purchased by the plaintiffs. The LLC did not file separate tax returns from the debtors. The debtors consistently referred to their homebuilding business in terms of “we” rather than the LLC. The plaintiffs always understood the debtors to be the sellers of the property rather than the LLC. On this basis, the court allowed the plaintiffs’ claim against the debtors. The court determined that the debt was dischargeable, rejecting the plaintiffs’ argument that the debt was based on false pretenses, false representations, or actual fraud of the debtors.


Michael Sanderson and Ann Gainous wanted to start their own ice rink business, and they signed a lease for an ice rink and formed a corporation, Ridglea Entertainment, Inc. (“Ridglea Entertainment”) to operate the business. After they experienced problems operating the business, they contacted W. Graeme Roustan, an investor in and operator of numerous ice rinks, about Roustan buying a controlling interest in their business. After meeting with Roustan, the parties signed a purchase agreement under which a new entity, Rouston Ridglea, LLC (the “LLC”), agreed to purchase the lease and all of the assets of the ice rink business. The LLC agreed to transfer a 25% ownership interest to Ridglea Entertainment and to pay $75,000 to Gainous and Ridglea Entertainment. Ridglea Entertainment and Roustan, Inc. (a company wholly owned by Roustan) executed an operating agreement for the LLC. Under the operating agreement, Roustan, Inc. owned a 65% interest, Ridglea Entertainment owned a 25% interest, and two trusts each owned a 5% interest. The agreement called for Roustan, Inc. to make a $150,000 capital contribution to the LLC, and Ridglea Entertainment’s capital contribution consisted of its assignment of its interest in the ice rink and the sale of its business assets as set out in the purchase agreement. The parties disputed at trial whether Roustan, Inc. satisfied all of its capital contribution and whether the LLC paid all of the purchase price under the purchase agreement. After the business fell on hard times and Roustan maneuvered to exclude Sanderson and Gainous from the business, Sanderson, Gainous, and Ridglea Entertainment (the “S&G parties”) filed suit against Roustan, the LLC, and others, alleging claims for fraud and breach of contract. Based on the jury verdict, the trial court entered a judgment against Roustan based on the failure to pay the entire purchase price for the ice rink business and statutory fraud. The jury found that Roustan agreed to pay Sanderson and Gainous $75,000 for the ice rink business and failed to pay $37,500 of that amount. The court of appeals pointed out that the purchase agreement was between the S&G parties and the LLC, not Roustan individually. Roustan signed the agreement as president of Roustan, Inc., which was the managing member of the LLC. Thus, the LLC could be liable for breach of the contract, but Roustan as an officer could not be held personally liable because, while his actions could cause the LLC to breach the contract, he was not a party to the contract. The S&G parties did not plead or prove a ground for ignoring the limitation of liability afforded in LLCs and did not allege that the limitation should be disregarded. Members of an LLC are protected by statute from liability for the debts, obligations, or liabilities of the LLC. The court noted that courts apply to LLCs the state law principles applied to pierce the corporate veil, and fraud is a ground for disregarding the corporate form. The S&G parties pled that Roustan fraudulently induced them to enter a contract, but they did not plead that Roustan used the LLC itself to perpetrate a fraud and that the entity should be disregarded to hold Roustan personally liable, and they did not plead any other ground for disregarding the corporate structure. The S&G parties argued that they understood Roustan would be supplying the funds for the purchase price, but they did not put on evidence of a separate contract with Roustan. The only contract they pled was breached was the purchase agreement to which Roustan was not a party. Because the S&G parties neither pled nor proved a ground for disregarding the corporate form or a separate contract with Roustan, they could not hold Roustan personally liable for breach of contract.


The debtor was the president, sole shareholder, and sole decision maker of a corporation and the sole member and sole decision maker of an LLC. The plaintiff in this adversary proceeding sought to hold the debtor liable for claims against the entities under veil piercing theories. The plaintiff asserted fraud, breach of contract, and various other claims.
against the debtor and his entities in connection with over $1.7 million lent to the entities by the plaintiff. The court noted that Texas has applied the principles used to pierce the corporate veil to pierce the liability shield of an LLC, and the court applied the same standards to the corporation and LLC in this case. First the court addressed the question of whether the actual fraud standard of Section 21.223 of the Business Organizations Code applied to the claims in this case, i.e., whether the claims were tort claims outside the scope of the statute or were based on a contractual obligation of the entities. The court discussed some inconsistency in the case law dealing with the precise scope of Section 21.223 and its predecessor, but the court found it unnecessary to resolve it because the court concluded that the plaintiff had satisfied the actual fraud standard assuming it applied. The court stated that “actual fraud” within the meaning of the statute is not the same as the common law tort of fraud and does not require proof of each element of common law fraud. The court stated that actual fraud for purposes of Section 21.223 simply requires proof of dishonesty of purpose or intent to deceive. The court described how the debtor was dishonest in his dealings with the plaintiff and intended to mislead the plaintiff in order to induce the plaintiff to invest in the debtor’s entities. The court also had no doubt that the debtor used the entities to perpetrate a fraud that primarily served to directly benefit him. As in other cases cited by the court, the debtor wholly owned and controlled the entities and was the only one who stood to benefit from their continued operations. He knew he would lose his livelihood if the companies failed, and he used the loan proceeds from the plaintiff to make distributions and advances to himself so that he could continue to support his family and lifestyle.

The court next discussed the sham to perpetrate a fraud theory and the alter ego theory. The court did not find that the sham to perpetrate a fraud theory applied in this case because neither of the debtor’s entities were resorted to as a means of evading an existing legal obligation. Both entities existed before the plaintiff invested, and the debtor did not transfer assets among his companies with the purpose of using the corporate form to shield those assets from creditors. However, the court did find the evidence supported a finding of alter ego. The court stated that alter ego liability results when there is such unity between the corporation and individual that the corporation ceases to be separate and holding only the corporation liable would promote injustice. The court listed factors a court may consider in determining alter ego but noted that the failure to follow any corporate formality is no longer a factor. The court found the plaintiff had proved various facts in support of an alter ego finding, including blended finances of the debtor and his two entities, sole ownership and control by the debtor of the entities, commingling of funds of the entities with his personal funds, the debtor’s taking of loans and distributions to fund his lifestyle rather than any regular salary, and occasional use of the entities for personal purposes without proper documentation. The court also found that the plaintiff proved that the debtor defrauded the plaintiff through the entities and that the entities were out of business and had no assets to satisfy a judgment.


The court determined that the transfer of a condominium from the debtor’s corporation to an LLC owned by Hensley, a friend of the debtor, was a fraudulent transfer. The court then proceeded to analyze whether Hensley was jointly and severally liable with his LLC under veil piercing theories. The court relied upon corporate veil piercing principles, noting that “corporate veil piercing law is equally applicable in the context of limited liability companies.” The court stated that the evidence showed that Hensley solely controlled the LLC and commingled funds but stated that this evidence was probably insufficient to pierce the veil under an alter ego theory. Nevertheless, the court found the evidence sufficient to establish that Hensley used the LLC to perpetrate a fraud. The court based this conclusion on its previous finding that Hensley did not act in good faith in connection with the transfer of the condo and helped the debtor carry out a fraudulent transfer. Therefore, Hensley was jointly and severally liable with the LLC.


Basurto sued Watkins for personal injuries suffered in an assault by bouncers at a bar known as The Tavern. Two LLCs (which were not defendants) were involved in the operation of The Tavern. One managed the operations, money, and income of The Tavern, and the other held the liquor license and employed the staff. Watkins was the registered agent and a member of both LLCs. The two bouncers involved in the fight with Basurto had several criminal convictions, but it was not the practice of Watkins to run background checks when hiring employees, and he did not run background checks on the bouncers. After a bench trial, the trial court entered a judgment against Watkins, and Watkins appealed. The trial court found that Watkins was liable for negligent hiring and supervision and as the alter ego of the LLCs operating The Tavern. The court of appeals first discussed the negligent hiring and supervision claim and held that it failed on the element of causation. The court of appeals next addressed the trial court’s finding that Watkins was the alter ego of the LLC that operated The Tavern. The court noted that the LLCs were not actually defendants in the case, which raised a question as to whether a defendant can be held personally liable under an alter ego theory for torts.
committed by a non-defendant entity. Because the court ultimately concluded the evidence was insufficient to support the trial court’s finding of alter ego, the court did not reach that question. The court recognized that members and managers of an LLC are not liable for judgments against the LLC but that courts have applied corporate veil-piercing principles to LLCs. Thus, an LLC member may be held individually liable for obligations of the LLC if the LLC is the mere alter ego of the member. Alter ego liability requires that there exists such unity between the LLC and the member that the LLC ceases to be separate, and holding only the LLC liable would promote injustice. The court listed factors that fact finders consider in determining whether an LLC is an alter ego of an individual and noted that in a tort case financial strength or weakness of the company is an important consideration with respect to the injustice aspect of alter ego. The court concluded that there was insufficient evidence that unity existed between Watkins and the entities that operated The Tavern or that injustice would result if Watkins was not held liable. Basurto presented no evidence that Watkins mingled his personal property with that of the companies or that he used either company for personal purposes. The record did not show the extent of Watkins’ ownership interest, but the evidence did show he exercised extensive control. However, mere control is insufficient to impose liability. Basurto also presented no evidence of failure to follow corporate formalities, so the court said it was not necessary to determine if corporate formalities remain a factor to be considered in piercing the LLC veil, noting that a corporate shareholder cannot be held liable on the basis of failing to follow corporate formalities. Finally, Basurto argued that the entities could not have satisfied his judgment, but he failed to present any evidence to support this argument. Basurto argued to the trial court that Watkins failed to timely disclose the LLC that employed The Tavern’s employees, and that the LLC was thus not made a party prior to the running of the statute of limitations, but the court of appeals said that this argument did not support a finding of alter ego. Basurto had available other avenues to obtain relief for discovery abuses, and the injustice that the alter ego remedy serves to remedy is that of the entity’s lack of ability to pay a judgment that it rightfully should pay. Finally, the court noted that the alter ego theory itself does not support a claim for damages, i.e., piercing the veil is not a cause of action. Because the court of appeals had already held that Basurto’s one theory of recovery, negligent hiring and supervision, was not supported by legally sufficient evidence of the causation element, there was no underlying cause of action that would support liability of Watkins in any event.


**In re Williams**, Bankruptcy No. 09-52514, Adversary No. 10-05077, 2011 WL 240466 (Bankr. W.D. Tex. 2011). The court noted that Texas courts have applied statutory veil piercing provisions applicable to corporations to LLCs.

**Genssler v. Harris County**, ___ S.W.3d ___, 2010 WL 3928550 (Tex.App.–Houston [1st Dist.] 2010, no pet.). The court analyzed the claim that an individual was liable for environmental violations committed by a group of entities that owned and operated two waste water facilities. Harris County and the State of Texas had obtained a receivership over the individual’s property on the theory that the individual was the alter ego of the entities. [The designators in the names of the entities indicate that the group of entities consisted of a limited partnership, two limited liability partnerships, and a limited liability company, but the court did not specify or discuss the nature of the entities.] The court spoke in general terms about the separate legal existence of a “business entity” and the application of the alter ego theory when “there is such unity between the business entity and the individual that the business entity has ceased to be a separate entity, and allowing the individual to avoid liability through the use of the business entity would work an injustice.” The court analyzed the evidence and concluded the entities were not the individual’s alter ego because there was no evidence he diverted profits for his individual use, owned any interest in the entities, or personally paid any debts owed by the entities. There was testimony that the individual was the president, the “man in charge,” and “made all the decisions,” but the court stated that the individual’s status as an officer or director, standing alone, was insufficient to support application of the alter ego theory.

**Valdez v. Capital Management Services, LP**, Civil Action No. B:09-246, 2010 WL 4643272 (S.D. Tex. Nov. 16, 2010). The plaintiff asserted that three LLCs were jointly and severally liable for their actions because they were under common control and management. The court examined whether the plaintiff had sufficiently pled facts to support liability under the alter ego theory and concluded the plaintiff had not. The court stated that the law in the Fifth Circuit made clear that 100% common ownership and common directors and officers, even together, are an insufficient basis
for applying the alter ego theory. These factors appeared to be the plaintiff’s only basis for applying the alter ego theory, and the plaintiff thus pled insufficient facts to support alter ego liability.


The court relied on the actual fraud standard in Section 21.223 of the Business Organizations Code in applying the alter ego theory in the LLC context and concluded the plaintiff did not show the LLC was formed for the purpose of wrongful conduct.


The creditor of an individual obtained a favorable veil piercing verdict against the individual’s wife, who was the owner and president of an LLC to which the husband had transferred assets to avoid paying the creditor. The jury charge included three corporate veil piercing theories: alter ego, evading an existing obligation, and sham to perpetrate a fraud. The court noted that Texas has applied corporate veil piercing principles to LLCs, and the court applied corporate veil piercing cases in reviewing the sufficiency of the evidence to support the verdict. Because neither party argued that Article 2.21 of the Texas Business Corporation Act or Section 21.223 of the Business Organizations Code were applicable, the court stated that it would review the sufficiency of the evidence solely with reference to the jury instruction (there having been no objection to the instruction in the trial court). The court concluded that the evidence did not support piercing the LLC veil to hold the member liable to the creditor of the member’s husband. Although there was evidence that the member’s husband improperly used the LLC to avoid paying his obligation to the creditor, there was no evidence that the member or the LLC had any obligation to the creditor, and there was no evidence that the member was acting as the LLC’s alter ego, used the LLC to avoid any obligation she had to the creditor, or acted with “dishonesty of purpose or intent to deceive.”

*In re Moore*, 608 F.3d 253 (5th Cir. 2010).

The bankruptcy court approved a settlement by the trustee of reverse veil piercing claims against a corporation and an LLC that allegedly were alter egos of the debtor. A creditor, which offered to purchase the claims for a higher value, objected to the settlement. On appeal, the Fifth Circuit held, as a matter of first impression, that the proposed compromise of the reverse veil piercing claims was a proposed sale of property of the estate that triggered the Section 363 sale provisions of the Bankruptcy Code.


In this False Claims Act case, the relator alleged that Integrated Coast Guard Systems, a Delaware LLC, operated as an alter ego of Lockheed Martin and Northrup Grumman Ship Systems, its two members, and that for purposes of the project in issue in the case the LLC and its two members were one and the same. Although not yet addressed in the Fifth Circuit, the court followed other circuits that have held that federal common law (rather than the law of the state where a corporation is incorporated) governs the veil piercing question in a False Claims Act case. Relying on a list of factors developed by the Fifth Circuit for determining the existence of an alter ego situation, the court concluded that the relator’s pleadings were sufficient to withstand dismissal of the alter ego claim. The court pointed to allegations that the LLC had no employees of its own and was operated by employees of its members, that the LLC’s board was dominated by directors of the boards of its members, that the LLC was grossly undercapitalized, that the LLC and its members had common business departments, and that the members executed the actions giving rise to the allegations of wrongdoing in the suit.


The court discussed and applied corporate veil piercing principles to an LLC as if the LLC were a corporation and concluded that the jury’s alter ego finding could not stand. The court concluded that there was no evidence of such unity between the LLC and its owner that the separateness of the LLC had ceased. Neither the owner’s complete control over the entity nor the owner’s practice of taking an owner’s draw (requiring payment of quarterly estimates to the IRS) rather than a salary (which would be subject to withholding for federal income tax and medicare tax purposes) demonstrated a lack of separateness between the entity and its owner, and the court thus did not have to reach the question of whether the evidence was sufficient to prove that the owner used the LLC for the purpose of perpetrating an actual fraud for his direct personal benefit.
In re HRM Holdings, LLC, 421 B.R. 244 (Bankr. N.D. Tex. 2009).

The bankruptcy trustee sought to pierce the veil of the debtor limited liability company (“LLC”) and hold several affiliated LLCs liable as a single business enterprise based on actual fraud consisting of the debtor LLC’s failure to notify creditors that it was terminating its business operations. The bankruptcy court applied corporate veil piercing principles in the LLC context, noting that “Texas courts and other jurisdictions have applied the same state law principles for veil-piercing that they have applied to corporations.” The trustee’s original complaint had simply asserted the single business enterprise theory as a basis of liability without specifying fraud, and the court found the complaint deficient based on SSP Partners v. Gladstrong Investments (USA) Corporation, 275 S.W.3d 444 (Tex. 2008). The court gave the trustee the opportunity to specify actual fraud as a basis to hold the affiliated defendants liable to the debtor’s creditors. According to the second amended complaint, the management of the LLC engineered the transfer of all the debtor LLC’s assets to the defendant LLCs without notifying the creditors of the debtor LLC. The court concluded that the failure to give the statutorily required notice of winding up could constitute actual fraud under the Texas veil piercing statutes, but the court found that the second amended complaint failed to specify who the perpetrators of the fraud were and how the fraud benefitted the defendants. The court gave the trustee a final opportunity to further amend its complaint and admonished the trustee to examine the Texas veil piercing statutes and the SSP Partners case when and if deciding to draft a third amended complaint.


Weatherford International, Inc. (“Weatherford”) sought to hold an LLC and its two member/managers, Bennett and Donaho, liable for breach of contract and copyright infringement. Bennett and Donaho argued that they were not personally liable because they did not act in their individual capacities. Weatherford argued that the LLC was thinly capitalized and that Bennett and Donaho were liable under an alter ego theory. The court concluded that it did not have sufficient information at this stage to determine whether the individuals could be liable under an alter ego theory.


The plaintiff sued two LLCs to collect unpaid overtime wages under the Fair Labor Standards Act (FLSA). The evidence showed that she was employed by only one of the LLCs. The plaintiff argued that the two LLCs were part of an “enterprise” as defined by the FLSA in order to hold the non-employer LLC jointly and severally liable as well as to aggregate the gross sales of the two LLCs to satisfy the threshold volume of gross sales required to bring an employer within the coverage of the FLSA. Relying on Eleventh Circuit precedent, the court rejected the argument that being part of the same enterprise is a basis to hold non-employer members of the enterprise liable for other members’ FLSA obligations. The non-employer LLC was thus dismissed. The court found that the two LLCs were part of an “enterprise” under the FLSA such that the gross volume of sales of the two LLCs could be aggregated to bring the employer LLC within the coverage of FLSA. The court applied the following test, which the Fifth Circuit has said will establish a single “enterprise” for FLSA purposes: (1) the corporations perform related activities (2) through unified operation of common control (3) for a common business purpose. The court concluded that the LLCs had related activities because the primary activity of both was to operate a restaurant business. The stated purpose in the articles of “incorporation” of the two LLCs was to operate a restaurant business, and each LLC in fact operated a restaurant under the same trade name with the same signature dish. The restaurants were also marketed through the same website. The court found that the LLCs met the unified operations or common control element because they were formed by the same organizer on the same day and had the same members and managing member, and they were held out to the public collectively on the website. Finally, the court concluded that the LLCs were operated for a common purpose based on the previously recited evidence that showed both LLCs were operated for the common purpose of providing not only complementary food services but also profits for the two members.


The court rejected the argument that the evidence showed two individuals used an LLC as their alter ego for personal interests and thus declined to exercise personal jurisdiction over the individuals based on the LLC’s breach of contract.
The trustee sought to pierce the veil of the debtor, The Heritage Organization, L.L.C. (“Heritage”), a Delaware LLC, and numerous related entities, in order to hold the related entities and Kornman, the individual who ultimately controlled all the entities, liable for Heritage’s liabilities. Most of the entities were Delaware entities. The members of Heritage included two Delaware limited partnerships and a Delaware LLC (the “Member Defendants”) that were in turn owned by other entities. Another group of entities controlled by Kornman or his son supplied goods and services to Heritage (the “Supplier Defendants”) and consisted of numerous Delaware LLCs and other entities that included a Tennessee corporation and a Texas corporation. In accordance with the court’s conclusion in a prior opinion in this bankruptcy proceeding, the court stated that, in Texas, the law of the state of formation governs a veil piercing claim to hold an owner liable for the entity’s debts; therefore, the court relied upon Delaware law in its veil piercing analysis except as to the Tennessee corporation and the Texas corporation. The court also reiterated its conclusion from its prior opinion that Delaware courts do not separately recognize a sham to perpetrate injustice theory. Rather, the sham concept is included in the alter ego analysis under Delaware law. The court discussed the two-pronged test for determining alter ego under Delaware law (which requires a determination that there is a single economic entity and an overall element of injustice or unfairness) and noted that, in an alter ego analysis involving an LLC, “somewhat less emphasis is placed on whether the LLC observed internal formalities because fewer such formalities are legally required.” Ultimately, the court concluded that the trustee’s veil piercing claims failed for several reasons. The court noted that the purpose of a veil piercing claim is to pierce an entity’s veil to hold the owners of the entity liable for the entity’s debts. Thus, with respect to Heritage, a proper veil piercing claim would seek to hold Heritage’s members liable for Heritage’s debts. Then, to the extent there was a basis to pierce the veil of each of those entities, the claimant could seek to hold their owners liable, and so forth. Assuming each of the entities is a Delaware entity, the Delaware two-prong alter ego test must be applied to and satisfied at each level or layer of ownership within the multi-faceted entity structure. However, the trustee simply took a global approach to all the entity defendants in an attempt to collapse the Kornman-controlled empire into Kornman and impose liability on all the entities and Kornman for Heritage’s debts. The court did not view the alter ego theory as working on such a global basis. The court stated that the trustee offered no evidence to support piercing the veil of any entities beyond Heritage. With respect to the Supplier Defendants, the court noted that not only was there no evidence of who the owners of the Supplier Defendants were or whether the operations of the Supplier Defendants and their owners satisfied the two-prong alter ego test, there was an additional conceptual problem raised by the trustee’s attempt to hold non-owners of Heritage liable for Heritage’s debts pursuant to the alter ego theory. The only connection shown between the Supplier Defendants and Heritage was the fact that they supplied goods and services to Heritage and that Kornman directly or indirectly controlled each of the entities. Even assuming Kornman was the ultimate owner of Heritage and each of the Supplier Defendants, the court said that the trustee would have to pierce the veils of each of the Supplier Defendants and their various owners up to Kornman’s ultimate ownership. Then the trustee would have to pierce Heritage’s veil and the veils of the various entities up the chain of ownership to Kornman. The two-prong alter ego test would have to be satisfied at each level of ownership of the Supplier Defendants and Heritage, and the trustee failed to offer such proof. Even with respect to the trustee’s attempt to pierce the veil of Heritage to hold its immediate owners, the Member Defendants, liable for Heritage’s debts, the court ultimately found that the trustee failed to carry his burden. With respect to the first prong of the Delaware alter ego test, the single economic entity analysis, the court acknowledged that there was some evidence of a failure to follow formalities in that one of the officers of Heritage was simply a puppet of Kornman. However, there was no evidence that the other officers of Heritage or the Member Defendants were not sufficiently diligent. And while the trustee presented some evidence that Heritage functioned as a facade for Kornman, the court characterized the evidence as equivocal. The court noted that it viewed siphoning of funds as different from making distributions to members permitted by law. The fact that the court had determined that distributions to the Member Defendants were fraudulent transfers did not make them unauthorized distributions from a corporate law standpoint according to the court. Rather, it simply permitted the trustee to avoid and recover the distributions on the basis that they were made with the intent to hinder, delay, or defraud Heritage creditors. With respect to the injustice or unfairness prong of the alter ego test, the court was also unable to conclude that the trustee satisfied his burden. The trustee’s argument centered around the fact that Heritage, which promoted tax shelters to wealthy individuals, continued to promote the tax shelters after the IRS began investigating them. While the court did not condone Heritage’s failure to disclose the IRS investigation to prospective clients (having characterized it as a “sharp practice” in the court’s fraudulent transfer analysis), the court found that the clients, who were extremely wealthy and chose an obviously risky strategy, were told of the relevant legal authorities and the risks of the tax strategies. Thus, the court concluded that the trustee failed to prove an overall element of injustice or unfairness with respect to Heritage’s sale of the tax shelters after the IRS investigation began. In sum, the trustee failed to prove his veil piercing claims as to Heritage and the various related Delaware entity defendants. The court also examined the veil piercing claims as to
the Tennessee and Texas corporations under Texas and Tennessee law and found that the trustee’s claims failed as to these entities as well.


The bankruptcy trustee brought an action to avoid payments that were made from an account funded by the debtor LLC’s business operations. The account was styled “Marcella Ortega dba Young Again Nutrients,” and Marcella Ortega was president of the debtor LLC. The payments challenged by the trustee were payments on mortgage debts of Ortega, and the court held that they were unavoidable as fraudulent transfers. In order to find that the payments were fraudulent transfers, the court had to find that the account was the property of the debtor LLC. The court discussed and applied corporate case law as if the LLC were a corporation, and the court found that the account was properly considered property of the LLC because the court could pierce the “individual veil” and view the account as property of the LLC. The court explained that a court may sometimes “pierce the corporate veil” to determine whether the activities and property of a corporation should be attributed to its individual principal or principals, but stated that the court here was being asked to do the opposite— to “pierce the individual veil” and attribute property of Ortega to the debtor LLC. The court noted that courts generally protect the individual assets from the reach of a corporation’s bankruptcy, but cited the corporate alter ego doctrine as a basis to treat individual property as corporate property. The court stated that it would treat the account as property of the LLC because Ortega herself disregarded the separation between the LLC’s funds and her funds by using the account exclusively to pay her personal expenses when the account was funded exclusively by the LLC’s business. Further, the court noted that injustice would result if the account were not treated as the property of the debtor because the fraudulent transfers, if not avoided, would seriously hinder the trustee’s ability to administer the bankruptcy case.


Prior to filing bankruptcy, the debtor, a Delaware LLC, provided estate and tax planning strategies to extremely wealthy individuals. The trustee filed this action against two individuals, Kornman and Walker, and numerous entities affiliated in some way with Kornman. Kornman was the former CEO and president of the manager of the LLC, and Walker was a long-time employee of various Kornman-controlled entities. Various defendants sought summary judgment on fraudulent transfer, preference, breach of fiduciary duty, and veil piercing claims asserted by the trustee.

The court addressed veil piercing claims by the trustee pursuant to which the trustee argued that each of the entities affiliated with Kornman should be liable for the LLC’s debts under one or more of the following theories: (1) single business enterprise, (2) alter ego, and (3) sham to perpetrate injustice. The court stated that Texas looks to the law of the jurisdiction of formation when determining the liability of an owner under a veil piercing claim. With the exception of a Tennessee corporation and a Texas corporation, the entity defendants were all Delaware LLCs, corporations, and limited partnerships. The court concluded that Delaware does not separately recognize the single business enterprise theory or sham to perpetrate injustice or fraud. Rather, the concepts involved in these theories are subsumed in the alter ego analysis under Delaware law. The court granted summary judgment in favor of the entities on the single business enterprise theory because it is not recognized as a stand-alone theory in Delaware or Tennessee, and the theory was rejected by the Texas Supreme Court after the court’s hearing on the summary judgment motions. The court also granted summary judgment in favor of all the entities other than the Texas corporation on the sham to perpetrate injustice/fraud claim because Delaware and Tennessee do not recognize that theory as a separate basis to pierce the veil. The court found genuine issues of material fact precluded summary judgment on the trustee’s alter ego claim. The court recognized that the debtor was an LLC rather than a corporation but noted that emerging LLC case law illustrates that situations resulting in a piercing of the LLC veil are similar to those that warrant piercing the corporate veil. The court stated that actual fraud was not required to pierce the veil based upon the alter ego theory under Delaware law, and the court characterized the test under Delaware law as: (1) whether the entities in question operate as a single economic entity, and (2) whether there was an overall element of injustice or unfairness. The court noted that, in an alter ego analysis involving an LLC, “somewhat less emphasis is placed on whether the LLC observed internal formalities because fewer such formalities are legally required,” but stated that the failure of commonly-owned entities to follow legal formalities when contracting with each other is tantamount to a declaration that the entities are one in the same. The court pointed to evidence that Kornman’s entities dealt informally with one another as raising a fact issue on the first prong of the alter ego test. With respect to the second prong (that the entities were used to effectuate fraud or for an unfair or inequitable purpose), the court pointed to the LLC’s failure to disclose to its clients concerns raised by the IRS regarding the LLC’s high risk estate and tax planning strategies, the LLC’s distributions of millions of dollars to its
members after the IRS raised concerns, and the LLC’s continued distributions after the filing of multi-million dollar claims against the LLC.


The plaintiffs sought to hold an LLC member liable for the LLC’s breach of contractual obligations on the basis that the LLC had forfeited its status as a Texas LLC. The court stated the general rule that members are not individually liable for the debts of a limited liability company. The court then stated that the LLC was a “limited liability corporation,” to which state law principles for piercing the corporate veil apply, and that the plaintiffs could hold the member liable for the LLC’s alleged breach of contract only to the extent they pierced the corporate veil. The plaintiffs relied only upon provisions of the Texas Tax Code regarding forfeiture and brought forth no evidence of fraud that would entitle them to hold the member individually liable; therefore, the court concluded that the trial court properly granted summary judgment in favor of the member on the breach of contract claim. However, the court of appeals stated that the trial court errred in rendering summary judgment in the member’s favor with respect to certain non-contract claims. The court stated that the plaintiffs’ allegations of the member’s own tortious and fraudulent actions, including alleged Deceptive Trade Practices Act violations, did not depend upon veil piercing because a corporation’s agent is personally liable for his own fraudulent or tortious acts, even when acting within the scope of employment.


The bankruptcy court concluded that Classic Holdings, L.L.C. (“Classic Holdings”), the general partner of a limited partnership, was a “sham corporation,” and that the individuals in control of Classic Holdings were thus personally liable for breaches of fiduciary duties as general partners of the limited partnership. Although the court identified and referred to Classic Holdings as a limited liability company in reciting the facts earlier in the opinion, the court discussed and applied corporate veil piercing principles to the LLC as if it were a corporation. The court stated that the corporate veil may be pierced when: (1) there is such a unity that the separateness of the corporation has ceased to exist and (2) the facts are such that adherence to the fiction of the separate existence of the corporation would, under the particular circumstances, promote injustice. Matt Seiffert created Classic Holdings to replace the initial general partner of the limited partnership. Although Seiffert’s daughter was the sole member of Classic Holdings and served as a manager and president, the court found that Seiffert, who held positions as a manager and vice president, had complete control over Classic Holdings. Seiffert’s daughter simply did as her father instructed. The court found that there was no separateness between Classic Holdings and Seiffert and his daughter. Both individuals had “plenary authority” to take all actions they deemed necessary. Though such a grant of power is not alone sufficient to constitute unity between a corporation and individual, the court stated that the power was used to “fleece unknowing limited partners” of the limited partnership while attempting to protect Seiffert and his daughter from personal liability. Seiffert formed Classic Holdings to replace the initial general partner without notifying all of the owners of limited partnership interests in the limited partnership and saw to it that his daughter was the sole owner of Classic Holdings while he remained in complete control. He used his position as manager of Classic Holdings and president of the limited partnership to transfer the partnership’s only valuable unencumbered asset to himself, his three daughters, and other insiders. The court stated that allowing Seiffert and his daughter to escape liability by hiding behind the corporate veil of Classic Holdings would unjustly benefit Seiffert and his daughters at the expense of the trustees of bankrupt limited partners who were excluded from the distribution of the partnership’s asset. Thus, the court treated Seiffert and his daughter as general partners for purposes of analyzing breach of fiduciary duty claims against them. The court noted that Seiffert’s fraudulent intent could be imputed to his daughters for purposes of the claims against them (in addition to the breach of fiduciary duty claim against the daughter who owned the general partner, there were fraudulent transfer claims against all three daughters) because they permitted their father, a twice-convicted felon, to think and act for them with reckless disregard for the consequences.


The court commented that its previous statements that the separate nature of corporations will be respected even where one dominates, controls, or treats another as a mere department or instrumentality are also applicable to the relationship between a parent corporation and its subsidiary limited liability company.

The court of appeals concluded that the trial court was presented with sufficient evidence to make an implied finding that a Texas LLC was the alter ego of Cardenas, a prominent Mexican citizen, and that Cardenas was thus subject to the reach of the Texas long arm statute as someone who “did business” in Texas. The court noted the difference between “jurisdictional veil-piercing” and veil-piercing for the purpose of imposing liability. In a jurisdictional veil-piercing case, the court stated that it does not assess certain issues such as fraud and undercapitalization. Instead, the focus was on whether Cardenas controlled the internal business operations of the LLC to a degree “greater than that normally associated with common ownership and directorship.” The business of the LLC was acquiring and selling trucks and related equipment, and the evidence was sufficient for the trial court to find that Cardenas was the alter ego of the LLC based on testimony that Cardenas gave personal assurances that he was “well-to-do” and there would be “no money problems with this type of business,” that Cardenas was so closely involved with the LLC business that he used its mailing address as his own and could almost always be reached by telephone when calling its phone number, and that, while the articles of organization did not distinguish between Cardenas and another individual as managing members, the other individual was in practice Cardenas’s subordinate and Cardenas was in charge of the business. There was also evidence that Cardenas negotiated with the plaintiff on behalf of the LLC, was virtually always present on the premises, owned the real estate on which the business was situated, and maintained an accountant at the facility to monitor the business at all times. The court stated that a business which is registered in Texas and has filed suit in Texas, such as the LLC in this case, is amenable to Texas jurisdiction because it has purposefully availed itself of Texas law, and, since the LLC was Cardenas’s alter ego, its amenability to suit was imputed to Cardenas.


The plaintiffs, judgment creditors of an individual, sought to reverse pierce numerous LLCs and hold them liable on the judgment against the individual on the basis that the LLCs were the alter egos of the individual under Texas corporate veil piercing principles. The LLCs sought summary judgment, arguing that there was no evidence of unity between the LLCs and the individual because the plaintiffs could not show that the individual had an ownership interest in, or control over, the LLCs. The court, however, found that the plaintiffs raised a fact question based on summary judgment evidence that the individual created a group of entities that ultimately became the LLC defendants in the case. Evidence that the individual was the sole owner of the entities that ultimately became the LLC defendants constituted evidence sufficient to raise a fact question regarding the individual’s ownership and control of the LLCs. The court also found that the plaintiffs had raised a fact question as to whether the individual judgment debtor used entities owned by him to fraudulently transfer assets to the LLCs. Further, the court concluded that the plaintiffs stated a claim against the LLCs for conspiring by agreement to commit fraudulent transfers to avoid collection on the judgment. The court found no authority, however, supporting liability beyond the amounts actually transferred.


A judgment creditor sought to reverse pierce the veil of an LLC to impose liability on the LLC for the creditor’s judgment against an individual debtor. The court applied Texas law to the veil piercing claims based on the rule that the law of the state of incorporation applies to corporate veil issues. The court discussed the development of both traditional and reverse corporate veil piercing under Texas law and concluded that the doctrine of reverse veil piercing is applicable under Texas law although the doctrine has rather “thin roots” in Texas. Noting that neither the Texas Supreme Court nor the Texas legislature has opined on reverse veil piercing, the court relied upon Fifth Circuit case law that has recognized the doctrine under Texas law. The court, however, was troubled by the fact that the doctrine of reverse piercing has evolved and been accepted into the mainstream of Texas veil piercing jurisprudence at the same time that the Texas legislature has been limiting traditional veil piercing and without meaningful discussion of what the doctrine in substance accomplishes. The court concluded that the concept should be applied only when it is clear that it will not prejudice non-culpable shareholders or other stakeholders (such as creditors) of the corporation. The court applied corporate veil piercing principles to the LLC in issue, stating that whether an entity is a corporation or an LLC is a “distinction without a difference” for purposes of veil piercing. The fact that reverse piercing was sought with respect to an individual who was not a record or nominal equity owner of the LLC did not preclude the claim since the plaintiffs sought to establish that the individual had a de facto interest in the LLC. The court concluded that fact issues precluded summary judgment for the LLC on the reverse veil piercing claim and a claim for constructive trust on the LLC’s assets. The court held that the ten year statute of limitations for enforcement of a judgment applied to the reverse alter ego and constructive trust claims since the claims were being pursued to collect a judgment.

The court found there was no pleading or evidence supporting alter ego and single business enterprise veil piercing claims against the owner of a professional LLC.


In this lengthy opinion, the court rejected the argument that a member’s statutory liability protection under the Texas LLC statute precludes veil piercing and followed Texas cases that have applied corporate veil piercing principles to LLCs. Ultimately, the court found that shutting down an LLC without notice to its creditor (in violation of the notice requirement under the winding up provisions of the LLC statute), allowing the creditor to take a default judgment against the LLC, and distributing the LLC’s assets to the owners who contributed them to a newly formed entity, was a scheme to isolate the judgment in a shell entity and constituted a “sham to perpetrate a fraud” constituting actual fraud for the personal benefit of the owners.

Nick Lopardo, a successful businessman, wanted to purchase an airplane. In his search for a seller, Lopardo contacted Jim Shelton and his brother Malcolm Shelton, the owners and operators of JNS Aviation, LLC (“JNS Aviation”), an airplane business in Amarillo, Texas. After a trip to Amarillo and a series of email negotiations, Lopardo and Jim Shelton (“Shelton”) agreed on Lopardo’s purchase of a Beechcraft King Air 200 airplane for $1.89 million. The purchase agreement and its amendments were signed by Shelton for JNS Aviation as seller and by Lopardo for Kahuna Partners III, LLC as purchaser. The purchase agreement was assigned to Nick Corp., an entity of Lopardo’s, which purchased the airplane. The contract included a guaranteed repurchase provision in which the seller would buy the airplane back for an adjusted price if the purchaser elected the seller as an agent in the negotiation and purchase of the buyer’s next aircraft. After owning the King Air for a few months, Lopardo, on behalf of Nick Corp. invoked the repurchase provision. JNS Aviation, however, was unable to honor its contractual promise to repurchase the airplane because of financial difficulties. Nick Corp. sued JNS Aviation for breach of contract in Delaware federal court. Shelton and his brother decided not to defend the lawsuit and a default judgment was entered in favor of Nick Corp. against JNS Aviation for $1.8 million.

Soon after Nick Corp. filed its law suit against JNS Aviation, the Shelton brothers formed JNS Aircraft Sales (“JNS Aircraft Sales”) as a New Mexico LLC and then distributed the assets of JNS Aviation to themselves and in turn transferred the assets to JNS Aircraft Sales. JNS Aircraft Sales did not assume the debts of JNS Aviation other than a bank note that was the line of credit. The Sheltons’ accountant testified that the purpose of forming this LLC in New Mexico was to avoid Texas property taxes. However, the physical location of the property, which continued to be Amarillo, Texas, determined the propriety of state property taxes. In addition, at the time of transfer, JNS Aviation had no aircraft remaining in its inventory. Meanwhile, Nick Corp. held the airplane for almost four years until selling the airplane for about $1 million and filing its proof of claim in JNS Aviation’s chapter 7 bankruptcy case. Nick Corp. asserted an unsecured claim of almost $788,000, which reflected credit for the sale of the airplane against the default judgment.

Nick Corp. asserted a claim based on veil-piercing theories against JNS Aviation, Inc. (i.e., the original business entity formed by the Sheltons which they converted into an LLC prior to the transaction with Lopardo and Nick Corp.), JNS Aviation, JNS Aircraft Sales, Shelton, and Malcolm Shelton. The veil-piercing theories alleged by the creditor were alter ego, single business enterprise, illegal purpose/evasion of existing legal obligation, and sham to perpetrate a fraud. In attempting to pierce the LLC’s veil, Nick Corp. sought recovery from the defendants other than JNS Aviation (i.e., “the non-debtor defendants”) for the default judgment it held against JNS Aviation. Nick Corp. primarily sought to recover from the Shelton brothers because their business entities were not financially viable.

First, the non-debtor defendants tried to avoid liability via veil piercing by contesting the validity of the underlying breach of contract claim that resulted in the default judgment. The court noted that under Texas law an assertion of veil piercing does not create a substantive cause of action. Instead, veil-piercing theories are remedial and merely expand the scope of potential sources of relief for liability. Thus, if the substantive cause of action failed, recovery based on veil piercing would fail too. However, by pursuing this argument, the non-debtor defendants were in essence trying to relitigate the underlying breach of contract claim, and the court had previously held that the non-debtor defendants were barred from doing so by the principles of res judicata. Even if res judicata principles had not resolved the breach of contract issue, the court analyzed the evidence and stated that the evidence sufficiently established a breach of contract by JNS Aviation.
The non-debtor defendants next attempted to avoid liability via veil piercing by disputing the validity of the assignment of the purchase agreement to Nick Corp., which would mean Nick Corp. would not have standing to bring suit. Again, this argument was foreclosed by the court’s prior holding that the non-debtor defendants were prohibited from relitigating this issue by res judicata principles. Nevertheless, the court analyzed whether Nick Corp. was the proper party to bring suit under the purchase agreement. The evidence showed that Kahuna Partners III, LLC (i.e., Lopardo’s business entity that purchased the airplane) never existed. The court applied corporate promoter liability principles and held that Lopardo acted as the promoter and was deemed to be the purchaser and assignor under the purchase agreement. The assignment by Lopardo to Nick Corp. was therefore valid.

Finally, the court addressed the veil-piercing claims made by Nick Corp. The threshold question was whether veil piercing applied to an LLC. The Texas Limited Liability Company Act provides that a member of an LLC is not liable for the debts and obligations of the LLC and does not address veil piercing, and the Sheltons argued that the statute protected them from Nick Corp.’s veil piercing claims. Based on Texas case law in the LLC context, however, the court held that veil-piercing theories that apply to corporations also apply to LLCs. The court cited Section 21.223 of the Texas Business Organizations Code, which addresses veil-piercing in relation to Texas corporations and requires that a claimant demonstrate that the shareholder caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the claimant primarily for the direct personal benefit of the shareholder in order to hold the shareholder liable on a claim arising out of a contract of a corporation. Thus, because the judgment in favor of Nick Corp. against JNS Aviation was based on a breach of contract, the court proceeded to analyze whether the facts satisfied any of the veil piercing theories asserted and whether the non-debtor defendants caused JNS Aviation to be used for the purpose of perpetrating, and did perpetrate actual fraud on Nick Corp. for the benefit of the non-debtor defendants. The court discussed the alter ego, single business enterprise, evasion of existing legal obligations, and sham to perpetrate a fraud theories of veil piercing. The court noted that the facts of the case had elements of all four veil-piercing theories but concluded that the facts best fell within the sham to perpetrate a fraud theory. The court stated that the overriding purpose of closing JNS Aviation and continuing operation as JNS Aircraft Sales was to isolate Nick Corp.’s default judgment in a worthless shell. Thus, the court held that Nick Corp. did establish a claim of veil piercing under Texas law, and the court proceeded to the ultimate question of whether the facts satisfied the requirement that the non-debtor defendants caused JNS Aviation to perpetrate actual fraud against Nick Corp. for their personal benefit. In this regard, the court again decided in favor of Nick Corp. Specifically, one month after the Delaware court entered the default judgment against JNS Aviation, the Sheltons formed the New Mexico LLC JNS Aircraft Sales for the stated but illegitimate reason of avoiding Texas property taxes. The Sheltons did not transfer the default judgment liability to the new LLC, and there was no evidence that they provided any formal notice to Nick Corp. of these developments. Instead, they hoped Nick Corp. would believe that JNS Aviation simply became defunct. Under Article 6.05(2) of the Texas Limited Liability Company Act, an LLC that ceases operation has a duty to notify its creditors of such fact. The Sheltons failed to do so. Although the Sheltons claimed Nick Corp. suffered no damages because JNS Aircraft Sales was in no better financial condition than JNS Aviation, the court decided that these actions caused injury to Nick Corp. because it could have avoided additional litigation and attorney fees had it known of the circumstances. Lastly, the court analyzed whether the Sheltons personally benefitted from the fraud. In transferring the assets from JNS Aviation to JNS Aircraft Sales, the Sheltons intended to continue their business without the encumbrance of Nick Corp.’s default judgment. They were the only owners of the LLCs, so the court concluded their actions were solely to personally benefit themselves. Therefore, the court concluded it was appropriate to pierce the veil of the defendant LLC and hold the non-debtor defendants personally liable for the default judgment held by Nick Corp. against JNS Aviation.

The court concluded that a Maryland REIT, Delaware corporation, Delaware limited partnership, and Delaware LLC (each of which had its principal place of business in Ohio) did not constitute a single business enterprise that would subject the entities to personal jurisdiction based on a related partnership’s ownership of commercial properties in Texas. There was no evidence of undocumented transfers of funds, unclear allocation of profits and losses, or other lack of corporate distinctness, and it was not necessary to pierce the veil to prevent an inequitable result. (Note: The Texas Supreme Court subsequently rejected the single business enterprise theory as a basis to impose personal jurisdiction in PHC-Minden, L.P. v. Kimberley Clark Corp., 235 S.W.3d 922 (Tex. 2007), summarized above.)

The court held that corporate veil piercing principles apply to Texas LLCs and that the evidence was sufficient to support the jury’s finding that the defendant, McCarthy, caused an LLC to be used to perpetrate an actual fraud upon the plaintiff for McCarthy’s direct personal benefit. McCarthy and two other individuals were the owners of numerous

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interrelated companies involved in the case. Among these entities was an LLC of which McCarthy was a one-third member and vice-president. The plaintiff supplied over $1 million of wallboard to the LLC, and the LLC paid for only about $500,000 of the wallboard. The plaintiff sued the LLC, several related entities, and the three individual members of the LLC, alleging tort, breach of contract, and veil piercing claims. At the time of trial, all of the original defendants other than McCarthy had filed bankruptcy, been severed out, or been non-suited. An expert testified about the dealings of the entities and individuals and expressed concern about various issues and irregularities. He summed up his findings by referring to “multiple companies that are intermingling,” “monies coming in, monies coming out,” “a lack of documentation,” “a lack of supporting information,” “an accounting nightmare,” “transfers between parties,” “a lot of red flags,” and “inventories that are being shifted and moved.” There was also evidence from which the court of appeals concluded that the LLC concealed material facts about its financial condition and operations and induced the plaintiff to supply the LLC wallboard for which it was never paid. The jury charge included a question that inquired whether McCarthy caused the LLC to be used to perpetrate an actual fraud, and did perpetrate an actual fraud upon the plaintiff, primarily for her own direct personal benefit (i.e., tracking the veil piercing standard specified by the Texas Business Corporation Act). The jury answered this issue in the affirmative, and also found damages in the amount of unpaid invoices and attorney’s fees. The trial court entered a judgment against McCarthy based on the findings, and McCarthy appealed. McCarthy argued that the trial court erred in holding her personally liable for the LLC’s debt because the Texas Limited Liability Company Act provides for liability of a member under very limited circumstances and specifically provides that a member is not liable for a debt of the LLC. McCarthy argued that the LLC veil is impenetrable because the LLC statute does not address whether or under what circumstances a litigant may pierce the veil of an LLC. The court disagreed, stating that courts in Texas and other jurisdictions have applied to LLCs the same state law principles for veil piercing that are applicable to corporations. McCarthy also argued that “actual fraud” was improperly defined for the jury, that there was insufficient evidence that the LLC committed fraud, that the evidence was insufficient to support the findings of damages and attorney’s fees, and that there was insufficient evidence that McCarthy caused the LLC to be used to perpetrate a fraud for her direct personal benefit. The court of appeals rejected all of these arguments. Although McCarthy argued that the evidence was insufficient to show she caused the LLC to be used to perpetrate an actual fraud on the plaintiff because she had not been active in the LLC during the time it dealt with the plaintiff and she herself never had any dealings with the plaintiff, the court stated that the fraudulent operation of the LLC would not have been possible without the seed money she supplied for the LLC at its inception. Furthermore, the court said that McCarthy was aware that one of her co-members was fraudulently operating the LLC, and she was repaid while the plaintiff went unpaid. A dissenting justice did not challenge the proposition that corporate veil piercing principles apply to Texas LLCs, but disagreed with the majority that the evidence was sufficient to support the jury’s finding that McCarthy caused the LLC to perpetrate a fraud for her direct personal benefit.


The court held that the fiduciary shield doctrine precluded exercise of jurisdiction over non-resident officers of an LLC where their contacts were in a representative capacity and were not systematic or continuous, and the evidence did not show that the LLC was used to perpetrate fraud, was a fiction or sham, or was operated in a manner indistinguishable from the officers’ personal affairs or in a manner calculated to mislead those dealing with them.


The court commented that, under Delaware law, LLC members generally are not liable for the LLC’s obligations absent a showing that the court should pierce the veil.


The plaintiffs sought to pierce the veil of a Delaware LLC and treat the LLC as the alter ego of the debtor in order to attribute to the debtor false representations made by the LLC in a private placement memorandum and pursue certain other claims for fraud, embezzlement, and breach of fiduciary duty that depended upon the disregard of the LLC’s separate existence. Applying Texas conflict of laws principles (citing the Texas Business Corporation Act), the court stated that Delaware substantive law determined whether the veil of a Delaware LLC should be pierced. In a previous suit, a Texas state court had found the LLC in question to be the alter ego of the debtor, and the court found that Delaware law dictated that the law of collateral estoppel of the state where a judgment was rendered determines the scope of collateral estoppel in the second case. Applying Texas offensive collateral estoppel principles, the court concluded that it could pierce the veil of the LLC based on the finding in state court that the LLC was the alter ego of the debtor. Alternatively, the court found that the same result could be achieved using Delaware offensive collateral estoppel. Additionally, even if offensive collateral estoppel under Texas or Delaware law could not be applied to prevent the
debt from denying that the LLC was his alter ego, the court concluded that the LLC’s veil could be pierced by directly relying on the alter ego doctrine under Delaware law. The court discussed the factors relevant to an alter ego determination under Delaware law and concluded that the plaintiff’s allegations were sufficient to support such a claim. The court acknowledged the dearth of Delaware case law on the issue of whether an LLC’s veil may be pierced using corporate veil piercing principles, but concluded that the Delaware Chancery Court has conceptually endorsed the application of corporate veil piercing principles to LLCs.


The court analyzed whether claims to pierce the LLC veil were property of the estate and declined to approve a settlement relating to fraudulent transfer and breach of fiduciary duty claims where the settlement purported to encompass the piercing claims.


DDH Aviation, L.L.C. ("DDH") brought suit against two individuals and several corporations for claims arising primarily out of the individuals’ alleged wrongdoing as DDH employees. DDH brought suit as “DDH Aviation, L.L.C., f/k/a DDH, Inc.”, and the opinion states that DDH was initially “formed as a corporation but later altered its business form to become a limited liability company.” The court does not indicate when the change in form took place or what events took place while DDH was a corporation versus an LLC. At one point in the opinion, the court identifies DDH as a “limited liability corporation.” The defendants filed counterclaims against DDH as well as third party claims against another entity and several individuals affiliated with DDH. Many of the third party claims were based on the single business enterprise and alter ego veil piercing theories. The court dismissed the claims that were based on the single business enterprise theory. Describing the “single business enterprise” theory as an equitable doctrine applied to reflect partnership-type liability principles when corporations integrate their resources to achieve a common business purpose, the court concluded that the doctrine did not apply because the two entities alleged to constitute a single business enterprise did not share a common business purpose. Because the court concluded the entities did not share a common business purpose, the court did not find it necessary to reach an analysis of whether the entities integrated their resources. (The Texas Supreme Court has since rejected the single business enterprise theory in the substantive veil piercing context in **SSP Partners v. Gladstrong Investments (USA) Corporation**, 275 S.W.3d 444 (Tex. 2008).) As to the alter ego claims, relying on Article 2.21A of the Texas Business Corporation Act, the court stated that the third party plaintiffs were required to demonstrate that the third party defendants used DDH to perpetrate an actual fraud in addition to establishing the application of the alter ego doctrine. The court found that the allegations relating to the alter ego liability of an individual shareholder/owner of DDH (the crux of which was that the shareholder pillaged DDH to provide for his lavish personal lifestyle) were sufficient to survive a motion to dismiss because the allegations showed unity between the shareholder/owner and DDH and met the requirements of Article 2.21. The court found the third party plaintiffs failed to show that DDH was the alter ego of the other entity sued by the third party plaintiffs. The court stated that the allegations demonstrated, at most, a situation similar to a parent/subsidiary relationship, but not that of absolute control of DDH by the other entity. Having found the third party plaintiffs failed to allege sufficient facts to establish alter ego, the court found it unnecessary to reach the question of Article 2.21A.


The court held the evidence was insufficient to support the trial court’s finding that a Missouri LLC was the alter ego of its members (noting that failure to follow formalities is no longer a factor in considering alter ego under Texas corporate law), but the evidence supported exercise of specific jurisdiction over one of the LLC’s members based on alleged torts committed by the member in Texas.


Pinebrook Properties, Ltd., a Texas limited partnership, owned the lake, dam, roadways and recreational areas at issue in this case. Pinebrook Properties Management, L.L.C., a Texas limited liability company, was the general partner. The court identified Musgrave, an individual, as the “president and general managing partner” of the LLC. The trial court found that the LLC and the partnership were alter egos of Musgrave and entered judgment against Musgrave individually. The court held that the alter ego doctrine is inapplicable to a partnership because “there is no veil that needs piercing, even when dealing with a limited partnership, because the general partner is always liable for the debts and obligations of the partnership to third parties.” With regard to the finding that the LLC was the alter ego of Musgrave, the court acknowledged that an LLC is a legal entity separate from its members and managers, who are by statute
protected from personal liability for the liabilities of the LLC. However, the court did not question the application of the alter ego doctrine to the LLC. The court cited *Castleberry v. Branscum*, a corporate veil piercing case, in declaring that it must examine the evidence to see if there is such unity between Musgrave and the LLC that separateness had ceased to exist and holding only the LLC as the general partner liable would result in injustice. The evidence of alter ego presented was that the LLC had no checking account, had not filed a tax return, and that Musgrave had sent a letter under his own signature without designating that he signed it in any other capacity. A second letter signed without any designation of a representative capacity was also argued to show lack of regard for the “corporate” structure. However, the court cited the Texas Business Corporation Act and corporate veil piercing cases for the principle that failure to follow corporate formalities is no longer a factor in determining alter ego. The court concluded that there was no evidence of alter ego, pointing to the fact that there was no evidence of commingling of funds or that Musgrave disregarded the “corporate” structure. The court noted that the evidence revealed that Musgrave was not the sole manager of the LLC (there being two other managers involved) and that there was no evidence that Musgrave used the LLC for personal purposes.

**Stauffacher v. Lone Star Mud, Inc.**, 54 S.W.3d 810 (Tex. App.—Texarkana 2001, no pet.).

The court of appeals upheld the trial court’s exercise of jurisdiction over a non-resident individual on the basis that a Wisconsin LLC was the individual’s alter ego. The court discussed and applied Texas corporate veil piercing cases in its analysis. The court found “ample” evidence to support the alter ego finding, noting that the individual and LLC had the same address, the individual was the managing member of the LLC and no other member was disclosed, the LLC was capitalized with member contributions, the individual used personal funds for the benefit of the LLC without creating corresponding debt, and numerous checks were drawn on the individual’s account to pay drilling and other operational expenses of the LLC’s Texas well. The court ultimately referred to arguments regarding the Texas Business Corporation Act veil piercing provisions and the Wisconsin LLC statutory provisions referring to common law veil piercing principles but determined that it need not reach these issues because it was not deciding whether the LLC was in fact the individual’s alter ego, only that the theory allowed the trial court to exercise jurisdiction over the individual.


In addressing the argument that investors in a foreign LLC were subject to the court’s personal jurisdiction, the court applied the principle that “a court may not assert personal jurisdiction over an individual based on the individual’s relation to a corporation unless the corporation is the individual’s alter ego.” The court stated that there was no evidence any of the LLC’s members had any individual contacts with Texas or that the LLC was acting as the alter ego of its members. See also additional cases cited under “Personal Jurisdiction” referring to the alter ego doctrine in the context of the issue of personal jurisdiction.

**R. Fraudulent Transfer**


Nwokedi and an LLC appealed a judgment against them in favor of a company that provided restoration services to the LLC’s property after it was damaged in Hurricane Ike. The plaintiff’s claims included claims for fraud, breach of contract, and fraudulent transfer, and the jury found in favor of the plaintiff on all its theories. The judgment awarded compensatory and punitive damages, voided four fraudulent transfers by Nwokedi and the LLC, imposed a constructive trust on fraudulently transferred insurance proceeds, and enjoined Nwokedi and the LLC from transferring any assets not subject to execution.

The fraudulent transfer claims were based on several transfers of funds from the LLC’s bank account to various other accounts. The plaintiff alleged that these transfers were made with the intent to hinder, delay, or defraud the plaintiff. Nwokedi and the LLC argued on appeal that there was insufficient evidence to support the jury’s finding that Nwokedi and the LLC fraudulently transferred property with the intent to hinder, delay, or defraud creditors. Based on the jury’s finding, the trial court set aside four transfers of insurance proceeds, amounting to $618,000, from the LLC’s account to other accounts. The court of appeals discussed each transfer and concluded the evidence supported a finding that the transfers were fraudulent. The court pointed to evidence of several badges of fraud, including that Nwokedi was an “insider,” that the accounts to which the transfers were made were held in the name of or controlled by Nwokedi, that Nwokedi attempted to conceal the transfers, and that the transfers were made after the plaintiff sued the LLC. The court also rejected the argument that a creditor is required to trace specific funds under the Texas Uniform Fraudulent Transfer Act. A constructive trust could only be imposed on traceable funds, but the other funds could be included in an award.
of damages. Nwokedi argued that he could not be held individually liable for the fraudulent transfers because there was no evidence that the assets transferred were his assets. The court rejected this argument on the basis that a corporate officer who knowingly participates in tortious or fraudulent conduct may be held individually liable to third persons even though the officer performed the act as an agent of the corporation.

Spring Street Partners-IV, LP v. Lam, 730 F.3d 427 (5th Cir. 2013).

The holder of an $8.5 million promissory note sought recovery against various individuals and entities on the basis of alleged fraudulent transfers to avoid paying the debt. Furthermore, the note holder argued that the veil of the debtor company’s successor LLC should be pierced to hold the individual owners of the LLC liable since they engaged in actual fraud. The district court granted the note holder’s motion for summary judgment. The Fifth Circuit Court of Appeals affirmed in part and vacated and remanded in part, holding that summary judgment on two of the three bases for fraudulent transfer was proper but that fact issues relating to the third basis precluded summary judgment on that claim. The appellate court also affirmed the summary judgment piercing the veil of the debtor’s successor LLC to hold the individual members personally liable for the fraudulent transfers in which the LLC was involved.

Bayou City Fish, Inc. (“Bayou”) incurred debt via promissory notes to a bank between 2001 and 2005. The debt eventually grew to the amount to $8.5 million. Douglas Lam (“Douglas”), the sole owner of Bayou, personally guaranteed the notes for all of the debt. The debt was sold twice and was ultimately acquired by the plaintiff.

Bayou began operating in 1994 as a retail and wholesale seafood distributor out of two locations in Houston. From 1994 through 2004, Douglas’s sister, Ten Lam, worked for Bayou as a sales representative, and Ten Lam’s husband, Vinh Ngo (“Ngo”), worked in the warehouse. Douglas agreed to sell the retail operation and one of Bayou’s buildings to Ten Lam and Ngo, and in 2005 Ten Lam and Douglas Lam formed LT Seafood with Douglas owning 49%, Ten Lam owning 50%, and an entity called LT Seafood Management, LLC, which Ten Lam owned, owning 1%. In order for the bank to continue loaning money, Bayou submitted borrowing base certificates to the bank. The borrowing base certificates combined the assets, finances, receivables, and inventory of Bayou and LT Seafood. Ten days after the bank sent a default notice to Bayou and Douglas, an LLC was formed by Douglas with his wife, Diane, and two siblings, Long Lam and En Kha Lam. Douglas transferred his interests in a group of limited partnerships and LT Seafood to the LLC as a gift and received no consideration from the LLC for any of the transfers. The LLC subsequently sold what was Douglas’s 49% interest in LT Seafood to Ngo.

The plaintiff sued Douglas and Bayou to recover on the defaulted notes. An amended complaint named as additional defendants the LLC, LT Seafood, Ten Lam, and Ngo, alleging fraudulent transfers under the Texas Uniform Fraudulent Transfer Act (TUFTA). (After the lawsuit was filed, Bayou filed a voluntary petition for bankruptcy, and the bankruptcy court approved a settlement between the trustee of Bayou’s bankruptcy estate and the plaintiff in which the trustee assigned all of the bankruptcy estate’s claims to the plaintiff. Thus, the plaintiff sought to obtain a right to the 49% interest in LT Seafood Douglas transferred to the LLC, which then transferred the interest to Ngo, and the plaintiff sought the value of the assets that Bayou transferred to LT Seafood.) Specifically the plaintiff contended that three transfers were fraudulent: (1) Douglas’s transfer of his 49% interest in LT Seafood to the LLC; (2) the LLC’s subsequent transfer of that 49% interest to Ngo; and (3) the transfer of “hard assets” from Bayou to LT Seafood when LT Seafood took over Bayou’s retail operations. As a result of the transfers, Douglas had no assets or income to pay the notes. The plaintiff sought to pierce the LLC veil and hold the individuals liable based on actual fraud they committed. The district court granted the plaintiff’s motion for summary judgment on Douglas’s guaranties holding him personally liable for the notes, which he did not appeal. LT Seafood, Ten Lam, and Ngo filed a motion for summary judgment on the plaintiff’s claims of fraudulent transfer, and the plaintiff filed its own motion for summary judgment against those parties on its fraudulent transfer claims. The LLC filed a motion for summary judgment claiming its corporate charter had expired, which then caused the plaintiff to obtain leave of the court to add the LLC’s individual members (i.e., Diane Lam, Long Lam, and En Kha Lam) as additional defendants. The district court granted summary judgment in favor of the plaintiff and ruled that the LLC and its individual members as well as Douglas and Ngo engaged in fraudulent transfers relating to the 49% interest in LT Seafood and were jointly and severally liable to the plaintiff for the amount of the interest, which the parties stipulated was $382,000. Furthermore, the court held that Ten Lam and Ngo were jointly and severally liable to the plaintiff for $150,000 for the fraudulent transfer of the hard assets from Bayou to LT Seafood. Long K. Lam, En Kha Lam, Ten Lam, and Vinh Ngo appealed.

Among other arguments, on appeal all appellants challenged their liability as to the plaintiff’s fraudulent transfer claim. Long Lam and En Lam also argued that the LLC’s veil should not be pierced to hold them individually liable for the fraudulent transfers.

As to the plaintiff’s claims for fraudulent transfer, the plaintiff alleged three grounds of fraudulent transfer in which the appellants, along with Douglas and Bayou, illegally placed assets outside of the plaintiff’s reach. The appellate
court discussed the applicable law under TUFTA, which it used to determine whether the district court’s grant of summary judgment in favor of the plaintiff was proper. TUFTA allows recovery for actual fraud and constructive fraud, and the statute includes a non-exclusive list of eleven factors, commonly referred to as “badges of fraud,” which courts may consider in determining whether a debtor actually intended to defraud creditors under TUFTA. Under the statute, if a fraudulent transfer occurred, subject to exceptions and to the extent a transfer is voidable, the creditor may recover the value of the assets transferred and judgment may be entered against the first transferee of the asset or any subsequent transferee other than a good faith transferee who took for value.

The first basis of fraud asserted by the plaintiff was that the LLC’s transfer of Douglas’s 49% interest in LT Seafood to the LLC. The facts showed that the LLC was created 10 days after the bank sent a notice of default to Douglas and Bayou, and it was undisputed that Douglas received no consideration in exchange for the transfer of his 49% interest in LT Seafood to the LLC. The appellate court found the evidence supported the conclusion that the transfer was fraudulent as to the plaintiff because Douglas made the transfer with the actual intent to hinder, delay, or defraud the plaintiff, and the transfer evidenced several badges of fraud. Thus, the appellate court found that the district court properly granted summary judgment in favor of the plaintiff on the ground that a fraudulent transfer occurred when Douglas transferred his 49% interest in LT Seafood to the newly created LLC.

The second basis of fraud alleged by the plaintiff was that the LLC’s subsequent transfer of the 49% interest in LT Seafood to Ngo violated TUFTA because Ngo was a subsequent transferee other than a good faith transferee. Ten Lam and Ngo maintained that summary judgment on this basis was erroneous because there were genuine disputes of facts as to whether Ngo was entitled to the good faith defense. Ten Lam and Ngo argued that Ngo paid for the 49% interest during the real estate transaction to purchase the retail operation of Bayou, while the plaintiff maintained the evidence presented relied on a real estate purchase between an entity Douglas controlled and an entity controlled by Ten Lam. The appellate court considered the evidence presented and agreed with the district court that Ngo failed to raise a genuine dispute that he paid any value in exchange for the 49% interest transferred to him. Furthermore, the evidence showed that Ngo was not entitled to TUFTA protection because he was not a good faith transferee. Ngo and Ten Lam were closely related to Douglas and were familiar business partners, so Ngo would have been aware of Douglas’s financial troubles and maneuvering tactics. The transfer at issue took place during the plaintiff’s attempts to collect on the notes. The appellate court noted that several badges of fraud were evident in this transfer as well. Thus, the appellate court affirmed the grant of summary judgment in favor of the plaintiff on this basis of its fraudulent transfer claim.

The third and final basis for the plaintiff’s fraudulent transfer claim involved the transfer of hard assets from Bayou to LT Seafood, Ten Lam, and Ngo when LT Seafood took over Bayou’s retail operations. These assets, worth approximately $150,000, included inventory from Bayou and items used to operate the retail business such as trucks, an ice machine, office furniture and computers, and miscellaneous other equipment. The district court granted summary judgment in favor of the plaintiff holding that Ten Lam and Ngo were jointly and severally liable for the value of the hard assets Bayou allegedly transferred to LT Seafood as it was a fraudulent transfer. Ten Lam and Ngo argued that summary judgment was improper on this basis because genuine issues of material fact existed as to the value of the hard assets, whether the property the plaintiff supposedly transferred to LT Seafood was in fact abandoned property, and whether LT Seafood’s overpayment for the real estate transaction compensated Bayou for the property at issue. The appellate court sided with Ten Lam and Ngo and found that the plaintiff did not carry its burden of demonstrating the transfer of hard assets was a fraudulent transfer such as to merit the granting of summary judgment. Because genuine issues of material fact existed as to the value and transfer of the hard assets at issue from Bayou to LT Seafood, summary judgment for the plaintiff on this basis was erroneous, and the appellate court vacated and remanded this portion of the district court’s judgment for further proceeding.

Finally, since the appellate court found that the transfer of Douglas’s 49% interest in LT Seafood to the LLC and the LLC’s subsequent transfer of that interest to Ngo was fraudulent, the appellate court addressed whether it was proper to pierce the veil of the LLC and hold its owners individually liable for the value of these transfers, which was approximately $382,000. Long Lam and En Kha Lam, two owners of the LLC, appealed the district court’s ruling that piercing the LLC’s veil was proper. The appellate court discussed the history of veil piercing in Texas and how it has evolved from case law and through various statutory forms. The parties argued over whether the applicable law required the plaintiff to prove actual or merely constructive fraud in order to pierce the LLC’s veil and hold Long Lam and En Kha Lam personally liable for the obligation. The owners argued actual fraud was the standard and that the plaintiff failed to show that the owners used the LLC to perpetrate an actual fraud for the owners’ direct personal benefit. The plaintiff contended that the standard was constructive fraud, but that under either standard its evidence met the fraud requirements. The appellate court stated that it did not need to determine which standard applied because the plaintiff offered ample evidence to prove the appellant owners engaged in actual fraud in relation to the fraudulent transfers discussed above.
Thus, the appellate court affirmed the district court’s grant of summary judgment in favor of the plaintiff such that the plaintiff could pierce the veil of the LLC on the basis of fraud and impose individual liability on the LLC members.


The plaintiff, a litigation trust, alleged a fraudulent transfer claim against the CEO of the debtor LLC for his role in approving a transaction involving a wrongful distribution. The CEO sought summary judgment on the wrongful distribution claim on the basis that it was barred by the Georgia two-year statute of limitations. The plaintiff alleged that its wrongful distribution claims were brought under applicable state law, including, but not limited to, claims under Delaware, Texas, Georgia, and North Carolina law. The court stated that the forum state, Texas, uses the Restatement’s “most significant relationship” test to decide choice-of-law issues. The CEO argued Georgia law should apply to the wrongful distribution claim because the LLC was a Georgia LLC and the claims arose out of the CEO’s role as manager and CEO of the LLC. The plaintiff argued that North Carolina law applied under the most significant relationship test, pointing out that the LLC had no apparent relationship to Georgia other than being formed under Georgia law. The CEO admitted that the LLC’s principal place of business was in North Carolina where he worked and that the injury flowed from an agreement executed in North Carolina with another party that was headquartered in North Carolina. The court concluded that the plaintiff had the better argument. While the court acknowledged that Georgia has an interest in seeing its law applied to LLCs formed in Georgia, the court found the relevant policy difference in this case, a mere one-year difference in the statute of limitations, was not a substantive difference in fraudulent transfer law. Also, the application of North Carolina law did not frustrate the application of an exculpation clause in the LLC agreement relied on by the CEO. Because the court concluded that North Carolina law applied to the wrongful distribution claims, the court rejected the CEO’s statute of limitations argument that was based on Georgia law.


Doyle contracted with Kontemporary Builders, Inc. (“KBI”) for KBI to install a cover and insulated roof over her patio. The patio cover collapsed, and Doyle refused to pay the balance owed KBI. An engineer suggested by KBI in a mediation between the parties submitted a written report in which he concluded the patio cover had been inadequately designed and installed. The parties failed to reach a settlement in the mediation, and shortly after the failed mediation, the owner of KBI, Bains, formed a new LLC and transferred all of KBI’s assets to the LLC and began operating under the name of the LLC. Doyle added Bains and the LLC to a suit she had filed against KBI, alleging violation of the Texas Uniform Fraudulent Transfer Act (TUFTA). Following a bench trial, the court entered a judgment against KBI on Doyle’s DTPA claim, but Doyle did not prevail against Bains and the LLC on her TUFTA claim. On appeal, the court of appeals reviewed the evidence with regard to the TUFTA claim and concluded that the evidence was sufficient to support the trial court’s findings that Bains did not conspire with the LLC or engage in any fraudulent transfer to the LLC. Bains offered several reasons for transferring the assets of KBI to the LLC and ceasing to make sales as KBI. He stated that he was trying to avoid paying a 15% royalty obligation to his franchisor, Four Seasons Sunrooms. His franchise agreement had expired, and he decided to set up a new entity that sold only Four Seasons products to limit his liability, testifying that he was trying to get a “fresh start” and hoping his old business “would be grandfathered” and that Four Seasons would not come after that for a 15% royalty and “those types of things.” Bains also testified that he stopped doing business as KBI because the company was burdened by debt. Another reason offered by Bains was that his father told him it was a good time to start a new venture. The record showed that the LLC paid KBI a total of $10,635 for its assets, and Doyle did not present any evidence contesting the value of KBI’s Ford F-150, Dodge Dakota, or computer, office furniture, and equipment. Bains testified that the LLC did not purchase KBI’s goodwill because it did not have any quantifiable goodwill. Doyle did not present any evidence that KBI transferred any goodwill to the LLC without receiving reasonably equivalent value. Since the trial court was the judge of the weight and credibility of Bains’s testimony, the court of appeals deferred to its determination and concluded the evidence was sufficient to support its findings that Bains did not conspire with the LLC or engage in any fraudulent transfer to the LLC.


The bankruptcy trustee brought an action to avoid payments that were made from an account funded by the debtor LLC’s business operations. The account was styled “Marcella Ortega dba Young Again Nutrients,” and Marcella Ortega was president of the debtor LLC. The payments challenged by the trustee were payments on mortgage debts of Ortega, and the court held that they were avoidable as fraudulent transfers. In order to find that the payments were fraudulent transfers, the court had to find that the account was the property of the debtor LLC. The court discussed and applied corporate case law as if the LLC were a corporation, and the court found that the account was properly considered property of the LLC because the court could pierce the “individual veil” and view the account as property.
of the LLC. The court explained that a court may sometimes “pierce the corporate veil” to determine whether the activities and property of a corporation should be attributed to its individual principal or principals, but stated that the court here was being asked to do the opposite— to “pierce the individual veil” and attribute property of Ortega to the debtor LLC. The court noted that courts generally protect the individual assets from the reach of a corporation’s bankruptcy, but cited the corporate alter ego doctrine as a basis to treat individual property as corporate property. The court stated that it would treat the account as property of the LLC because Ortega herself disregarded the separation between the LLC’s funds and her funds by using the account exclusively to pay her personal expenses when the account was funded exclusively by the LLC’s business. Further, the court noted that injustice would result if the account were not treated as the property of the debtor because the fraudulent transfers, if not avoided, would seriously hinder the trustee’s ability to administer the bankruptcy case.


In a very lengthy and detailed opinion, the court concluded that $46 million in distributions by the debtor, The Heritage Organization, L.L.C. (“Heritage”), to its members were recoverable by the trustee under the Bankruptcy Code and the Texas Uniform Fraudulent Transfer Act (“TUFTA”). Heritage was a Delaware LLC that, prior to its bankruptcy filing, provided tax planning strategies to extremely wealthy individuals. The trustee asserted a number of claims against various individuals and entities related to Heritage, but the largest claims sought avoidance of distributions by Heritage to insiders between April 2001 and February 2003 in the aggregate amount of $46 million. The trustee sought recovery from three Delaware entities that were members of Heritage, and from Kornman, the individual who ultimately controlled Heritage and its members. The issues addressed by the court in its analysis were the existence of a triggering creditor and standing of the trustee; the governing law and applicable limitations period; the burden of proof and whether the triggering creditor must be the creditor who was hindered, delayed, or defrauded; the evidence of fraudulent intent; alleged legitimate business purposes for the distributions; and the amount of avoidable transfers and from whom they were recoverable.

The defendants argued that the three-year statute of limitations applicable to an impermissible distribution under the Delaware Limited Liability Company Act (“DLLCA”) applied to the trustee’s claim to recover the distributions made by Heritage since it was a Delaware LLC. The court held that the Delaware legislature could not limit the reach of the Texas Uniform Fraudulent Transfer Act (“TUFTA”), which contains a four year statute of repose applicable to the fraudulent transfer claims asserted by the trustee. The court stated that a fraudulent transfer claim sounds in tort, and the court thus applied the most significant relationship test called for under Texas choice-of-law rules. The only connection between the trustee’s fraudulent transfer claims and Delaware was the fact that Heritage and its members were Delaware entities. Heritage and its members were headquartered in Texas and controlled by a Texas resident, and the decision making took place in Texas. Distribution checks were drawn on and deposited in Texas banks. Furthermore, the court stated that the internal affairs rule did not apply because fraudulent transfer claims like those at issue involve the rights of creditors rather than internal corporate governance issues that are the subject of the internal affairs doctrine. The trustee was not challenging Heritage’s ability to properly pay distributions to its members as a matter of corporate law or seeking to hold the members liable for Heritage’s debts, which is the other purported statutory basis for the application of Delaware law. Thus, the DLLCA three-year limitations period was not applicable to the trustee’s TUFTA claims.

The court discussed direct evidence of fraudulent intent in the form of evidence that the distributions were made to keep an investor from pursuing recovery of its investment in Heritage, and the court discussed circumstantial evidence relating to numerous badges of fraud. The badges of fraud or indirect evidence included the fact that the transfers were made to insiders (the members of Heritage), that there was inadequate consideration, that Heritage was threatened with suit, that there was a cumulative course of conduct giving rise to an inference of fraud, and a number of other indicia of fraudulent intent. With respect to the issue of whether Heritage received reasonably equivalent value for the distributions, the defendants argued that there was an obligation under the operating agreement to distribute “excess cash” and that payment of this antecedent debt supplied consideration. The court rejected this argument on the basis that the obligation was illusory because Kornman had absolute discretion to determine whether there was excess cash. Furthermore, even assuming there was an obligation, the court pointed out that TUFTA addressed the avoidance of both obligations and transfers, and the obligation itself would be avoidable because Heritage did not receive consideration for the obligation. The obligation to distribute excess cash was also offered as an alleged legitimate business purpose for the distributions, but the court rejected the argument and stated that Kornman was not consistent or systematic about determining distributions, and appeared to be concocting a legitimate business purpose from a provision of the operating agreement that he ignored in practice. The defendants also argued that the distributions were needed to facilitate payment of taxes by the members of Heritage since it was a pass-through entity, but the court again found this argument was
concocted after the fact to justify the distributions. There was no evidence that the members actually needed the money to pay taxes, and there was no evidence the amounts had anything to do with the members’ actual or potential tax liability. The court pointed out that the distributions far exceeded the entire taxable income for Heritage, let alone the amount of taxes that would be due from a member, in each of the years in issue.

The court determined the total amount of recoverable distributions to the members was $46 million, which included $4 million in cash in a safety deposit box that was in issue. In addition to determining that the transfers were recoverable from Heritage’s members, the court analyzed whether any amounts could be recovered from Kornman under Section 550(a) of the Bankruptcy Code as an entity for whose benefit such transfer was made or an immediate or mediate transferee of an initial transferee. The court determined that Kornman was not an entity for whose benefit the transfers were made, but the court determined that he was a subsequent transferee of over $11 million distributed to members of Heritage and then distributed or loaned to Kornman.

The court also concluded that certain transfers to other Kornman-controlled entities within 90 days preceding Heritage’s bankruptcy filing were preferential transfers under Section 547(b) of the Bankruptcy Code.


Prior to filing bankruptcy, the debtor, a Delaware LLC, provided estate and tax planning strategies to extremely wealthy individuals. The trustee filed this action against two individuals, Kornman and Walker, and numerous entities affiliated in some way with Kornman. Kornman was the former CEO and president of the manager of the LLC, and Walker was a long-time employee of various Kornman-controlled entities. Various defendants sought summary judgment on fraudulent transfer, preference, breach of fiduciary duty, and veil piercing claims asserted by the trustee.

The court found that there were genuine issues of material fact precluding summary judgment on claims that millions of dollars transferred by the LLC to several parties were made with actual intent to hinder, delay, or defraud the LLC’s creditors. The evidence included at least three badges of fraud: the transfers were made to insiders, the LLC had been sued or threatened with suit at the time of the transfers, and there was no reasonably equivalent value given in exchange for the transfers. The court also concluded that the trustee’s preference claims survived summary judgment because the defendants failed to produce evidence that the payments were made according to ordinary business terms.


The court found that the plaintiffs had raised a fact question as to whether an individual judgment debtor used entities owned by him to fraudulently transfer assets to LLCs, and the court concluded that the plaintiffs stated a claim against the LLCs for conspiring by agreement to commit fraudulent transfers to avoid collection of the judgment. The court found no authority, however, supporting liability beyond the amounts actually transferred.


The court found that transfers from the debtor LLC to a commonly controlled LLC were fraudulent under the constructive and actual fraud provisions of the Texas Fraudulent Transfer Act and Bankruptcy Code; however, the trustee failed to prove fraud or breach of fiduciary duty on the part of the individuals who owned and controlled the LLCs because there was insufficient evidence of actual damages arising from any fraud or breach of fiduciary duty distinct from a failure to transfer reasonably equivalent value to the debtor as alleged under the fraudulent transfer cause of action. The court acknowledged the trustee’s arguments that fiduciary duties arise in favor of creditors when a debtor approaches a “zone of insolvency,” but noted the cogent analysis and rejection of this theory by Judge Harmon in Floyd v. Hefner, 2006 WL 2844245 (S.D. Tex. Sept. 29, 2006).

Cadle Co. v. Wilson, 136 S.W.3d 345 (Tex. App.—San Antonio 2004, no. pet.).

A judgment creditor (“Cadle”) brought a fraudulent transfer action against Wilson, the judgment debtor, and Greenfield, a friend of Wilson who purchased a note on which Wilson was obligated. As collateral for the note, Wilson pledged his membership interest in William T. Wilson, Attorney & Counselor at Law, Ltd., which was described by the court as a “limited liability corporation” formed by Wilson for the conduct of his legal practice. The court further noted that Wilson held a 99% ownership interest in the “limited liability corporation” while the remaining 1% interest was owned by his daughter. Cadle sought to avoid Wilson’s pledge of his membership interest, and the principal issue in the case was the application of the discovery rule to the statute of limitations applicable to a transfer made with actual intent to hinder, delay, or defraud a creditor. The Texas Fraudulent Transfer Act provides that a transfer made with intent to
hinder, delay, or defraud a creditor is extinguished unless an action is brought within four years after the transfer or, if later, within one year after the transfer was or could reasonably have been discovered. Cadle argued the action was not barred until one year after it suspected the transfer was fraudulent, but the court disagreed and concluded the action was barred because Cadle learned of the transfer in 1997 and did nothing to determine whether it was fraudulent until 2002. In other words, the discovery rule under the Texas Fraudulent Transfer Act required Cadle to bring suit within one year after it learned of the transaction, not within one year after the allegedly fraudulent details were discovered. The court also held that Cadle had no right to bring a common law fraudulent transfer claim because allowing common law fraudulent transfer claims would frustrate the express purpose of the legislature in enacting the Texas Uniform Transfer Act. Finally, the court determined that Cadle’s request for a turnover order with respect to Wilson’s membership interest was properly denied by the trial court. Cadle did not cite any grounds for turnover relief apart from the allegation that the transaction between Wilson and Greenfield was a party to the second action and not the first. The court stated that Greenfield’s inclusion in the second action was immaterial because a turnover action cannot be pursued against a third party who merely possesses property belonging to the judgment debtor, and the second action merely repeated the earlier action against the same defendant.


The Chapter 7 trustee brought an adversary proceeding to set aside alleged fraudulent transfers. The court held that certain excess cash flow distributions to the members of an LLC engaged in the property management business were fraudulent transfers because they were made with the intent to hinder and delay collection of a note owed by the LLC. The court reached this conclusion based on evidence that the LLC’s officers knew that a note payment was due shortly after the distributions, knew that the LLC would have insufficient cash to make the note payment, and viewed its business as worth less than the debt on the note. Furthermore, the LLC’s officers and board did not tell the noteholder about the distributions, had not yet provided financial information from the prior year to the noteholder, and did not tell the noteholder that it would not make the next note payment. LLC officers testified that they intended to force the noteholder to renegotiate the note and they believed the distributions and failure to make the note payment would give the LLC leverage in the negotiations. The court found intent to hinder or delay could be inferred from this evidence. The court rejected the argument that the distributions were in the nature of compensation for services of the members. The court noted that there were no employment contracts providing that excess cash flow distributions would be part of their salary or bonus, no funds withheld from the distributions for income tax purposes, and no board resolutions treating the excess cash flow as salary or bonus. The noteholder did not consider excess cash flow distributions as compensation, but rather considered the distributions to be dividends or payments on account of the equity interests of the members. The court thus concluded that the LLC did not receive reasonably equivalent value for the distributions. The court analyzed whether the LLC was insolvent within the meaning of the Texas fraudulent transfer provisions and concluded that the LLC was insolvent. The court concluded that certain payments for legal and accounting services did not constitute fraudulent transfers, nor did the cancellation of certain contracts with the LLC and the formation of another entity that took over some of the contracts constitute fraudulent transfers.

The court also addressed breach of fiduciary duty claims against members of the LLC who were officers. The court discussed the fiduciary duties of the LLC’s officers as if they were officers of a corporation. The court stated that the officers of a corporation owe a fiduciary duty to the corporation and its shareholders. Further, the court stated that the officers owe a fiduciary duty to the creditors of the corporation when the corporation is insolvent. According to the court, “[o]fficers of an insolvent corporation breach their fiduciary duty by transferring funds to themselves, in effect, as equity holders, to the detriment of the corporation’s creditors.” The court determined, however, that the trustee and the LLC’s major creditor were estopped from pursuing the breach of fiduciary duty claim. The noteholder was a “sophisticated player” and understood companies in the LLC’s business. It conducted its own assessment of the LLC’s assets and concluded that the LLC’s assets supported its debt structure. The excess cash distributions were permitted under the terms of the note. The court thus applied the equitable estoppel doctrine to the fiduciary duty claim related to the excess cash distributions. The court also concluded that the officers of the LLC did not breach a fiduciary duty when they resigned from the LLC, formed another LLC, and transferred some business to the new LLC. The court stressed that the officers did not have a non-competition or non-solicitation agreement. Additionally, the agreement under which the LLC was acquired from the noteholder recognized that the officers had fiduciary duties to other interest holders in the real estate controlled by them and permitted the officers to exercise discretion regarding property management contracts when their fiduciary duty to other interest holders required.
S. Creditor’s Remedies: Charging Order, Turnover Order, Garnishment


Clark obtained a judgment against Orr, and Orr then gave $225,000 to an LLC owned by Orr and his wife. Clark applied for a post-judgment writ of garnishment to obtain the $225,000 in the LLC’s possession. After a bench trial, the trial court awarded Clark a judgment against the LLC for $225,000. On appeal, the court held that the evidence was insufficient to support the trial court’s finding that the $225,000 belonged to Orr at the time the writ of garnishment was served on the LLC. The $225,000 at issue was received by Orr from a limited partnership in payment for his 25% limited partnership interest. On the day after this sale, Orr deposited the check directly into the LLC’s bank account, and Orr’s wife signed an unsecured 30-year promissory note on behalf of the LLC with an interest rate of 3%. Interest was payable annually, but the principal was not due until the expiration of the 30-year term. Clark then applied for the writ of garnishment against the LLC and later added fraudulent transfer claims. At the bench trial, Orr testified that he made the loan to the LLC because it was in dire need of capital. He testified the loan was structured the way it was because the LLC could not afford to pay more. Evidence showed that the LLC had gross revenue in 2011 of over $900,000. Clark chose not to try his fraudulent transfer claims and nonsuited those at the time of trial to avoid a continuance. The trial court found for Clark, stating on the record that Orr’s maneuvering was for the sole purpose of getting $225,000 out of Clark’s grasp. The trial court found that the LLC had in its possession $225,000 owned by Orr and entered a judgment against the LLC in that amount. The court of appeals noted that it was Clark’s burden to prove Orr’s ownership of the $225,000 at the time of the writ of garnishment. Since Clark nonsuited his fraudulent transfer claims and there was no pleading to support a fraudulent transfer claim, the court said the judgment in the garnishment could not be sustained on the basis of a fraudulent transfer. The court thus found unpersuasive and irrelevant the contentions that the evidence showed, and the trial court found (orally or impliedly), that Orr intended to avoid paying the judgment. The trial court could and apparently did disbelieve Orr’s testimony that the LLC was in dire need of capital, and the court of appeals accordingly disregarded that testimony in its review. But the court of appeals said that disregarding Orr’s testimony did not prove that Orr owned the $225,000 at the time the writ of garnishment was served. The only remaining evidence relied on by Clark was the fact that Orr and his wife were the sole members of the LLC. But Clark acknowledged the general rule that a partnership fund is not subject to garnishment for the individual debt of a member of the firm, and the court stated that this rule applies equally to an LLC, citing Sections 154.001 and 101.106 of the Texas Business Organizations Code, which provide that a partner is not a co-owner of partnership property and a member of an LLC does not have an interest in any specific property of the LLC. The parties agreed that at the time of the writ of garnishment the $225,000 was in a bank account of the LLC, and Clark did not establish that Orr had the right to recover the money regardless of whether the transfer was a bona fide loan. Thus, there was no evidence to support the trial court’s finding that the LLC possessed $225,000 “belonging to” Orr.


A judgment creditor of an LLC member, Brouillette, filed a post-judgment garnishment proceeding against the LLC in Travis County with respect to money or other assets in the LLC’s possession believed by the judgment creditor to be owed by the LLC to Brouillette. The LLC filed an answer verified by its manager denying that it was indebted to Brouillette or had any of Brouillette’s assets in its possession. The day after filing its answer, the LLC transferred a large amount of money from its own bank to Security State Bank and Trust (“Security Bank”). The judgment creditor argued that the transferred funds constituted Brouillette’s share of proceeds from the LLC’s development of a medical center and that the LLC’s answer falsely stated that it was not indebted to Brouillette. The LLC responded that Brouillette had assigned the funds to Security Bank before entry of the judgment and that the funds belonged to Security Bank pursuant to a valid security agreement. After the garnishment action had been pending for almost two years, the LLC filed a motion to dismiss for lack of jurisdiction, arguing that exclusive jurisdiction for such a proceeding is vested in the court in which the original action was filed. 24/7 Grill, LLC v. Clark, No. 14-13-0009-CV, 2014 WL 709221 (Tex. App.–Austin 2014, pet. filed) (mem. op.).

The court of appeals analyzed the garnishment statute and concluded that subject-matter jurisdiction over garnishment proceedings is vested exclusively in the court in which the original action was filed. Thus, the trial court did not err in dismissing the garnishment action. But the court of appeals held that the judgment creditor’s tort claim against Brouillette, the LLC, and its manager contained all the essential elements of a
members, i.e., the corporation’s and his own. The court stated that it would amend the previous order to reflect that the 100% of the LLC, could exercise control over the LLC because the receiver managed the business and affairs of both by the receiver, could approve the admission of the receiver as a member. Thus, the receiver, in addition to owning Kornman’s approval thus need not be sought. The other member of the LLC, the corporation now owed and controlled Kornman’s assignment of his stock to the receiver resulted in the receiver’s obtaining the ability to manage the business and affairs of the corporation and thus exercise the corporation’s rights as a member. The court stated that one of the two members of the LLC, Kornman, was no longer entitled to object to the admission of the receiver as a member, and Kornman’s approval thus need not be sought. The other member of the LLC, the corporation now owed and controlled by the receiver, could approve the admission of the receiver as a member. Thus, the receiver, in addition to owning 100% of the LLC, could exercise control over the LLC because the receiver managed the business and affairs of both members, i.e., the corporation’s and his own. The court stated that it would amend the previous order to reflect that the


The court of appeals affirmed an order of the trial court setting aside a receiver’s sale and sanctioned the judgment creditor’s attorney given circumstances that included the following: the sale occurred without notice to the judgment debtor while a motion for new trial was pending and the parties were in settlement negotiations; the sales price appeared to be grossly inadequate; the sale covered LLC interests without obtaining a charging order; and, after the receiver’s sale, the judgment debtors entered into a settlement in full satisfaction of the judgment without knowledge that all of their property had been sold in the receiver’s sale. Nearly two months after the judgment creditor’s attorney filed a satisfaction of judgment based on the settlement, the judgment creditor’s attorney filed a motion for approval of the receiver’s sale. The court of appeals discussed the legal requirements and circumstances surrounding the turnover orders and receiver’s sale and concluded that the trial court did not abuse its discretion by setting aside the receiver’s sale. The trial court also did not err in setting aside the turnover orders because the turnover orders had no further force or effect once the judgment was satisfied. In its order sanctioning the judgment creditor’s attorney for filing groundless or bad faith pleadings, the trial court listed, *inter alia*, the turnover order that ordered the judgment debtors “to turn over their interests in various L.L.C.s, which is prohibited by statute,” and the motion to approve the receiver’s sale even though the judgment creditor’s attorney “was aware that the sale was held without notice, purported to convey L.L.C. interests which were prohibited by statute and that the judgment had already been satisfied.” In the course of analyzing whether the trial court’s order of sanctions was an abuse of discretion, the court of appeals pointed out that the judgment creditor’s attorney sought the sale of interests in numerous LLCs and that he “asked for a turnover order as to these interests, but he did not do so via a charging order.” The court of appeals cited Section 153.256 of the Texas Business Organizations Code (the limited partnership charging order provision), parenthetically quoting subsection (d), which states: “The entry of a charging order is the exclusive remedy by which a judgment creditor of a partner or of any other owner of a partnership interest may satisfy a judgment out of the judgment debtor’s partnership interest."


After a judgment entered in the Northern District of Texas was registered in the Southern District, this court issued an order for turnover relief and appointment of a receiver requiring the judgment debtors, Gary Kornman and various related entities, to turn over all nonexempt property to the receiver. Kornman executed a conveyance of interest on behalf of himself and all judgment debtors in which the judgment debtors conveyed all of their right, title, and interest to property identified in the conveyance. Kornman objected to the court’s ruling as to the effect of the conveyance with respect to the control of an LLC and several limited partnerships. The LLC at issue had two members: Kornman, who owned 95% of the LLC, and a corporation, which owned the remaining 5%. Kornman owned 100% of the stock of the corporation. As a result of the conveyance executed by Kornman to the receiver, the court had previously entered an order stating that the receiver owned 100% of the LLC and that the receiver was the sole member and could exercise control of the LLC. Kornman stipulated to the receiver’s ownership of 100% of the membership interest but contested that the receiver was the sole member in control of the LLC. The court recognized that the receiver, as an assignee, did not automatically become a member because Section 101.108(b)(2)(B) of the Texas Business Organizations Code provides that an assignee of a membership interest is entitled to become a member on the approval of all the members. With respect to Kornman’s assignment of his 95% interest in the LLC, the court stated that Kornman did not merely assign his 95% membership interest, but all of his rights as a member. The court stated that this distinction is recognized in Section 101.111(a) of the Texas Business Organizations Code, which provides: “An assignor of a membership interest in a limited liability company continues to be a member of the company and is entitled to exercise any unassigned rights or powers of a member of the company until the assignee becomes a member of the company.” (Emphasis added by court). The court stated that Kornman assigned all of his rights as a member, including the ability to approve the admission of new members, in addition to the assignment of his membership interest. The only member of the LLC other than Kornman was a corporation owned by Kornman. Because Kornman was the 100% shareholder of the corporation, Kornman’s assignment of his stock to the receiver resulted in the receiver’s obtaining the ability to manage the business and affairs of the corporation and thus exercise the corporation’s rights as a member. The court stated that one of the two members of the LLC, Kornman, was no longer entitled to object to the admission of the receiver as a member, and Kornman’s approval thus need not be sought. The other member of the LLC, the corporation now owed and controlled by the receiver, could approve the admission of the receiver as a member. Thus, the receiver, in addition to owning 100% of the LLC, could exercise control over the LLC because the receiver managed the business and affairs of both members, i.e., the corporation’s and his own. The court stated that it would amend the previous order to reflect that the
receiver is the “sole owner” rather than “sole member” since the receiver and a corporation owned by the receiver were both members.


A judgment debtor sought a turnover order and receiver for ownership interests in businesses of the judgment debtors, but the court held that the evidence relied upon by the judgment creditor failed to show that the judgment debtors owned non-exempt property that cannot be readily attached or levied on by ordinary process. The judgment debtor relied upon records obtained from the Secretary of State listing one of the judgment debtors as a director, member, or officer of various businesses. The court cited provisions of the Business Organizations Code for the proposition that a person’s right to manage a company is not an “ownership interest.” Specifically, the BOC provides that a person need not be a shareholder to be a director of a corporation. With respect to an LLC, the court cited provisions of the BOC stating that the right to participate in management of an LLC is not a membership interest and a person may be a member of an LLC without acquiring a membership interest. The court also held that county records showing an LLC as owner of the residence of the judgment debtors, and a deed conveying the residence from another company to the LLC, were not evidence that the judgment debtors owned the LLC.


A wife was awarded a divorce from her husband along with actual damages for intentional infliction of emotional distress and punitive damages. Following the verdict, the husband debtor created two new Alaska limited partnerships and transferred the business assets of a corporation that he owned to these new partnerships in which he had a controlling interest. The husband had a 98% interest in each limited partnership, and he owned 100% of each general partner, a pair of newly-created West Indies LLCs. (His daughter owned the remaining 1% of each partnership.) The trial court granted the remedies requested by the wife, including (1) a temporary injunction prohibiting the husband from transferring assets related to his businesses, (2) a charging order against the husband’s interests in the limited partnerships, (3) a turnover order, and (4) a receiver and master of chancery. The husband did not challenge the injunction or charging order but contended the trial court abused its discretion with respect to the other relief. The trial court found that the judgment debtor's interests in the LLCs were nonexempt property and issued an order allowing the receiver to take possession of all nonexempt property in “the actual or constructive possession or control of [the husband debtor], including but not limited to all property incidental to or associated with the daily operations of” the two general partner LLCs and the corporation predecessor of one of the limited partnerships, and further including a laundry list of broad categories of property. The court of appeals reversed the issuance of the turnover order, holding that it did not comply with Texas Civil Practice and Remedies Code Section 31.002 because it failed to identify specific items of nonexempt property. The order went beyond the sole nonexempt property which the trial court found was possessed and controlled by the husband and could not be readily attached or levied upon, i.e., his 100% interests in the LLCs. Furthermore, there was no evidence of the items of property referred to in the turnover order even existed. The court of appeals then held that the trial court abused its discretion in appointing the receiver, who had served as the judgment creditor's expert witness in the underlying cause, because no evidence was offered under Texas Civil Practice and Remedies Code Section 64.021 to establish that he had no financial interest in the receivership. The trial court also erred by setting the receiver’s fee without evidence of reasonableness. Finally, the court held that the trial court order appointing a master in chancery under Rule 171 of the Texas Rules of Civil Procedure was not a matter which could be appealed.


A $10 million default judgment was taken in Texas state court against Ross, the sole member of two Arizona LLCs. When the plaintiff sought to enforce the judgment in Arizona, the Arizona court found the Texas judgment void for insufficient service of process. The plaintiff filed a motion in the Texas court for a turnover order requiring Ross to surrender his interests in the LLCs. The Texas court found the default judgment was final and enforceable and granted the turnover order, and the judgment and turnover order were affirmed on appeal. Ross did not comply with the turnover order. After the default judgment and first turnover order were upheld, the plaintiff sought a second turnover order requiring Ross to turn over a $1.2 million letter of credit owned by the LLCs. The plaintiff claimed that Ross, as owner of the LLCs, controlled the $1.2 million letter of credit, and that the statutory criteria for a turnover were met: (1) the property could not be readily attached or levied upon by ordinary legal process, and (2) the property was not exempt from attachment, execution, or other seizure. The LLCs were not joined as parties nor was it alleged that the LLCs were the alter ego of Ross. Ross argued that the turnover order could not issue without initiation of proceedings against the LLCs.
The court reviewed the case law dealing with turnover proceedings and non-judgment debtors. The Texas Supreme Court has emphasized the general principle that “Texas courts do not apply the turnover statute to non-judgment debtors,” but has also stated that a turnover order “may be against one or more parties other than the judgment debtor” upon proof of necessary facts. The court of appeals acknowledged that intermediate courts have taken divergent approaches to the application of this rule, and the court examined the case law to determine if there was supporting authority for the trial court’s action since the standard of review was abuse of discretion. The court found guidance in a case that held a court may issue a turnover order against a third party if it is shown that the property held by the third party is “non-exempt, owned by the judgment debtor and subject to the judgment debtor’s possession or control.” The court also discussed a case that indicated a turnover order encompassing corporate assets would be appropriate if the judgment debtor owned a majority of the stock of the corporation. Applying this principle, the court of appeals found no abuse of discretion in the trial court’s issuance of the turnover order for the letter of credit. A “defining point” for the trial court and the court of appeals was the fact that Ross had been ordered to turn over the “stock” of the LLC and had failed to do so. (The trial court assumed that the plaintiff would have controlled the LLC’s and the letter of credit had Ross turned over his “stock.”) According to the case law examined by the court of appeals, once the judgment creditor traces the assets to the judgment debtor, a presumption arises that those assets are in his possession, and the burden shifts to the judgment debtor to account for the assets. Further applying the case law, the court reasoned that the presumption applies to assets held by a corporate entity as long as the trial court finds that the true judgment debtor owns at least a controlling majority of the stock. Based on these authorities, the court found no abuse of discretion in the trial court’s issuance of the turnover order because Ross was the sole owner of the “stock” of the LLCs that had sole control of the letter of credit. The court also rejected Ross’s argument that there was no showing the property in question was not readily subject to execution. In support of its conclusion, the court noted that the original letter of credit was held in a safe in Arizona, efforts to obtain the “stock certificates” through a turnover order had failed, efforts to depose Ross had failed, efforts to enforce the judgment in Arizona had failed, and contempt orders and sanctions against Ross (for failing to appear for his deposition, failing to produce records sought during post-judgment discovery, and failure to turn over the LLC “stock”) had proved unsuccessful. Although the Texas and Arizona LLC acts contain charging order provisions, the court did not mention these provisions in the case, nor did the court discuss the difference between an LLC interest and corporate stock when relying on cases dealing with corporate stock ownership.


A judgment creditor (“Cadle”) appealed the denial of a turnover order. After Cadle obtained a judgment against Wilson, a friend of Wilson’s, Greenfield, purchased a note on which Wilson was obligated. As collateral for the note, Wilson pledged his membership interest in William T. Wilson, Attorney & Counselor at Law, Ltd., which was described by the court as a “limited liability corporation” formed by Wilson for the conduct of his legal practice. The court further noted that Wilson held a 99% ownership interest in the “limited liability corporation” while the remaining 1% interest was owned by his daughter. The court determined that Cadle’s request for a turnover order with respect to Wilson’s membership interest was properly denied by the trial court. Cadle did not cite any grounds for turnover relief apart from the allegation that the transaction between Wilson and Greenfield was a sham, and the trial court had denied a previous request by Cadle for a turnover order. The court held the second claim for turnover relief was barred by res judicata. Cadle argued its turnover action was not barred by res judicata because Greenfield was a party to the second action and not the first. The court stated that Greenfield’s inclusion in the second action was immaterial because a turnover action cannot be pursued against a third party who merely possesses property belonging to the judgment debtor, and the second action merely repeated the earlier action against the same defendant.


The plaintiff registered a foreign judgment in Texas and sought a turnover order and receivership with respect to the defendant’s non-exempt assets. Included in these assets were stocks, bonds, debentures, options, accounts receivable, and other property interests pledged to various third parties. The plaintiff also sought a charging order against the defendant’s interest in two limited partnerships and an LLC. The court upheld the magistrate’s issuance of a turnover order and appointment of a receiver to take possession and control of all the defendant’s non-exempt assets and property interests and to sell the assets and property interests in satisfaction of the judgment. With respect to the request for the charging order, the court upheld the magistrate’s finding that the charging order was “unnecessary” because the receivership included the limited partnership and LLC interests. (The court’s receivership order specifically gave the receiver authority to exercise all powers and rights exercisable by the defendant with respect to his stock, bonds, warrants, debentures and options in corporations in which the defendant had any legal or beneficial interest, including voting rights, but the order did not mention specifically the rights of the receiver with respect to the limited partnership.
and LLC interests. The order generally gave the receiver authority to take possession and control of, and to sell, all the defendant’s non-exempt assets and to perform any and all acts necessary and appropriate in order to take possession and control of, and to sell, the defendant’s assets.)

T. Franchise Tax


In this action to determine dischargeability of a debt, the plaintiff argued that Higgs obtained materials on credit by falsely representing that he made purchases on behalf of an LLC when the LLC had forfeited its charter and could not do business in Texas. The plaintiff alleged that Higgs made this representation with intent to deceive and that the plaintiff relied on the representation to its detriment. Higgs denied that he purchased materials from the plaintiff on behalf of his LLC and asserted that the plaintiff extended credit to him personally. It was undisputed that Higgs executed the plaintiff’s credit application in 2004 in which he listed the type of business as “Construction LLC.” For several years, Higgs made purchases, presumably acting through “RH Construction.” Two invoices in 2012 were not paid. It was also undisputed that “RH Construction” was an assumed name of RHC Consultants, LLC, and that the LLC forfeited its right to do business in Texas in 2009. The court concluded that the plaintiff failed to show that Higgs made a false representation. The court said it was unclear from the complaint what representation was at issue—whether it was the statement on the credit application that Higgs would make purchases for an LLC or the representation on the two unpaid invoices that the materials were ordered for RH Construction. The representation on the credit application was not false in 2004 when it was made because RH Construction was a valid assumed name for an existing LLC at that time. At trial, the plaintiff contended the false representation was Higgs writing “RH Construction” on the invoices when the LLC had lost its charter. However, Higgs did not write “RHC Consultants, LLC” on the invoice; he wrote “RH Construction.” Further, there was no evidence that Higgs no longer did business as “RH Construction” after the LLC lost its charter. In his answer, Higgs stated that the purchases were made for RH Construction and that it still existed. The question was whether Higgs had a duty to tell the plaintiff that RHC Consultants, LLC (of which RH Construction was an assumed name) forfeited its charter and lost its status as an LLC. The plaintiff did not establish that Higgs had such a duty. In addition, the evidence did not establish that Higgs intended to deceive the plaintiff. Statements by Higgs at a meeting of creditors indicated that he did not know or understand the significance of the name of the buyer on the invoice. His statements suggested that he did not differentiate between himself and RH Construction. According to the court, if Higgs did not differentiate between himself and his company or his assumed name, or understand the significance of a name on an invoice, then he could not have put the name “RH Construction” on the invoice with intent to deceive the plaintiff. Finally, the plaintiff failed to prove justifiable reliance because there was no evidence that the plaintiff made even a cursory examination or investigation of RH Construction’s creditworthiness. Thus, the plaintiff failed to establish that the debt was nondischargeable.


This case involved a dispute over whether the trial court had personal jurisdiction over a nonresident manager of a foreign limited liability company when the LLC had forfeited its certificate of authority for failure to pay its Texas franchise tax. In 2009, ACS Partners, LLC (“ACS”) contracted with two Delaware limited partnerships to perform improvements on two apartment complexes in Houston. Alleging it did not receive payment under the contracts, ACS sued GFI Houston Holdings Management, LLC (“GFI”) and Allen Gross. GFI, a general partner of the two limited partnerships, was a Delaware LLC. Gross was a manager of GFI residing in New York. ACS alleged that GFI was subject to personal jurisdiction of the court because GFI did business in Texas. As to Gross, ACS contended that jurisdiction was proper because GFI’s certificate of authority had been forfeited in 2005, and under an alter ego theory GFI’s jurisdictional contacts were imputed to Gross. Gross filed a special appearance supported by a sworn affidavit in which he testified that he was an employee of GFI, had a business address in New York, and lived in New York all his life. Gross denied having sufficient contacts with Texas or the underlying litigation to be subject to personal jurisdiction in Texas, and he presented affidavits showing that GFI was not the general partner at the time the contracts were executed. At the hearing on the special appearance, ACS argued that because GFI had failed to satisfy all of its franchise tax requirements, Section 171.255(a) of the Tax Code—which under certain circumstances makes corporate directors and officers liable for corporate debts incurred after a tax becomes due but is unpaid—operated to make Gross personally liable for the debts of GFI and conferred personal jurisdiction over Gross. ACS claimed that personal jurisdiction could be asserted over Gross by virtue of GFI’s status as the officially registered general partner and the
and director. On the 2006 report, Bruce was listed as the only director. Bruce was also shown as the person signing the
Reports prepared for the LLC in 2003, 2004, and 2006. On the 2003 and 2004 reports, Bruce was listed as an officer
officer or director of the LLC at the time it incurred the debt, the plaintiff presented the Texas Franchise Tax Information
debt to the plaintiff if he was an officer or director at the time the debt was incurred. To prove Bruce’s status as an
was the same even if the amended version applied, i.e., Bruce is personally liable under Section 171.255 for the LLC’s
stated that it need not resolve any issues relative to the effective date of the amendments because the result in this case
Subchapter F, including Section 171.255, applicable to forfeiture of the right of a taxable entity to transact business in
Texas. Therefore, under the current version of Chapter 171, Section 171.255 remains applicable to LLCs. The court
In 2006, the legislature revised some provisions of Chapter 171, including Section 171.001, effective January 1, 2008. The definition of “corporation” was deleted, but a definition of “taxable entity” was added
that the LLC’s privileges had been forfeited and incurred the debt at issue, provided that a franchise tax was imposed on each
due and before the corporate privileges are revived. ACS argued that the forfeiture of GFI’s certificate of authority pursuant to this Tax Code provision meant that GFI’s contacts in Texas were imputable to Gross for jurisdictional purposes. The appellate court concluded that Section 171.255 of the Texas Tax Code did not provide an independent basis for personal jurisdiction over Gross, a nonresident defendant. Because ACS failed to suggest any other factual basis for asserting personal jurisdiction over Gross, the appellate court affirmed the order of the trial court granting Gross’s special appearance and dismissing him from the suit.


Freeman Decorating Services, Inc. filed suit on a sworn account against an LLC and Larry Bruce, an individual who was alleged to be an officer or director of the LLC, for amounts owed for services provided by the plaintiff. The plaintiff alleged that Bruce was liable for the LLC’s debt under Section 171.255 of the Tax Code because the LLC had been forfeited for failure to pay franchise taxes. After a bench trial, the court rendered judgment for the plaintiff against the LLC and Bruce, jointly and severally, and Bruce appealed. The court of appeals explained that Section 171.255(a) provides that each director and officer of a corporation whose corporate privileges are forfeited for the failure to file a report or pay a tax or penalty is liable for each debt of the corporation that is created or incurred in Texas after the date on which the report, tax, or penalty is due and before the corporate privileges are revived. The plaintiff presented evidence that the LLC’s privileges had been forfeited as of February 10, 2006, that the privileges had not been revived, and that the plaintiff provided the services at issue to the LLC in February 2007. First, Bruce argued that Section 171.255 imposes liability on directors and officers of corporations, not LLCs. The court explained that Section 171.001, as in effect when the LLC forfeited its charter and incurred the debt at issue, provided that a franchise tax was imposed on each “corporation” and “limited liability company” doing business in Texas and defined “corporation” for purposes of Chapter 171 of the Tax Code to include a limited liability company. Thus, Section 171.255 applied to an LLC under the former version of Chapter 171. In 2006, the legislature revised some provisions of Chapter 171, including Section 171.001, effective January 1, 2008. The definition of “corporation” was deleted, but a definition of “taxable entity” was added and includes an LLC. Additionally, the legislature added Section 171.2515, which expressly makes the provisions of Subchapter F, including Section 171.255, applicable to forfeiture of the right of a taxable entity to transact business in Texas. Therefore, under the current version of Chapter 171, Section 171.255 remains applicable to LLCs. The court stated that it need not resolve any issues relative to the effective date of the amendments because the result in this case was the same even if the amended version applied, i.e., Bruce is personally liable under Section 171.255 for the LLC’s debt to the plaintiff if he was an officer or director at the time the debt was incurred. To prove Bruce’s status as an officer or director of the LLC at the time it incurred the debt, the plaintiff presented the Texas Franchise Tax Information Reports prepared for the LLC in 2003, 2004, and 2006. On the 2003 and 2004 reports, Bruce was listed as an officer and director. On the 2006 report, Bruce was listed as the only director. Bruce was also shown as the person signing the
2006 report and certifying that the information in the report was true and correct to the best of his knowledge. Bruce denied that he was a director in 2006 and claimed he did not sign the report, but the fact finder was free to disbelieve his testimony. The 2006 report did not include an expiration date of Bruce’s terms as director as required to be included for each officer and director listed, and there was no evidence that the report was amended during the year following its filing on June 8, 2006. Therefore, the court said that the trial court could have reasonably inferred that Bruce remained a director in February 2007, only eight months after the filing of the report. The court of appeals acknowledged that Section 171.255(c) contains two exceptions to the personal liability of a director or officer under subsection (a). Under Section 171.255(e), a director or officer is not liable for a debt if the director or officer shows that the debt was created or incurred over the director’s objection or without the director’s knowledge and the exercise of reasonable diligence to become acquainted with the affairs of the corporation would not have revealed the intention to create the debt. Bruce waived any appellate contention that he met his burden to prove an exception by failing to adequately brief the contention. Finally, the court reviewed the evidence relating to the debt of the LLC and rejected Bruce’s argument that the plaintiff failed to prove the LLC incurred a debt to the plaintiff.

Gale v. Carnrite, 559 F.3d 359 (5th Cir. 2009).

In 1999, the Gales bought all of the membership interest in a Nevada LLC that owned a condominium unit in Mexico. Because of a legal restriction on non-Mexican ownership of real property, the Gales had to purchase the outstanding membership interest in the LLC. The sole asset of the LLC was beneficial ownership of a leasehold interest in the condominium under a special trust arrangement with a Mexican bank. In the sale agreement between seller, Carnrite, and the Gales, Carnrite included a warranty that as of the date of closing “the LLC has and will have no liabilities of any nature…including without limitation tax liabilities due or to become due.” When the sale was completed in January 2000, no one reported the transaction to the Mexican government and no taxes were paid on the transfer. After the Gales used the condominium for a number of years, the LLC sold the beneficial interest in the condominium to the Vaudagnas. The sale resulted in a substantial Mexican capital gains tax liability. The Gales filed suit against Carnrite for allegedly breaching the contractual warranty he gave to them regarding tax liability when they bought the LLC. The Gales alleged that Carnrite breached the warranty by failing to report and pay taxes on the sale to the Gales. The district court entered summary judgment in favor of the Gales, finding that Carnrite breached the warranty because the parties’ transaction gave rise to tax liability for the LLC. Carnrite appealed, and the first issue discussed in the opinion on appeal was the whether the Gales had standing to pursue the claim. Carnrite argued that it was the LLC rather than the Gales that were liable for the capital gains tax and that the Gales did not have standing since they suffered no injury. The Gales responded that the LLC assigned the claim to them when they filed the lawsuit in 2007. Carnrite did not dispute the usual propriety of such an assignment, but argued that the assignment was ineffective because Nevada had revoked the LLC’s right to do business in 2004 for failure to pay franchise taxes and fees and file annual reports. The court concluded that the Gales had standing to pursue the claim, however, based on Nevada LLC statutes regarding dissolution and the fact that payment of the taxes ultimately fell on the Gales. The court pointed out that the Nevada LLC statutes provide that the property and assets of an LLC whose charter has been revoked must be held in trust and that dissolution proceedings should be pursued. Another statutory provision provides that dissolution does not impair a remedy or cause of action arising before dissolution and commenced within 2 years after the date of dissolution. Additionally, the Nevada statutes provide that the assets of a dissolved LLC may be distributed to its members. Based on these statutes, the court concluded the assets of the LLC, which included the cause of action against Carnrite, were held by the Gales in trust when its right to transact business was forfeited, and, moreover, the Gales were permitted to transfer those assets to themselves as the LLC’s only members. As the parties ultimately injured and the assignees of the LLC’s claims, the Gales had standing to pursue the action. After analyzing the tax liability, however, the court held that the record did not establish that Carnrite breached the terms of the warranty as worded in the contract he made with the Gales because the record indicated that Carnrite’s failure to pay taxes on the transaction resulted in a tax liability of the Gales rather than the LLC.


Weatherford International, Inc. (“Weatherford”) sought to hold an LLC and its two member/managers, Bennett and Donaho, liable for breach of contract and copyright infringement. Bennett and Donaho argued that they were not personally liable because they did not act in their individual capacities. Weatherford argued that Bennett and Donaho were personally liable because the LLC’s charter had been forfeited under the Tax Code at the time the negotiations for the contract took place, and the Tax Code provides that a corporate officer of an LLC whose charter has been revoked is liable for a debt that is incurred after the date on which the tax is due. However, the LLC was reinstated after its
forfeiture, and Weatherford’s complaint did not indicate when the contract with the LLC was signed. Because Texas case law holds that a debt created by a contractual obligation is created when the contract is signed for purposes of the Tax Code provision imposing personal liability on corporate officers and directors, the court could not determine as a matter of law whether the individuals were personally liable.


Gray and Neely entered into a contract for the sale of Neely’s homestead in June 2005. One month later Gray assigned his rights in the contract to Graywest, LLC (“Graywest”), which the court referred to as a “limited liability corporation.” Neely attempted to avoid the contract for sale, and Graywest filed suit to enforce it. Neely filed a motion to abate and alternatively to dismiss the suit arguing that Graywest did not have the capacity to sue because it had forfeited its corporate status by failing to pay franchise taxes. The parties agreed that Graywest had been involuntarily dissolved in March of 2001 for not paying its franchise taxes. The trial court ruled that Graywest lacked the capacity to file suit on the contract at issue because its charter had not been revived within the 36-month window for reinstatement allowed by Article 7.01E of the Texas Business Corporation Act (“TBCA”), and the three year survival period under Article 7.12 of the TBCA had expired. [Note: Although TBCA Articles 7.01E and 7.12 were applicable to LLCs under Article 8.12 of the Texas Limited Liability Company Act, Article 7.01E was not actually applicable in this case. It has long been the practice of the Secretary of State to effectuate forfeitures for failure to pay franchise taxes under the Tax Code provisions, which have their own reinstatement provisions and do not contain a time limitation on reinstatement, rather than to rely on the involuntary dissolution provisions of the TBCA. The successor to Article 7.01 of the TBCA, Section 11.251 of the BOC, does not specify failure to pay franchise taxes as a basis for involuntary termination. Thus, there should be less confusion in this regard under current law.] Since Graywest was not an existing entity and no other proper party was before the court, the trial court dismissed the case with prejudice. The court of appeals affirmed, explaining that the assignment from Gray to Graywest fifty-one months after dissolution was invalid and that Graywest was not an appropriate party to the suit. The court of appeals stated that the trial court could have allowed the litigation to continue if the appellant had amended its petition by substituting Gray individually as the plaintiff, but Graywest did not pursue this remedy at the abatement hearing. Thus, dismissal with prejudice as to Graywest was proper.


The court held that an LLC plaintiff, which was reinstated after forfeiture for failure to pay its franchise taxes, could maintain this action, but its member lacked standing to assert claims arising out of the LLC’s contract. The member was not a party to the contract and had no rights under the contract. The court cited Section 101.113 of the Texas Business Organizations Code for the proposition that a member of an LLC may be named as a party in an action by or against the LLC only if the action is brought to enforce the member’s right against or liability to the LLC.


This case merely illustrates that the Texas franchise tax applies to LLCs just as it does to corporations. The case was a suit for refund of franchise tax paid by Texas Utilities Electric Company (TUEC). TUEC claimed it was entitled to deduct as “debt” future rental expense under certain operating agreements. The court noted that the franchise tax applies to both corporations and LLCs in Texas, even though most of the statutory provisions use only the word “corporation,” because the Texas Tax Code defines “corporation” to include an LLC. The court stated that it used the term corporation in its discussion for convenience even though it appeared that TUEC was an LLC. The court concluded that the future rentals in issue were not deductible “debt” for franchise tax purposes.

U. Series LLC


The court discussed the question of whether a series of a Delaware LLC is a separate juridical entity in this wrongful foreclosure action arising out of a judgment of foreclosure obtained in Louisiana by a series of a Delaware LLC that was not named as a defendant in the wrongful foreclosure action. After the series, which was the holder of the note secured by Alphonse’s home, obtained the judgment of foreclosure, Alphonse brought this action in federal court asserting claims under Louisiana law and the Federal Fair Debt Collection Practices Act. Alphonse sued the mortgage servicing company and the Delaware parent LLC of the series. On appeal, the parties agreed that the district court erred in its analysis of the Rooker-Feldman doctrine, but the defendants argued that dismissal was proper on res judicata
grounds and because of the separate juridical status of the series. The success of the res judicata argument turned on whether there was an identity of parties between the series and the defendants. The court of appeals held that the defendants did not meet their burden of showing an identity of parties at the motion to dismiss stage. The analysis of this question depended on fact-bound issues involving control and virtual representation, and the court held that the district court’s decision to dismiss before discovery was erroneous. In the course of its discussion, the court of appeals acknowledged that the series that obtained the judgment of foreclosure “is a Series LLC [noting by way of footnote that ‘[a] “Series LLC” is basically a business entity within a business entity’], and Series LLCs only exist to represent the interest of the parent LLC.” but the court characterized the question of the legal separation of the series and its parent as a fact-bound question under Louisiana law. The court next discussed the question of whether dismissal could be upheld on the basis that Alphonse sued the wrong party when it sued the parent LLC rather than the series. Alphonse argued that the series and its parent LLC are not legally distinct entities and that the district court erred in relying on the statutory limitation of liability and capacity and power of a series to sue and be sued in its own name to conclude that the series in this case was a separate juridical entity from its parent LLC and thus responsible for the trade violations alleged in the complaint. The court of appeals took issue with the district court’s conclusion that Delaware law applied under the applicable Louisiana conflict-of-laws provision, which states that “[t]he laws of the state or other jurisdiction under which a foreign limited liability company is organized shall govern its organization, its internal affairs, and the liability of its managers and members that arise solely out of their positions as managers and members.” The court of appeals discussed the distinction between internal and external affairs and stated that it is not clear whether the liability of an LLC, or its series, to third parties like Alphonse is internal or external. Because the district court apparently did not consider “whether the liability as between a third-party plaintiff with respect to a holding company LLC or its Series LLC constitutes internal or external affairs,” the court of appeals remanded the case for consideration of the question. The court suggested that factual development might be necessary to resolve the question.

V. Property Tax Exemption

Galveston Central Appraisal District v. TRQ Captain’s Landing, 423 S.W.3d 374 (Tex. 2014).

Like AHF-Arbors at Huntsville I, LLC v. Walker County Appraisal District, 410 S.W.3d 831 (Tex. 2012), this case concerned the ad valorem tax exemption available under Section 11.182 of the Texas Tax Code for property owned by a community housing development organization (CHDO). The court decided in AHF-Arbors that equitable title is sufficient “ownership” for this exemption. In this case, a limited partnership acquired legal title to an apartment complex. A nonprofit corporation was formed and became the sole member of an LLC, which in turn acquired the limited partnership by acquiring the limited partners’ 99% interest and acquiring the general partner, which owns 1% of the limited partnership. The nonprofit corporation is a CHDO, but the LLC and limited partnership are not CHDOs. The CHDO’s equitable title pursuant to this arrangement qualifies for the exemption under Section 11.182(b) of the Texas Tax Code. The remaining issue in the appeal related to the timely submission of the application for exemption. The appraisal district argued that the relevant occurrence for determining the timeliness of the application was the limited partnership’s acquisition of the apartment complex years earlier, but the court rejected this argument because it was based on the appraisal district’s position that the exemption must be based on legal title, which the court rejected. Because the CHDO applied within 30 days of acquiring equitable title to the apartment complex, the application was timely under the statute in effect at that time.

AHF Arbors at Huntsville I, LLC v. Walker County Appraisal District, 410 S.W.3d 831 (Tex. 2012).

Two LLCs that owned low-income housing apartment complexes asserted that they met the statutory requirements for exemption from ad valorem taxation available to a community housing development organization (“CHDO”) under Section 11.182 of the Texas Tax Code. The principal issue addressed in this opinion was whether a CHDO must have legal title to property to qualify for the exemption, and the Texas Supreme Court held that equitable title is sufficient. The sole member of each of the two LLCs in this case was a nonprofit corporation exempt from federal income taxation under Section 501(c)(3) and certified as a CHDO by the Texas Department of Housing and Community Affairs. Section 11.182(b) of the Texas Tax Code provides a tax exemption to an organization on “property it owns” if it is organized as a CHDO and “owns the property for the purpose of” providing low- or moderate-income housing without profit. The LLCs argued that their apartments were exempt because ownership, within the meaning of the statute, includes equitable title, which the LLCs’ sole member, a certified CHDO, held by virtue of its complete control of the LLCs. The appraisal district argued that ownership means legal title, and that the LLCs were not entitled to an exemption since there was no evidence they themselves were CHDOs. The court looked to Section 11.182(e) of the Tax Code as an indication that ownership in subsection (b) included equitable title. Section 11.182(e) allows property “owned by a
limited partnership” to be tax-exempt in certain instances if 100% of its general partner is controlled by a CHDO meeting the requirements of subsection (b). The court was unconvinced that limited partnerships are the one exception to subsection (b)’s requirement of legal ownership by a CHDO and saw no reason to distinguish between a general partner’s control of a limited partnership and other types of corporate control over related entities, such as the CHDO’s complete ownership of its subsidiary LLCs in this case. The court characterized the purpose of subsection (e) as limiting exemptions for limited partnerships to those in which the CHDO wholly owns the general partner rather than as carving out an exception for non-CHDO limited partnerships. The court observed that this construction acknowledges the realities of the commercial housing industry, in which lenders often require that property be purchased by a single-asset entity. The court also noted that tiered ownership allows greater flexibility for investors, encouraging the involvement of private funds in developing low-income housing consistent with the purpose in creating the concept of CHDOs. The court rejected several arguments made by the appraisal district, including an argument that entities that are separate for purposes of imposing liability should not be treated as one for purposes of qualifying for tax exemptions. The court pointed out that federal tax law disregards the separate identity of some entities (e.g., the LLCs in this case, which are disregarded as separate entities from their owner), and the court stated that there was no reason why Section 11.182 should not do the same. The court discussed five cases in which courts of appeals adopted varying constructions of Section 11.182. The court agreed with the reasoning in TRQ Captain’s Landing v. Galveston Central Appraisal District, 212 S.W.3d 726 (Tex. App.–Houston [1st Dist.] 2006, pet. granted, appeal abated), in which the court of appeals upheld an exemption for a limited partnership that was wholly owned by an LLC whose only member was a CHDO. Applying the rule that a CHDO’s equitable ownership of property qualifies for an exemption under Section 11.182 to the facts in the instant case, the court concluded that the CHDO had complete control over the LLCs and equitable title to the property—the power to compel the transfer of legal title. The court acknowledged that each of the LLCs had managers, which were the governing authority of the entities, but concluded that the member CHDO had complete control over the LLCs because managers serve at the pleasure of the members. The court noted that it was not addressing and expressed no view on numerous other issues raised by the parties, including the appraisal district’s arguments that the LLCs were not charitable organizations, that their apartments were not used for low- and moderate-income housing, and that other requirements of Section 11.182 and of federal law were not met.

Justice Willett dissented from the majority’s opinion, pointing out that the companies were asking the court to pierce the corporate veil that they themselves created. He argued that Texas law respects corporate formalities and usually limits piercing to circumstances of fraud or other malfeasance. He pointed out that the legal and business communities would be astounded if taxing authorities could routinely look to the parent to pay taxes on property of a subsidiary, and the granting of a tax exemption to a subsidiary struck Justice Willett as equally untenable. Justice Willett viewed the legislature’s failure to provide a provision similar to the one provided for limited partnerships in Section 11.182(e) as reason enough to disagree with the majority. Though he found it unnecessary to consider why the legislature would treat the two entities differently, he pointed out various differences between limited partnerships and LLCs that might provide plausible reasons for drawing a statutory distinction. In sum, Justice Willett stated that he would respect what he viewed as the legislature’s policy choice to treat LLCs and limited partnerships differently.


The court held that, for purposes of the low income housing tax exemption under Section 11.182 of the Tax Code, a nonprofit organization was the equitable owner of an apartment complex that was owned by a limited partnership, the general and limited partners of which were wholly owned LLCs of the nonprofit organization. The court reasoned that the nonprofit parent possessed the “present right to [compel] legal title” based on the fact that the partnership’s assets would revert to the LLC partners upon dissolution of the partnership, and, on the dissolution of the LLCs, the assets would revert to the nonprofit parent. A dissenting opinion argued that the majority’s reasoning was erroneous, citing statutory provisions that specify property of a partnership or LLC is not property of the partners or members. According to the dissenting justice, the right to dissolve and wind up the affairs of the partnership and LLCs did not amount to a present, vested right to compel title.

W. Workers’ Compensation


Two corporations formed an LLC and entered a management agreement in which one of the corporations agreed to manage and operate the LLC and cause the LLC to maintain workers’ compensation insurance. A worker was injured, and the worker sued the two members of the LLC alleging they were negligent in failing to provide certain safeguards.
The members argued that they were “employers” protected from suit under the exclusive remedy provision of the Texas Workers’ Compensation Act. The court considered cases dealing with this issue in the partnership and corporate parent-subsidiary context. The court concluded that the current statutory treatment of partnerships as entities had overruled case law treating partners as employers, and analogized to the parent-subsidiary context because of the liability shield provided to members of an LLC. Since the case law in the corporate parent-subsidiary context has recognized the separate existence of the parent and subsidiary for purposes of the workers’ compensation law, the members were not permitted to argue they were the same entity as the LLC for such purposes.

X. Wage and Employment Laws


The plaintiff sued two LLCs to collect unpaid overtime wages under the Fair Labor Standards Act (FLSA). The evidence showed that she was employed by only one of the LLCs. The plaintiff argued that the two LLCs were part of an “enterprise” as defined by the FLSA in order to hold the non-employer LLC jointly and severally liable as well as to aggregate the gross sales of the two LLCs to satisfy the threshold volume of gross sales required to bring an employer within the coverage of the FLSA. Relying on Eleventh Circuit precedent, the court rejected the argument that being part of the same enterprise is a basis to hold non-employer members of the enterprise liable for other members’ FLSA obligations. The non-employer LLC was thus dismissed. The court found that the two LLCs were part of an “enterprise” under the FLSA such that the gross volume of sales of the two LLCs could be aggregated to bring the employer LLC within the coverage of FLSA. The court applied the following test, which the Fifth Circuit has said will establish a single “enterprise” for FLSA purposes: (1) the corporations perform related activities (2) through unified operation of common control (3) for a common business purpose. The court concluded that the LLCs had related activities because the primary activity of both was to operate a restaurant business. The stated purpose in the articles of “incorporation” of the two LLCs was to operate a restaurant business, and each LLC in fact operated a restaurant under the same trade name with the same signature dish. The restaurants were also marketed through the same website. The court found that the LLCs met the unified operations or common control element because they were formed by the same organizer on the same day and had the same members and managing member, and they were held out to the public collectively on the website. Finally, the court concluded that the LLCs were operated for a common purpose based on the previously recited evidence that showed both LLCs were operated for the common purpose of providing not only complementary food services but also profits for the two members.


The court granted the defendant’s motion for summary judgment on the plaintiff’s employment discrimination claim where the evidence showed the plaintiff was employed by an LLC rather than defendant “Pyle Properties.” Though the individual who did business under the name Pyle Properties was a member of plaintiff’s LLC employer, that connection was not sufficient to find plaintiff was an employee of Pyle Properties.

Y. Marital Property


On July 27, 2006, the trial court signed a final divorce decree for Cynthia Fleming (“Cindy”) and Davis Fleming (“Davis”). The decree divided the former couple’s community property. In February 2007, Cindy filed a petition for a post-divorce division of property. Cindy alleged that Davis had previously been a member of a Louisiana LLC formed in 2005 to buy boats and do offshore diving to repair pipes, that his ownership interest in the LLC was a community asset, and that the trial court failed to dispose of the interest in the LLC in its original divorce decree. At trial, Cindy testified that she brought the post-divorce proceeding because at the time of the divorce she could not prove that Davis had the ownership interest in the LLC that he was denying he had. Cindy testified that Davis signed the LLC’s operating agreement, which reflected that he owned 5% of the company and that his initial capital contribution was $25,000. Cindy further testified that she derived no benefit from Davis’s interest in the LLC and that she never received any share of Davis’s ownership interest or his salary or bonuses. Davis testified that he never had an ownership interest in the LLC and that he was formally removed as a member on July 28, 2006, for failure to pay his required capital contribution to the LLC. In March 2007, Davis did receive $550,000 in bonuses from the LLC, which he testified was based on work he performed and not as a result of cashing out an ownership interest in the LLC. The trial court admitted deposition
testimony from several individuals associated with the LLC. Some testimony supported Davis’s stance that he never had an ownership interest in the LLC and that the amount the LLC paid him was a bonus for the work he performed and his value as an employee to the company. Other testimony indicated Davis represented himself as an owner of the LLC or that he was an owner through “sweat equity” (e.g., bringing in accounts for the company) rather than paying money as a capital contribution. The trial court denied Cindy’s petition to divide the alleged community asset of ownership in the LLC and rendered judgment that the evidence did not support a finding that Davis held an ownership interest in the LLC that remained undivided from the original divorce decree. On appeal, Cindy argued that the trial court erred in failing to divide the alleged community interest in the LLC or the proceeds from Davis’s disposition of his ownership interest in the LLC. She contended that the trial court’s finding that Davis did not have an ownership interest in the LLC was not supported by legally sufficient evidence. The court of appeals reviewed the record and noted that at trial Davis repeatedly testified that he never had an ownership interest in the LLC. Davis testified that he was given an opportunity to invest in the LLC and become a member but never did so because he was unable to pay the initial capital contribution of $25,000. The LLC’s operating agreement originally listed Davis as a member but was later amended to remove him as a member for failure to pay the capital contribution. Davis also testified that he later received $550,000 from the LLC as a bonus for services performed for the company and not as a payment for cashing out an ownership interest in the LLC. Deposition testimony from the LLC’s managing director and former CEO corroborated Davis’s testimony regarding his alleged ownership interest in the LLC. The appellate court found that viewing the evidence in the light most favorable to the finding under review, there was legally sufficient evidence that Davis did not have an ownership interest in the LLC, and the trial court thus did not err in failing to divide the alleged community asset.

**In re Marriage of Davis**, 418 S.W.3d 684 (Tex. App.–Texarkana 2012, no pet.).

William and Eleanor Davis entered a Rule 11 agreement in their divorce action in which they agreed to the appointment of a receiver to sell the property of their LLC horse farm. William asserted certain complaints about the receiver’s authority and a modified order issued by the trial court after the first order appointing the receiver, but William failed to preserve those issues for appeal. William also complained that the trial court erred in issuing an order placing the LLC’s property into receivership because the LLC was not a party in the divorce proceeding. The LLC was co-owned and managed by Eleanor and William in equal shares. The governing documents stated that the LLC was manager-managed and that Eleanor and William were the managers, but the LLC was operated by them informally “as a partnership” without holding meetings or observing other formalities. Although the court acknowledged that the LLC’s property was owned by the LLC and not Eleanor and William, the court found it sufficient that Eleanor and William agreed to the appointment of the receiver in the Rule 11 agreement given that Eleanor and William enjoyed complete authority over the property as members and managers of the LLC, “especially given that they exercised that control over it informally as a matter of course.” A concurring justice wrote to express his view that the trial court was without authority to enter its first order appointing a receiver for the LLC’s property because the LLC was not a party at that time, and the Rule 11 agreement was not signed by Eleanor and William in their capacities as managers of the LLC, but rather as individuals who were parties to the divorce action. The concurring justice argued that past mutually agreed informal management of an entity does not forever bar insistence on obedience to the governing documents of the entity, and an agreement in the capacity of an individual does not unwillingly bind that same person in the capacity as manager of an LLC. Because the LLC had been made a party to the divorce proceeding by the time a subsequent order appointing a receiver was entered nunc pro tunc, the concurring justice concurred in the result reached by the majority.


The court determined that the debtor’s receipt of a 25% interest in a California LLC pursuant to a divorce did not result in her becoming a member; rather, she was only an economic interest holder. The debtor’s community property interest in her husband’s 50% interest terminated upon the divorce, and she received her ownership share through an agreement incident to divorce. The agreement was silent as to the nature of the interest, stating only that it was a 25% interest in the LLC. The LLC’s operating agreement prohibited transfer of membership interests except with the prior approval of all members. The ex-wife argued that the ex-husband gave his approval by signing the divorce agreement, but there was no evidence that the other member of the LLC gave his approval. The LLC operating agreement provided that a transfer of an interest in violation of the provision requiring approval of all members entitled the transferee to receive a share of the net profits and losses, but not to vote or participate in the management. Because a valid transfer of a full membership interest required the prior approval of all members, the debtor held a purely economic interest rather than a full voting membership interest.

A husband in a divorce action complained that the trial court erroneously awarded to the wife accounts belonging to the family partnership and an LLC and a car owned by a professional association. The court rejected the husband’s argument because the husband did not during the trial proceedings argue that the assets were “corporate business assets” that should not have been awarded to the wife. In fact, he listed these assets in his proposed property division, representing to trial court that they were community property assets. Since he failed to inform the trial court of the existence of corporate or partnership assets, he could not obtain reversal of the property division on this basis.


The court noted that a membership interest in an LLC is personal property and that a member has no interest in specific LLC property and that a member has no interest in the LLC. The court held that the trial court in a divorce action abused its discretion when it awarded to the husband all interest in an entity variously referred to as a corporation and LLC where a mediated settlement agreement did not divide or mention the entity and alter ego was neither pled nor tried.


A judgment creditor of the husband of an LLC member sought to reach the LLC interest of the wife. The creditor argued the LLC interest was joint management community property that could be levied on to satisfy her husband’s debts. The wife argued the LLC interest was sole management community property and thus not subject to the husband’s non-tortious liabilities incurred during marriage. The wife relied upon the inception of title rule and claimed her interest was sole management community property because she purchased it with funds from her personal bank account. The creditor urged the court to look at the totality of the circumstances, noting that the husband conceived the idea behind the formation of the LLC, negotiated and drafted the articles of organization, secured financing for the venture, located most of the real estate, and actually managed the development of the LLC. The creditor also pointed to evidence that the husband and wife decided jointly on how to use profits from the venture and the husband used equipment and supplies from his home office (listed as joint community property on his bankruptcy schedules) to work on behalf of the LLC. The court concluded that fact issues precluded summary judgment.

Z. Recovery of Attorney’s Fees


Kennebrew founded a private security company as an LLC, and Kennebrew was initially the sole manager and member. The parties executed a management agreement under which Harris obtained a 40% interest in the LLC. After a short time, the parties became dissatisfied with each other, and Harris notified Kennebrew of his intent to withdraw. The LLC accepted Harris’s withdrawal, and the parties could not agree on the amount that Harris was owed. Harris sued Kennebrew and the LLC. The trial judge entered a judgment rescinding the management agreement, concluding there was an oral loan agreement between the parties, and holding Kennebrew and the LLC liable to Harris for damages and attorney’s fees. All parties appealed, and the court of appeals held that the trial court erred in rescinding the management agreement, that there was no oral loan agreement but that Harris was entitled under the management agreement to be repaid for amounts spent on the LLC’s behalf, and that Harris was entitled to be paid the value of his interest in the LLC as a result of his valid withdrawal as permitted by the company agreement and management agreement. Kennebrew argued on appeal that there was no basis to hold him personally liable for the amounts owed to Harris, and the court of appeals agreed. Both the funds advanced by Harris to the LLC and the distribution owed for the value of his interest were liabilities only of the LLC. The attorney’s fees were based on Harris’s recovery for breach of contract under Section 38.001(8) of the Texas Civil Practice and Remedies Code. To recover attorney’s fees under that provision, a party must prevail on a breach-of-contract claim and recover damages. Because Harris was entitled to damages for breach of contract only from the LLC, the court concluded there was no basis to hold Kennebrew jointly and severally liable for attorney’s fees. The court noted that a provision of the management agreement also permitted recovery of attorney’s fees, but Harris did not rely on that provision at trial or on appeal.


Sumer Pinglia sued Jaikishin and Nanik Bhagia alleging various wrongful acts in connection with two transactions involving certain apartment complexes. One of the transactions involved the acquisition and development
by Pinglia and the Bhagias of an apartment complex which was held by them in an LLC formed for that purpose. Pinglia sued the Bhagias for breach of fiduciary duty and sued the LLC seeking access to its books. In a post-trial motion, the LLC sought to recover one-third of its litigation expenses from Pinglia under the LLC’s regulations (i.e., company agreement). According to the LLC, the regulations provided that all allocations of income, gain, deduction, loss, and credit were made in accordance with the interest of each member. The LLC contended that Pinglia, a 1/3 member, was thus responsible for one third of the LLC’s litigation expenses. The court of appeals stated that it was unclear what expenses the LLC sought. In Pinglia’s post-trial filings, Pinglia indicated that he was successful in obtaining relief on his claim for access to the LLC’s books. At a hearing on attorney’s fees, the evidence and argument apparently focused on another defendant’s claim for attorney’s fees against Pinglia as sanctions. The LLC presented no evidence of any expenses it incurred for which Pinglia was purportedly responsible under the regulations. In the absence of evidence or argument by the LLC at the hearing on attorney’s fees, the trial court did not err in denying the LLC’s request.


Two cardiologists, Guniganti and Pokala, owned an out-patient laboratory known as East Texas Cardiovascular Labs, L.L.C., and they signed regulations (i.e., a company agreement) governing operation of the LLC. Among the various claims asserted in this litigation was a claim by Pokala to recover distributions from the LLC for 2006 until the date of trial under provisions of the regulations providing for net cash flow for each fiscal year to be distributed to Guniganti and Pokala in proportion to their sharing ratios. The jury found that the LLC failed to distribute to Pokala his share of net cash flow for 2009, but the trial court refused to submit a jury question on Pokala’s breach of contract claim for failure to distribute his portion of net cash flow for the years 2006 through 2008. The court of appeals concluded that there was sufficient evidence to support the jury’s finding that the LLC failed to distribute to Pokala his share in 2009 and that the issue of Pokala’s entitlement to a distribution for 2006-2008 was conclusively established against him as a matter of law. Because LLC regulations are a contract and Pokala prevailed on his claim for payment of a distribution for 2006 under the regulations, the court of appeals upheld the award of attorney’s fees to Pokala with respect to that issue under Texas Civil Practice and Remedies Code § 38.001(8).


An LLC sued Potter, one of its members, to enforce a capital call. Potter argued that the regulations did not obligate him to make additional capital contributions without his consent. Potter filed suit against the other members, alleging breach of fiduciary duty, fraud, and negligent misrepresentation claims. The suits were consolidated and tried to a jury. The regulations were ambiguous as to whether additional capital contributions were required of members who objected. The jury found Potter was obligated to make the capital contribution. The jury found for Potter on his breach of fiduciary claim against one of the other members. The trial court awarded the LLC attorney’s fees against Potter. Potter argued that the LLC was not entitled to recover attorney’s fees on its claim that he failed to make the required capital call. Alternatively, Potter argued that he was entitled to recover attorney’s fees on his breach of fiduciary duty claim if the LLC was entitled to recover attorney’s fees on its claim. The court of appeals concluded that the LLC’s regulations were a contract and that the LLC’s claim was precisely the type of claim for which attorney’s fees are recoverable under Section 38.001(8) of the Texas Civil Practice and Remedies Code. The court stated that the legislature intended to allow attorney’s fees to be recoverable by persons who are wronged as a result of a breach of contract and forced to bring suit to collect damages. The court concluded that Potter was not entitled to recover attorney’s fees. Potter argued that the breach of fiduciary duty was incidental to the LLC regulations, but the court concluded Potter’s claims for breach of fiduciary duty were not founded on the contract.

_AA. Arbitration_


Lyon, the author and director of a film, objected to being compelled to arbitrate because there was no arbitration clause in the contracts he signed with the other parties in this dispute. The court held that Lyon was bound by the arbitration clause in an LLC operating agreement on a direct-benefits estoppel basis because he “knowingly exploited” the LLC operating agreement containing the arbitration clause. The LLC was formed for the purpose of developing and producing Lyon’s film, and Lyon assigned his copyright to the film to the LLC, sold his literary rights in the film to the LLC, and entered into a direct services agreement with the LLC under which Lyon would provide services and be paid.

In 2008, a corporation adopted an “Arbitration Policy and Agreement,” which it required its employees to sign to continue employment. In 2010, the corporation converted to an LLC. Later that year, the LLC terminated the employment of Yazhari, and Yazhari sued the LLC and its owner asserting numerous causes of action. The defendants moved to compel arbitration, and Yazhari resisted arbitration on various grounds. One argument Yazhari made was that neither the LLC nor its owner were parties to the arbitration agreement because the arbitration agreement did not refer to members, successors, or assigns, and the LLC was not in existence in 2008. The court of appeals pointed out that the Texas Business Organizations Code provides that when a conversion takes effect, “the converting entity continues to exist without interruption in the organizational form of the converted entity” and that “all liabilities and obligations of the converting entity continue to be liabilities and obligations of the converted entity in the new organizational form without impairment or diminution because of the conversion.” Thus, the corporation did not cease to exist when the certificate of conversion was filed with the Secretary of State, and the LLC as the converted entity was entitled to enforce the arbitration agreement to the extent the parties formed an agreement. Further, because the agreement applied to “[a]ny controversy between Employee and the Company or any of its owners, employees, officers, agents, affiliates or benefits plans,” Yazhari’s claims against the individual owner and president were within the scope of the agreement.


Investors in an LLC filed suit against the LLC and two individuals, and the defendants moved to compel arbitration based on an arbitration clause contained in the regulations and operating agreement of the LLC provided to the investors when they invested in the LLC. The trial court never ruled on the motion to compel arbitration and granted summary judgment in favor of the plaintiffs. The defendants appealed arguing that it was improper to grant summary judgment without ruling on the motion to compel arbitration. The plaintiffs argued that the trial court was not required to rule because the defendants did not request a hearing or object to any refusal by the trial court to rule. The court of appeals held that the trial court had a ministerial duty to rule on the motion to compel arbitration, and the court of appeals thus reversed the summary judgment and remanded to the trial court for a hearing on the defendants’ motion to compel arbitration.


A Delaware LLC sued a former member/manager of the LLC asserting various claims for debt, theft, and breach of fiduciary duty, and the former member sought to compel arbitration based on an arbitration clause in the company agreement. The arbitration clause addressed disputes and disagreements by “Members,” and the definition of a “Member” in the company agreement excluded “any Person who has ceased to be a Member.” The former member acknowledged that he had voluntarily resigned and relinquished his position as a member before the suit was filed, but he argued that his resignation did not preclude him from compelling arbitration because the dispute involved acts that allegedly occurred while he was a member and manager of the LLC. The former member relied on cases holding that an arbitration agreement contained in a contract survives the termination or repudiation of the contract, but the court concluded that these cases were distinguishable because they did not involve provisions expressly limiting application to disputes or disagreements between “Members” and expressly defining “Member” to exclude any person “who has ceased to be a Member.” The former member also argued that the LLC could be compelled to arbitrate its claims, even though it did not separately sign the company agreement, because the LLC was bound by the company agreement and because the LLC artfully pled claims belonging to the other member in order to avoid arbitration. Because the court determined that the former member did not have the right to compel arbitration, the court did not reach this issue.


The appellants, members of a Delaware LLC, initiated an arbitration against the majority members of a subsidiary Delaware LLC in relation to a dispute over the ownership and control of the two companies. The trial court granted a stay in favor of the appellees, finding that the dispute contained no arbitrable issues. The court of appeals held that the trial court properly exercised jurisdiction to determine the scope of arbitrability of the issues but erred in granting the stay. The court of appeals discussed and applied Delaware law to determine whether the arbitration clauses contained in the LLC agreements of the LLCs provided for the arbitrator or a court to determine the question of arbitrability of a particular dispute. Under Delaware Supreme Court precedent, a reference to the AAA rules in an arbitration agreement serves as the type of clear and unmistakable evidence that the parties agreed to submit the question of arbitrability to the arbitrator. The clauses in this case referred disputes to arbitration under the AAA rules but
contained a significant exception for “ancillary measures in aid of arbitration and for proceedings to obtain provisional remedies and interim relief, including injunctive relief.” Where this type of exception is included, something more than mere reference to the AAA rules is needed to show the parties clearly and unmistakably intended to delegate arbitrability to the arbitrator rather than the court. The court said that the dispute here fell within the carve-outs because the appellees sought to enjoin the appellants from proceeding in arbitration. After determining that the trial court had jurisdiction to determine arbitrability, the court of appeals turned to the question of whether the underlying dispute raised arbitrable issues. The court of appeals concluded that it did. The appellants challenged a merger of the subsidiary LLC into the parent LLC, and this claim plainly related to the LLC agreement of the subsidiary. The appellants’ demand for rescission of a restructuring agreement providing for the restructuring and recapitalization of the subsidiary LLC would change the ownership of the subsidiary and likewise fell within the broad scope of the arbitration clause. The court agreed with the appellants that nothing in the restructuring agreement negated the arbitration clauses in the LLC agreements or even addressed dispute resolution at all. The court of appeals held that the trial court did not err in staying arbitration as to one party who was never a member of either LLC and thus was not a party to the LLC agreements and not bound by the arbitration clauses in the agreements. The trial court erred in staying the arbitration as to a party who was not originally a member but became a member of the subsidiary LLC under the restructuring agreement that appellants sought to rescind. Because rescission of the restructuring agreement would affect ownership and control of the subsidiary LLC, the remedy was inherently linked to the rights, duties, and obligations in the LLC agreement and subject to the arbitration clause. The court of appeals also held that the trial court erred in staying the arbitration with respect to the subsidiary LLC itself. Under Delaware case law, an LLC is bound by the arbitration provisions of its own founding agreement.


Main Carr Development, LLC (“MCD”), a Delaware series LLC, was organized to engage in the development of real estate. The operating agreement identified MCD’s manager as Main Christian Brothers Development (“MCBD”), a Texas LLC. The agreement reflected that Carr was a director of MCD and provided for the establishment of eleven series LLCs to own and lease the projects contemplated by the agreement. The operating agreement did not contain an arbitration clause, and MCD did not sign the agreement. Carr, Christian Brothers Automotive Corporation (“CBAC”), and MCBD entered into a development agreement to provide for the development of projects. The development agreement contained an arbitration clause, but MCD was not a signatory to this agreement. The development agreement referred to the ownership of joint development projects “by a Delaware Series Limited Liability Company” and a buy-sell provision “more particularly described in the Operating Agreement of such Delaware Series Limited Liability Company,” but the development agreement did not specifically name MCD. MCD sued Carr, alleging breach of fiduciary duties owed under Delaware law to MCD, its series, and its members in connection with the development agreement. Carr demanded arbitration, but the trial court denied the motion to compel. On appeal, the issue for the court to resolve was whether MCD was bound to the arbitration clause as a nonsignatory. The theories addressed by the court were that MCD was third-party beneficiary of the development agreement or was estopped from avoiding arbitration because it sought and obtained benefits from the development agreement.

For a nonsignatory to be bound to an arbitration clause under the third-party beneficiary theory, there must be an intent to confer a direct benefit upon a third party that is clearly and fully spelled out. The court found the reference to “a Delaware Series Limited Liability Company” and a buy-sell provision “more particularly described in the Operating Agreement of such Delaware Series Limited Liability Company” were not specific enough to show a clear intent to refer to MCD. The court also rejected the argument that a carve-out of the section referencing the Delaware series LLC in the no third-party beneficiary clause of the development agreement demonstrated that the parties intended to make the Delaware series LLC a third party beneficiary. The court did not view the no third-party beneficiary clause or the provisions carved out as pertaining to MCD, and the court rejected other arguments made by Carr that MCD was an intended beneficiary based on an interrelationship of the development agreement and operating agreement.

With respect to the estoppel theory, the court concluded that MCD’s breach of fiduciary duty claim against Carr was not dependent upon the development agreement, and if the breach of fiduciary duty claim somehow related to the development agreement, the relationship was not sufficient to compel arbitration. The court characterized the breach of fiduciary duty claim as arising from general obligations imposed by Delaware law and as capable of determination without reference to the development agreement. To the extent MCD’s breach of fiduciary duty claim might require reference to a contract, the court stated that it would be the operating agreement rather than the development agreement. In sum, the court concluded that MCD’s breach of fiduciary duty claim against Carr did not depend upon a showing that Carr breached the development agreement. Further, the benefits realized by MCD, if any, were insufficient to satisfy the direct benefits estoppel test because the test does not apply where the benefits are insubstantial or indirect. Thus, the estoppel theory did not preclude MCD from suing Carr.
In re Wolff, 231 S.W.3d 466 (Tex. App.—Dallas 2007, no pet.).
The court ordered de novo review of a prior order compelling arbitration under the provisions of LLC regulations.

The court held that the arbitration clause in the regulations of a two-member LLC did not require arbitration of claims against a separate corporation that contracted to manage the apartment complex owned by the LLC even though the corporation was owned by the members of the LLC and its only activity was managing the sole asset of the LLC.

LLC regulations contained an arbitration clause the validity of which was not disputed. The issue was whether the right to arbitrate had been waived, and the court held that it had not.

BB. Personal Jurisdiction

An Iowa LLC challenged the trial court’s exercise of personal jurisdiction over the LLC, and the court of appeals affirmed the trial court. The question was whether the actions of Cox, a Texas resident and member of the LLC, were attributable to the LLC for purposes of specific jurisdiction. Under the Iowa LLC statute, a person is not necessarily an agent simply because the person is a member, but the statute provides that a person’s status as a member does not prevent other law from imposing liability on the LLC because of the person’s conduct. The court of appeals relied heavily on an Iowa court of appeals decision, Three Minnows, LLC v. CREAM, LLC, which explained that an Iowa LLC is presumed to be managed by its members unless the members agree that the LLC will be managed by managers. As the court in Three Minnows further explained, the party asserting an agency relationship must prove its existence, and an agency results from manifestation of consent by a principal that an agent shall act on the principal’s behalf and subject to the principal’s control and consent by the agent to do so. In Three Minnows, where the LLC was manager-managed, a member did not have authority to bind the LLC to a contract. The LLC’s articles of organization in that case expressly provided that no member, agent, or employee of the LLC had any power to bind the LLC unless authorized by the operating agreement or the managers of the LLC. Here, by contrast, the LLC’s operating agreement provided that the LLC’s business and management was to be exercised by the members. Although the members were permitted to delegate to officers, the officers remained subject to the direction and control of the members. Thus, the court concluded that Cox had express authority to act on behalf of the LLC. The LLC argued that it did not control Cox and that Cox was not its agent for purposes of the jurisdictional analysis, but the operating agreement expressly provided that the management of its business would be conducted solely by its members. Cox was recruiting dealers to contract with the LLC, and the court relied on the general rule that the actions of a corporate agent are generally deemed the corporation’s acts. As a member of a member-managed LLC with express authority to conduct the LLC’s business, Cox was the LLC’s agent. As an agent, he recruited dealers to contract with the LLC, and the LLC contracted with recruited dealers, evidencing both the LLC’s consent for Cox to act and Cox’s consent to do so. The LLC, not Cox, controlled the terms of the contractual relationships with the recruited dealers. Thus, the court concluded that Cox’s contacts with Texas were attributable to the LLC for purposes of the specific jurisdiction analysis. The court went on to find the other requirements for the exercise of specific jurisdiction were met as well, i.e., that the contacts were purposeful and were done to obtain a benefit for the LLC, and the exercise of jurisdiction would not offend notions of fair play and substantial justice.

Guarino v. 11327 Reeder Road, Inc., No. 05-12-01573-CV, 2013 WL 4478202 (Tex. App.—Dallas Aug. 20, 2013, no pet.) (mem. op.).
The plaintiff argued that Guarino, a nonresident individual, and Guarino’s Rhode Island corporation were subject to personal jurisdiction in Texas on the basis that an LLC tenant that defaulted on a lease with the plaintiff in Texas was the alter ego of Guarino and the Rhode Island corporation. The court of appeals set forth the test for alter ego in the personal jurisdiction context and listed the types of evidence that a court will consider as proof of alter ego. The plaintiff presented no evidence of this type. An individual’s status as an officer, director, or majority shareholder is not alone sufficient to support a finding of alter ego, and there was no evidence that Guarino was an officer, director, or
Injured on the job. The court said that this allegation of ownership standing alone was insufficient to establish an alter ego theory as a form of "jurisdictional veil piercing." The Texas Supreme Court has held that, to disregard the corporate fiction and "fuse" a parent and subsidiary, a plaintiff must demonstrate a degree of corporate formality and the degree of the parent's control, the testimony showed a high degree of control, but the court concluded that exercise of jurisdiction over the parent would be necessary to prevent fraud or injustice.


The court concluded that personal jurisdiction over the parent of an LLC (previously organized as a corporation) was lacking. Although the subsidiary had extensive contacts with Texas, the evidence did not show that the parent and its subsidiary should be fused for jurisdictional purposes. The court examined the factors relied on by the Texas Supreme Court when determining whether a subsidiary is separate and distinct from its parent corporation for jurisdictional purposes. Although it was undisputed that the parent's wholly owned subsidiary owned 100% of the LLC's "stock," the subsidiaries maintained separate headquarters from the parent. With respect to the extent of observance of corporate formalities and the degree of the parent's control, the testimony showed a high degree of control, but the court concluded that the testimony did not establish that the parent controlled the internal business operations and affairs of the subsidiary such that exercise of jurisdiction over the parent would be necessary to prevent fraud or injustice.


The plaintiff sued the managing member of a Delaware LLC who signed a deed and an agreement for the purchase and sale of the property, alleging DTPA, fraud, and breach of contract claims. The plaintiff alleged that the managing member actively concealed problems with the property of which he had personal knowledge. The managing member filed a special appearance, and the trial court granted it and dismissed the claims against him for lack of jurisdiction. The plaintiff argued on appeal that the trial court erred because the managing member committed torts in Texas subjecting him to specific jurisdiction. The court of appeals discussed the fiduciary shield doctrine, under which an individual's transaction of business within the state solely as a corporate officer does not create personal jurisdiction over the person. The plaintiff argued that the managing member was not protected by the doctrine because his misrepresentations as an agent of the LLC subjected him to individual liability. The court concluded that the factual basis for the tort causes of action were alleged breaches of the provisions of the purchase and sale agreement and that the alleged loss or damage dealt with the property that was the subject of the contract. Thus, the managing member did not commit independent torts that would subject him to specific jurisdiction. The managing member showed that he was not personally a party to the contract, signed in his representative capacity, and had no separate and independent duty to the plaintiff. Further, he did not do business in Texas or engage in any transactions in Texas in his individual capacity, was not a resident of Texas, was not required to maintain a registered agent in Texas, was served with process outside of Texas, did not maintain a place of business in Texas, and had no employees, servants, or agents in Texas. Thus, there was sufficient evidence to support the trial court's judgment. The court also held that the trial court did not have specific jurisdiction because the managing member did not have the necessary minimum contacts and did not purposefully avail himself of the privilege of conducting activities within Texas.


An employee of a nursing home asserted negligence claims against her employer and numerous related entities based on an alleged workplace injury suffered by the employee. The employee added two individual defendants and alleged claims for conspiracy and alter ego theory against the individuals. The trial court granted special appearances by the individual defendants, and the employee appealed. The court of appeals interpreted the employee's argument to be that, through a chain of entities, the court could establish jurisdiction over a Delaware LLC, and by reaching the LLC extend jurisdiction to the individuals because they were managing members of the LLC. The court noted that Texas courts have applied to LLCs the same state-law principles for piercing the veil that apply to corporations. Here, the employee sought to use the alter ego theory as a form of "jurisdictional veil piercing." The Texas Supreme Court has held that to disregard the corporate fiction and "fuse" a parent and subsidiary, a plaintiff must demonstrate a degree of control by the parent entity exceeding that normally associated with common ownership and directorship by means of evidence showing that the entities ceased to be separate. According to the court, the employee pleaded only that the individuals "were managing members of Canyon Sudar Partners, LLC and Canyon Sudar is the sole member of Svcare Holdings, LLC, which is the sole member of SavaSeniorCare, LLC, which owns 100% of SSC Equity Holdings, LLC, which is the sole member of SSC Submaster Holdings, LLC, which owns 100% of the equity of SSC Greenview Operating Company, GP, LLC, which operates the Waco nursing home where the appellant worked and was allegedly injured on the job." The court said that this allegation of ownership standing alone was insufficient to establish an alter ego theory as a form of "jurisdictional veil piercing."
ego relationship. The employee presented no jurisdictional facts to the district court establishing minimum contacts with Texas, and the individual defendants provided affidavits negating all bases of jurisdiction. Thus, the district court did not err in granting the special appearances.


This case involved a dispute over whether the trial court had personal jurisdiction over a nonresident manager of a foreign limited liability company when the LLC had forfeited its certificate of authority for failure to pay its Texas franchise tax. In 2009, ACS Partners, LLC (“ACS”) contracted with two Delaware limited partnerships to perform improvements on two apartment complexes in Houston. Alleging it did not receive payment under the contracts, ACS sued GFI Houston Holdings Management, LLC (“GFI”) and Allen Gross. GFI, a general partner of the two limited partnerships, was a Delaware LLC. Gross was a manager of GFI residing in New York. ACS alleged that GFI was subject to personal jurisdiction of the court because GFI did business in Texas. As to Gross, ACS contended that jurisdiction was proper because GFI’s certificate of authority had been forfeited in 2005, and under an alter ego theory GFI’s jurisdictional contacts were imputed to Gross. Gross filed a special appearance supported by a sworn affidavit in which he testified that he was an employee of GFI, had a business address in New York, and lived in New York all his life. Gross denied having sufficient contacts with Texas or the underlying litigation to be subject to personal jurisdiction in Texas, and he presented affidavits showing that GFI was not the general partner at the time the contracts were executed. At the hearing on the special appearance, ACS argued that because GFI had failed to satisfy all of its franchise tax requirements, Section 171.255(a) of the Tax Code – which under certain circumstances makes corporate directors and officers liable for corporate debts incurred after a tax becomes due but is unpaid – operated to make Gross personally liable for the debts of GFI and conferred personal jurisdiction over Gross. ACS claimed that personal jurisdiction could be asserted over Gross by virtue of GFI’s status as the officially registered general partner and the forfeiture of GFI’s certificate of authority. The trial court granted Gross’s special appearance and dismissed him from the suit for lack of jurisdiction.

On appeal, the appellate court found that ACS did not allege that Gross performed any actions so as to come within the Texas long-arm statute, and Gross met his burden of proof to negate personal jurisdiction based on his own forum contacts by means of his sworn affidavit that he did not and had never lived in Texas. However, ACS also alleged personal jurisdiction over Gross was proper based on an alter ego theory. The court explained that a presumption of legal separateness between an LLC and its managers existed, and ACS had the burden to prove facts that would justify imputing GFI’s contacts with the forum to Gross such that the contacts of GFI and Gross should be fused for jurisdictional purposes. ACS did not premise its jurisdictional veil-piercing theory on the traditional alter ego doctrine in which the plaintiff must show that one of two entities exerted a level of control over the other such that in reality they constituted the same entity. Instead, ACS contended that Gross was subject to personal jurisdiction in Texas based on Section 171.255(a) of the Texas Tax Code. The Tax Code provides in relevant part that if the corporate privileges are forfeited for the failure to file a report or pay a tax or penalty, then each director or officer of the corporation is liable for each debt of the corporation that is created or incurred in Texas after the date on which the report, tax, or penalty is due and before the corporate privileges are revived. ACS argued that the forfeiture of GFI’s certificate of authority pursuant to this Tax Code provision meant that GFI’s contacts in Texas were imputable to Gross for jurisdictional purposes. The appellate court disagreed. The court considered the plain language of the statute and strictly construed the statute so as to protect those individuals against whom liability was sought. Section 171.255 does not create a basis for asserting personal jurisdiction over a nonresident officer or director of an entity that enjoyed or once enjoyed corporate privileges in Texas. The statutory provision does not mention jurisdiction in any way. The court explained that a crucial distinction existed between liability and personal jurisdiction. Even if ACS proved that GFI’s corporate privileges had been forfeited, that established the potential liability of GFI’s officers or directors but not personal jurisdiction over them. A defendant’s potential liability to a plaintiff is not dispositive of the personal jurisdiction requirement. The appellate court concluded that Section 171.255 of the Texas Tax Code did not provide an independent basis for personal jurisdiction over Gross, a nonresident defendant. Because ACS failed to suggest any other factual basis for asserting personal jurisdiction over Gross, the appellate court affirmed the order of the trial court granting Gross’s special appearance and dismissing him from the suit.


The court addressed the enforceability of a forum selection clause in an agreement referred to as a “partnership agreement” in the opinion but which appeared to be an LLC agreement of a Nevada LLC. [The court stated that the
“agreement formalized Hill’s position with iDesta USA, LLC, a Nevada limited-liability company,” and a quoted portion of the agreement referred to the “Company,” which the court noted was defined in the agreement as iDesta USA.] The court first addressed whether Marrocco signed the agreement in his individual capacity so as to be personally bound by the agreement, and the court concluded that he did. The court next addressed Marrocco’s argument that the forum selection clause in the agreement was “inherently unjust” because it required Marrocco, a U.K. resident who allegedly had no contacts to Texas other than the agreement at issue, to litigate in Texas. The court held enforcement of the forum selection clause was neither unreasonable nor unjust because “Marrocco bargained away [his rights to assert lack of personal jurisdiction] by signing the partnership agreement with Hill and consenting to the agreement’s forum-selection clause.”


The court concluded that a New York resident who was a manager of the Texas LLC general partner of a Texas limited partnership, as well as the indirect 100% owner of a Delaware limited partnership that was an 80% limited partner, was subject to specific jurisdiction with respect to certain claims against him in a dispute over ownership of the Texas limited partnership and control of its operations. The court found that the plaintiffs alleged sufficient facts to support specific jurisdiction with respect to an interference with contract claim based on allegations that the New York resident, acting as manager of the Texas LLC, caused the limited partnership to sell Texas property, caused a distribution of those revenues to the limited partner owned by the New York resident, and withheld any distribution to the other limited partner. The court found that the plaintiffs alleged sufficient facts with respect to the fraud claim against the New York resident based on an alleged representation to the plaintiffs in Texas regarding the operation of the Texas entities. The New York resident conceded jurisdiction over the breach of fiduciary duty claims against him based on his position as manager of the Texas LLC. The court found the plaintiff’s allegations insufficient to support specific jurisdiction over several other claims. The court concluded that the New York resident purposefully directed his activities towards Texas as required for a Texas court to exercise specific personal jurisdiction over him with respect to the interference with contract and fraud claims based on his participation in the business of Texas entities formed to carry out business in Texas, the choice of Texas law provision in the limited partnership agreement, numerous visits to Texas to engage in activities related to the business, and numerous phone calls regarding the ongoing business.

_Citrin Holdings, LLC v. Minnis_, 305 S.W.3d 269 (Tex. App.–Houston [14th Dist.] 2009, no pet.).

A New York resident and a Delaware LLC wholly owned by the New York resident were subject to specific jurisdiction in Texas based on multiple Texas contacts and Texas-based contractual obligations. Also, two other foreign LLCs were subject to specific jurisdiction in Texas based on activities in Texas attributable to the LLCs.


The court concluded that two individuals’ contacts with Texas in connection with the activities of two LLCs fell within the scope of the fiduciary shield doctrine and thus provided no basis for the exercise of personal jurisdiction over the individuals. The court rejected the argument that the evidence showed the individuals used an LLC as their alter ego for personal interests, and the court thus declined to exercise personal jurisdiction over the individuals based on the LLC’s breach of contract.


The court examined the activities of an Arkansas LLC and held that the LLC was not subject to general or specific jurisdiction in Texas. The court looked to partnership law for guidance as to whether to attribute the member’s contacts to the LLC and concluded that the member’s unrelated contacts with Texas could not be attributed to the LLC to establish general jurisdiction.


The court of appeals concluded that the trial court was presented with sufficient evidence to make an implied finding that a Texas LLC was the alter ego of Cardenas, a prominent Mexican citizen, and that Cardenas was thus subject to the reach of the Texas long arm statute as someone who “did business” in Texas. The court noted the difference between “jurisdictional veil-piercing” and veil-piercing for the purpose of imposing liability. In a jurisdictional veil-piercing case, the court stated that it does not assess certain issues such as fraud and undercapitalization. Instead, the focus was on whether Cardenas controlled the internal business operations of the LLC to a degree “greater than that
normally associated with common ownership and directorship.” The business of the LLC was acquiring and selling trucks and related equipment, and the evidence was sufficient for the trial court to find that Cardenas was the alter ego of the LLC based on testimony that Cardenas gave personal assurances that he was “well-to-do” and there would be “no money problems with this type of business,” that Cardenas was so closely involved with the LLC business that he used its mailing address as his own and could almost always be reached by telephone when calling its phone number, and that, while the articles of organization did not distinguish between Cardenas and another individual as managing members, the other individual was in practice Cardenas’s subordinate and Cardenas was in charge of the business. There was also evidence that Cardenas negotiated with the plaintiff on behalf of the LLC, was virtually always present on the premises, owned the real estate on which the business was situated, and maintained an accountant at the facility to monitor the business at all times. The court stated that a business which is registered in Texas and has filed suit in Texas, such as the LLC in this case, is amenable to Texas jurisdiction because it has purposefully availed itself of Texas law, and, since the LLC was Cardenas’s alter ego, its amenability to suit was imputed to Cardenas.

The court concluded that a Maryland REIT, Delaware corporation, Delaware limited partnership, and Delaware LLC (each of which had its principal place of business in Ohio) did not constitute a single business enterprise that would subject the entities to personal jurisdiction based on a related partnership’s ownership of commercial properties in Texas. There was no evidence of undocumented transfers of funds, unclear allocation of profits and losses, or other lack of corporate distinctness, and it was not necessary to pierce the veil to prevent an inequitable result. (Note: The Texas Supreme Court subsequently rejected the single business enterprise theory as a basis to impose personal jurisdiction in PHC-Minden, L.P. v. Kimberley Clark Corp., 235 S.W.3d 163 (Tex. 2007), summarized above.)

The court held that the fiduciary shield doctrine precluded exercise of jurisdiction over non-resident officers of an LLC where their contacts were in a representative capacity and were not systematic or continuous, and the evidence did not show that the LLC was used to perpetrate fraud, was a fiction or sham, or was operated in a manner indistinguishable from the officers’ personal affairs or in a manner calculated to mislead those dealing with them.

The court held that it lacked personal jurisdiction over an individual who formed two Texas LLCs and made occasional visits to Texas where the LLCs had never maintained a principal place of business in Texas and conducted little business in Texas.

The court concluded that it lacked personal jurisdiction over a Florida LLC and its managing members.

The court held the evidence was insufficient to support the trial court’s finding that a Missouri LLC was the alter ego of its members (noting that failure to follow formalities is no longer a factor in considering alter ego under Texas corporate law), but the evidence supported exercise of specific jurisdiction over one of the LLC’s members based on alleged torts committed by the member in Texas.

Non-resident managers of a Texas LLC were subject to personal jurisdiction in Texas inasmuch as they attended several board meetings in Dallas and the claims against them were based upon their roles as managers of a Texas LLC. The plaintiff alleged that the managers were “control persons” and “aiders” under the Texas Securities Act and that they engaged in negligent conduct as managers.

The court rejected the argument that an individual who received an interest in an LLC pursuant to an agreement to sell the individual’s business to the LLC was subject to personal jurisdiction in Texas based on a forum selection clause in the agreement and the LLC regulations. The court held that allegations the individual was the alter ego of the corporate signatory to the agreement were merely conclusory. Though the individual signed the LLC regulations in his individual capacity, the court stated a forum selection clause is but one factor in determining minimum contacts.
Boissiere v. Nova Capital, LLC, 106 S.W.3d 897 (Tex. App.—Dallas 2003, no pet.).

The plaintiff sued a Delaware LLC and its agents individually in Texas. The individuals filed a special appearance. The plaintiff alleged that the individuals committed the torts of fraud and negligent misrepresentation. The court stated that the individuals may have been acting on behalf of the LLC but that corporate agents are liable for fraudulent or tortious acts committed while in the service of their corporation. The alleged misrepresentations occurred in telephone calls from California to Texas, with reliance (and thus the tort) occurring in Texas. The court determined that the Texas long-arm statute authorized the exercise of personal jurisdiction over the individuals and held that the exercise of jurisdiction satisfied due process requirements.


The court of appeals upheld the trial court’s exercise of jurisdiction over a non-resident individual on the basis that a Wisconsin LLC was the individual’s alter ego. The court discussed and applied Texas corporate veil piercing cases in its analysis. The court found “ample” evidence to support the alter ego finding, noting that the individual and LLC had the same address, the individual was the managing member of the LLC and no other member was disclosed, the LLC was capitalized with member contributions, the individual used personal funds for the benefit of the LLC without creating corresponding debt, and numerous checks were drawn on the individual’s account to pay drilling and other operational expenses of the LLC’s Texas well. The court ultimately referred to arguments regarding the TBCA veil piercing provisions and the Wisconsin LLC statutory provisions referring to common law veil piercing principles but determined that it need not reach these issues because it was not deciding whether the LLC was in fact the individual’s alter ego, only that the theory allowed the trial court to exercise jurisdiction over the individual.

Royal Mortgage Corp. v. Montague, 41 S.W.3d 721 (Tex. App.—Ft. Worth 2001, no pet.).

The court found that an individual and corporation were acting as agents of a foreign LLC and that their contacts with Texas were such that the court could exercise jurisdiction over the foreign LLC. The court concluded, however, that there was no basis to exercise personal jurisdiction over the LLC’s members. The plaintiff argued that the LLC was a partnership and that the liability of the partners for partnership debts subjected them to personal jurisdiction. The plaintiff relied upon the fact that the LLC filed a partnership return, but the court pointed to various documents referring to the company as an LLC. The court applied the principle that “a court may not assert personal jurisdiction over an individual based on the individual’s relation to a corporation unless the corporation is the individual’s alter ego.” The court stated that there was no evidence any of the LLC’s members had any individual contacts with Texas or that the LLC was acting as the alter ego of its members.


Two non-resident members of an LLC formed to develop oil and gas leases in Texas argued that they were not subject to personal jurisdiction in Texas in an action against the members for breach of contract and breach of fiduciary duty. The members argued that their contacts with Texas were made in their official capacities on behalf of the LLC and were thus insufficient to support jurisdiction over them individually. The court equated an LLC to a corporation in this context, stating that “[j]urisdiction over an individual generally cannot be based on jurisdiction over a corporation with which he is associated unless the corporation is the alter ego of the individual.” The court examined the record, however, and found that the individuals purposefully established minimum contacts with Texas in their individual capacities by negotiating personal rights in certain transactions and by breaching their contractual and fiduciary duties.


The court described the defendants as limited liability companies organized under the laws of Hong Kong and the People’s Republic of China. The court found the companies lacked sufficient contacts with the State of Texas to support general or specific jurisdiction. The court also rejected the plaintiff’s argument that the companies were the alter egos of one another and of a Texas corporation such that the Texas corporation’s contacts should be imputed to the foreign companies. The court noted both a lack of evidence and a lack of cited authority for the alter ego argument.
CC. Service of Process


The plaintiffs’ leases listed the owner of their apartments as “JIK Arbors of Las Colinas, LLC.” In pre-suit communications, the defendant’s attorney told the plaintiff’s attorney that “JIK Arbors of Las Colinas, LLC” was an assumed name for JIK Properties, Inc., a management company. After being unable to find any record of “JIK Arbors of Las Colinas, LLC” in the records of the Secretary of State or assumed name records in Dallas County, the plaintiffs sued “JIK Arbors” and served the Secretary of State as the defendant’s statutory agent. The Secretary of State forwarded the service to the address of the owner’s representative listed in the plaintiffs’ leases. Ultimately, it was revealed that the apartments were owned by several entities as tenants in common, and an agreement was reached under which these entities would enter the action as parties and that their counsel would accept service on their behalf. The defendants removed the action, and the date of service became important in determining whether removal was timely. The court stated that the plaintiffs’ pleading was sufficient to make out a basis for service on the Secretary of State under Section 5.251(1) of the Texas Business Organizations Code since they pled that the defendant was a foreign limited liability company that did not have a registered agent listed with the Secretary of State. The defendants contended that the plaintiffs were required to plead that the defendant transacted business in Texas. The court stated that this requirement was met by allegations that the defendant entered into lease agreements with the plaintiffs.


The court noted that the Business Organizations Code provides that a domestic or foreign LLC is required to maintain a registered agent for service of process in Texas. The court stated that each member of an LLC is an agent for service of process as a matter of law. (This broad statement fails to indicate that the Business Organizations Code provides that a member is an agent for service of process only if the LLC is member-managed; if an LLC is manager-managed, each manager is an agent for service of process.) The court also pointed out that the Business Organizations Code provides that the Secretary of State serves as agent for service of process if an entity fails to designate a registered agent. The court thus summarized the potential methods of service of process on an LLC as follows: (1) service on a registered agent; (2) service on a member of the LLC; or (3) long-arm service through the Secretary of State. In addition to citing the Business Organizations Code, the court cited Section 17.044 of the Civil Practice and Remedies Code and Rules 106 and 108 of the Texas Rules of Civil Procedure. In this case, there were problems effectuating proper service on the LLC defendant, but the defendant voluntarily appeared and removed the case, thus rendering the issue moot.


An LLC challenged a default judgment rendered after the LLC was served by substituted service on the Secretary of State, and the court of appeals upheld the judgment, holding that the plaintiff complied with the requirements of Section 5.251(1)(B) of the Texas Business Organizations Code. The process server first attempted to serve the LLC’s registered agent at the registered address on file with the Secretary of State but found the property vacant. The process server then attempted service several times at another address, but the registered agent was reportedly out of the country for a few weeks. The process server recommended service upon the secretary of state, and a second process server delivered duplicates of the citation and the original petition to the Secretary of State. The plaintiff obtained a default judgment after filing a motion with attached certification from the Secretary of State that a copy of the citation and original petition was received and forwarded to the LLC at the registered address. The process was returned to the Secretary of State bearing the notation “Not Deliverable As Addressed, Unable To Forward.” The plaintiff also filed a certificate of last known address listing the registered office address as the registered agent’s address. In this restricted appeal, the LLC alleged numerous errors on the face of the record. The LLC first argued that the process server failed to exercise reasonable diligence because he did not inquire as to when the registered agent would return from being out of the country or attempt to serve the registered agent at a third address where the plaintiff allegedly knew the registered agent could be found. The court of appeals rejected this argument, stating that the process server was not required to attempt to find the registered agent at any address other than the address of the registered office. Attempts made at a second address or any other address were unnecessary and irrelevant to the court’s consideration of reasonable diligence. Because the property where the registered office was located was vacant, any other attempts at that address would have been futile; thus, the one attempt made at that address was sufficient to show the registered agent could not be found with reasonable diligence at the registered office. The plaintiff also argued that the plaintiff failed to file a motion requesting substituted service or obtain an order by the trial court permitting substituted service under Rules 106(b) and 107 of the
Texas Rules of Civil Procedure. The court held, however, that Section 5.251 is independent of Rules 106(b) and 107 and allows for substituted service on the Secretary of State when reasonable diligence is shown. Thus, the plaintiff was not required to file a Rule 106(b) motion, nor was the process server required to effectuate a return in compliance with a court order under Rule 107. Finally, the LLC argued that the certificate of last known address filed by the plaintiff was false because the plaintiff knew the registered agent’s residential address. This information did not appear in the record, however, and error must be apparent on the face of the record in order to prevail in a restricted appeal. In sum, based on the record, the plaintiff satisfied Section 5.251(1)(B) for substituted service, and the certificate from the Secretary of State conclusively established that process was served. The trial court’s default judgment was thus affirmed.


An LLC contended that the plaintiff failed to properly effect service of process. The court stated that Federal Rule of Civil Procedure 4(h) sets forth the acceptable methods of serving an LLC. The plaintiff did not refute its failure to comply with Rule 4(h)(1)(B) or the failure to comply with the requirements of Texas law as allowed by Rule 4(e)(1), but the plaintiff argued that it properly served the LLC by complying with Oregon law. Because Rule 4(e)(1) and 4(h)(1)(A) provide for service of process in accordance with the law of the state in which service is made, the plaintiff complied with the rule by serving the LLC in accordance with the Oregon rules.


The court held that discrepancies in the names on the cross-claim, citation, and return did not render service improper where the LLC designators varied only slightly and did not suggest a different entity than that listed in the petition was served.


Service on an LLC was defective where it was addressed to the LLC’s registered agent, but an individual other than the registered agent signed the return receipt. The court concluded service was improper under Rules 106 and 107 of the Texas Rules of Civil Procedure. The court referred to the LLC as a “limited liability corporation” and also referenced provisions of the Texas Business Corporation Act, which were apparently relied upon by the plaintiff, in its discussion.


The court held that the Texas Limited Liability Company Act, which provides for service on an LLC by serving a manager or its registered agent, does not provide for effective service by serving the personal assistant of a manager or registered agent. The court also noted that the plaintiff cited no authority for the proposition that Section 17.021 of the Texas Civil Practice and Remedies Code, which provides for service on individuals, partnerships, and unincorporated associations, applies to LLCs.


An LLC appealed a default judgment arguing based on improper service of process. The petition and citation identified the LLC’s registered agent as “Mr. Chris Lytle,” but the return recited that the citation was executed by delivery to “Christopher Lytle.” The court stated that it could not tell whether “Mr. Chris Lytle” and “Christopher Lytle” were the same or different persons. The court did not view the difference between “Chris” and “Christopher” as just a “slight variance.” Because proper service was not affirmatively shown and error existed on the face of the record, the default judgment against the LLC was void.


The court reversed a default judgment against a foreign LLC because the plaintiff did not plead facts necessary to show that the Texas Secretary of State was the LLC’s agent for service of process under the applicable long-arm statute, Tex. Civ. Prac. & Rem. Code § 17.044, and nothing in the record established the strict compliance required under the statute.
The court found that, assuming *arguendo* the defendant Delaware LLC was not subject to the Texas Limited Liability Company Act requirement to maintain a registered agent in Texas, the plaintiff’s attempted service on the LLC failed to comply with the requirements of the Texas long-arm statute permitting service on a “person in charge.”

The plaintiff sued “Rehab 2112, L.L.C., d/b/a Rehab 2112, North Texas MRI, and White Rock MRI.” The suit was brought for breach of contract based upon three contracts the plaintiff made with the defendant doing business under one of its assumed names. The trial court granted summary judgment against the defendant, and the defendant appealed. The defendant contended that North Texas Open MRI, L.L.C. and White Rock Open MRI, L.L.C. were separate limited liability companies and that the trial court did not have jurisdiction to enter judgment against them because they were not properly served and did not appear or waive service. The court of appeals affirmed the trial court’s judgment, holding that the judgment was not against North Texas Open MRI, L.L.C. and White Rock Open MRI, L.L.C. The judgment was against Rehab 2112, L.L.C., doing business as Rehab 2112, North Texas MRI, and White Rock MRI, and the trial court had jurisdiction over this entity. The defendant appeared and filed an answer and a counterclaim under the assumed names alleged in the petition, and it did not file a verified denial of the capacity in which it was sued, of the execution of the contracts on its behalf, or that it was doing business under an assumed name as alleged. Furthermore, the defendant did not submit any summary judgment proof indicating the agreements were with separate legal entities rather than assumed names of the same company.

**Redwood Group, LLC v. Louiseau**, 113 S.W.3d 866 (Tex. App.—Austin 2003, no pet.).
The court held the record did not show compliance with the statutory requirements for serving a foreign LLC by serving the Secretary of State.

**DD. Venue**


In applying the federal venue statute, the court recognized that 28 U.S.C. § 1391(d) refers only to a “corporation,” but felt compelled to follow the precedent that reads the “corporation” language to refer to unincorporated entities like LLCs. The court noted that basic principles of statutory construction (i.e., to follow the plain language and give meaning to different language in the statute) would seem to require applying Section 1391(d) only to corporations in view of the much broader reference to “an entity with the capacity to sue and be sued in its common name under applicable law” in Section 1391(c). The court explained the history and development of the language in subsections (c) and (d). In the Venue Clarification Act of 2011, Congress codified a judicial interpretation of language in prior subsection (c) (pursuant to which the courts had included unincorporated associations like partnerships and LLCs in the term “corporation”) by adding the phrase “whether or not incorporated” in subsection (c)’s general residence provision, but Congress also moved the multi-district rule into a separate subsection (d), which retained the prior use of “corporation.” The failure to include unincorporated associations in subsection (d) has been characterized by commentators as an oversight.


In discussing the scope of 28 U.S.C. § 1391(c) in an opinion addressing appropriate venue of a claim against an LLC, the court noted that the wording of § 1391(c) appears to apply only to corporations but that it is generally accepted that unincorporated business associations such as partnerships and limited liability companies are analogous to corporations for venue purposes.

**EE. Standing or Capacity to Sue**


In this patent infringement action, one of the plaintiffs, a Delaware LLC, was formed by its Delaware parent corporation, one day before this suit was filed. The defendant argued that the LLC lacked standing because Section 9.001 of the Texas Business Organizations Code requires a foreign entity to register with the Secretary of State in order to transact business in Texas, and the LLC did not register until more than 2 months after the suit was filed. Section 9.051
of the Texas Business Organizations Code provides that a foreign filing entity may not maintain an action in a court of Texas unless it is registered as required by the statute. The court first noted that it was not clear whether the Business Organizations Code requires a foreign entity to register before pursuing a federal action in federal court. The court commented that a federal court may be a court “of” this state when sitting in diversity or otherwise applying state law, but it was hard for the court to see how a federal court adjudicating a cause of action arising under federal law could be considered a court “of” Texas. The court also pointed out that Section 9.251 distinguishes “transacting business in interstate commerce” from transacting business “in this state.” The court found it unnecessary to undertake this interpretation of the Texas statute because it concluded that the court had subject-matter jurisdiction, and the LLC had standing to sue for patent infringement, even if the statute did purport to prohibit the LLC from suing in federal court. Though state law may not restrict federal jurisdiction, federal jurisdiction may depend on state law. The court stated that the defendant’s argument, though framed as an argument of standing, was actually one of capacity. An entity’s capacity to sue in federal court is governed by Rule 17(b). Under this rule, a corporation’s capacity to sue is determined by the law of the state of incorporation, and the capacity of all other entities is determined by the law of the state where the court is located, except that a partnership or unincorporated association with no capacity under that state’s law may sue or be sued in its common name to enforce a right under federal law. The court stated that it was not necessary to determine whether an LLC organized in Delaware is a “corporation” or an “unincorporated association” for purposes of Rule 17(b). Under Delaware law, an LLC can sue or be sued in its own name, and if it is an unincorporated association, it has capacity to sue in its common name to enforce a right under federal law even if Texas law would otherwise deny the association’s capacity to sue. In either case, the LLC had capacity to sue for patent infringement.


Cherer brought a forcible entry and detainer action against the Barreras and was awarded possession of the property by the justice court and by the county court after the Barreras appealed. The Barreras argued Cherer lacked standing to bring the action because the property was purchased at a tax foreclosure sale by Chererco LLC and the tax deed listed the LLC as the grantee of the property. The tax deed listed Cherer as the member and registered agent of Chererco LLC, and Cherer asserted that this case was a case of misnomer rather than standing because he had “a tendency to use the first person singular pronoun when referring both to himself and to his LLC.” The court of appeals concluded that Cherer was not the correct party to bring the suit, and misnomer did not apply. The court relied on case law recognizing that an LLC is considered a separate legal entity from its members and Section 101.106 of the Texas Business Organizations Code, which provides that a member of an LLC does not have an interest in any specific property of the LLC. Further, the court pointed out that Section 101.113 provides that a member may be named as a party in an action by an LLC only if the action is brought to enforce the member’s right against or liability to the LLC. Here, Cherer did not bring suit for the purpose of enforcing his right against or liability to the LLC. He brought the forcible entry and detainer suit himself and acquired possession of property belonging to the LLC. A member lacks standing to assert a cause of action that belongs to the LLC. Thus, the court vacated the county court’s judgment and rendered judgment dismissing the suit.


The plaintiffs did not have standing to bring RICO claims that resulted in injury to a New Mexico LLC. Federal courts sitting in Texas apply the Texas internal affairs rule under which the law of the state of incorporation governs a corporation’s internal affairs. Thus, New Mexico law governs a New Mexico LLC, and New Mexico law provides that an LLC alone holds its causes of action. A member of an LLC has no right to sue on the LLC’s behalf. Any injury derived from the investment at issue in this case was the LLC’s, and the plaintiffs did not have standing to assert claims based on the injury.


Investors of an LLC asserted claims against the managers of the LLC, the LLC’s law firm, and the LLC’s lender in connection with an allegedly fraudulent exchange offering that transformed the investors from equity holders to note holders in order to cover up long-time, ongoing violations of securities laws and liquidity problems in the LLC. The confirmation plan in the LLC’s bankruptcy released the lender from claims that the LLC owned against it, and the lender sought to prevent the investors from asserting their claims against it on the basis that their claims involved recovery of damages derivative of damages to the LLC. The bankruptcy court had previously held that the investors’ claims based on the exchange offering were direct claims owned by the investors and not property of the bankruptcy estate. The court

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said that the lender appeared to concede that the claims against it arising from the exchange offering (aiding and abetting 
breach of fiduciary duty, secondary liability for securities fraud, and violation of unfair competition law) belonged to 
the investors rather than the bankruptcy estate, but the court made clear that these claims are direct and personal to the 
investors and could not have been brought by the LLC on the date it filed for bankruptcy. The court stated that this 
conclusion did not end its analysis, however, because the lender argued that the investors were attempting to recover 
damages that were derivative of damages suffered by the LLC on claims that could have been brought on the bankruptcy 
petition date. With respect to the investors’ claim against the lender for aiding and abetting breach of fiduciary duty, the 
court concluded that it would be impossible to know until the conclusion of the trial of the investors’ claim what facts 
would be proven. Thus, the court said it was impossible to enjoin the investors from pursuing their direct claim against 
the lender for aiding and abetting the managers’ breach of fiduciary duty owed to them as members of the LLC. But the 
court found it appropriate to enjoin the investors from attempting to recover damages attributable to the managers’ post-
exchange offering mismanagement of the LLC. The court left it to the California court where the investors’ class action 
was pending to correctly apportion damages to the extent necessary at trial. With respect to the investors’ claim against 
the lender for secondary liability for securities fraud, the court was satisfied that the investors were not attempting to 
recover for harm to the LLC itself. The court said it was theoretically possible that some component of damages proven 
at trial might be derivative of damage to the LLC based on the managers’ post-exchange offer mismanagement, and 
the investors would not be entitled to recover such a component of damages but would share as creditors under the plan any 
recovery for the managers’ post-exchange offer mismanagement. Finally, the court concluded that the investors’ claims 
under California unfair competition law would only entitle the investors to restitution, not damages; thus, the investors 
were not seeking to recover damages that would compensate them for the managers’ post-exchange offer mismanagement.


Three individuals each formed new Delaware LLCs to serve as the purchasers of property they sought to 
acquire. The LLC’s entered into a co-tenancy agreement under which the property would be acquired and managed. The 
LLC owned by the debtor in this bankruptcy was appointed the “Managing Cotenant” under the agreement, and the other 
individuals and their LLCs sought to have indebtedness of the debtor arising out of the acquisition and operation of the 
property excepted from discharge. The court concluded that any misconduct by the debtor pertaining to post-acquisition 
operation of the property that could constitute fraud or defalcation in a fiduciary capacity was actionable only by the 
LLCs as the actual co-tenants affected by the misconduct. The court stated that an individual stakeholder does not have 
a right to recover personally for harms to the legal entity and that this principle applies to the rights of a member of an 
LLC. The court relied on Section 101.106(b) of the Texas Business Organizations Code, which provides that a member 
of an LLC does not have an interest in any specific LLC property. Thus, the court concluded that the members of the 
LLCs had no standing in their individual capacities to litigate claims that arose from the debtor’s misconduct after the 
acquisition of the property owned by the LLCs as cotenants under the co tenancy agreement.

BJVSD Bird Family Partnership, L.P. v. Star Electricity, L.L.C., 413 S.W.3d 780 (Tex. App.–Houston [1st 
Dist.] 2013, no pet.).

The appellant filed a petition in intervention in a case in which a judgment had been entered against a limited 
partnership and its LLC general partner and a receiver of the property of the limited partnership and general partner had 
been appointed. The appellant was a limited partner and member of the judgment debtors, and the appellant sought to 
appeal a modified order of the trial court appointing receiver and an order severing the limited partnership from the 
underlying cause. The judgment creditor argued that the appellant lacked standing to appeal because the appellant was 
not a party to the underlying judgment or to the trial court’s subsequent severance or modified order appointing a 
receiver. The appellant argued that it had standing under the virtual representation doctrine. In connection with the first 
element of the virtual representation doctrine, the appellant argued that it was bound to the judgment as the sole limited 
partner of the limited partnership and sole member of the LLC general partner. The court stated that the appellant 
mischaracterized the liability of a limited partner or LLC member for judgments against the entity. The court discussed 
the statutory provisions addressing liability of a limited partner in a limited partnership and concluded that there was no 
showing that the appellant had liability for the judgment against the limited partnership. Likewise, the court concluded 
that the appellant had no liability for the judgment against the LLC general partner because Section 101.106(b) of the 
Business Organizations Code states that a member has no interest in any specific property of the LLC, and Section 
101.114 states that a member has no liability for a debt, obligation, or liability of the LLC unless the company agreement 
specifically provides otherwise. Furthermore, the appellant did not show that it was an insurer or other party having a 
duty to pay all or part of the judgment, and there was no showing that the limited partnership and LLC general partner
were not able to adequately represent their own interests, and thus those of their limited partners or members. The
appellant argued that it had a privity of interest and a strong identity of interest with the entities such that the trial court’s
post-judgment rulings directly harmed the appellant, but the court stated that any harm flowed from the appellant’s role
as a limited partner and LLC member and that individual stakeholders in a legal entity do not have a right to recover
personally for harms to the entity. Thus, the appellant was not a proper party to challenge the trial court’s orders, and
the appeal was dismissed.

A member’s 50% interest in an LLC was awarded to his wife in their divorce. Before the divorce, the other
member closed an LLC bank account and transferred $160,000 in the account to another account as a “payment to
owner.” After the divorce, the other member caused the LLC to make payments to him for services provided to the LLC.
The ex-wife, now an assignee of her husband’s 50% interest, sued the other member and the LLC, asserting claims that
included unjust enrichment. The court of appeals agreed with the other member’s challenge to the trial court’s finding
on the ex-wives’s unjust enrichment claim. The trial court found that the other member wrongfully utilized funds and
assets of the LLC for his own use and unilaterally obligated the LLC to pay himself for management services that were
not performed at all or were performed in a manner that damaged the LLC. A claim for unjust enrichment on these facts
belonged to the LLC rather than the ex-wife.

The members of R.E. Loans, LLC (“REL”), a Chapter 11 debtor, filed a class action in California on behalf of
former REL investors, contending the investors lost millions of dollars as a result of a scheme carried out by REL acting
in concert with Wells Fargo Capital Finance, LLC (“Wells Fargo”), Greenberg Traurig, LLP (“Greenberg”), and others.
Among other allegations, the class action suit asserted that Wells Fargo was liable for aiding and abetting the managers’
breach of fiduciary duties. Wells Fargo initiated an adversary proceeding against the members of the LLC who filed the
class action suit. Wells Fargo sought a determination that the claims of the members in the class action were property
of the estate of REL and therefore could only have been brought by REL as the debtor-in-possession. Wells Fargo also
filed a motion to stay the class action and enjoin the members from prosecuting their claims against it based on the
argument that the claims asserted in the class action were property of the REL bankruptcy estate. The bankruptcy court
held that the claim that Wells Fargo aided and abetted breach of fiduciary duties owed by the managers to the members
did not belong to REL and was not property of the REL bankruptcy estate because REL could not have sued Wells Fargo
on such a claim on the petition date. The bankruptcy court reasoned that the members alleged separate duties owed to
them and misrepresentations made to them, and the harm alleged was to the members rather than REL. The bankruptcy
court denied Wells Fargo’s motion to stay the class action claims and for issuance of a temporary injunction, and the
bankruptcy court dismissed Wells Fargo’s adversary proceeding. Wells Fargo appealed to the district court.
The district court explained that the property of the bankruptcy estate includes all legal or equitable interests
of the debtor in property as of the commencement of the case. If the cause of action belongs to the estate, then the trustee
has exclusive standing to assert the claim. If the cause of action belongs solely to the estate’s creditors (i.e., here the
members), then the trustee has no standing to bring the cause of action. Whether the claim is part of the property of the
estate depends on whether the debtor could have raised the claim as of the commencement of the case, and part of the
inquiry is to consider the nature of the injury for which relief is sought. A third-party defendant may logically have
inflicted direct injury on both the debtor and the creditor during the course of dealings that give rise to the claims;
however, if the creditor suffers only indirect harm (i.e., an injury which derives from harm to the debtor) and the debtor
could have raised a direct claim for its injuries, then the cause of action belongs to the estate. The court considered
whether the members’ claim for aiding and abetting the managers’ breach of fiduciary duties was property of the REL
estate.
The members first alleged that Wells Fargo aided and abetted the managers in incurring debt on behalf of REL
that the managers had no authority to incur. The members argued that Wells Fargo aided and abetted the breach of
fiduciary duties owed by the managers to the members by being a part of a scheme that made Wells Fargo a highly
oversecuritized creditor and that heavily encumbered REL’s assets. The members alleged that the managers’ decision
impaired the interests and rights of the members and placed them in a subordinate position to Wells Fargo. The court
stated that although the members attempted to cast the injury as harming them directly, this component of their claim
implicitly alleged harm to REL itself with only a derivative injury to the members. The line of credit loan was made to
REL, and its assets were encumbered. The encumbering of REL’s assets injured REL, and in turn injured the members’
equity interest. Thus, the court reasoned that the injury suffered by the members when REL’s assets were encumbered
by Wells Fargo’s security interest was incurred derivatively. The members maintained three bases for their claims for direct harm, all of which the court found lacked force. First, the members alleged Wells Fargo helped the managers consummate a line of credit loan in secret, which breached the managers’ fiduciary duties of truthful disclosure and of fair treatment owed directly to the members under California law. The court stated that this argument addressed to whom the duty was owed rather than the direct or derivative nature of the injuries allegedly incurred by the members. Next, the members contended that the managers’ breach of fiduciary duties directly injured them by substantially impairing the value of the members’ investments in REL by unilaterally and without notice encumbering REL’s assets, which backed the members’ investments. The court disagreed because the members were equity investors in REL prior to the exchange offering and at the time of the loan, and the argument thus implicitly conceded that the injury to the members was derivative. Finally, the members claimed they did not allege that the managers breached any duties to REL or that the line of credit loan injured REL by placing the LLC in debt; to the contrary, the members contended that the loan provided REL with operating cash, enabled the managers to pay distributions to members, and allowed the LLC to continue in existence. The court stated that this argument was defeated by the allegations of the class action complaint, which clearly asserted that the managers injured REL by encumbering its assets in connection with the line of credit loan from Wells Fargo. In relation to the line of credit issue, the court also considered whether REL could have brought the claim against Wells Fargo itself for aiding and abetting breach of fiduciary duties. The members relied on their harm-related arguments to allege that REL could not have raised the claim, and the members argued that the breaches of fiduciary duties owed to the members harmed them while there were no allegations that the managers owed the same fiduciary duties to REL or that there was injury to REL directly. The members maintained it was immaterial that REL could have brought a completely separate claim against the managers for mismanagement or self-dealing. The court rejected the members’ arguments. Again, the class action complaint on its face demonstrated that REL could have raised a claim for aiding and abetting breach of fiduciary duties. Therefore, the court held that to the extent the members’ claim against Wells Fargo for aiding and abetting breach of fiduciary duties was based on the line of credit loan transaction, the claim was property of the REL estate. The members were not the proper plaintiffs as to this issue, and the court reversed and remanded this portion of the bankruptcy court’s judgment.

The members also alleged that Wells Fargo aided and abetted breach of fiduciary duties committed by the managers based on an exchange offering. The members alleged that by entering into the exchange offering they lost the ability they had to control REL or remove the managers. Wells Fargo maintained that the members were alleging derivative harm because the members suffered injury from the exchange offering by losing the right to control REL and thus prevent the alleged mismanagement and mishandling of money that ultimately resulted in REL’s bankruptcy. The court disagreed. The class action complaint contained numerous allegations that the members were misled into exchanging their equity interests in REL for promissory notes such that the members went from equity owners in REL to creditors with security interests junior to Wells Fargo. The allegations of injury with regard to the exchange offering were allegations of direct harm to the members rather than harm to REL that injured the members derivatively or indirectly. Thus, the court held that to the extent the members’ claims against Wells Fargo for aiding and abetting breach of fiduciary duties was based on the exchange offering, the claim was not property of the REL estate. The members were proper plaintiffs as to this issue, and the court affirmed this portion of the bankruptcy court’s judgment.


The Estate of Vasquez-Ortiz brought this action seeking a declaratory judgment that an insurance policy issued to a Delaware LLC covered the death of passengers and crew members. The LLC was set up and owned by Hoffman, a broker of aircraft, who advised Vasquez-Ortiz that it would be prudent and advantageous to set up a separate United States entity for airplanes acquired by Vasquez-Ortiz because Vasquez-Ortiz was not a U.S. citizen. The LLC acquired several airplanes, but neither Hoffman nor the LLC paid for the planes; Vasquez-Ortiz negotiated and paid for the planes. The LLC obtained a liability insurance policy, and a plane covered by the policy crashed. Vasquez-Ortiz, who was the pilot, and a passenger died in the crash. The passenger’s estate sued the LLC and the Estate of Vasquez-Ortiz, and the insurer denied coverage when presented with the law suit. The Estate of Vasquez-Ortiz (the “Estate”) then brought this suit alleging various causes of action, including for declaratory judgment. The insurer argued that the Estate had no standing to bring an action on the insurance contract between the LLC and the insurer. The Estate argued that it had standing to bring the suit because Vasquez-Ortiz was the alter ego of the LLC. Because Vasquez-Ortiz purchased all of the LLC’s assets, paid for any maintenance, and controlled the assets of the LLC, the Estate argued that he should be able to step in and sue on the LLC’s behalf. The court acknowledged that Texas courts have recognized the alter ego doctrine for purposes of allowing a party to bring a claim directly against a corporation’s owner as a means of protecting creditors injured by the corporate form. However, the Estate did not cite, and the court did not find, any cases supporting an “alter
ego” concept of standing. The court stated that the alter ego doctrine is a sword to be used by creditors against the corporation rather than a sword to be used by the corporation against those who assumed in good faith that they were dealing with a corporation, and the court declined to derive from this doctrine a novel theory of standing. The court stated that it was not unsympathetic to the Estate’s predicament since it was up to Hoffman, as sole owner of the LLC, to bring the LLC’s claims, and it appeared that Hoffman had a close relationship with family members of Vasquez-Ortiz who were trying to remove assets from the Estate in order to protect them from the rightful heir. Even so, the court stated that it was simply not aware of any doctrine that would allow an individual with no legal ownership of an entity to sue on its behalf. The court noted that the predication could have been avoided if Vasquez-Ortiz had maintained legal ownership of the LLC, and the court did not see any reason he could not have registered the LLC in his own name under the Delaware LLC statute.

**Baisden v. I’m Ready Productions, Inc.**, 693 F.3d 491 (5th Cir. 2012).

The court held that an individual did not have standing to bring a claim for tortious interference with a contract because the individual was not a party to the contract. The contract was between an LLC (of which the individual was apparently a member) and a production company to develop a movie based on a novel written by the individual, and the individual argued that he was an intended third-party beneficiary because the contract directed that payments be made directly to him and that he provide chain of title. The court held that the individual’s claim was properly dismissed because he was not a party to the contract and thus could not assert a claim for tortious interference. The individual argued for the first time in his appellate reply brief that the LLC had dissolved, leaving him to bring the suit for tortious interference, but the court stated that the standing inquiry was focused on whether the party invoking jurisdiction had the requisite stake in the outcome when the suit was filed.


The court held that the individual pro se plaintiff who challenged a foreclosure sale of property held in the name of “Roy’s and Son’s L.L.C.” did not state a facially plausible claim for relief. The plaintiff alleged that he did not receive personal notice of the foreclosure sale but did not allege that he was a debtor according to the mortgage servicer’s records. Additionally, Texas law does not require notice to persons who are not parties to the deed of trust, and the plaintiff did not allege that he was a party to any deed of trust. His allegation that he obtained title through a warranty deed, standing alone, was insufficient to give rise to a reasonable inference that he was a debtor according to the mortgage servicer’s records or became a party to any deed of trust, and the allegation was suspect in view of the warranty deed naming Roy’s and Son’s L.L.C. as the grantee. Finally, the plaintiff failed to allege that the defendant was the lender, mortgagee, mortgage servicer, or note holder around the time of the foreclosure.


Yammine purchased property at a sheriff’s sale and then sold the property to an LLC. Six months later, Yammine filed suit against Wise County due to a discrepancy in the acreage conveyed. The court held that Yammine lacked standing to pursue the relief he sought under the Tax Code because he no longer owned the property. The court noted that LLCs are separate legal “persons” under the Tax Code based on the definition of a “person” in the Code Construction Act. Thus, to the extent Yammine argued that he remained an owner because he was one of the members of the LLC, his argument failed.

**Storguard Investments, LLC v. Harris County Appraisal District**, 369 S.W. 3d 605 (Tex. App.–Houston [1st Dist.] 2012, no pet.).

A corporation filed a suit for judicial review of an order determining the corporation’s protest of taxes assessed for 2008, and the appraisal district filed a plea to the jurisdiction on the basis that the corporation lacked standing to pursue judicial review because it did not own the property on January 1, 2008. The corporation moved to add the LLC record owner of the property as a plaintiff, but the trial court granted the plea to the jurisdiction. On appeal, the LLC argued that the trial court erred because the corporation amended its petition to cure a misnomer, the LLC had standing to pursue the petition for judicial review, and the LLC satisfied the requirements for Rule 28 substitution. The court of appeals affirmed the trial court’s judgment. The corporation conveyed its interest in the property to the LLC in 2003, and the corporation had no legal right to protest the valuation or seek judicial review. Under the Tax Code as in effect at the time of the proceeding, the LLC, as record legal owner of the property, had standing to protest the valuation, but it never became involved in the administrative protest, and there was no protest determination brought by the LLC on
which it could premise a suit for judicial review. The court reviewed other provisions of the Tax Code, including certain amendments to the Tax Code in 2011, and determined that they did not avail the corporation and the LLC. In the course of rejecting the misnomer argument, the court noted that the corporation—the party that completed the administrative protest and initiated the judicial review—had an ownership interest in the LLC, and the LLC—the property owner and substituted plaintiff—were separate and distinct entities. The court cited case law for the proposition that parent and subsidiary corporations are separate and distinct "persons" and Section 101.106 of the Business Organizations Code for the proposition that a member of an LLC does not have an interest in any specific property of the LLC. Because the corporation and LLC were distinct entities with separate existences, the LLC record owner could not rely on the corporation's conduct to satisfy the jurisdictional prerequisites of completing the administrative protest process and timely filing a suit for review. The court rejected the substitution argument because there was no showing that the LLC was doing business under the corporation's name, held itself out as the corporation, or requested the appraisal district to refer to it as the corporation in its records. Rule 28 allows an entity doing business under an assumed or common name to sue or be sued in that name and for the true name to be substituted on the motion of any party or the court. Under these facts, Rule 28 was not applicable and did not permit substitution of the "true name" of the LLC for the "common name" of the corporation.


The plaintiff entered into a contract with the LLC defendant. The contract was signed on behalf of the LLC by the LLC's sole member. The member asserted a counterclaim against the plaintiff, but the court granted the plaintiff's motion to dismiss the counterclaim because the LLC was the party with standing to assert the counterclaim as the party who entered into the contract with the plaintiff. The only way in which the member was personally bound by the contract was under an addendum in which he agreed that he was bound by a non-compete clause in the contract.


Brothers David and Harvey Gartley sued Smith for fraud based on misrepresentations made by Smith to induce the Gartleys to invest in an LLC and for misrepresentations after they invested that induced them to personally guarantee the company's debt. Smith argued that the Gartleys did not have standing or capacity to bring their claims against Smith. Relying on case law form the corporate context, the court acknowledged that an individual stakeholder in a legal entity does not have a right to recover personally for harms done to the entity, but the court concluded that the Gartley brothers suffered direct harm above and beyond a mere reduction in the value of their "stock" in the LLC. The court held that the Gartleys had standing and capacity to assert their claims for damages flowing from Smith's misrepresentations that induced them to invest funds and personally guarantee the company's debt.


In a suit brought by certain creditors of an LLC, Vilhauer, one of the members of the LLC, asserted cross claims against Rich, his fellow member, alleging that Rich took various actions that resulted in the LLC's inability to pay creditors and harm to Vilhauer personally. Rich sought dismissal of Vilhauer's cross claims. The court dismissed Vilhauer's claims to the extent Vilhauer sought to assert claims on behalf of the LLC. The court stated that any claims belonging to the LLC at the time of its bankruptcy filing belonged to the bankruptcy estate and that Vilhauer did not have standing to assert claims on behalf of the LLC. The court found that Vilhauer had sufficiently pled the existence of an informal fiduciary relationship between Vilhauer and Rich and that certain allegations of conduct by Rich sufficiently pled breach of Rich's duties to Vilhauer, but allegations of conduct that prevented the LLC from paying creditors alleged a breach of fiduciary duty to the LLC that could not be raised by Vilhauer. Similarly, the court concluded that a conversion claim asserted by Vilhauer should be dismissed because it identified only property belonging to the LLC, and Vilhauer did not have standing to assert claims for Rich's alleged conversion of LLC property.


Mack obtained a judgment against K. Harris R&D, LLC (the "defendant LLC") declaring a transfer of intellectual property to the LLC to be void as a fraudulent transfer. Gator Licensing, LLC ("Gator Licensing") and Old Warrior, LLC ("Old Warrior"), two members of the defendant LLC, sought to bring a restricted appeal to challenge the judgment against the defendant LLC on the basis that Gator Licensing and Old Warrior were "virtually represented" at trial. Another entity, GI Innovations, LLC ("GI Innovations"), also sought to bring a restricted appeal arguing that it was "virtually represented" because the defendant LLC was one of GI Innovations' members and the defendant LLC licensed
the intellectual property transferred to it to GI Innovations. As for the argument of Gator Licensing and Old Warrior, the court stated that it had found case law to support the proposition that shareholders are in privity with the corporation as to corporate matters and are bound by a decree against the corporation. Because members of an LLC are comparable to shareholders of a corporation, the court said it would appear to follow that they are similarly bound by a judgment against and in privity with the LLC. However, the court found no law to support the proposition that a shareholder is entitled to bring a restricted appeal challenging a judgment against a corporation based on the doctrine of virtual representation. The court assumed, however, that Gator Licensing and Old Warrior had standing to bring the restricted appeal because they could not prevail on the merits in any event. Gator Licensing and Old Warrior argued that the judgment should be reversed because they were necessary parties and were not served. However, title to ownership to property of a corporation rests with the corporation, not in any shareholder, and shareholders of a corporation are not necessary parties to a suit against a corporation. Similarly, a member of an LLC does not have any interest in specific LLC property. Thus, the court concluded that a member of an LLC is not a necessary party to a lawsuit against an LLC just as a shareholder is not a necessary party to a lawsuit against a corporation. With respect to the argument of GI Innovations, the court said that a company could be bound by a judgment against a shareholder or member only through a theory of “outsider reverse corporate veil piercing.” No party in the underlying lawsuit sought to hold GI Innovations liable for the actions of the defendant LLC, and the record showed GI Innovations to be a separate legal entity from its members. Thus, the court found no support in the record for the proposition that GI Innovations would be bound by a judgment against one of its members. The court also found no support for the proposition that GI Innovations would by bound by a judgment against the defendant LLC by virtue of its licensing agreement. Thus, GI Innovations had no standing to bring a restricted appeal.


The court dismissed claims belonging to an LLC that were asserted by the LLC’s member because an LLC can only be represented by licensed counsel and a member is not a proper party to proceedings by or against an LLC except where the object is to enforce the member’s right against or liability to the LLC.

**Gale v. Carnrite, 559 F.3d 359 (5th Cir. 2009).**

In 1999, the Gales bought all of the membership interest in a Nevada LLC that owned a condominium unit in Mexico. Because of a legal restriction on non-Mexican ownership of real property, the Gales had to purchase the outstanding membership interest in the LLC. The sole asset of the LLC was beneficial ownership of a leasehold interest in the condominium under a special trust arrangement with a Mexican bank. In the sale agreement between the seller, Carnrite, and the Gales, Carnrite included a warranty that as of the date of closing “the LLC has and will have no liabilities of any nature…including without limitation tax liabilities due or to become due.” When the sale was completed in January 2000, no one reported the transaction to the Mexican government and no taxes were paid on the transfer. After the Gales used the condominium for a number of years, the LLC sold the beneficial interest in the condominium to the Vaudagnas. The sale resulted in a substantial Mexican capital gains tax liability. The Gales filed suit against Carnrite for allegedly breaching the contractual warranty he gave to them regarding tax liability when they bought the LLC. The Gales alleged that Carnrite breached the warranty by failing to report and pay taxes on the sale to the Gales. The district court entered summary judgment in favor of the Gales, finding that Carnrite breached the warranty because the parties’ transaction gave rise to tax liability for the LLC. Carnrite appealed, and the first issue discussed in the opinion on appeal was the whether the Gales had standing to pursue the claim. Carnrite argued that it was the LLC rather than the Gales that were liable for the capital gains tax and that the Gales did not have standing since they suffered no injury. The Gales responded that the LLC assigned the claim to them when they filed the lawsuit in 2007. Carnrite did not dispute the usual propriety of such an assignment, but argued that the assignment was ineffective because Nevada had revoked the LLC’s right to do business in 2004 for failure to pay franchise taxes and fees and file annual reports. The court concluded that the Gales had standing to pursue the claim, however, based on Nevada LLC statutes regarding dissolution and the fact that payment of the taxes ultimately fell on the Gales. The court pointed out that the Nevada LLC statutes provide that the property and assets of an LLC whose charter has been revoked must be held in trust and that dissolution proceedings should be pursued. Another statutory provision provides that dissolution does not impair a remedy or cause of action arising before dissolution and commenced within 2 years after the date of dissolution. Additionally, the Nevada statutes provide that the assets of a dissolved LLC may be distributed to its members. Based on these statutes, the court concluded the assets of the LLC, which included the cause of action against Carnrite, were held by the Gales in trust when its right to transact business was forfeited, and, moreover, the Gales were permitted to transfer those assets to themselves as the LLC’s only members. As the parties ultimately injured and the assignees of
the LLC’s claims, the Gales had standing to pursue the action. After analyzing the tax liability, however, the court held that the record did not establish that Carnrite breached the terms of the warranty as worded in the contract he made with the Gales because the record indicated that Carnrite’s failure to pay taxes on the transaction resulted in a tax liability of the Gales rather than the LLC.


The court held that the plaintiff had standing to sue for breach of its contract with defendant in which the parties agreed to form an LLC to operate a casino. The court rejected the defendant’s argument that the plaintiff must sue derivatively, explaining that a party lacks standing to sue derivatively where it has contracted with another to acquire ownership in an entity but is then prevented from doing so by the other’s breach of contract.


Although the Texas assumed name statute states that a party shall not maintain an action arising out of a contract or act in which an assumed name was used until an assumed name certificate has been filed as required by law, and the plaintiff LLC filed suit prior to filing its assumed name certificate as required by law, the defendant failed to raise the argument in the trial court and never filed a motion to abate. Thus, the court of appeals found that the defendant waived this complaint. The court of appeals also concluded that the trial court did not err in awarding relief to Shiva Investment First, L.L.C., an assumed name of SIFCO, L.L.C., in a declaratory judgment action regarding a lease entered by an individual doing business as Shiva Investment First, L.L.C. The court pointed out that the Texas Rules of Civil Procedure permit a party to sue or be sued in its assumed name. Further, the record indicated that proper assumed name certificates were filed establishing Shiva Investment First, L.L.C. as an assumed name for SIFCO, L.L.C., and SIFCO, L.L.C. transacted business and corresponded with the defendant in its assumed name and identified itself in all pleadings as SIFCO, L.L.C. or Shiva Investment First, L.L.C. As a result, the court concluded that SIFCO, L.L.C. was a party to the lease by virtue of its assumed name, Shiva Investment First, L.L.C., and was entitled to relief.


The court held that the plaintiff LLC lacked capacity to sue because its corporate existence had been forfeited under the Texas Tax Code which provides that forfeiture results in loss of ability to sue or defend. The court stated that the plaintiff cited no authority for its requested abatement, and the court denied abatement pending reinstatement.


The court held that a member did not have standing to represent the LLC’s interest and that an LLC may not be represented by a non-lawyer.


Gray and Neely entered into a contract for the sale of Neely’s homestead in June 2005. One month later Gray assigned his rights in the contract to Graywest, LLC (“Graywest”), which the court referred to as a “limited liability corporation.” Neely attempted to avoid the contract for sale, and Graywest filed suit to enforce it. Neely filed a motion to abate and alternatively to dismiss the suit arguing that Graywest did not have the capacity to sue because it had forfeited its corporate status by failing to pay franchise taxes. The parties agreed that Graywest had been involuntarily dissolved in March of 2001 for not paying its franchise taxes. The trial court ruled that Graywest lacked the capacity to file suit on the contract at issue because its charter had not been revived within the 36-month window for reinstatement allowed by Article 7.01E of the Texas Business Corporation Act (“TBCA”), and the three year survival period under Article 7.12 of the TBCA had expired. [Note: Although TBCA Articles 7.01E and 7.12 were applicable to LLCs under Article 8.12 of the Texas Limited Liability Company Act, Article 7.01E was not actually applicable in this case. It has long been the Secretary of State’s practice to effectuate tax forfeitures under the Tax Code provisions, which have their own reinstatement provisions and do not contain a time limitation on reinstatement, rather than the involuntary dissolution provisions of the TBCA. The successor provision of Article 7.01 of the TBCA, Section 11.251 of the BOC, does not specify failure to pay franchise taxes as a ground for involuntary termination. Thus, there should be less confusion under current law.] Since Graywest was not an existing entity and no other proper party was before the court, the trial court dismissed the case with prejudice. The court of appeals affirmed, explaining that the assignment from Gray
to Graywest fifty-one months after dissolution was invalid and that Graywest was not an appropriate party to the suit. The court of appeals stated that the trial court could have allowed the litigation to continue if the appellant had amended its petition by substituting Gray individually as the plaintiff, but Graywest did not pursue this remedy at the abatement hearing. Thus, dismissal with prejudice as to Graywest was proper.


The court held that an LLC plaintiff, which was reinstated after forfeiture for failure to pay its franchise taxes, could maintain this action, but its member lacked standing to assert claims arising out of the LLC’s contract. The member was not a party to the contract and had no rights under the contract. The court cited Section 101.113 of the Texas Business Organizations Code for the proposition that a member of an LLC may be named as a party in an action by or against the LLC only if the action is brought to enforce the member’s right against or liability to the LLC.


The court held that LLC members were “parties in interest” with standing to object to a claim against the LLC debtor, but a prior judgment barred the members from contesting the validity of the claim under the federal doctrine of res judicata.


The court noted that courts have found a corporation can have imputed racial identity and concluded that the LLC plaintiff had standing to assert a § 1983 action if it suffered harm from discrimination regardless of whether it was found to have a racial identity.

FF. Pro Se Representation


The defendant LLC’s counsel withdrew, and the court advised the LLC that it could not appear pro se and must be represented by licensed counsel. The LLC failed to retain counsel, and the court warned the LLC that the failure to do so would result in a default judgment against it. After the LLC’s continued failure to retain counsel, the court struck the LLC’s answer and counterclaim, and the plaintiff moved for a default judgment, which was granted.


The court dismissed this wrongful foreclosure action filed by an individual pro se plaintiff because the plaintiff sought to assert the rights of an LLC that was not before the court and whom he could not represent pro se. “Although an individual has a right to proceed pro se, business entities such as limited liability companies—fictional legal persons—have no such right, and must be represented by licensed counsel.” The court noted that this is the case “even when the person seeking to represent the corporation is its president or major shareholder.”


The court dismissed the claims of an LLC plaintiff because the individuals who signed the complaint apparently were not licensed attorneys. The court recognized that individual plaintiffs may proceed pro se, but stated that artificial entities such as corporations, partnerships, associations, and limited liability companies may only be represented by licensed counsel.


The court granted a motion to strike an LLC’s response to motion for default judgment because the response was signed by the LLC’s sole member, who was not an attorney. “A corporation ‘cannot appear in proper person as a corporation or through its corporate officer’” and can appear only through an attorney admitted to practice before the court.

The court noted that an individual’s pro se answer was effective as to the individual but that the individual could not appear on behalf of the LLC defendant. Likewise, the court stated that the individual’s pro se notice of appeal was only effective to perfect appeal as to the individual and that the LLC was thus not a party to the appeal.


An LLC was ordered to appear through a licensed attorney (the court noting that a corporation must be represented by a licensed attorney and cannot appear pro se) at a hearing on the motion of their attorneys to withdraw. Because the plaintiffs failed to appear as ordered, the magistrate recommended dismissal of the case.


The court dismissed claims belonging to an LLC that were asserted by the LLC’s member because an LLC can only be represented by licensed counsel and a member is not a proper party to proceedings by or against an LLC except where the object is to enforce the member’s right against or liability to the LLC.


The court denied an attorney’s request to withdraw as counsel for the plaintiff LLC where the attorney knew of the potential conflict and failed to take any action for almost one and one-half months, the defendant waived any potential conflict on the part of the attorney, and the defendant objected to the attorney’s withdrawal because an LLC must be represented by counsel and the plaintiff LLC had not fully complied with the court’s prior order for contempt and sanctions.


The court held that an LLC may not be represented by a non-lawyer.

GG. Derivative Suits


The court held that the plaintiff had standing to sue for breach of its contract with defendant in which the parties agreed to form an LLC to operate a casino. The court rejected the defendant’s argument that the plaintiff must sue derivatively, explaining that a party lacks standing to sue derivatively where it has contracted with another to acquire ownership in an entity but is then prevented from doing so by other’s breach of contract.

**Kira Inc. v. All Star Maintenance Inc.**, 267 Fed. App’x 352 (5th Cir. 2008).

A minority member of a Nevada LLC brought a derivative suit against the other two members of the LLC. The plaintiff asserted various claims based on the alleged improper use by the defendant members of the LLC’s name and the payment of management fees to affiliates of the defendants. The plaintiff argued that the district court erred in denying its motion to disqualify defense counsel due to conflicts in representing the LLC and the defendant members accused of harming the LLC’s interests. The court stated that any conflicts asserted by the plaintiff were more theoretical than real. All members were parties to the action, and the plaintiff was the only party who stood to benefit from a plaintiff’s verdict. The court could not imagine any remedy that could have been obtained by the LLC that would have been different from a remedy in favor of the plaintiff and saw no purpose that would have been served by independent counsel for the LLC in this case. Thus, the court held that the district court did not abuse its discretion in denying the motion to disqualify.


The court of appeals held that the trial court did not err in allowing the three individual owners of an LLC to proceed in their individual capacities under Article 5.14L of the Texas Business Corporation Act where the record showed that they were the owners of the LLC and there was no evidence that the LLC had shares listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national securities association.
of members or partners of unincorporated associations for diversity jurisdiction purposes, the court concluded that an

Supreme Court decisions in which the Supreme Court has refused to examine the particulars of the position or control

interest should be included in determining the citizenship of an LLC. Relying on

is a dearth of authority as to whether the citizenship of individuals who are not members yet still own a membership

on the company but was not admitted as a member.] The court noted that the Fifth Circuit Court of Appeals has held, based

from the opinion whether the individual was an assignee or a person who received a membership interest directly from

a member must be included when determining the LLC’s citizenship for diversity jurisdiction purposes. [It is not clear

addressing a novel issue is included below.

district court decisions in Texas on this issue are too numerous to include in this paper, but one district court decision

circuit to address the issue, has held that the rule applied in

partnership’s citizenship is determined by the citizenship of each of its partners. The Fifth Circuit, as well as every other

Complaint Against Darwin Deason, Dennis Debo, Star Chen, William Deckelman, Jr. and ACS, Inc.” The third party

plaintiffs characterized the claims as direct based on DDH’s status as a closely held corporation under Texas Business

and styling of the third party action strongly suggested that some portion of the claims were derivative. Many of the

claims, most notably those for breach of fiduciary duty, involved duties owed to DDH rather than the third party

plaintiffs, and the third party complaint was entitled “DDH Aviation, L.L.C. f/k/a DDH Aviation, Inc.’s Supplemental

Complaint Against Darwin Deason, Dennis Debo, Star Chen, William Deckelman, Jr. and ACS, Inc.” The third party

plaintiffs characterized the claims as direct based on DDH’s status as a closely held corporation under Texas Business

Code Art. 5.14L, but the court stated the third party plaintiffs clearly appeared to be pursuing their claims in a

derivative fashion. Though Article 5.14L states that “a derivative proceeding brought by a shareholder of a closely

held corporation may be treated by a court as a direct action brought by a shareholder for his own benefit,” the court

stated that the statute does not mean the action is no longer a derivative proceeding. Having determined that the claims

were derivative, the court turned to the question of whether DDH was a closely held corporation such that Article 5.14L

exempted the third party plaintiffs from the usual demand requirement. Under Article 5.14L of the Texas Business

Corporation Act, a corporation is a closely held corporation if it has less than 35 shareholders and has no shares listed

on a national securities exchange or regularly quoted in an over-the-counter market. The third party plaintiffs claimed

that DDH was closely held in their briefing but did not allege it in their pleadings. The court thus dismissed the
derivative claims but gave the third party plaintiffs leave to amend their complaint. (The court applied Article 5.14 of

the Texas Business Corporation Act without discussing its applicability to an LLC, DDH’s entity type at the time of the

suit. Under Article 8.12 of the Texas Limited Liability Company Act, Article 5.14 of the Texas Business Corporation

Act applies to LLCs.)

HH. Diversity Jurisdiction

[In Carden v. Arkoma Associates, 494 U.S. 185 (1990), the United States Supreme Court held that a limited

partnership’s citizenship is determined by the citizenship of each of its partners. The Fifth Circuit, as well as every other

circuit to address the issue, has held that the rule applied in Carden v. Arkoma Associates applies to limited liability

companies. There are many district court decisions within and outside the Fifth Circuit following this approach. The
district court decisions in Texas on this issue are too numerous to include in this paper, but one district court decision

addressing a novel issue is included below.]
owner of an LLC is an obvious component part of the LLC and that the extent of the owner’s involvement in the LLC’s operations is not relevant. The court found that it made sense to consider the 1.75% owner to be one of the “several persons composing” the LLC because the Supreme Court has included such persons without regard to their level of control or involvement in the affairs of a company.

**Harvey v. Grey Wolf Drilling Company**, 542 F.3d 1077 (5th Cir. 2008).

As a matter of first impression in this circuit, the Fifth Circuit Court of Appeals determined that the citizenship of an LLC for diversity jurisdiction purposes is determined by the citizenship of all of its members. Noting that the United States Supreme Court has not specifically addressed the citizenship of an LLC, the court joined other circuits in applying the Supreme Court’s decision in *Carden v. Arkoma Associates* (which held that the citizenship of an unincorporated association, such as a limited partnership, is based on the citizenship of all of its members) to LLCs. The court pointed out that Congress has created a statutory exception to the *Carden* rule of citizenship for unincorporated associations in the limited context of class actions, but has made no similar exception in any other part of the general diversity jurisdiction statute. The court also noted that the Louisiana LLC statute explicitly provides that an LLC is an “unincorporated association” and that no LLC “shall be deemed, described as, or referred to as ... [a] corporation.”


The Fifth Circuit Court of Appeals upheld the district court’s award of attorney’s fees based on a finding that an LLC’s argument regarding citizenship for diversity purposes was frivolous. The LLC argued that it was a corporation for diversity purposes although it was undisputed that it was an LLC. The district court found that it had diversity jurisdiction because the LLC and a limited partnership of which the LLC was a partner were not citizens of Texas. In analyzing the limited partnership’s citizenship, the district court necessarily had to analyze the citizenship of its partners, including the LLC. The district court ruled that the limited partnership was not a citizen of Texas even though one of its partners, the LLC, had its principal place of business in Texas. The district court found that the LLC’s argument to the contrary was frivolous because *Carden* establishes that corporations are treated differently than unincorporated associations for purposes of determining diversity of citizenship.

**Unity Communications Inc. v. Unity Communications of Colorado LLC**, 105 Fed. App’x 546 (5th Cir. 2004).

In this case, the Fifth Circuit Court of Appeals made a point of stating that it was expressing no opinion as to whether an LLC has the citizenship of each of its members for diversity purposes. The court later joined other courts of appeals that have adopted the *Carden* approach. See *Harvey v. Grey Wolf Drilling Company*, 542 F.3d 1077 (5th Cir. 2008).

II. Bankruptcy


The court concluded that the automatic stay in the bankruptcy of an LLC did not extend to its managing member. The managing member was not a debtor in the bankruptcy, and the debtor was a separate legal entity from its managing member. The plaintiffs in a state-court action against the managing member sought to pursue a motion to hold the managing member in criminal contempt in that action. The bankruptcy court found that the debtor did not establish that the assets of the bankruptcy estate would be at risk if the state court proceeded with its criminal contempt hearing against the managing member. The bankruptcy court also concluded that Section 362(b)(1) would prevent the automatic stay from going into effect even if it did apply to the managing member of the debtor. Section 362(b)(1) provides that a bankruptcy filing does not operate as a stay of a criminal action or proceeding against the debtor. Finally, if the stay was in effect and applied to the managing member, the court found sufficient cause to lift the stay.


Investors of an LLC asserted claims against the managers of the LLC, the LLC’s law firm, and the LLC’s lender in connection with an allegedly fraudulent exchange offering that transformed the investors from equity holders to note holders in order to cover up long-time, ongoing violations of securities laws and liquidity problems in the LLC. The confirmation plan in the LLC’s bankruptcy released the lender from claims that the LLC owned against it, and the lender sought to prevent the investors from asserting their claims against it on the basis that their claims involved recovery of damages derivative of damages to the LLC. The bankruptcy court had previously held that the investors’ claims based
on the exchange offering were direct claims owned by the investors and not property of the bankruptcy estate. The court said that the lender appeared to concede that the claims against it arising from the exchange offering (aiding and abetting breach of fiduciary duty, secondary liability for securities fraud, and violation of unfair competition law) belonged to the investors rather than the bankruptcy estate, but the court made clear that these claims are direct and personal to the investors and could not have been brought by the LLC on the date it filed for bankruptcy. The court stated that this conclusion did not end its analysis, however, because the lender argued that the investors were attempting to recover damages that were derivative of damages suffered by the LLC on claims that could have been brought on the bankruptcy petition date. With respect to the investors’ claim against the lender for aiding and abetting breach of fiduciary duty, the court concluded that it would be impossible to know until the conclusion of the trial of the investors’ claim what facts would be proven. Thus, the court said it was impossible to enjoin the investors from pursuing their direct claim against the lender for aiding and abetting the managers’ breach of fiduciary duty owed to them as members of the LLC. But the court found it appropriate to enjoin the investors from attempting to recover damages attributable to the managers’ post-exchange offering mismanagement of the LLC. The court left it to the California court where the investors’ class action was pending to correctly apportion damages to the extent necessary at trial. With respect to the investors’ claim against the lender for secondary liability for securities fraud, the court was satisfied that the investors were not attempting to recover for harm to the LLC itself. The court said it was theoretically possible that some component of damages proven at trial might be derivative of damage to the LLC based on the managers’ post-exchange offer mismanagement, and the investors would not be entitled to recover such a component of damages but would share as creditors under the plan any recovery for the managers’ post-exchange offer mismanagement. Finally, the court concluded that the investors’ claims under California unfair competition law would only entitle the investors to restitution, not damages; thus, the investors were not seeking to recover damages that would compensate them for the managers’ post-exchange offer mismanagement.


In this action to determine dischargeability of a debt, the plaintiff argued that Higgs obtained materials on credit by falsely representing that he made purchases on behalf of an LLC when the LLC had forfeited its charter and could not do business in Texas. The plaintiff alleged that Higgs made this representation with intent to deceive and that the plaintiff relied on the representation to its detriment. Higgs denied that he purchased materials from the plaintiff on behalf of his LLC and asserted that the plaintiff extended credit to him personally. It was undisputed that Higgs executed the plaintiff’s credit application in 2004 in which he listed the type of business as “Construction LLC.” For several years, Higgs made purchases, presumably acting through “RH Construction.” Two invoices in 2012 were not paid. It was also undisputed that “RH Construction” was an assumed name of RHC Consultants, LLC, and that the LLC forfeited its right to do business in Texas in 2009. The court concluded that the plaintiff failed to show that Higgs made a false representation. The court said it was unclear from the complaint what representation was at issue—whether it was the statement on the credit application that Higgs would make purchases for an LLC or the representation on the two unpaid invoices that the materials were ordered for RH Construction. The representation on the credit application was not false in 2004 when it was made because RH Construction was a valid assumed name for an existing LLC at that time. At trial, the plaintiff contended the false representation was Higgs writing “RH Construction” on the invoices when the LLC had lost its charter. However, Higgs did not write “RHC Consultants, LLC” on the invoice; he wrote “RH Construction.” Further, there was no evidence that Higgs no longer did business as “RH Construction” after the LLC lost its charter. In his answer, Higgs stated that the purchases were made for RH Construction and that it still existed. The question was whether Higgs had a duty to tell the plaintiff that RHC Consultants, LLC (of which RH Construction was an assumed name) forfeited its charter and lost its status as an LLC. The plaintiff did not establish that Higgs had such a duty. In addition, the evidence did not establish that Higgs intended to deceive the plaintiff. Statements by Higgs at a meeting of creditors indicated that he did not know or understand the significance of the name of the buyer on the invoice. His statements suggested that he did not differentiate between himself and RH Construction. According to the court, if Higgs did not differentiate between himself and his company or his assumed name, or understand the significance of a name on an invoice, then he could not have put the name “RH Construction” on the invoice with intent to deceive the plaintiff. Finally, the plaintiff failed to prove justifiable reliance because there was no evidence that the plaintiff made even a cursory examination or investigation of RH Construction’s creditworthiness. Thus, the plaintiff failed to establish that the debt was nondischargeable.
The members of R.E. Loans, LLC (“REL”), a Chapter 11 debtor, filed a class action in California on behalf of former REL investors, contending the investors lost millions of dollars as a result of a scheme carried out by REL acting in concert with Wells Fargo Capital Finance, LLC (“Wells Fargo”), Greenberg Traurig, LLP (“Greenberg”), and others. According to the class action complaint, REL and its affiliate made real estate development loans using funds raised from investors. REL was organized as an LLC, and the investors became its members. REL was managed by a group of individuals through two affiliated companies, and REL members had control rights (e.g., a majority in interest could remove and replace the managers, vote to dissolve REL, and amend the operating agreement with limited exceptions).

The members were entitled to withdraw all or part of the investments on written notice. The class action suit alleged that the managers of REL, Wells Fargo, and Greenberg developed and carried out a scheme against REL’s members that caused the members significant harm by stripping the members of their ownership interest in and rights of control over REL. Specifically, REL’s auditors had warned the managers that REL had been violating securities laws since 2002 by selling REL membership but failing to register the offerings with the Securities and Exchange Commission. In March 2007, REL’s lawyers advised the managers to stop soliciting or accepting future investor contributors due to the substantial civil penalties REL faced for violating the securities laws. By mid-2007, REL experienced a severe cash liquidity shortage. Although the managers knew they were obligated by their fiduciary duties to disclose to the members their past securities violations and cash liquidity problems, they failed to disclose such information because of the fear that members would lose confidence in the safety of their investments, which could prompt members to withdraw their investments and exercise their control rights to remove the managers. The class action alleged that the managers together with their counsel Greenberg and Wells Fargo, who was brought in to lend money to REL, enabled REL to maintain the illusion that REL was liquid. The managers, Greenberg, and Wells Fargo knew that, without the prior approval of REL’s members, REL was not authorized to borrow operating cash from a third-party lender and encumber REL’s assets or any portion of its loan portfolio as security for third-party borrowings. The managers entered into a secret transaction with Wells Fargo in which Wells Fargo extended a $65 million line of credit to REL secured by a perfected first-priority lien against REL’s assets, which was an amount in excess of $700 million. Wells Fargo also required REL to endorse and deliver $250 million in notes receivables. Greenberg created an exchange transaction that transformed the members from equity owners of REL into creditors with promissory notes whose security interests were junior to Wells Fargo’s lien.

The managers portrayed the exchange offering as a restructuring of REL when in reality it was a scheme that persuaded members to approve the unauthorized Wells Fargo loan after the fact, legitimize the managers’ past undisclosed securities laws violations, and divest the members of their interests and control rights in REL. The managers and Greenberg made numerous false and misleading statements of material fact to obtain the members’ agreement to the exchange offering, which constituted a breach of their fiduciary duties to the members, among other alleged causes of action. When the scheme was discovered, REL defaulted on the line of credit loan from Wells Fargo and the promissory notes it had issued to the members. In sum, the actions of the managers, Greenberg, and Wells Fargo disenfranchised the members, encumbered the assets on which the members’ investments were based, and hid from the members REL’s ongoing liquidity problems.

Among other allegations, the class action suit asserted that Wells Fargo was liable for aiding and abetting the managers’ breach of fiduciary duties. Wells Fargo initiated an adversary proceeding against the members of the LLC who filed the class action suit. Wells Fargo sought a determination that the claims of the members in the class action were property of the estate of REL and therefore could only have been brought by REL as the debtor-in-possession. Wells Fargo also filed a motion to stay the class action and enjoin the members from prosecuting their claims against REL on the argument that the claims asserted in the class action were property of the REL bankruptcy estate. The bankruptcy court held that the claim that Wells Fargo aided and abetted breach of fiduciary duties owed by the managers to REL was not property of the REL bankruptcy estate because REL could not have sued Wells Fargo on such a claim on the petition date. The bankruptcy court reasoned that the members alleged separate duties owed to them and misrepresentations made to them, and the harm alleged was to the members rather than REL. The bankruptcy court denied Wells Fargo’s motion to stay the class action claims and for issuance of a temporary injunction, and the bankruptcy court dismissed Wells Fargo’s adversary proceeding. Wells Fargo appealed to the district court.

The district court explained that the property of the bankruptcy estate includes all legal or equitable interests of the debtor in property as of the commencement of the case. If the cause of action belongs to the estate, then the trustee has exclusive standing to assert the claim. If the cause of action belongs solely to the estate’s creditors (i.e., here the members), then the trustee has no standing to bring the cause of action. Whether the claim is part of the property of the estate depends on whether the debtor could have raised the claim as of the commencement of the case, and part of the inquiry is to consider the nature of the injury for which relief is sought. A third-party defendant may logically have
inflicted direct injury on both the debtor and the creditor during the course of dealings that give rise to the claims; however, if the creditor suffers only indirect harm (i.e., an injury which derives from harm to the debtor) and the debtor could have raised a direct claim for its injuries, then the cause of action belongs to the estate. The court considered whether the members’ claim for aiding and abetting the managers’ breach of fiduciary duties was property of the REL estate.

The members first alleged that Wells Fargo aided and abetted the managers in incurring debt on behalf of REL that the managers had no authority to incur. The members argued that Wells Fargo aided and abetted the breach of fiduciary duties owed by the managers to the members by being a part of a scheme that made Wells Fargo a highly oversecured creditor and that heavily encumbered REL’s assets. The members alleged that the managers’ decision impaired the interests and rights of the members and placed them in a subordinate position to Wells Fargo. The court stated that although the members attempted to cast the injury as harming them directly, this component of their claim impliedly alleged harm to REL itself with only a derivative injury to the members. The line of credit loan was made to REL, and its assets were encumbered. The encumbering of REL’s assets injured REL, and in turn injured the members’ equity interest. Thus, the court reasoned that the injury suffered by the members when REL’s assets were encumbered by Wells Fargo’s security interest was incurred derivatively. The members maintained three bases for their claims for direct harm, all of which the court found lacked force. First, the members alleged Wells Fargo helped the managers consummate the line of credit loan in secret, which breached the managers’ fiduciary duties of truthful disclosure and of fair treatment owed directly to the members under California law. The court stated that this argument addressed to whom the duty was owed rather than the direct or derivative nature of the injuries allegedly incurred by the members. Next, the members contended that the managers’ breach of fiduciary duties directly injured them by substantially impairing the value of the members’ investments in REL by unilaterally and without notice encumbering REL’s assets, which backed the members’ investments. The court disagreed because the members were equity investors in REL prior to the exchange offering and at the time of the loan, and the argument thus implicitly conceded that the injury to the members was derivative. Finally, the members claimed they did not allege that the managers breached any duties to REL or that the line of credit loan injured REL by placing the LLC in debt; to the contrary, the members contended that the loan provided REL with operating cash, enabled the managers to pay distributions to members, and allowed the LLC to continue in existence. The court stated that this argument was defeated by the allegations of the class action complaint, which clearly asserted that the managers injured REL by encumbering its assets in connection with the line of credit loan from Wells Fargo. In relation to the line of credit issue, the court also considered whether REL could have brought the claim against Wells Fargo itself for aiding and abetting breach of fiduciary duties. The members relied on their harm-related arguments to allege that REL could not have raised the claim, and the members argued that the breaches of fiduciary duties owed to the members harmed them while there were no allegations that the managers owed the same fiduciary duties to REL or that there was injury to REL directly. The members maintained it was immaterial that REL could have brought a completely separate claim against the managers for mismanagement or self-dealing. The court rejected the members’ arguments. Again, the class action complaint on its face demonstrated that REL could have raised a claim for aiding and abetting breach of fiduciary duties. Therefore, the court held that to the extent the members’ claim against Wells Fargo for aiding and abetting breach of fiduciary duties was based on the line of credit loan transaction, the claim was property of the REL estate. The members were not the proper plaintiffs as to this issue, and the court reversed and remanded this portion of the bankruptcy court’s judgment.

The members also alleged that Wells Fargo aided and abetted breach of fiduciary duties committed by the managers based on the exchange offering. The members alleged that by entering into the exchange offering they lost the ability they had to control REL or remove the managers. Wells Fargo maintained that the members were alleging derivative harm because the members suffered injury from the exchange offering by losing the right to control REL and thus prevent the alleged mismanagement and mishandling of money that ultimately resulted in REL’s bankruptcy. The court disagreed. The class action complaint contained numerous allegations that the members were misled into exchanging their equity interests in REL for promissory notes such that the members went from equity owners in REL to creditors with security interests junior to Wells Fargo. The allegations of injury with regard to the exchange offering were allegations of direct harm to the members rather than harm to REL that injured the members derivatively or indirectly. Thus, the court held that to the extent the members’ claims against Wells Fargo for aiding and abetting breach of fiduciary duties was based on the exchange offering, the claim was not property of the REL estate. The members were proper plaintiffs as to this issue, and the court affirmed this portion of the bankruptcy court’s judgment.


In this adversary proceeding, an LLC and two of its members sought a determination that debts to them arising from activities of the debtor, Hardee, while he was managing member of the LLC were nondischargeable in Hardee’s
bankruptcy. The plaintiffs alleged that Hardee’s debts to them were nondischargeable on the basis that the debts were obtained by actual fraud or false representations or as debts arising from a defalcation by a fiduciary and/or embezzlement. The court granted a partial summary judgment in favor of the LLC on the basis that the summary judgment evidence established that Hardee owed a debt to the LLC arising from the unauthorized diversion of corporate funds and that the debt was nondischargeable as a debt arising out of a defalcation by a fiduciary or embezzlement. The issue of the amount of the debt was reserved for trial. After the trial, the court concluded that a debt to the LLC representing over $250,000 in embezzled funds was nondischargeable as a debt arising from a defalcation by a fiduciary and embezzlement, and a debt to the LLC of approximately $248,000 arising from Hardee’s failure to tender employment taxes owed to the IRS was nondischargeable as a debt arising from a defalcation by a fiduciary. The court concluded, however, that the two members who sought an exception to Hardee’s discharge failed to establish that Hardee was in a formal or informal fiduciary relationship with them as would be required to render the debt to them for the unpaid tax liabilities nondischargeable as arising out of a defalcation by a fiduciary, and the members failed to establish that their initial investments in the LLC were procured by actual fraud or false representations so as to support an exception to discharge with respect to the amount of their investments.

The court’s opinion consists of findings of fact and conclusions of law after the trial in the adversary proceeding. The parties agreed to the basic facts of the case. ETRG Investments, LLC was a Texas limited liability company formed in 2005 for the purpose of owning and operating restaurants in Arkansas. Tomlin and Scott were individuals who resided in Georgia and invested as members in the LLC. Hardee, the debtor in this bankruptcy proceeding, was also a member of the LLC and resided in Texas. Although Hardee invested no money in the LLC, he held the title of “Managing Member” of the LLC from its inception until December 2008. The LLC paid Hardee a yearly salary. In September 2006, the LLC obtained a loan in the amount of $350,000. Hardee sent falsified financial statements via email to the LLC investors to conceal his taking of LLC funds in excess of his compensation for personal purposes. In December 2010, the LLC, Tomlin, and Scott filed a lawsuit against Hardee. The lawsuit was stayed when Hardee filed for relief under Chapter 7 of the Bankruptcy Code in March 2011. In October 2011, Hardee was charged with and pled guilty to the federal crime of wire fraud. Hardee listed the LLC, Tomlin, and Scott as creditors in his bankruptcy filings. Hardee admitted that he was responsible for the LLC’s tax matters, wrote checks on behalf of the LLC, and sent letters to potential investors of the LLC, and that the LLC’s regulations (i.e., company agreement) required him to obtain unanimous consent from the LLC’s members prior to incurring any indebtedness of $100,000 on behalf of the LLC.

In additional findings of fact, the court determined that Hardee embezzled significant sums of money from the LLC and that his breaches of fiduciary duty included entering into an unauthorized lending relationship, not properly managing the LLC’s affairs by diverting funds, and not tendering required tax payments to the IRS on behalf of the LLC. The failure to tender the required tax payments also clearly breached the regulations (i.e., company agreement) of the LLC. The court determined the amount of the debt arising from Hardee’s embezzlement of money from the LLC to pay personal expenses, obtain excessive expense reimbursements, and otherwise receive compensation in amounts in excess of what he was authorized to receive was $253,331. The court found that the tax debt owed by the LLC to the IRS remained in flux but was at least $248,000. The court found that Hardee, as the sole person authorized to transact business and direct the financial activities of the LLC, including the payment of tax obligations, acted as an agent of the LLC and as such had a formal fiduciary relationship. The failure to tender the tax payments was a willful breach of duty and thus a defalcation while acting in a fiduciary capacity. As for Hardee’s relationship to the other plaintiffs, Tomlin and Scott, the court found that these members failed to establish that Hardee had a formal fiduciary relationship with them. The company agreement governing the LLC did not impose or even address any fiduciary duties owed by and among the LLC members. Furthermore, the court found that Tomlin and Scott failed to establish that Hardee had an informal fiduciary relationship with them or a trust relationship that existed prior to the creation of the tax obligations at issue that would create fiduciary duties to the members. Tomlin and Scott also failed to show that the amounts they invested in the LLC were paid due to false representation, false pretenses, or actual fraud. The plea of guilt to the wire fraud charge did not establish that Hardee induced the original investment of Tomlin and Scott by actual fraud. The evidence showed Hardee devised his embezzlement scheme subsequent to the original investment solicitations and made no false representations at the time of the investment solicitation.

In its conclusions of law, the court addressed the nondischargeability of debts arising from breach of fiduciary duties. The court addressed the concept of a fiduciary under federal bankruptcy law and the requirement that the relationship amount to a “technical” or “express” trust. The court then proceeded to set forth numerous conclusions of law regarding fiduciary duties as they related to this proceeding. The Texas Business Organizations Code, which governs LLCs, does not directly address or define the duties owed by managers and members but implies that certain duties may be owed and allows the contracting parties to specify the breadth of those duties in the LLC agreement. One type of fiduciary relationship recognized under Texas law is a formal fiduciary relationship that arises as a matter of law and
includes relationships between principal and agent. An agent has authority to transact business or manage some affair for another person or entity and owes a duty of care. Texas law also recognizes that a fiduciary relationship exists between corporate officers or directors and the corporation they serve, and one of the duties imposed on corporate management is a duty of care that requires diligence and prudence in the management of the corporation’s affairs. Although LLCs are not corporations in the strictest sense, Texas law implies that the fiduciary status of corporate officers and directors and their corresponding duties of care, loyalty, and obedience apply to managers and/or members governing the activities of an LLC. Thus, imposition of fiduciary duties on the management of an LLC under Texas law is appropriate and warranted, and Hardee acted in a fiduciary capacity as to the LLC. Breach of Hardee’s fiduciary duties required a willful neglect of duties owed, which is measured objectively by reference to what a reasonable person in the debtor’s position knew or reasonably should have known and charges the debtor with knowledge of the law without regard to actual intent or motive. Hardee was charged with insuring that all required payments of employment taxes were made by the LLC to the appropriate taxing authorities, and Hardee’s failure in each instance to make the tax payments on behalf of the LLC constituted a breach of the fiduciary duties he owed the LLC. Therefore, the debt owed by the LLC to the IRS to satisfy its tax obligations for the period in which the defendant was the managing member of the LLC constituted a defalcation by a fiduciary and was excepted from discharge in Hardee’s bankruptcy proceeding. As for the individual members’ request that any amount they were required to pay to satisfy the accrued IRS tax liabilities should also be a nondischargeable debt, the court noted a significant difference between a manager’s fiduciary relationship to the LLC and the manager’s relationship to fellow members. Case law has recognized that there is no formal fiduciary relationship created as a matter of law between members of an LLC. The designation of Hardee in the LLC agreement as the “Tax Matters Member” had no legal significance in the absence of a demonstration that the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) applied to this LLC—the small partnership exception might well have exempted the members of the LLC from the application of TEFRA. Thus, Hardee had no formal fiduciary relationship with either Tomlin or Scott. An informal fiduciary relationship is a confidential relationship arising from moral, social, domestic, or personal relationships in which one person trusts in and relies on another. The effect of imposing a fiduciary duty is to require the fiduciary party to place another’s interest above its own, and a fiduciary relationship is thus not one that is created lightly. Hardee had no informal fiduciary relationship with either Tomlin or Scott. Any liability of Hardee to either Tomlin or Scott created by Hardee’s failure to render tax payments on behalf of the LLC was not excepted from discharge as a result of a breach of fiduciary duties because the debtor owed no fiduciary duties to the members.

The court next set forth conclusions of law relating to nondischargeability of debts arising from false representation, false pretenses, or actual fraud. Tomlin and Scott argued that the amounts each of them invested in the LLC as a result of the solicitations by Hardee should be declared nondischargeable debts on these bases. The Fifth Circuit has distinguished actual fraud from false representations and false pretenses, and the distinction rests upon whether a debtor’s representation is made with reference to a future event or to a past or existing fact. That is, a debtor’s promise related to a future action may be actual fraud, while a debtor’s promise related to past or current fact may be a false representation (e.g., involving an express statement) or false pretense (e.g., misleading conduct without an explicit statement). Any representations made by Hardee that may have induced the members into investing in the LLC must have pertained to a future event as the LLC had not yet been engaged in the restaurant business at the time of the solicitation. Thus, the members’ claims related to a future event, and their claim required proof that the debt was obtained by actual fraud. Failure to perform the terms of a contract is a breach of contract, and a debt arising from a breach of contract is not normally sufficient to make a debt nondischargeable. Likewise, future predictions and opinions of the profitability of a business cannot form the basis of fraud as a matter of law. Tomlin and Scott failed to prove actual fraud on the part of Hardee.

In sum, the managing member’s debt to the LLC based on his embezzlement of LLC property for his personal use was nondischargeable as a debt arising from a defalcation by a fiduciary and from embezzlement. In addition, the debt owed by the managing member to the LLC to fulfill the LLC’s employment tax obligations was excepted from discharge as a debt arising from a defalcation by a fiduciary. However, the individual investor members did not prove by a preponderance of the evidence that the managing member owed them a fiduciary duty or committed actual fraud against them. Thus, the debts owing by the managing member to the other members were dischargeable in the bankruptcy proceeding.


The bankruptcy of the debtor LLC was dismissed because the member who filed the case did not have authority to do so. The Chapter 11 petition was filed August 13, 2012, and the decision to file was made solely by Hellman, who claimed to do so as the sole manager of the LLC. Hellman was a one-third member, and there were two other members
at the time of the filing. The other two members, Whitten and Schuil, were not consulted regarding the filing, but
Hellman knew they were opposed to putting the company in bankruptcy. The three members had approved an amended
operating agreement on August 3, 2011, under which Whitten was named as manager and all significant decisions
concerning the company were required to be made by a majority of the members. The filing was clearly in contravention
of the amended operating agreement, but Hellman raised several technical arguments that the amended operating
agreement should set aside and that the original operating agreement should be consulted to determine whether he
had authority to file the bankruptcy. Hellman argued that he had authority to file the case as sole manager of a manager-
managed LLC and under the general powers granted the manager under the original operating agreement. The court
examined the provisions of the original operating agreement and characterized them as ambiguous at best. The
agreement granted extensive powers to the manager but also referred to decisions of members. The agreement contained
no specific direction concerning the filing of a bankruptcy. Hellman admitted during his testimony that as manager he
could not force the liquidation of the company, and the court pointed out that the New Mexico Limited Liability
Company Act provides for majority consent or vote of members in the analogous circumstance of filing suit. The court
stated that it defied common sense to conclude that a one-third owner of an LLC has authority to place the company in
Chapter 11 when he knew that the majority of members were opposed to the action. The court went on to discuss how
Whitten used his financial muscle to gain majority control of the LLC and force the amendments to the operating
agreement. In multiple instances, Hellman acknowledged, at least implicitly, the validity of the amended operating
agreement. The court commented that Whitten’s tactics and actions might provide Hellman with a cause of action against
Whitten but did not cure Hellman’s lack of authority. In essence, said the court, this case involved a dispute among the
owners of the LLC. Whitten used his financial leverage to orchestrate a liquidation of the LLC on his terms. Hellman
vehemently disagreed with the terms of a sale that was proposed by Whitten and Schuil on August 9, 2012, and Hellman
filed the Chapter 11 case a few days later. He withheld from his own attorneys the amended operating agreement. The
court stated that even if it sustained the filing, the rift among the members, with Hellman in the minority, made a
reorganization impossible. Concluding that Hellman lacked authority to file the case, that cause existed for dismissal,
and that the case did not present the type of “unusual circumstances” sufficient to condone the filing, the court dismissed
the case.


This adversary proceeding was brought in the bankruptcy cases of a limited partnership, the limited
partnership’s LLC general partner, and the individual who owned 100% of the LLC and 28% of the limited partnership.
The Chapter 7 trustees for these debtors brought this action to recover preferential and fraudulent transfers and to pierce
the corporate veil of various entities affiliated with the entity debtors. Some of the defendants sought dismissal of claims
that were based on transfers made by non-debtor entities. The defendants argued that the trustees must show that the non-
debtor entities should be substantively consolidated under bankruptcy law with one or more debtors in order to assert
claims for transfers made by the non-debtor entities. The court stated that the trustees did not have to plead substantive
consolidation because they stated claims for state-law reverse veil piercing with respect to the entities and thus had
standing to assert fraudulent or preferential transfer claims based on transfers from the non-debtor entities. The court
relied upon *ASARCO LLC v. Americas Min. Corp.*, 382 B.R. 49 (S.D. Tex. 2007) for the proposition that a debtor can
pursue its wholly owned subsidiary’s fraudulent transfer claim where state-law veil-piercing requirements are met. The
court explained that traditional veil piercing uses the alter ego doctrine to include the assets of a shareholder as assets of
a corporation while the common law doctrine of reverse veil piercing counts the assets of a corporation or other entity as
the assets of its shareholder. In this case, the trustees sought to count the assets of the non-debtor entities as assets of
the debtors. The court reviewed specific facts alleged by the trustees that supported the allegation that the entities
were a sham and were not truly separate from the debtors and that the sham entities were used to facilitate the fraudulent
diversion of assets. The court concluded that the allegations adequately stated a claim for reverse veil piercing under
Texas law.


Cardwell appealed a bankruptcy court’s order granting summary judgment on Gurley’s claim that Cardwell was
not entitled to discharge of his debt owed to Gurley under exceptions to discharge provided by Section 523(a)(2)(A)
(false pretenses, false representation, or fraud) and 523(a)(4) (fraud or defalcation in a fiduciary capacity). In previous
litigation in state court between Cardwell and Gurley, the state district court found that Cardwell and Gurley formed a
Texas LLC of which they were equal members and Cardwell was designated the managing member. The state court also
found that Cardwell made numerous materially false and misleading statements and promises and failed to disclose material facts which led Gurley to agree to certain transactions. The state court’s conclusions of law included conclusions that Cardwell, as managing member of the LLC, owed fiduciary duties of loyalty, care, and disclosure to the LLC, and that Cardwell also owed such duties to Gurley directly, as the only other member of the LLC, as a matter of law. The court concluded that Cardwell breached these duties and that Cardwell and the LLC were damaged while Cardwell profited by his breach. The federal district court in this case held that the bankruptcy court did not err in giving preclusive effect to the state court’s findings and conclusions and further held that the fiduciary duty owed by a managing member to his fellow LLC member was similar to the trust-type obligation owed by partners and corporate officers and thus sufficient to support an exception to discharge under Section 523(a)(4) of the Bankruptcy Code. The court discussed the requirement that a fiduciary capacity for purposes of Section 523(a)(4) must constitute a technical or express trust. The court relied on Fifth Circuit case law recognizing that persons exercising control of a business such as general partners and corporate officers owe trust-type obligations to partners and shareholders who do not control the business and that breach of such obligations is sufficient to except such persons from discharge under Section 523(a)(4). Cardwell argued that there is no authority for imposing a fiduciary duty between LLC members, but the court reasoned that the Fifth Circuit has likely not had occasion to address Section 523(a)(4) in the context of an LLC since the LLC is a relatively new form of business entity. The court noted that an LLC is a business entity that has certain characteristics of both a corporation and a partnership and that managing partners of a partnership and officers and directors of a corporation owe fiduciary duties. The court stated that the Texas Business Organizations Code does not directly address the duties owed by LLC managers to members, but the court cited Section 101.401 (permitting the company agreement to expand or restrict duties, including fiduciary duties, that a member, manager, officer, or other person has to the company or to a member or manager of the company) as an example of certain provisions that are premised on the assumption that such duties exist. Because the state court found that Cardwell, as managing member of the LLC, owed Gurley direct fiduciary duties of loyalty, care, and full disclosure as a matter of law, the federal district court saw no reason to distinguish this case, simply because the entity was an LLC, form prior Fifth Circuit precedent concluding that managing partners of partnerships and officers of corporations were not entitled to discharge under Section 523(a)(4). (The court noted that the state court had also found that Cardwell owed Gurley fiduciary duties as a result of a long-standing relationship of trust and confidence, but the court acknowledged that this type of relationship is too broad to satisfy the federal standard for fiduciary duty in a bankruptcy case.) Having concluded that Cardwell owed Gurley a fiduciary duty sufficient to meet the standard required for Section 523(a)(4), the district court next concluded that the state court’s findings regarding Cardwell’s materially false and misleading statements and promises and failures to disclose material facts met the “willful neglect” standard for a “defalcation” under Section 523(a)(4). In sum, the court held that the bankruptcy court did not err in giving preclusive effect to the state court findings and in entering judgment that Cardwell’s debt to Gurley was nondischargeable under Section 523(a)(2)(A) and 523(a)(4).

In re Moore, 608 F.3d 253 (5th Cir. 2010).

The bankruptcy court approved a settlement by the trustee of reverse veil piercing claims against a corporation and an LLC that allegedly were alter egos of the debtor. A creditor, which offered to purchase the claims for a higher value, objected to the settlement. On appeal, the Fifth Circuit held, as a matter of first impression, that the proposed compromise of the reverse veil piercing claims was a proposed sale of property of the estate that triggered the Section 363 sale provisions of the Bankruptcy Code.


The Heritage Organization, L.L.C. (“Heritage”) was a Delaware LLC that, prior to its bankruptcy filing, provided tax planning strategies to extremely wealthy individuals. The trustee asserted a number of claims against various individuals and entities related to Heritage, but the largest claims sought avoidance of distributions by Heritage to insiders between April 2001 and February 2003 in the aggregate amount of $46 million. The trustee sought recovery from three Delaware entities that were members of Heritage, and from Kornman, the individual who ultimately controlled Heritage and its members. The issues addressed by the court in its analysis were the existence of a triggering creditor and standing of the trustee; the governing law and applicable limitations period; the burden of proof and whether the triggering creditor must be the creditor who was hindered, delayed, or defrauded; the evidence of fraudulent intent; alleged legitimate business purposes for the distributions; and the amount of avoidable transfers and from whom they were recoverable.

The court determined the total amount of recoverable distributions to the members was $46 million, which included $4 million in cash in a safety deposit box that was in issue. In addition to determining that the transfers were recoverable from Heritage’s members, the court analyzed whether any amounts could be recovered from Kornman under
Section 550(a) of the Bankruptcy Code as an entity for whose benefit such transfer was made or an immediate or mediate transferee of an initial transferee. The court determined that Kornman was not an entity for whose benefit the transfers were made, stating that there was no showing that Kornman received any benefit from the initial transfers. The court stated that the fact that Heritage’s income passed through various entities and ended up on Kornman’s personal tax return did nothing to change the analysis regarding the transfers at issue. The court determined, however, that Kornman was a subsequent transferee of over $11 million distributed to members of Heritage and then distributed or loaned to Kornman.

The court also concluded that certain transfers to other Kornman-controlled entities within 90 days preceding Heritage’s bankruptcy filing were preferential transfers under Section 547(b) of the Bankruptcy Code.


The court concluded that the debtor did not owe the plaintiff a fiduciary duty for purposes of the exception to discharge for a debt based on fraud or defalcation in a fiduciary capacity. The debtor was the majority member and manager of an LLC that served as the general partner for a limited partnership. In a prior opinion, the bankruptcy court found that the debtor exercised sufficient control over the LLC and limited partnership to establish a fiduciary relationship with the plaintiff, who was the minority member of the LLC and limited partner of the limited partnership. However, the court stated that it did not have the partnership agreement before it at the time of the prior decision, and the court found that the terms of the partnership agreement eliminated any fiduciary relationship. The partnership agreement provided: “[T]he General Partner [i.e., the LLC controlled by the debtor] shall conduct the affairs of the Partnership in good faith toward the best interest of the Partnership. The General Partner, however, is liable for errors and omissions in performing its duties with respect to the Partnership only in the case of bad faith, gross negligence, or breach of the provisions of this Agreement, but not otherwise.” Both the LLC and limited partnership were Delaware entities, and the Delaware Revised Uniform Limited Partnership Act permits partners to contract out of common law fiduciary duties in the partnership agreement. The partners may not eliminate the implied contractual covenant of good faith and fair dealing, but the court concluded that the partnership agreement in this case reduced the general partner’s duties from a fiduciary duty to merely a duty of good faith. The plaintiff argued that a fiduciary duty existed because the debtor controlled the LLC which in turn was the general partner, and the debtor was thus essentially acting as the general partner. However, the court stated that, if the partnership agreement limited the LLC general partner’s duties to that of merely good faith, a higher standard could not be imposed on the debtor as the controlling member of the LLC.


The debtors and certain creditors filed this action to subordinate claims of the defendants on the basis that the defendants’ claims arose out of the rescission of equity security interests in the debtors. Subordination of claims arising from rescission of a purchase or sale of a security of a debtor is mandatory under the Bankruptcy Code. The bankruptcy court pointed out that the term “security” includes an interest in a limited partnership, and the court assumed without discussion that an interest in an LLC is also a “security” within the meaning of the Bankruptcy Code. The bankruptcy court found that the final judgment resolving the disputes arising out of the defendants’ acquisition of limited partnership and LLC interests in debtors constituted a rescission of those acquisitions rather than a redemption; thus, the court granted summary judgment subordinating the claims.


The court concluded that the debtor, the majority member and manager of a Delaware LLC that served as general partner of a limited partnership, exercised sufficient control over the LLC and limited partnership to establish a fiduciary relationship with an individual who was the minority member of the LLC and limited partner of the limited partnership for purposes of the dischargeability exception for fraud or defalcation in a fiduciary capacity.


The court concluded that the trustee made an initial showing that a draft operating agreement of the debtor LLC’s managing member related to the debtor LLC’s property or financial affairs.


The court held that a party removed as a manager prior to the bankruptcy filing of the LLC had no standing to assert that the bankruptcy filing was not authorized, but a creditor was a “party in interest” with standing to challenge
the bankruptcy on the basis that all members did not consent as required by the operating agreement. The court dismissed the bankruptcy because it was filed without consent of all the members as required under Washington law and the operating agreement.


The court held that the automatic stay in a member’s bankruptcy did not preclude the other member from seeking receivership of the LLC because the bankrupt member had no interest in the assets or property of the LLC.


The court noted the inclusive and flexible nature of the definition of “insider” under the Bankruptcy Code, and stated that the fact that the debtor was an LLC rather than a corporation was a “distinction without a difference” for purposes of analyzing the status of the debtor’s president as an insider. The court concluded that the debtor’s president was an insider as a matter of law (even though the debtor’s president did not exercise the same control that a president of a company would normally enjoy) just as an officer of a corporation is an insider as a matter of law.


The court held that LLC members were “parties in interest” with standing to object to a claim against the LLC debtor, but a prior judgment barred the members from contesting the validity of the claim under the federal doctrine of res judicata.

**JJ. Securities Laws**


Jim Sandt, a CPA employed by Enron as vice president of its tax group, became interested in buying Enron assets that had substantial value when he became aware that many Enron assets were being sold in Enron’s bankruptcy. Sandt and his wife became friends with Tim Nesler and his wife, and Jim and Tim began working on a business plan for the purchase and management of an Enron business. Four other individuals joined the group, and Jim formed an LLC to be managed by Jim, Tim, and the other individuals. The group became interested in purchasing the interest of Enron in a limited partnership. Another LLC, Energy Maintenance Services Group I, LLC (“Energy Maintenance”) and a subsidiary LLC were formed. Jim became nervous that he might have a conflict of interest because he was still working at Enron and was also CFO of a group seeking to buy Enron’s interest in the limited partnership. Although Tim sought to provide reassurance to Jim that he did not have a conflict of interest, Jim resigned from his positions at all three LLCs that had been formed by the group. Tim was upset about Jim’s resignation and feared it would jeopardize the deal. Jim continued to work on the deal but played a lesser role. After Jim’s resignation, he and the other five members of the group met at a lawyer’s office to sign various documents. Jim tendered his anticipated contribution of $75,000 and signed a subscription agreement. Tim and another member of the group, Art Robbins, signed a written consent of directors in lieu of organizational meeting that reflected Jim contributed $75,000 and was a membership interest unitholder of 75 of 400 units. The documents also included an LLC agreement specifying that Jim was a member of Energy Maintenance and owned 75 of 400 outstanding units based on his capital contribution of $75,000. The LLC agreement provided that all amendments to the agreement must be submitted to all members in writing and approved by members owning an aggregate of more than fifty percent of the outstanding units of Energy Maintenance. The agreement did not address the issuance of additional units beyond the initial 400 units. A few days later, without notice to Jim, the other five members of Energy Maintenance met and approved various amendments to the LLC agreement, including an amendment that gave the board of the LLC the authority to issue units. The next day, Energy Maintenance’s subsidiary signed an agreement to purchase Enron’s interest in the limited partnership. Additional units were issued to members of the group other than Jim without Jim’s knowledge, and the purchase of Enron’s interest was closed. Jim did not learn until over a year later that an additional 1,200 units had been issued. Jim and his wife sued Energy Maintenance, Tim, Art, and another member/ officer of Energy Maintenance (the “EMS parties”), alleging various claims for fraud, breach of fiduciary duty, and breach of contract. The jury found that Tim breached a fiduciary duty to the Sandts and found against Tim, Art, and Energy Maintenance on claims for statutory fraud, common law fraud, and negligent misrepresentation. On appeal, the EMS parties argued that the evidence was insufficient to support the findings of statutory fraud by the jury. The statutory fraud claim was based on Chapter 27 of the Texas Business and Commerce Code. [All parties apparently assumed that Section 27.01 of the Texas Business and Commerce Code, which provides
a cause of action for fraud in a transaction involving “stock in a corporation or joint stock company” applied to the purchase of the LLC units in this case.] The court of appeals concluded that the evidence was sufficient for a reasonable and fair-minded jury to find that: (1) Tim made a false, material promise to Jim to do an act with the intention of not fulfilling the promise; (2) Tim made the promise to Jim for the purpose of inducing Jim to enter into an agreement to purchase stock; and (3) Jim relied on the promise in entering into an agreement to purchase stock. The court of appeals reviewed the evidence relating to Jim’s investment in Energy Maintenance and the amendment of the LLC agreement empowering the board to issue additional units and concluded that the jury reasonably could have found Tim falsely promised Jim he would receive an interest of approximately 18.75% in Energy Maintenance, that the promise was material and made for the purpose of inducing Jim to purchase units in Energy Maintenance, that Jim relied upon the promise, that the LLC agreement was amended without Jim’s knowledge although it required amendments to be submitted to all members, that 1,200 additional units were issued to members other than Jim as “sweat equity” within fifteen days after the amendment for no additional consideration, that Tim was furious with Jim for resigning from the management team at a critical time in the transaction, and that Tim promised Jim he would receive an ownership interest of approximately 18.75% with the intent that Jim would receive a significantly lower ownership interest as a result of the issuance of additional units, i.e. with no intention of fulfilling the promise. Because the jury could reasonably have concluded Tim was acting as an agent of Energy Maintenance, the evidence was sufficient to support the jury’s finding that Energy Maintenance committed statutory fraud. The court rejected the argument that the evidence was insufficient to support the jury’s finding that Tim had actual awareness of the falsity of his promise. The court of appeals agreed with the argument that the evidence was insufficient to show statutory fraud against Jim’s wife. She did not sign the subscription agreement, which contained various representations that he was acting on his own behalf and for his own account. Thus, the court concluded that the evidence was insufficient to show that she entered into an agreement to purchase stock. The court rejected the argument that the use of community property funds to purchase the Energy Maintenance units allowed Jim’s wife to assert the fraud claim. The court said that it had not seen any case in which a court has held that a spouse’s interest in community funds expands the substantive law and allows a spouse to recover based on tort claims against third parties that only run in favor of the other spouse. The court found that the evidence was legally insufficient to support the jury’s finding of statutory fraud on the part of Art but upheld the judgment against Art because unchallenged conspiracy findings predicated on the statutory fraud finding against Tim provided a basis for holding Art liable.

Allen v. Devon Energy Holdings, L.L.C., 367 S.W.3d 355 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgm’t vacated w.r.m.).

This case dealt with a dispute arising from the redemption of a minority interest owned by Allen in a closely held limited liability company. Allen alleged that the LLC and Rees-Jones, the LLC’s manager and majority owner, fraudulently induced him to redeem his interest. In addition to common law and statutory fraud claims, Allen brought claims for breach of fiduciary duty, shareholder oppression, and violations of the Texas Securities Act. In a lengthy opinion analyzing numerous issues bearing on the various claims, the court held that some, but not all, of the statements relied upon by Allen were actionable, that release and disclaimer provisions in the redemption agreement did not bar Allen’s claims based on the actionable statements, that there was a formal fiduciary duty owed by Rees-Jones as the majority member/sole manager of the LLC to Allen as a passive minority member in the context of the redemption of Allen’s interest, that Rees-Jones did not conclusively establish that he owed no duty of loyalty to members individually under the terms of the exculpation clause in the LLC’s articles of organization, that summary judgment was properly granted on Allen’s shareholder oppression claim, that the defendants conclusively established that Allen had certain knowledge that barred his fraud claims relating to the value of the LLC or its assets or the appropriateness of the redemption price, that the defendants did not otherwise disprove justifiable reliance or establish a “knowledge” defense, and that the defendants did not establish that Allen’s claims under the Texas Securities Act were barred by limitations or that Allen had no recoverable damages.

The factual backdrop for this case was the redemption of Allen’s minority interest in an LLC engaged in natural gas exploration and development. The LLC redeemed Allen’s interest in 2004 based on a $138.5 million appraisal of the LLC performed in 2003. In 2006, the LLC was sold for $2.6 billion. The increase in value of the LLC was essentially due to advancements made in horizontal drilling. Allen claimed that Rees-Jones and the LLC made misrepresentations and failed to disclose facts regarding the LLC’s future prospects and that he would not have sold his interest in 2004 if he had known these material facts.

Affirmative Defense of Release. The defendants sought summary judgment on the affirmative defense of “release” based on a general mutual release in the redemption agreement as well as a provision in which the parties released each other from claims arising from a determination that the value of Allen’s interest was more or less than the
reduction price. Although a contractual release may be avoided by proof it was fraudulently induced, the court recognized that the contract itself may preclude a fraudulent inducement claim if it clearly expresses the parties’ intent to waive fraudulent inducement claims or disclaims reliance on representations about specific matters in dispute. The court noted that the redemption agreement did not specifically waive fraudulent inducement claims, and the court held that the general release did not amount to a clear expression of intent to waive fraudulent inducement claims as required in order to bar such claims. Further, as discussed later in its opinion, the court rejected the defendants’ arguments that “finality” and “independent investigation” clauses in the redemption agreement precluded Allen’s fraudulent inducement claims.

Fraud: Actionable and Non-actionable Statements. The court of appeals addressed whether eight alleged statements were actionable as either statements of fact or statements of opinion falling within the exception to the general rule that statements of opinion are not actionable in fraud. The court held that the defendants failed to establish that six statements were non-actionable as a matter of law but that the trial court properly granted summary judgment as to the other two statements relied on by Allen as supporting a fraud claim.

Fraud: Effect of Contractual Releases and Disclaimers on Reliance Element. The defendants sought summary judgment on the ground that the reliance element of Allen’s claim was negated as a matter of law by the terms of the redemption agreement and Allen’s knowledge of changes in the LLC’s value between the redemption offer and its closing. The defendants argued that the redemption agreement’s “finality” and “independent investigation” clauses amounted to a clear and unequivocal disclaimer of reliance so as to preclude a fraudulent inducement claim. The “finality” clause provided that the redemption agreement was the “complete and final integration” of the parties’ undertakings and superseded all prior agreements and undertakings between the parties. The “independent investigation” clause stated that the redemption price was calculated and agreed to based on specified documents and recognized that intervening events may have increased or decreased the value of Allen’s interest; that Allen had the opportunity to obtain additional information; and that Allen had the opportunity to discuss and obtain answers regarding any information relating to the redemption from the LLC, the authors of the documents on which the purchase price was based, and Allen’s own advisors. Further, Allen represented in this clause that he based his decision to sell on his own independent due diligence investigation, his own expertise and judgment, and the advice and counsel of his own advisors and consultants. The court held that the “finality” clause was a generic merger clause that did not clearly disclaim reliance. The court held that the “independent investigation” clause did not contain the kind of absolute and all-encompassing language satisfying the clarity requirement as to any fraudulent inducement claim, but the clause did embody a clear and unequivocal intent to bar reliance on representations concerning price, the documents that were the basis for the price, and whether those documents accurately reflected the LLC’s value or the value of its assets. Applying this disclaimer to each of the actionable statements asserted by Allen, the court concluded that the agreement clearly and unequivocally disclaimed reliance on representations to the extent they conveyed information about the LLC’s value and the suitability of the redemption price but did not clearly and unambiguously disclaim reliance on representations to the extent they conveyed information about the LLC’s future prospects in light of drilling technology and other companies’ expansion-area endeavors, and all of the actionable statements related at least in part to the state of drilling technology and other companies’ expansion-area endeavors.

Having analyzed the threshold issue of whether the disclaimer was clear and unequivocal, and having found that the agreement was sufficiently clear and unequivocal to disclaim reliance with respect to representations regarding the value of the LLC and its assets or the redemption price, the court turned to an examination of the four remaining Forest Oil factors to determine whether the disclaimer of such reliance was enforceable. These factors are: (1) whether the contract was negotiated or boilerplate; (2) whether the complaining party was represented by counsel; (3) whether the parties dealt with each other at arm’s length; and (4) the parties’ relative knowledge in business matters. The court concluded that the second and fourth of these extrinsic factors favored enforcement, but the defendants did not conclusively establish the first and third factors. The court concluded that a disclaimer is not enforceable when only clarity, sophistication, and representation by counsel are present. Thus, although the agreement was sufficiently clear to disclaim reliance with respect to the value of the LLC and its assets, the defendants were not entitled to a summary judgment that the disclaimer was enforceable because the totality of the circumstances surrounding the agreement did not satisfy the Forest Oil test.

Fraud: Justifiable Reliance. The court stated that reliance is an element of fraud by omission and that justifiable reliance was thus an element of Allen’s claims for common law fraud and fraud under the Business and Commerce Code. The court noted that reliance is not an element of a claim for fraud under the Texas Securities Act. [The statutory fraud claims were based on Section 27.01 of the Texas Business and Commerce Code and the Texas Securities Act, and the opinion does not contain any discussion indicating that any argument was made regarding the nature of Allen’s LLC interest as “real estate or stock in a corporation or joint stock company” under Section 27.01 of the Texas Business and
the purchaser of the LLC to Rees-Jones for his ownership interest as “income” under the TSA. The court pointed out, more consistent with the way it is used throughout the TSA. Thus, Allen was not entitled to recover the amount paid by Allen, i.e., fraud, breach of fiduciary duty, and TSA violations. The court held that “income received by the buyer makes material misrepresentations or omits material facts necessary to make a statement not misleading. The defendants sought summary judgment on Allen’s TSA claims on the basis that Allen had knowledge preventing his recovery and that the claims were barred by the statute of limitations. The court of appeals held that the trial court erred in granting summary judgment on both of these grounds.

The court then discussed whether the TSA statute of limitations barred Allen’s TSA claims. Under the TSA, a defrauded seller must bring suit within “five years after the purchase” and within “three years after discovery of the untruth or omission, or after discovery should have been made by the exercise of reasonable diligence.” Allen filed suit within three years of the sale of his interest. Thus, the two key issues presented were: (1) when limitations began to run under the TSA; and (2) when Allen’s “discovery” of his claim occurred or should have occurred. The defendants argued that the limitations period began on the date Allen discovered or should have discovered the alleged fraud, while Allen argued that it should begin no earlier than the date of the sale. The court held that the five-year repose period ran from the date of the redemption, and the three-year limitations period began on the date Allen discovered or, in the exercise of reasonable diligence, should have discovered the untruths or omissions. Thus, the limitations period could begin to run prior to the plaintiff’s injury. Just as the court had held that Allen’s actual knowledge of the LLC’s increased value did not bar the TSA claims other than claims relating to the value of the LLC or redemption price, Allen’s knowledge did not commence limitations on the remaining TSA claims. Further, the court rejected the defendants’ argument that various public sources of information were sufficient to conclusively establish that limitations had expired because the defendants failed to establish when Allen should have been aware of any specific information that revealed one or more alleged untruths or omissions.

Common Law and TSA Damages. The court addressed the defendants’ argument that Allen had no recoverable damages as a matter of law. The defendants argued that Allen could not recover damages measured by the difference between the value of his interest at the time of the redemption and at the time of the subsequent sale of the company because (1) those damages are too speculative as a matter of law, and (2) the TSA limits his damages to the value of his interest as of the date of the sale. Allen responded that he was entitled to recover such damages based on disgorgement of the increased value received by Rees-Jones, that the damages are not too speculative, and that the damages are recoverable under the TSA as “income.” The court first noted that the defendants’ summary judgment motion did not address whether Allen could recover the equitable remedy of disgorgement, and the court stated that Allen did not have to prove actual damages with respect to his common law fraud and breach of fiduciary duty claims. In any event, the court concluded that the defendants did not establish that Allen had no recoverable actual damages as a matter of law. The court distinguished the two cases relied upon by the defendants because the plaintiffs in those cases had failed to produce evidence to support their damages model at trial in contrast to the instant case in which Allen bore no evidentiary burden on damages in the face of a traditional summary judgment motion. The court further distinguished one of the cases relied upon by the defendants because it did not address damages recoverable under the causes of action asserted by Allen, i.e., fraud, breach of fiduciary duty, and TSA violations. The court held that “income received by the buyer on the security” recoverable as damages under the TSA does not include the defrauding buyer’s proceeds on a subsequent sale because interpreting “income” to refer to dividends and other periodic payments but not profits on a subsequent sale is more logical given the way “income” is used in other subsections of the section of the TSA at issue as well as being more consistent with the way it is used throughout the TSA. Thus, Allen was not entitled to recover the amount paid by the purchaser of the LLC to Rees-Jones for his ownership interest as “income” under the TSA. The court pointed out,
however, that the defendants did not conclusively establish that Allen did not have other damages under the TSA, such as distribution income.

The plaintiffs invested in a complex tax avoidance scheme that was later disallowed by the IRS. The plaintiffs sued a number of defendants, including the law firm of Proskauer Rose, L.L.P. (“Proskauer”), asserting claims under RICO and the Securities Exchange Act of 1934. The tax avoidance scheme involved investments in LLCs, and the district court dismissed the RICO claim on the basis of the Private Securities Litigation Reform Act, which bars civil RICO claims based on predicate acts of securities fraud. The plaintiffs argued that the investments in the LLCs were not securities, but the court of appeals concluded that the ownership interests were investment contracts and thus securities under the federal securities laws. The court began by setting forth the three elements of the Howey test and noting that the only issue raised on appeal was whether the profits, i.e., the tax benefits, were to come solely from the efforts of others. The court discussed cases in which it has held that an investor’s theoretical power to make management decisions did not automatically preclude a finding the investor relied solely on the efforts of others. The court stated that the control of the LLC investors in this case was more theoretical than actual. The plaintiffs did not plead that they exercised any managerial authority over the LLCs. The complaint portrayed the plaintiffs as passive investors who depended—both in reality and according to their investment contracts—upon the efforts of investment consulting and brokerage entities for their profits. Thus, the investments were securities, and the district court did not err in dismissing the RICO claim as barred by the Private Securities Litigation Reform Act based on the face of the pleadings.

The court also analyzed the sufficiency of the pleadings with regard to the plaintiffs’ securities fraud claim against Proskauer under Section 10(b) of the Exchange Act and Rule 10b-5. Specifically, the court examined whether the plaintiffs had adequately pled the required element of reliance. The court looked to the Supreme Court’s decision in Stoneridge regarding scheme liability in the absence of Supreme Court authority (at the time of this opinion) directly addressing whether a secondary actor can be held liable in a private Section 10(b) action for deceptive conduct not attributed to it before the investor decides to invest. The court acknowledged that the causal chain between Proskauer’s conduct and the plaintiff’s injury was shorter than in Stoneridge, but the court stated that the plaintiffs bore a heavy burden in showing that they in fact relied upon Proskauer’s own deceptive conduct. The court said that Stoneridge appears to imply that a secondary actor’s conduct or statement must be known to the investor in order for the investor to rely on it, and the court thus concluded that explicit attribution is required to show reliance under Section 10(b). Applying this standard, the court concluded that the district court properly dismissed the securities fraud claims against Proskauer. Although the plaintiffs’ pleadings clearly described the intimate involvement of Proskauer in the tax scheme, the plaintiffs did not explicitly assert that they had knowledge of Proskauer’s role prior to the actual investment. Thus, the plaintiffs failed to show reliance.

**KK. Conflict of Laws**

The plaintiff sued two individuals and four LLCs asserting claims arising out of the sale of allegedly harmful dietary supplements. The plaintiff sought to impose collective liability on all these defendants based on veil piercing. The defendants sought dismissal on the basis that the plaintiff failed to adequately allege that veil piercing was warranted. The court first addressed the law governing the case and applied Texas choice-of-law principles since the events allegedly occurred in Texas. Under Texas choice-of-law rules, whether a corporation, LLC, or individual may be held liable pursuant to veil-piercing theory is governed by the law of the state in which the entity is organized. Three of the LLCs were Wyoming LLCs, and the other LLC and the two individuals were a Texas LLC and Texas residents. The court proceeded to analyze the veil piercing claims as to the Wyoming LLCs under Wyoming law and the claims against the Texas defendants under Texas law and concluded that the complaint was insufficient to allege veil-piercing claims as to both sets of defendants. The court stated that the plaintiff could seek leave to amend.

In this patent infringement action, one of the plaintiffs, a Delaware LLC, was formed by its Delaware parent corporation, one day before this suit was filed. The defendant argued that the LLC lacked standing because Section 9.001 of the Texas Business Organizations Code requires a foreign entity to register with the Secretary of State in order to transact business in Texas, and the LLC did not register until more than 2 months after the suit was filed. Section 9.051 of the Texas Business Organizations Code provides that a foreign filing entity may not maintain an action in a court of
Texas unless it is registered as required by the statute. The court first noted that it was not clear whether the Business Organizations Code requires a foreign entity to register before pursuing a federal action in federal court, but the court found it unnecessary to undertake this interpretation of the Texas statute because it concluded that the court had subject-matter jurisdiction, and the LLC had standing to sue for patent infringement, even if the statute did purport to prohibit the LLC from suing in federal court. Though state law may not restrict federal jurisdiction, federal jurisdiction may depend on state law. The court stated that the defendant’s argument, though framed as an argument of standing, was actually one of capacity. An entity’s capacity to sue in federal court is governed by Rule 17(b). Under this rule, a corporation’s capacity to sue is determined by the law of the state of incorporation, and the capacity of all other entities is determined by the law of the state where the court is located, except that a partnership or unincorporated association with no capacity under that state’s law may sue or be sued in its common name to enforce a right under federal law. The court stated that it was not necessary to determine whether an LLC organized in Delaware is a “corporation” or an “unincorporated association” for purposes of Rule 17(b). Under Delaware law, an LLC can sue or be sued in its own name, and if it is an unincorporated association, it has capacity to sue in its common name to enforce a right under federal law even if Texas law would otherwise deny the association’s capacity to sue. In either case, the LLC had capacity to sue for patent infringement.


The plaintiffs did not have standing to bring RICO claims that resulted in injury to a New Mexico LLC. Federal courts sitting in Texas apply the Texas internal affairs rule under which the law of the state of incorporation governs a corporation’s internal affairs. Thus, New Mexico law governs a New Mexico LLC, and New Mexico law provides that an LLC alone holds its causes of action. A member of an LLC has no right to sue on the LLC’s behalf. Any injury derived from the investment at issue in this case was the LLC’s, and the plaintiffs did not have standing to assert claims based on the injury.


The plaintiff contracted to provide various therapy services for a limited partnership engaged in the business of providing home health care services. After the limited partnership stopped paying the plaintiff, the plaintiff sued the limited partnership, numerous related entities (two corporations, a limited partnership, and numerous LLCs), and individuals who were limited partners, officers, and members of these entities. The court in this opinion addressed a motion to dismiss in which the individual defendants argued that the plaintiff failed to state a claim against them. In determining whether the plaintiff stated a claim against the individual defendants under Rule 12(b)(6), the court first addressed the scope of the motion and concluded that it only pertained to the individuals’ liability with respect to one Texas corporation and six Texas LLCs because the individual defendants relied on Section 21.223 of the Texas Business Organizations Code, which the court pointed out applied only to Texas corporations and Texas LLCs. Tex. Bus. Orgs. Code §§ 21.223, 1.102, 1.104, 101.002. Thus, the court said the motion did not relate to the individuals’ liability with respect to the two Texas limited partnerships, a Nevada corporation, two Delaware LLCs, and one Michigan LLC.


The court discussed the question of whether a series of a Delaware LLC is a separate juridical entity in this wrongful foreclosure action arising out of a judgment of foreclosure obtained in Louisiana by a series of a Delaware LLC that was not named as a defendant in the wrongful foreclosure action. After the series, which was the holder of the note secured by Alphonse’s home, obtained the judgment of foreclosure, Alphonse brought this action in federal court asserting claims under Louisiana law and the Federal Fair Debt Collection Practices Act. Alphonse sued the mortgage servicing company and the Delaware parent LLC of the series. On appeal, the parties agreed that the district court erred in its analysis of the _Rooker-Feldman_ doctrine, but the defendants argued that dismissal was proper on res judicata grounds and because of the separate juridical status of the series. The success of the res judicata argument turned on whether there was an identity of parties between the series and the defendants. The court of appeals held that the defendants did not meet their burden of showing an identity of parties at the motion to dismiss stage. The analysis of this question depended on fact-bound issues involving control and virtual representation, and the court held that the district court’s decision to dismiss before discovery was erroneous. In the course of its discussion, the court of appeals acknowledged that the series that obtained the judgment of foreclosure “is a Series LLC [noting by way of footnote that ‘a’ “Series LLC” is basically a business entity within a business entity’], and Series LLCs only exist to represent the interest of the parent LLC,” but the court characterized the question of the legal separation of the series and its parent as a fact-bound question under Louisiana law. The court next discussed the question of whether dismissal could be upheld.
on the basis that Alphonse sued the wrong party when it sued the parent LLC rather than the series. Alphonse argued that the series and its parent LLC are not legally distinct entities and that the district court erred in relying on the statutory limitation of liability and capacity and power of a series to sue and be sued in its own name to conclude that the series in this case was a separate juridical entity from its parent LLC and thus responsible for the trade violations alleged in the complaint. The court of appeals took issue with the district court’s conclusion that Delaware law applied under the applicable Louisiana conflict-of-laws provision, which states that “[t]he laws of the state or other jurisdiction under which a foreign limited liability company is organized shall govern its organization, its internal affairs, and the liability of its managers and members that arise solely out of their positions as managers and members.” The court of appeals discussed the distinction between internal and external affairs and stated that it is not clear whether the liability of an LLC, or its series, to third parties like Alphonse is internal or external. Because the district court apparently did not consider “whether the liability as between a third-party plaintiff with respect to a holding company LLC or its Series LLC constitutes internal or external affairs,” the court of appeals remanded the case for consideration of the question. The court suggested that factual development might be necessary to resolve the question.


The plaintiff, a litigation trust, alleged claims against the CEO of the debtor LLC for approving a wrongful distribution and for breach of fiduciary duty.

The CEO sought summary judgment on the wrongful distribution claim on the basis that it was barred by the Georgia two-year statute of limitations. The plaintiff alleged that its wrongful distribution claims were brought under applicable state law, including, but not limited to, claims under Delaware, Texas, Georgia, and North Carolina law. The court stated that the forum state, Texas, uses the Restatement’s “most significant relationship” test to decide choice-of-law issues. The CEO argued Georgia law should apply to the wrongful distribution claim because the LLC was a Georgia LLC and the claims arose out of the CEO’s role as manager and CEO of the LLC. The plaintiff argued that North Carolina law applied under the most significant relationship test, pointing out that the LLC had no apparent relationship to Georgia other than being formed under Georgia law. The CEO admitted that the LLC’s principal place of business was in North Carolina where he worked and that the injury flowed from an agreement executed in North Carolina with another party that was headquartered in North Carolina. The court concluded that the plaintiff had the better argument. While the court acknowledged that Georgia has an interest in seeing its law applied to LLCs formed in Georgia, the court found the relevant policy difference in this case, a mere one-year difference in the statute of limitations, was not a substantive difference in fraudulent transfer law. Also, the application of North Carolina law did not frustrate the application of an exculpation clause in the LLC agreement relied on by the CEO. Because the court concluded that North Carolina law applied under the most significant relationship test, the court rejected the CEO’s statute of limitations argument that was based on Georgia law.

The CEO also sought summary judgment on the plaintiff’s breach of fiduciary duty claims. The court stated that both Georgia and North Carolina appear to have followed the lead of Delaware in adopting the standard theories of corporate director liability, including the duties of loyalty, care, and good faith, and the business judgment rule. The court also noted that North Carolina follows the traditional rule that the business judgment rule does not apply to self-dealing or conflicted directors. The CEO contended that he was protected by both an exculpation clause in the LLC agreement and the business judgment rule. The exculpation clause provided that the board members, officers, and directors of the LLC were not liable for damages for actions taken on behalf of the LLC unless those actions were performed fraudulently or constituted gross negligence or willful misconduct. Thus, he argued he could not be liable for making a reasonably informed decision to approve the transaction at issue on behalf of the LLC. The CEO argued that he was at most negligent and did not act with the heightened state of mind required under the exculpation clause to hold him liable. The court concluded, however, that the summary judgment record raised substantial questions as to whether the CEO, a self-interested director with a financial stake in the transaction, could even take advantage of the exculpation clause or the business judgment rule. Assuming he could, the court said there were factual disputes as to whether he was merely negligent or something more. The CEO was not entitled to summary judgment on the breach of fiduciary duty claims by simply professing in an affidavit that he acted in good faith.


The court rejected the argument that the three-year statute of limitations applicable to an impermissible distribution under the Delaware Limited Liability Company Act (“DLLCA”) applied to millions of dollars of distributions made by a Delaware LLC. The court held that the Delaware legislature could not limit the reach of the Texas Uniform Fraudulent Transfer Act (“TUFTA”), which contains a four year statute of repose applicable to the fraudulent transfer claims asserted by the trustee. The court stated that a fraudulent transfer claim sounds in tort, and
the court thus applied the most significant relationship test called for under Texas choice-of-law rules. The only connection between the trustee’s fraudulent transfer claims and Delaware was the fact that the LLC and its members were Delaware entities. The LLC and its members were headquartered in Texas and controlled by a Texas resident, and the decision making took place in Texas. Distribution checks were drawn on and deposited in Texas banks. Furthermore, the court stated that the internal affairs rule did not apply because fraudulent transfer claims like those at issue involve the rights of creditors rather than internal corporate governance issues that are the subject of the internal affairs doctrine. The trustee was not challenging the LLC’s ability to properly pay distributions to its members as a matter of corporate law, or seeking to hold the members liable for the LLC’s debts, which is the other purported statutory basis for the application of Delaware law. Thus, the DLLCA three-year limitations period was not applicable to the trustee’s TUFTA claims.

In accordance with the court’s conclusion in a prior opinion in this bankruptcy proceeding, the court stated that, in Texas, the law of the state of formation governs a veil piercing claim to hold an owner liable for the entity’s debts; therefore, the court relied upon Delaware law in analyzing the trustee’s attempt to pierce the veils of numerous Delaware entities. With respect to a Tennessee corporation and a Texas corporation, the court applied Tennessee and Texas law, respectively. The court reiterated its conclusion from its prior opinion that Delaware and Tennessee courts do not separately recognize a sham to perpetrate injustice theory. Rather, the sham concept is included in the alter ego analysis under Delaware and Tennessee law.


The court stated that Texas looks to the law of the jurisdiction of formation when determining the liability of an owner under a veil piercing claim. With the exception of a Tennessee corporation and a Texas corporation, the entity defendants were all Delaware LLCs, corporations, and limited partnerships. The court found that Delaware and Tennessee did not recognize sham to perpetrate injustice as a separate veil piercing theory; rather, the sham concept is subsumed in the alter ego doctrine in those jurisdictions.


The debtor and the defendant formed a Wisconsin LLC under a formation agreement that provided Wisconsin law would govern. Applying Texas choice of law rules and using a “most significant relationship” analysis, the court concluded that Wisconsin law applied to breach of contract and breach of duty claims brought by the trustee against the defendant member.


The plaintiffs sought to pierce the veil of a Delaware LLC and treat the LLC as the alter ego of the debtor in order to attribute to the debtor false representations made by the LLC in a private placement memorandum and pursue certain other claims for fraud, embezzlement, and breach of fiduciary duty that depended upon the disregard of the LLC’s separate existence. Applying Texas conflict of laws principles (citing the Texas Business Corporation Act), the court stated that Delaware substantive law determined whether the veil of a Delaware LLC should be pierced. In a previous suit, a Texas state court had found the LLC in question to be the alter ego of the debtor, and the court found that Delaware law dictated that the law of collateral estoppel of the state where a judgment was rendered determines the scope of collateral estoppel in the second case. Applying Texas offensive collateral estoppel principles, the court concluded that it could pierce the veil of the LLC based on the finding in state court that the LLC was the alter ego of the debtor. Alternatively, the court found that the same result could be achieved using Delaware offensive collateral estoppel. Additionally, even if offensive collateral estoppel under Texas or Delaware law could not be applied to prevent the debtor from denying that the LLC was his alter ego, the court concluded that the LLC’s veil could be pierced by directly relying on the alter ego doctrine under Delaware law.


The court applied Delaware law to the question of standing to bring a derivative suit on behalf of a Delaware LLC.


In a suit by one member of a Nevada LLC against the other two members, a magistrate analyzed provisions of the operating agreement requiring action to be “agreed upon by members” as well as provisions waiving or limiting
of Quisenberry for trial.

of Quisenberry’s interest supported the trial court’s res judicata judgment, the court remanded McNeil Interests’ claims 

impacted Quisenberry’s obligations as guarantor and co-maker was to pay the judgment, in which case he could urge a 

that he actively or openly participated in the proceeding or that he even hired an attorney to appear for the LLC. The only 

evidence was to the contrary since McNeil Interests obtained a default judgment against LLC after no one appeared to 

defend the LLC. Further, the court stated that if Quisenberry, as 50% owner and the registered agent of the LLC, had 

hired an attorney for the LLC and served as its corporate representative at trial, all of these actions would have been in 

a representative capacity and would not have amounted to “control” sufficient for privity for purposes of res judicata. 

Next, the court analyzed whether Quisenberry and the LLC were in privity through a prior representation of interests. 

Privity may exist if the parties share an identity of interest in the basic legal right that is the subject of the litigation, but 

distinct capacities are an obstacle to res judicata. There was no evidence that the LLC, through its failure to appear as 

the maker of the Amegy and McNeil Interests notes, represented or should be deemed to have represented Quisenberry 
as guarantor and co-maker of those notes. The court stated that the only commonality of interest between the LLC and 

Quisenberry with respect to the notes was the dollar amount of the obligations, and the only way that the LLC could have 

controlled the litigation. Quisenberry was served as registered agent of the LLC in the first suit, but there was no evidence 

that he actively or openly participated in the proceeding or that he even hired an attorney to appear for the LLC. The only 

evidence was to the contrary since McNeil Interests obtained a default judgment against LLC after no one appeared to 
defend the LLC. Further, the court stated that if Quisenberry, as 50% owner and the registered agent of the LLC, had 
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Next, the court analyzed whether Quisenberry and the LLC were in privity through a prior representation of interests. 

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Quisenberry with respect to the notes was the dollar amount of the obligations, and the only way that the LLC could have 
impacted Quisenberry’s obligations as guarantor and co-maker was to pay the judgment, in which case he could urge a 
bar under the one-satisfaction rule. Since neither control of the prior litigation by Quisenberry nor prior representation 
of Quisenberry’s interest supported the trial court’s res judicata judgment, the court remanded McNeil Interests’ claims 
against Quisenberry for trial.

MM. Effect of Merger or Conversion


filed).

In 2000, Ancor Holdings LLC (“Ancor LLC”) executed a guaranty agreement in favor of a bank. The guaranty 

agreement prohibited Ancor LLC from merging unless it was the survivor and further provided that it could not change 
its legal structure without the bank’s permission. When Ancor LLC failed to pay the guaranty, the bank’s successor sued 
it in Dallas County. After three years of arbitration, the plaintiff obtained a judgment against Ancor LLC confirming the 

arbitrator’s award. A few months later, the plaintiff discovered that eight years earlier Ancor LLC had merged into a 
limited partnership, Ancor Holdings L.P. (“Ancor LP”). The agreement and plan of merger provided that Ancor LP 
assumed all the liabilities of Ancor LLC. The plaintiff sought to modify the judgment to include Ancor LP on the grounds 
of misnomer. Ancor LLC opposed the modification on the grounds that Ancor LLC and Ancor LP were two separate and 

fiduciary duties and made recommendations regarding the parties’ motions for summary judgment. The magistrate 

applied Nevada law based on the parties’ position that Nevada law should apply, the choice of law provision in the 

operating agreement, and the internal affairs doctrine.

LL. Res Judicata


McNeil and Quisenberry formed an LLC of which each was a 50% owner. The LLC obtained a revolting line 
of credit with Amegy Bank secured by guaranties signed by McNeil and Quisenberry and a pledge of a mutual fund 
account held by McNeil Interests, Inc. (“McNeil Interests”), a corporation owned by McNeil and his mother. When the 
LLC needed additional operating funds, McNeil Interests loaned the LLC money, and Quisenberry co-signed this note. 
In 2008, the LLC defaulted on payment of the Amegy note (resulting in Amegy’s exercise of its right to take more than 
$600,000 out of McNeil Interests’ mutual fund account) and its note to McNeil Interests, and McNeil Interests filed a 
lawsuit against the LLC asserting various claims related to the LLC’s failure to pay the Amegy note and the McNeil 
Interests note. The trial court entered a default judgment in favor of McNeil Interests against the LLC in that lawsuit. 
In 2010, McNeil Interests and McNeil, individually and on behalf of the LLC, sued Quisenberry for contribution on the 
Amegy note and liability as obligor on the McNeil Interests note. The trial court ordered that McNeil and McNeil 
Interests take nothing from Quisenberry based on Quisenberry’s affirmative defense of res judicata, and McNeil and 
McNeil Interests appealed. The res judicata analysis in this case turned on the issue of privity. The court of appeals 
stated that it was unclear whether the trial court determined that Quisenberry’s 50% interest in the LLC placed him in 
privity for purposes of the first lawsuit because he was “in control” of the litigation against the LLC or because 
Quisenberry’s interests were represented in the first lawsuit. The court of appeals confined its analysis to these two 
circumstances of privity because Quisenberry did not argue that he was the LLC’s successor, and there was no evidence 
to support a determination of successorship. First, the court of appeals analyzed whether privity existed through 
Quisenberry’s control of the first lawsuit. The trial court did not make an explicit finding that Quisenberry controlled 
the first lawsuit, and the court of appeals concluded that the evidence did not support an implied finding that Quisenberry 
controlled the litigation. Quisenberry was served as registered agent of the LLC in the first suit, but there was no evidence 
that he actively or openly participated in the proceeding or that he even hired an attorney to appear for the LLC. The only 
evidence was to the contrary since McNeil Interests obtained a default judgment against LLC after no one appeared to 
defend the LLC. Further, the court stated that if Quisenberry, as 50% owner and the registered agent of the LLC, had 
hired an attorney for the LLC and served as its corporate representative at trial, all of these actions would have been in 
a representative capacity and would not have amounted to “control” sufficient for privity for purposes of res judicata. 

Next, the court analyzed whether Quisenberry and the LLC were in privity through a prior representation of interests. 

Privity may exist if the parties share an identity of interest in the basic legal right that is the subject of the litigation, but 
distinct capacities are an obstacle to res judicata. There was no evidence that the LLC, through its failure to appear as 
the maker of the Amegy and McNeil Interests notes, represented or should be deemed to have represented Quisenberry 
as guarantor and co-maker of those notes. The court stated that the only commonality of interest between the LLC and 
Quisenberry with respect to the notes was the dollar amount of the obligations, and the only way that the LLC could have 
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bar under the one-satisfaction rule. Since neither control of the prior litigation by Quisenberry nor prior representation 
of Quisenberry’s interest supported the trial court’s res judicata judgment, the court remanded McNeil Interests’ claims 
against Quisenberry for trial.

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distinct entities and that a misidentification had occurred. That case was appealed to the Dallas Court of Appeals, and meanwhile the plaintiff brought this suit against Ancor LP and its partners for satisfaction of the judgment award against Ancor LLC. The plaintiff sought declaratory judgment that the limited partnership was liable on the judgment and asserted various causes of action sounding in contract and tort. Ancor LP and its partners sought summary judgment on the declaratory judgment and contract claims on the grounds of res judicata and limitations. The trial court granted summary judgment for Ancor LP and its partners and dismissed the plaintiff’s claims. On appeal, the plaintiff argued that Ancor LP and its partners had not met the elements of res judicata. According to Ancor LP and its partners, the plaintiffs’ claims were barred because they could have been brought in the earlier action. In the appeal of the earlier case, the Dallas Court of Appeals concluded that Ancor LLC and Ancor LP were two separate and distinct entities, and because Ancor LP was not served, it could not be included in the judgment. The court of appeals in this case concluded that Ancor LP and the partners had not established all of the elements required for res judicata because they had not established that the parties in this action were the same or in privity with the parties in the original action. In fact, Ancor LP and its partners had asserted in their motion for summary judgment that Ancor LP was not a party to the judgment in the first action. Thus, the trial court erred in granting summary judgment on the basis of res judicata. The court of appeals next concluded that Ancor LP and its partners were estopped to assert limitations as a defense because their current position—that Ancor LLC did not exist as an independent entity following its merger with Ancor LP—was inconsistent with their previous successful one—that Ancor LLC and Ancor LP were separate and distinct entities. This position was intentional, not inadvertent. Two of the partner defendants in this action testified in the previous action that they served as officers of Ancor LLC and that it was a viable entity. In this case, however, they claimed that Ancor LLC ceased to be a viable, ongoing entity after the merger. Thus, the court of appeals concluded that Ancor LP and its partners were estopped to assert limitations as an affirmative defense in this action.


The defendant argued that the plaintiff’s non-diverse Delaware citizenship was the result of “tampering” to artificially destroy diversity jurisdiction. The defendant admitted that both the plaintiff and defendant were Delaware corporations and thus non-diverse citizens of Delaware at the time of removal, but the defendant sought leave to conduct discovery regarding the timing, motive, and intention of the formation of the plaintiff’s Delaware corporate identity and its conversion from its previous business form as a Texas LLC. The defendant’s argument for looking behind the facts as they existed on the date of removal was that the plaintiff incorporated only the day before filing suit, presumably for the purpose of defeating federal diversity jurisdiction. The court stated that the defendant offered no basis for determining that the plaintiff’s conversion to a Delaware corporation was not a lawful exercise of its rights under relevant state law or involved an incomplete transfer of assets, including the cause of action brought in the case. The court saw no distinction between plaintiff’s conversion from a Texas LLC to a Delaware corporation and an individual’s relocation of his or her domicile from one state to another. “Highly suspect timing” was not a basis to challenge the legitimacy of the plaintiff’s corporate conversion. Without some allegation that the corporate conversion was legally improper or incomplete the court saw no reason to prolong the action in federal court and subject the parties to the delay and expense of jurisdictional discovery. The defendant’s request for jurisdictional discovery was denied, and the action was remanded to state court where it was filed.


In 2008, a corporation adopted an “Arbitration Policy and Agreement,” which it required its employees to sign to continue employment. In 2010, the corporation converted to an LLC. Later that year, the LLC terminated the employment of Yazhari, and Yazhari sued the LLC and its owner asserting numerous causes of action. The defendants moved to compel arbitration, and Yazhari resisted arbitration on various grounds. One argument Yazhari made was that neither the LLC nor its owner were parties to the arbitration agreement because the arbitration agreement did not reference members, successors, or assigns, and the LLC was not in existence in 2008. The court of appeals pointed out that the Texas Business Organizations Code provides that when a conversion takes effect, “the converting entity continues to exist without interruption in the organizational form of the converted entity” and that “all liabilities and obligations of the converting entity continue to be liabilities and obligations of the converted entity in the new organizational form without impairment or diminution because of the conversion.” Thus, the corporation did not cease to exist when the certificate of conversion was filed with the Secretary of State, and the LLC as the converted entity was entitled to enforce the arbitration agreement to the extent the parties formed an agreement. Further, because the agreement applied to “[a]ny controversy between Employee and the Company or any of its owners, employees, officers,
agents, affiliates or benefits plans,” Yazhari’s claims against the individual owner and president were within the scope of the agreement.


The defendant argued that the trial court erred in rendering summary judgment to Wells Fargo Auto Finance, LLC because the lawsuit was filed by Wells Fargo Auto Finance, Inc. The defendant asserted that Wells Fargo Auto Finance, Inc. ceased to exist January 8, 2010, and the lawsuit was filed February 8, 2010. The defendant raised the issue pertaining to the conversion of Wells Fargo from a corporation to an LLC in a motion to abate. Wells Fargo responded to the motion to abate by filing a motion to substitute true name of party, asserting that the conversion had no effect on the corporate entity. The trial court’s order denying the motion to abate recited that the court had considered the record, evidence, and argument of counsel. The reporter’s record from the hearing was not requested and included in the record on appeal, and the court of appeals thus presumed that the record contained all matters supporting the trial court’s denial of the defendant’s motion to abate.

Wasserberg v. Flooring Services of Texas, LLC, 376 S.W.3d 202 (Tex. App.–Houston [14th Dist.] 2012, no pet.).

The plaintiff sought to hold Wasserberg and Felt liable as guarantors for amounts owed for goods and services sold by the plaintiff to Waterhill Companies Limited (“WCL”). In 2002, Wasserberg and Felt signed a credit application on behalf of Waterhill Company, LLC, in which Wasserberg and Felt purported to “personally guarantee all indebtedness hereunder” in order to obtain credit from Flooring Services of Texas, L.P. Waterhill Company, LLC converted into WCL in 2003, and Flooring Services of Texas, L.P. merged into Flooring Services of Texas, LLC (the “plaintiff”) in 2007. Goods and services were provided on credit before and after these transactions. The guarantors argued that they were not liable for debts incurred after these transactions (i.e., debts incurred by WCL, the converted entity, for goods and services provided by the plaintiff, the survivor of the merger) because the terms of a guaranty must be strictly followed and “neither the party seeking to enforce the guaranty nor the party whose performance was guaranteed is named in the existing document.” The court of appeals held that the trial court properly concluded that the guaranties were applicable to debts incurred after Waterhill Company, LLC converted into WCL because the Texas conversion statutes and the articles of conversion filed with the Secretary of State provided that the converting entity continues in existence in the organizational form of the converted entity. (Relying on a statement in the articles of conversion, the court erroneously referred to the Texas Business Corporation Act rather than the Texas Limited Liability Company Act, but the conversion statutes for partnerships, corporations, and LLCs all contained similar language.) The court of appeals also rejected the argument that the guaranties did not apply to indebtedness for goods and services provided by the plaintiff, Flooring Services of Texas, LLC, as the survivor of a merger with Flooring Services of Texas, L.P. The guarantors argued that the guaranties did not cover these post-merger transactions because the guaranties did not name the plaintiff or refer to its “successors or assigns.” The court noted that the Texas merger statutes provide that all rights and obligations of the parties to the merger are allocated and vested in the surviving entity without the need for any formal transfer or assignment. The court also distinguished other Texas cases relied upon by the guarantors. According to the court, unlike a guaranty that covered payment for goods sold by Ford Marketing Corporation (which was held not to be enforceable by Ford Motor Company for goods sold by it as the post-merger successor), the document in this case referred to “all indebtedness hereunder” and was not limited to goods and services provided by Flooring Services of Texas, L.P. Additionally, the court rejected the argument that Texas cases have required language extending a guaranty to actions by a successor entity in order for a successor to enforce the guaranty.


After the trial court signed a final judgment against Ancor Holdings, LLC confirming an arbitration award in favor of the plaintiff on a guaranty executed by the LLC, the plaintiff learned that the LLC had merged into Ancor Holdings, LP and that Ancor Holdings, LP had assumed the liabilities of the LLC. The plaintiff asked the trial court to modify the judgment to correctly list the defendant as Ancor Holdings, LP. The plaintiff argued that this case was a simple case of misnomer in which it sued the right defendant under the wrong name, but the court of appeals stated that Ancor Holdings, LLC and Ancor Holdings, LP were two separate and distinct legal entities and that only the LLC was sued, was served with process, and appeared. The court noted that Texas statutes of limitation and rules of practice “afford plaintiffs ample time and many means of figuring out the proper identity of the parties sued.” Because a judgment may not be entered against a party that has neither been named nor served, and the judgment must conform to the
pleadings, the court of appeals refused the plaintiff’s request to include Ancor Holdings, LP as a judgment debtor and held that the trial court did not err in denying the plaintiff’s motion to modify the judgment to name Ancor Holdings, LP.


The court held that a limited partnership’s rights as the designated beneficiary of a key man life insurance policy vested in an LLC pursuant to a merger of the limited partnership into the LLC so that the policy proceeds were payable to the surviving LLC. The policy in issue insured the life of Marvin Fred Allen, who was the CEO of CreditWatch Services, L.P., a Texas limited partnership, and the president of the limited partnership’s LLC general partner when the policy was purchased in 2001. Allen signed the application in his individual capacity as the insured and in his capacity as president of the LLC general partner as the policy’s applicant/owner. He designated the limited partnership as the sole beneficiary. In 2002, the limited partnership merged with an Ohio limited liability company. The survivor of the merger was the Ohio LLC, CreditWatch Services, Ltd. (which later changed its name to CreditWatch Services LLC). The insurance policy’s beneficiary designation was never changed. Six months after the merger, Allen died, and the insurer subsequently issued a check in the amount of the policy proceeds payable to “CreditWatch Services.” CreditWatch Services LLC deposited the check into its account. Allen’s widow brought suit claiming that the insurer should have paid the proceeds to Allen’s estate because the policy’s designated beneficiary ceased to exist after the merger and because the LLC had no insurable interest in Allen’s life at the time of his death. The court held that, regardless of whether the limited partnership’s interest as beneficiary was characterized as a chose in action or an expectancy, the interest was transferable and vested in the surviving LLC pursuant to the language of the merger agreement and the Texas and Ohio merger statutes. Both the Texas Revised Limited Partnership Act and the Ohio Revised Code provide for the vesting of all rights and interests in the surviving entity without further act or deed, and the terms of the merger agreement were consistent with the statutes. The court rejected the argument that the merger was the corporate equivalent of the death of a natural person beneficiary. The court stated that, while the separate existence of a non-surviving entity ceases, all of its rights and obligations continue to exist in the surviving entity. The court also rejected the argument that, because Allen was no longer employed by the limited partnership or its successors, the surviving LLC had no insurable interest in Allen’s life at the time of his death. The court held that the limited partnership had an insurable interest in Allen’s life when Allen designated the beneficiary designation and at all times thereafter because the Legislature has enlarged the class of persons considered to have an insurable interest by enacting Sections 1103.054 and 1103.056 of the Texas Insurance Code. These provisions allow an insured individual to designate or consent to the designation of “any individual, partnership, association, or corporation” as beneficiary, and Section 1103.053 provides that a beneficiary designated in accordance with these sections has, at all times after the designation, an insurable interest in the life of the insured individual. According to the court, other provisions of the Insurance Code that confer on corporations and partnerships insurable interests in their officers, shareholders, and members do not limit the provisions of 1103.054 and 1103.056 to partnerships in which the insured is a member.

**NN. Professional LLC**


In this breach of contract action arising out of a business transaction involving anesthesia management services, one of the parties claimed that a physician who held an administrative medical license in Texas (but was not licensed to practice clinical medicine in Texas) was prohibited from controlling or managing a Texas professional limited liability company. An administrative medical license does not authorize the practice of clinical medicine but allows a person to administer or manage the practice of medicine in Texas. The court perceived no violation of the Texas Business Organizations Code (BOC) in the exercise of control or management of the PLLC by a physician who held only an administrative medical license in Texas. The court pointed out that the BOC allows individuals licensed as doctors of medicine by the Texas Board of Medical Examiners to jointly form and own a professional association or professional LLC to perform professional services that fall within the scope of those practitioners. Further, the BOC provides that each practitioner’s authority is limited by the scope of his practice and requires an organizer of the entity to be a physician who ensures that a physician or physicians control and manage the entity. A physician is defined in the Texas Occupations Code as a person licensed to practice medicine in Texas. Under the Texas Occupations Code, a limited license to practice administrative medicine is a recognized type of limited medical license. Since the individual in this case received a limited license to practice administrative medicine, the court did not think his control or management of the PLLC violated the provision of the BOC requiring that a physician or physicians control and manage the entity.
OO. Attorney-Client Privilege


The court discussed the attorney-client privilege in the context of a bankruptcy trustee’s attempt to compel turnover of documents by a law firm that had represented the debtor LLC.

PP. Attorney Disqualification

Kira Inc. v. All Star Maintenance Inc., 267 Fed. App’x 352 (5th Cir. 2008).

A minority member of a Nevada LLC brought a derivative suit against the other two members of the LLC. The plaintiff asserted various claims based on the alleged improper use by the defendant members of the LLC’s name and the payment of management fees to affiliates of the defendants. The plaintiff argued that the district court erred in denying its motion to disqualify defense counsel due to conflicts in representing the LLC and the defendant members accused of harming the LLC’s interests. The court stated that any conflicts asserted by the plaintiff were more theoretical than real. All members were parties to the action, and the plaintiff was the only party who stood to benefit from a plaintiff’s verdict. The court could not imagine any remedy that could have been obtained by the LLC that would have been different from a remedy in favor of the plaintiff and saw no purpose that would have been served by independent counsel for the LLC in this case. Thus, the court held that the district court did not abuse its discretion in denying the motion to disqualify.

V. Texas Cases Involving Registered Limited Liability Partnerships

A. Limited Liability of Partners


The plaintiffs sought to hold Babb, a partner in Jenkins/Babb, LLP, liable under the Fair Debt Collection Practices Act (FDCPA) based on a collection letter sent on behalf of Jenkins/Babb, LLP and signed by Jenkins. The plaintiffs contended that Babb was liable under the FDCPA because he was a “principal” of Jenkins/Babb, LLP, and as such should have been aware of the actions taken by Jenkins and the law firm and had a duty to oversee their actions. The plaintiffs’ pleadings contained no information showing that Babb was involved in any of the communications received by the plaintiffs from the law firm, and there was no showing that Babb either engaged in a business with the principal purpose of collection of debts or regularly collected or attempted to collect debts. Thus, the court concluded that the plaintiffs failed to raise a reasonable inference that Babb was a debt collector. With respect to vicarious personal liability of Babb, the court noted that Section 152.801(b) of the Business Organizations Code, as in effect at the time of the events giving rise to the plaintiffs’ FDCPA claims, provided that a partner in an LLP was not personally liable for a debt or obligation of the partnership arising from an error, omission, negligence, incompetence, or malfeasance committed by another partner or representative of the partnership unless the partner: (1) was supervising or directing the other partner or representative when the error, omission, negligence, incompetence, or malfeasance was committed; (2) was directly involved in the specific activity in which the error, omission, negligence, incompetence, or malfeasance was committed; or (3) had notice or knowledge of the error, omission, negligence, incompetence, or malfeasance and failed to take reasonable steps to prevent or cure it. The court stated that the Fifth Circuit has not yet ruled on the issue of whether and under what circumstances a partner in an LLP can be held personally liable for FDCPA violations committed by his partnership or another partner. The court noted that other circuit courts of appeals and district courts within the Fifth Circuit have reached differing conclusions as to whether a shareholder, officer, or employee of a corporation who is personally involved in the debt collection at issue may be held personally liable as a debt collector without piercing the corporate veil. The court concluded that the plaintiff failed to allege any facts that would support a finding of either vicarious or direct liability. The complaint was devoid of facts showing that Babb was a debt collector under the FDCPA and asserted no facts to support a finding that any of the exceptions listed in Section 152.801(b) applied in this case.


The plaintiff sought to hold Van Wey, a partner in an LLP law firm, liable for allegedly defamatory statements posted on the firm’s website by another partner, Johnson. The court noted that Van Wey appeared to argue that she could not be held liable for Johnson’s allegedly defamatory statements because, as of September 1, 2011, the Texas LLP statute
was amended to remove all exceptions to the general rule that partners in an LLP are not liable for the debts of the partnership. The court stated that the amendments to the Texas Business Organizations Code were not expressly retroactive and thus did not govern the claims against Van Wey, which were based on events predating the amendments. Before the 2011 amendments, Section 152.801(b) of the BOC provided that a partner could be liable for a liability arising out of another partner’s negligence or malfeasance if the first partner: (1) was supervising or directing the other partner when the error, omission, negligence, incompetence, or malfeasance was committed; (2) was directly involved in the specific activity in which the error, omission, negligence, incompetence, or malfeasance was committed; or (3) had notice or knowledge of the other partner’s error, omission, negligence, incompetence, or malfeasance at the time of the occurrence and failed to take reasonable action to prevent or cure the error, omission, negligence, incompetence, or malfeasance. Van Wey maintained that she was not supervising or directing Johnson or in any way directly involved in Johnson’s actions. Van Wey also stated that she was unaware of the content Johnson added to the firm website, and Van Wey adduced evidence that she did not regularly monitor the site. The plaintiff failed to present evidence that would enable a reasonable trier of fact to find that any of the exceptions in Section 153.801(b) (as in effect before September 1, 2011) applied, and the court thus granted summary judgment in favor of Van Wey.


Henry and Masson, who were partners in an orthopedic surgery practice organized as an LLP in 2001, became embroiled in disputes leading to litigation during which they agreed in principle to wind up the partnership and sever all ties between them. Eventually, they executed a settlement agreement, but litigation ensued over alleged breaches of the settlement agreement. Among the issues addressed in this appeal was a claim by Masson that the trial court erred in ordering Henry and Masson to make capital contributions to the partnership to allow the partnership to pay out funds it had taken in that actually belonged to two new entities formed by the parties. Masson based his argument on the liability protection provided partners in an LLP under the Texas Revised Partnership Act. The court stated that neither the partnership agreement nor the statute prevented the trial court from ordering contributions to the partnership during winding up. According to the court, the payments the trial court ordered Henry and Masson to make were capital contributions to discharge debts of the partnership during winding up, not an adjudication of individual liability for the debts or obligations as contemplated by the statute. The court relied upon the partnership agreement, which provided that if no partner agreed to lend funds needed to discharge the partnership’s debts, obligations, and liabilities as they came due, each partner was required to timely contribute the partner’s proportionate share of funds needed. Masson argued that this provision was not intended to apply in the winding up process and that reference elsewhere in the partnership agreement to payment of the partnership’s debts upon dissolution “to the extent funds are available” evidenced the partners’ intent that they would not be required to make additional capital contributions during the winding up. The court stated that the phrase relied upon by Masson appeared in a section referring to steps to be taken after the sale of partnership property, and the funds mentioned are funds received from the sale of partnership property. The court did not interpret the agreement to mean that sale of partnership property was the only source of funds to pay debts. The court also rejected Masson’s argument that the reference in the capital contribution provision to payment of debts as they become “due and payable” was evidence that the parties did not intend to require capital contributions during winding up. The court stated that “due and payable” simply modified the type of debt to be paid and did not limit the provision to “operational” status of the partnership.


The court analyzed the claim that an individual was liable for environmental violations committed by a group of entities that owned and operated two waste water facilities. Harris County and the State of Texas had obtained a receivership over the individual’s property on the theory that the individual was the alter ego of the entities. [The designators in the names of the entities indicate that the group of entities consisted of a limited partnership, two limited liability partnerships, and a limited liability company, but the court did not specify or discuss the nature of the entities.] The court spoke in general terms about the separate legal existence of a “business entity” and the application of the alter ego theory when “there is such unity between the business entity and the individual that the business entity has ceased to be a separate entity, and allowing the individual to avoid liability through the use of the business entity would work an injustice.” The court analyzed the evidence and concluded the entities were not the individual’s alter ego because there was no evidence he diverted profits for his individual use, owned any interest in the entities, or personally paid any debts owed by the entities. There was testimony that the individual was the president, the “man in charge,” and “made all the decisions,” but the court stated that the individual’s status as an officer or director, standing alone, was insufficient to support application of the alter ego theory.

In 2003, Kimberlea Roe (“Roe”) contracted with Metro Townhomes & Homes, L.L.P. (“Metro LLP”), a Texas registered limited liability partnership, to renovate her home. The contract defined Roe as the “Owner” and Metro LLP as the “Contractor.” Blane Ladymon (“Ladymon”), a partner in Metro LLP, signed the contract in his capacity as a partner. The contract contained a detailed arbitration provision that required mediation and arbitration of “any controversy in question between the parties.” In 2004, Ladymon, as president of Metro Townhomes and Homes, Inc. (“Metro, Inc.”), filed two documents with the Texas Secretary of State. One withdrew Metro LLP’s registration as a registered limited liability partnership, and the other was a certificate of limited partnership for Metro Townhomes Limited Partnership (“Metro LP”). The certificate stated that Metro LLP was converting to a limited partnership and identified Metro, Inc. as the sole general partner and Ladymon as a limited partner. Ladymon testified that there was no transfer or formal assignment of Roe’s contract to Metro LP and that the partners continued to do the work on the renovation for Roe. In 2006, Roe demanded arbitration against Metro LLP and Ladymon alleging several construction defects. Ladymon argued that he should not be included in the arbitration proceedings because he signed the contract between Roe and Metro LLP containing the arbitration agreement solely in his capacity as a partner in a registered limited liability partnership, that he became a limited partner when Metro LLP withdrew its registration and converted to a limited partnership, and that the contracts and obligations of the old partnership were assigned to the new partnership by operation of law. Ladymon contended that as a limited partner he had no personal liability for the partnership’s obligations. Roe alleged that even though Ladymon did not sign the arbitration agreement in his individual capacity, he was bound to arbitrate the claims against him because he was an officer, agent, or representative of the entity that signed the arbitration agreement as well as a successor in interest once the entity converted from a limited liability partnership to a limited partnership. The arbitrator awarded damages to Roe and ruled that Metro LLP and Ladymon were jointly and severally liable for Roe’s damages. The trial court affirmed the damages awarded against the partnership but vacated the award against Ladymon individually. The court of appeals affirmed the trial court’s judgment, holding that Ladymon was not individually a party to the contract containing the arbitration clause. The court stated that Ladymon’s signature did not make him a party to the contract because he clearly indicated that he signed the agreement on behalf of Metro LLP. The court pointed out that being a partner in a registered limited liability partnership, and thus its “representative,” does not make the partner personally liable for the obligations of the partnership. The court also rejected Roe’s argument that Ladymon was liable as a successor following the conversion of the entity. Roe relied upon a provision in the agreement addressing successors and assigns and Ladymon’s deposition testimony that there was no formal assignment of the contract and that he continued to complete the project after Metro LLP converted to Metro LP. The court relied upon the filings with the Secretary of State to conclude that Metro LLP’s obligations transferred to Metro LP as a matter of law and that Metro LP— and not Ladymon— was thus the successor of Metro LLP, notwithstanding Ladymon’s lay opinions about the legal effect of the filings. The court quoted Section 9.05(h)(3) of the Texas Revised Partnership Act, which provided that “all liabilities and obligations of the converting entity shall continue to be liabilities and obligations of the converted entity in its new organizational form without impairment or diminution by reason of the conversion.” [The court apparently overlooked the fact that the conversion of a general partnership into a limited partnership at the time of this conversion would have been governed by Section 9.01, which was repealed September 1, 2005.] As a partner in Metro LLP and a limited partner in Metro LP, Ladymon was not liable on the contract or bound to arbitration before or after the conversion. Also, because Ladymon did not clearly and unmistakably agree to submit to arbitration, the trial court was not bound to a deferential review of an arbitrator’s decision that a non-signatory was bound by an arbitration agreement.

**Evanston Insurance Company v. Dillard Department Stores, Inc.**, 602 F.3d 610 (5th Cir. 2010).

Dillard Department Stores, Inc. (“Dillard’s”) sued a law firm, Chargois & Ernster, L.L.P., in 2003 for federal and state trademark infringement, cyberpiracy, and various business torts based on the law firm’s use of the Dillard’s name and logo on a website developed by the law firm to solicit clients with claims against Dillard’s. The law firm was registered as a Texas LLP. Early in 2004, while the litigation with Dillard’s was ongoing, the partners executed a separation agreement providing for dissolution of the partnership, and they did not renew the firm’s LLP registration when it expired in July, 2004. In November, 2004, the court entered a final judgment against “Chargois & Ernster, L.L.P.” Dillard’s was unable to collect the judgment, and Dillard’s filed a complaint against the two partners of the law firm in 2008. Each partner was served, and Dillard’s sought summary judgment declaring that the partners were personally liable on the judgment against the law firm. The district court granted summary judgment, and the partners appealed. The partners argued that they were protected from liability under the provisions of the Texas Revised Partnership Act. The court rejected the partners’ argument that they were protected from liability under the LLP provision of the Texas Revised Partnership Act that provided a partner is not liable for a debt or obligation of the
partnership incurred while the partnership is an LLP. [This provision is now found in Section 152.801 of the Business Organizations Code.] The partners argued that the law firm’s debt was incurred when the infringing website was created in 2003, at which time the firm was registered as an LLP. Noting that the terms “debt” and “incurred” are not defined in the statute, the court, however, that a plain reading of the statute supported the argument of Dillard’s that the debt was incurred when the judgment was entered in 2004, at which time the LLP registration had expired. The court stated that the underlying conduct gave rise to the possibility of a future debt, but that a debt was not incurred at that time because the conduct might have gone undetected, might have been adjudged innocent, or Dillard’s might have opted not to sue. The parties did not rely on another provision of the LLP statute that states a partner is not personally liable for another person’s “errors, omissions, negligence, incompetence, or malfeasance committed while the partnership is a registered limited liability partnership,” but the court considered it significant that liability of a partner is limited in that provision for malfeasance “committed” while the partnership is an LLP. The court stated that the legislature’s use of different language created a regime in which partners could be held liable for debts and obligations incurred when the partnership is not a registered LLP but would not bear liability for one another’s “independent malfeasance” committed while it is an LLP. Thus, the court concluded that the partners in this case were not protected from personal liability because the law firm was not registered as an LLP at the time its debt was incurred. [Note: The parties apparently did not raise, and the court did not address, commentary to the LLP provision of the Revised Uniform Partnership Act stating that “[p]artnership obligations under or relating to a tort are generally incurred when the tort conduct occurs” so as to prevent a culpable partnership from engaging in wrongful conduct and then filing an LLP registration to sever vicarious liability of the partners for future injury or harm caused by conduct prior to the filing. Uniform Partnership Act (1997) (U.L.A.) § 306, cmt.3. The court also did not discuss how its interpretation squares with the provisions addressing the liability of an incoming partner or a withdrawing partner. See Tex. Bus. Orgs. Code §§ 152.304(b), 152.505(a). Effective September 1, 2011, amendments to the Business Organizations Code LLP provisions eliminated the redundant term “debt,” eliminated the provision specifying an LLP partner’s liability for the error, omission, negligence, incompetence, or malfeasance of another, and clarified when an obligation is incurred.]


The court declined to dismiss claims against the managing partner of an LLP law firm that allegedly engaged in cybersquatting and copyright and trademark infringement and dilution. The court noted that Section 3.08 of the Texas Revised Partnership Act provides for liability of a partner in an LLP who is directly involved in the specific activity in which the negligence or malfeasance of another occurred or who had notice or knowledge of negligence or malfeasance at the time of the occurrence and failed to take reasonable steps to prevent or cure the negligence or malfeasance. In addition, the statute specifies that it does not affect the liability of a partner independent of his partner status. The plaintiff alleged that the managing partner “controlled” the activities of the law firm complained of in the complaint. This allegation was sufficient to survive a motion to dismiss because the allegation supported recovery under the theory that the managing partner was directly involved in the wrongful conduct or had knowledge of the wrongful conduct but failed to take reasonable steps to prevent it. In the course of its discussion, the court commented that no limited liability partnership law in any state extends so far as to shield a partner from his own wrongful conduct.


Two professional associations were partners in a partnership that was sued for breach of a commercial lease. The plaintiff sued the partnership and its two partners. The plaintiff obtained a judgment against the partnership, and that judgment was severed and became final. After the plaintiff was not able to collect the judgment from the partnership, the plaintiff obtained a summary judgment against one of the partners. The partner appealed arguing that the plaintiff’s suit against the partner was barred because the plaintiff initially obtained judgment against the partnership alleging it was an LLP. The court held that the partner was not protected from individual liability because the partnership was not a properly registered limited liability partnership under the Texas Revised Partnership Act at the time it incurred the lease obligations. Section 3.08 of the Texas Revised Partnership Act requires that an LLP carry insurance or meet certain financial responsibility requirements with respect to the “errors, omissions, negligence, incompetence, or malfeasance” for which a partner’s liability is limited by the statute. The court noted that, unlike the limited partnership statute, the LLP provisions contain no substantial compliance language. Therefore, the court concluded that strict compliance with the statute is required. Although the partner itself carried errors and omissions insurance, the court pointed out that the policy did not appear to cover the partnership or the other partner. Because the partnership did not have the required
insurance or other forms of financial responsibility designated by the statute, it was not a properly registered LLP, and the partner was not protected from liability.


A lessor brought suit against Smith & West, LLP (the “partnership”) and its individual partners Gaus and West to recover rent owed under a lease agreement with the partnership. The lease was entered in 1999, and Gaus and West signed a personal guaranty in which they guaranteed performance of the lease during the first 24 months of the lease term. The partnership registered as a Texas LLP in 1995 but did not renew its registration. The LLP provisions of TRPA Section 3.08 require an LLP to renew the registration annually in order to continue the LLP’s status as an LLP. The trial court granted the partners summary judgment based on limited partnership cases in which limited partners were not deprived of their liability protection even though the statutory filing requirement for the limited partnerships had not been met. The court of appeals distinguished the limited partnership cases from the LLP context because the clear language of the LLP statute provides that partners in an LLP are protected from liability only for debts and obligations incurred while the partnership is an LLP, and the registration of an LLP expires in one year unless it is renewed prior to the expiration date. While the Texas Revised Limited Partnership Act specifies a “substantial compliance” standard for formation of a limited partnership, Section 3.08 of TRPA does not contain a “substantial compliance” standard, nor does it contain a grace period for filing a renewal. Since the lease was signed more than three years after the partnership’s LLP registration expired, the partners were not protected from personal liability. The court rejected the argument that the partners’ guaranty limited their liability by providing that the guaranty terminated after 24 months. The court distinguished the partners’ liability under the guaranty from their liability as partners for the lease obligation, and the guaranty did not limit the partners’ liability as partners. The court thus reversed the summary judgment in favor of the partners.


The court cited _Pinebrook Properties, LTD. v. Brookhaven Lake Property Owners Association_ (in which the Texarkana Court of Appeals declined to apply the alter ego theory to a limited partnership because there is always a general partner with liability), in support of the court’s statement that the alter ego theory of liability did not apply to the relationship between KPMG LLP and its Moroccan member firm because KPMG is not a corporate entity but an LLP organized under Delaware law.


Bennett and Cochran were partners in a law firm LLP with no written partnership agreement. Bennett argued that Cochran orally agreed to pay half of all expenses and overhead of the partnership. The court noted that partners in a registered limited liability partnership ordinarily have no personal liability for the debts and obligations of the partnership. The court concluded there was no evidence the partners agreed to be personally liable for the expenses and overhead of the partnership as opposed to merely having their partnership interests equally burdened by the financial obligations of the partnership.


The court noted that the mere fact an entity is referred to as a “partnership” does little to define the nature of the liability of its “partners,” as there are partnerships, such as LLPs, where partners are not jointly and severally liable for partnership obligations.

**B. Effect of Registration; LLP as “Successor” Partnership**


A law firm sued to recover fees under a contingency fee contract with the Levines. The law firm was organized as a professional corporation when it was engaged by the Levines, and it subsequently reorganized as a limited liability partnership and then a limited partnership. The Levines argued the contract was a personal services contract that was not assignable without their consent and that Bayne, Snell & Krause, Ltd. was not a proper party. The court rejected this
argument on the basis that attorneys can assign their accounts receivable and that the assignments involved the contractual right to payment.


It appears that the court erroneously referred to an LLP as an LLC in this case. In reciting the facts of the case, the court states that a judgment based on legal malpractice was entered against Hager, an individual attorney, and his former law firm Nichols, Jackson, Kirk and Dillard, as well as Nichols, Jackson, Dillard, Hager & Smith, L.L.P. The style of the case also refers to Nichols, Jackson, Dillard, Hager and Smith, L.L.P. On appeal, the court held that the malpractice occurred prior to registration as a limited liability company. The court sustained the contention that the trial court improperly held the “registered firm” of Nichols, Jackson, Kirk and Dillard liable. According to the court, since the firm had registered as a “limited liability company” prior to the time of the particular act that damaged the client, Hager “alone” was responsible for the damages. It is not clear whether the court was actually saying that the LLC or LLP law firm would not be liable. In reversing the judgment based upon various errors in the trial court, the court of appeals specifically decreed that the plaintiff take nothing against Nichols, Jackson, Kirk and Dillard but did not mention the judgment against Nichols, Jackson, Dillard, Hager & Smith, L.L.P.


In this case, the law firm of Shannon, Gracey, Ratliff & Miller, L.L.P. was sued for malpractice and obtained a summary judgment that was upheld on appeal on the basis that a “successor partnership” is not liable for the torts of a predecessor partnership. It is not clear from the opinion whether the partnership’s registration as an LLP, which apparently took place after the malpractice suit was filed, was alone enough to make the partnership a “successor partnership” as that term was used by the court, but it seems unlikely. It is unfortunate, however, that the court did not provide greater insight into what it deemed a “successor partnership.” The law firm involved had, subsequent to the time the alleged malpractice occurred, merged and unmerged with another law firm, and the plaintiff alleged that Shannon, Gracey, Ratliff & Miller, L.L.P. was liable as the successor partnership of the Shannon, Gracey, Ratliff & Miller firm that had represented the plaintiff in the matter giving rise to the malpractice claim. (The plaintiff’s pleadings alleged that the firm was previously known as Reynolds, Shannon, Miller, Blinn, White & Cook, and, prior to that, as Shannon, Gracey, Ratliff, & Miller, and that the plaintiff’s suit was against the firm in its current form and all of its predecessors.)

The court of appeals upheld the trial court’s summary judgment on the basis that “even if Shannon, Gracey, Ratliff, & Miller, L.L.P. is a successor law firm, Texas does not recognize that successor partnerships are liable for the tortious conduct of predecessor partnerships.” The court’s opinion is brief and explores neither the factual background of the changes in the Shannon, Gracey firm nor the rationale for distinguishing between tort and contract claims when it comes to successor partnership liability. If the court’s opinion stands for the proposition that registration as an LLP is enough to make the partnership a different “successor” partnership, and thus cut off the entity’s liability for pre-registration tort claims, the opinion obviously has profound implications. It is unlikely, however, that this was the basis for the court’s opinion. [Such a view is inconsistent, in this writer’s opinion, with the underlying premise of the LLP statutes that an LLP is the same partnership as prior to registration.] Based upon the cases relied upon by the court, it appears that the court may have concluded that a dissolution results in a successor partnership which is not liable for the pre-dissolution torts of its predecessor. In view of the Uniform Partnership Act ("UPA") approach to dissolution, under which any change in membership results in a technical dissolution, this proposition itself has significant implications. Query whether this approach suggests that the departure of a partner in a UPA partnership would, in some states, require a new LLP registration to preserve the liability limitation of the partners in the "new" partnership? Such a result obviously seems absurd and points to the wisdom of the clearer entity approach under RUPA.

In a subsequent decision by another Texas court of appeals, the court addressed the possibility that a professional corporation might be liable for the malpractice of the predecessor partnership. The court pointed out in dicta that the lawyer who committed the malpractice in the Shannon, Gracey case was not employed by the successor law firms whereas a principal of both the earlier partnership and the successor professional corporation was alleged to have acted negligently in the case before the court. The court suggested, but did not decide, that this distinction might be outcome determinative. See Andrews v. Diamond, Rash, Leslie & Smith, 959 S.W. 2d 646 (Tex. App.—El Paso 1997, writ denied).
In 2003, Kimberlea Roe (“Roe”) contracted with Metro Townhomes & Homes, L.L.P. (“Metro LLP”), a Texas registered limited liability partnership, to renovate her home. The contract defined Roe as the “Owner” and Metro LLP as the “Contractor.” Blane Ladymon (“Ladymon”), a partner in Metro LLP, signed the contract in his capacity as a partner. The contract contained a detailed arbitration provision that required mediation and arbitration of “any controversy in question between the parties.” In 2004, Ladymon, as president of Metro Townhomes and Homes, Inc. (“Metro, Inc.”), filed two documents with the Texas Secretary of State. One withdrew Metro LLP’s registration as a registered limited liability partnership, and the other was a certificate of limited partnership for Metro Townhomes Limited Partnership (“Metro LP”). The certificate stated that Metro LLP was converting to a limited partnership and identified Metro, Inc. as the sole general partner and Ladymon as a limited partner. Ladymon testified that there was no transfer or formal assignment of Roe’s contract to Metro LP and that the partners continued to do the work on the renovation for Roe. In 2006, Roe demanded arbitration against Metro LLP and Ladymon alleging several construction defects. Ladymon argued that he should not be included in the arbitration proceedings because he signed the contract between Roe and Metro LLP containing the arbitration agreement solely in his capacity as a partner in a registered limited liability partnership, that he became a limited partner when Metro LLP withdrew its registration and converted to a limited partnership, and that the contracts and obligations of the old partnership were assigned to the new partnership by operation of law. Ladymon contended that as a limited partner he had no personal liability for the partnership’s obligations. Roe alleged that even though Ladymon did not sign the arbitration agreement in his individual capacity, he was bound to arbitrate the claims against him because he was an officer, agent, or representative of the entity that signed the arbitration agreement as well as a successor in interest once the entity converted from a limited liability partnership to a limited partnership. The trial court affirmed the damages awarded against the partnership but vacated the award against Ladymon individually. The court of appeals affirmed the trial court’s judgment, holding that Ladymon was not individually a party to the contract containing the arbitration clause. The court stated that Ladymon’s signature did not make him a party to the contract because he clearly indicated that he signed the agreement on behalf of Metro LLP. The court pointed out that being a partner in a registered limited liability partnership, and thus its “representative,” does not make the partner personally liable for the obligations of the partnership. The court also rejected Roe’s argument that Ladymon was liable as a successor following the conversion of the entity. Roe relied upon a provision in the agreement addressing successors and assigns and Ladymon’s deposition testimony that there was no formal assignment of the contract and that he continued to complete the project after Metro LLP converted to Metro LP. The court relied upon the filings with the Secretary of State to conclude that Metro LLP’s obligations transferred to Metro LP as a matter of law and that Metro LP— not Ladymon— was thus the successor of Metro LLP, notwithstanding Ladymon’s lay opinions about the legal effect of the filings. The court quoted Section 9.05(b)(3) of the Texas Revised Partnership Act, which provided that “all liabilities and obligations of the converting entity shall continue to be liabilities and obligations of the converted entity in its new organizational form without impairment or diminution by reason of the conversion.” [The court apparently overlooked the fact that the conversion of a general partnership into a limited partnership at the time of this conversion would have been governed by Section 9.01, which was repealed September 1, 2005.] As a partner in Metro LLP and a limited partner in Metro LP, Ladymon was not liable on the contract or bound to arbitration before or after the conversion. Also, because Ladymon did not clearly and unmistakably agree to submit to arbitration, the trial court was not bound to a deferential review of an arbitrator’s decision that a non-signatory was bound by an arbitration agreement.

In re Hawthorne Townhomes, L.P., 282 S.W.3d 131 (Tex. App.—Dallas 2009, no pet.).

In 2005, Branch entered into a contract to purchase a new house from Metro Townhomes/Hawthorne Townhomes, L.P. The sale closed in February 2006, and the deed Branch received showed the seller as Hawthorne Townhomes, L.P. The closing documents included a limited warranty agreement containing an arbitration clause. The limited warranty/arbitration agreement was signed by Branch as the purchaser and Metro Townhomes & Homes, L.L.P. as the builder. After the closing, the house suffered water damage every time it rained, and the builder’s attempts to repair the problem were unsuccessful. In 2008, Branch sued. The defendants moved to dismiss, or in the alternative to compel arbitration. The trial court denied both motions, and the defendants appealed. Branch argued that Metro Townhomes & Homes L.L.P. did not exist at the time it executed the limited warranty agreement at the closing, that there was thus no meeting of the minds, and that the limited warranty agreement with its arbitration provisions never became a valid contract. The defendants presented records filed with the Secretary of State of Texas showing Metro Townhomes
Homes, Inc. was incorporated in 2000. Later in 2000, Metro Townhomes & Homes, L.L.P. registered as an LLP with Metro Townhomes & Homes, Inc. as general partner. Metro Townhomes & Homes, L.L.P. renewed the registration annually until July 5, 2004 when it withdrew its registration as an LLP. That same day, a certificate of limited partnership for Metro Townhomes, L.P. was filed showing Metro Townhomes & Homes, Inc. as its general partner. The certificate of limited partnership stated that the partnership was converting from a Texas general partnership, Metro Townhomes & Homes, L.L.P., into the limited partnership, Metro Townhomes, L.P. Branch argued that Metro Townhomes & Homes, L.L.P. ceased to exist on July 5, 2004, when it withdrew its registration, and it thus could not sign the limited warranty agreement in February 2006. The court quoted Section 9.05(h)(1) of the Texas Revised Partnership Act, which provides: “When a conversion of a converting entity takes effect: (1) the converting entity shall continue to exist, without interruption, but in the organizational form of the converted entity rather than in its prior organizational form.” [The court apparently overlooked the fact that the conversion of a general partnership into a limited partnership at the time of this conversion would have been governed by Section 9.01, which was repealed September 1, 2005.] Based on this provision, the court concluded that Metro Townhomes & Homes, L.L.P. did not cease to exist when it withdrew its registration as an LLP. The limited warranty agreement contained a provision stating that the agreement and the binding arbitration process was binding on the builder’s successors and assigns, and the court stated that Metro Townhomes, L.P. was the successor of Metro Townhomes & Homes, L.L.P. and was bound by the arbitration clause. The court thus concluded that the defendants established the existence of a valid arbitration agreement.

D. Bankruptcy


The issue in this case was whether an individual who was a partner of a Texas LLP was a general partner with standing to be a petitioner in an involuntary bankruptcy case. The partnership was a general partnership registered under the Texas full shield LLP statute. The court stated that it had been unable to find any case law addressing the ability of a partner in an LLP to file an involuntary action, and the court relied upon Collier on Bankruptcy in concluding that the petitioning general partner should be treated as a shareholder of a corporation under the Bankruptcy Code and thus ineligible to be a petitioning partner under Section 303(b)(3). Collier on Bankruptcy takes the position that a full shield LLP should be treated as a corporation because the definition of a “corporation” under the Bankruptcy Code broadly encompasses a “partnership association organized under a law that makes only the capital subscribed responsible for the debts of the association” and because, in view of the purpose of Section 303(b)(3), which is to protect general partners who are exposed to personal liability for partnership obligations, it makes sense that Section 303(b)(3) should not be available to LLP partners. The court went on to conclude that, even if the petitioning individual was a general partner, he should be estopped to make that claim because it was clearly inconsistent with the individual’s position in prior litigation in which he claimed to be a limited partner. The court stated that the individual’s view of what type of partner he was seemed to change as his perceived interest changed, and that is precisely the situation judicial estoppel was designed to address.

E. Suits Against Foreign LLPs


Although not a Texas case, a summary of this opinion is included because it involves a Texas LLP. Issues discussed in this case include the capacity of an LLP to be sued, jurisdiction over partners of the LLP, the treatment and status of various partners of the LLP, and choice of law. The court addressed these issues as they related to the court’s consideration of the defendants’ motion to transfer venue from Massachusetts to Texas. The case was brought by Liberty Mutual Insurance Company (“Liberty Mutual”) in federal district court in Massachusetts against a Dallas law firm, Gardere & Wynne, L.L.P. (Gardere & Wynne), a Texas registered limited liability partnership, and two Gardere & Wynne attorneys.

Gardere & Wynne frequently represented Liberty Mutual in litigation involving Liberty Mutual and its insureds. Two attorneys, Nabors and Woods, left another Texas law firm to join Gardere & Wynne (Nabors as a partner and Woods as an associate), bringing with them a client whose interests were adverse to Liberty Mutual in some pending litigation. Liberty Mutual sued Gardere & Wynne, Nabors, and Woods in Massachusetts for breach of fiduciary duty in connection with the handling of a conflict of interest. The defendants moved for dismissal or transfer of the case to Texas. The court pointed out that a number of thorny issues would be avoided or best resolved if the case were litigated in Texas. Thus, the court concluded that the litigation should be transferred to Texas under 28 U.S.C. § 1404(a).
Under the rule governing suits against general partnerships in Massachusetts, Liberty Mutual would have had to name and serve each partner individually. In contrast, Texas law permits a partnership to sue and be sued in the partnership name (and service upon one partner will constitute service on the partnership). The court noted that a plaintiff may sue a limited partnership in Massachusetts by naming only the general partners and speculated that it might be possible to characterize an LLP as a limited partnership and bring suit by naming only those partners that would be personally liable for the claims Liberty Mutual was asserting. However, this would have required the court to determine whether a breach of fiduciary duty claim fell within the liability protection provided by the Texas statute at the time and, if so, whether some or all of the partners would nevertheless be liable under certain other provisions of the act. The court was reluctant to delve into these unsettled questions of Texas law, especially in the preliminary context of a motion to dismiss. Transfer of the suit to Texas, where suit could be maintained against the partnership in its common name and without joining all partners, obviated the need for such a determination as a threshold matter.

Nabors and Woods sought to dismiss the Massachusetts lawsuit brought by Liberty Mutual based upon lack of personal jurisdiction. Though there had been other partners of Gardere & Wynne who had visited Liberty Mutual at its Boston office over the years, the court observed that it would not have jurisdiction over either Nabors or Woods based solely on their own personal contacts with Massachusetts. Jurisdiction over them would have to be based upon the contacts by other partners, who, by operation of partnership law, were acting as agents of Nabors and Woods. The court noted that personal jurisdiction over a person may be based upon acts of the person's agent or business partner, but noted a number of factors complicating the analysis in this case, including whether Woods had become a partner at all, whether jurisdictional contacts of partners could be used to maintain jurisdiction over other partners who were admitted after those contacts occurred, and whether jurisdiction could be predicated on contacts of partners of an LLP who may not be vicariously liable on the underlying claim. None of these questions had to be decided upon transfer of the case to Texas because the Texas district court would unquestionably have jurisdiction over all the defendants.

The court noted that there would ultimately be difficult issues of Texas law involved in litigation of the merits of the case, and a Texas court would be best suited to determine these. The court as well as the parties evidently assumed that the Texas LLP statute would be given effect and that Texas law would govern the extent to which damages and injunctive relief could be granted against partners other than those directly involved in the alleged wrongdoing. The court noted, however, that the issues involving Gardere & Wynne's conflicts of interest and compliance with rules of ethics might be governed by national standards.


The plaintiff in this medical malpractice case sued a Michigan LLP that had a contract with a Texas hospital to provide emergency room physician staffing. The plaintiff also sued a Michigan corporation that had contracted with the LLP to provide administrative and support services to the LLP. (While the emergency physician partnership is identified in the opinion as “Memorial Southeast Emergency Physicians, LLP” and is initially referred to by the court as an LLP, the physician partnership is also repeatedly referred to as a limited partnership in the course of the opinion, so it is not entirely clear whether the partnership is a general partnership registered as an LLP or a limited partnership.) The plaintiff argued that the Michigan LLP, which was registered to do business in Texas, was the alter ego of, or was in a single business enterprise with, the Michigan corporation so that the LLP’s Texas contacts could be imputed to the corporation. The court refused to apply the single business enterprise theory based on the Texas Supreme Court’s rejection of the theory in the jurisdictional veil piercing context. The court analyzed the alter ego argument and concluded that the record did not provide a basis to find that the LLP was the alter ego of the corporation. The plaintiff relied upon the following evidence: the CEO and sole shareholder (“Johnson”) of the corporation was the managing partner and 99.5% owner of the LLP; the LLP and corporation were located at the same address in Michigan; the LLP and corporation shared a centralized accounting system; the corporation performed administrative and support services for the LLP; Johnson determined many of the LLP’s policies; the contract with the hospital was “system-wide” and Johnson approved the transfer of funds from one physician partnership to another, treating the transfers as “loans” that were charged as expenses; the contract between the corporation and LLP favored the corporation; and physician partners of the LLP were eligible to participate in employee benefits provided by the corporation. The court found that there was no basis for an alter ego finding because there was no evidence that the corporation exercised substantial control over the daily medical practice of the LLP, and there was evidence that corporate formalities were respected (such as separate financial documents and separate tax returns) precluded a finding of alter ego.
F. Diversity Jurisdiction

In the following cases, the court held that the citizenship of an LLP for diversity jurisdiction purposes depends upon the citizenship of all of its partners. In other words, an LLP is a citizen of each state in which a partner resides. This rule follows from the United States Supreme Court case of Carden v. Arkoma Associates, 494 U.S. 185 (1990). In Carden, the Court reiterated the rule that the citizenship of an unincorporated association is determined based upon the citizenship of all of its members. Specifically, the Court held that a limited partnership is a citizen of every state in which a general or limited partner resides.


G. Pro Se Representation


The court held that the appellant, an LLP, could not appear pro se, and the court dismissed the appeal because corporations and partnerships are fictional legal persons that cannot appear for themselves and must be represented by counsel.


The court disqualified a partner of a law firm LLP from representing the LLP because the partner was going to be a fact witness at trial. The court rejected the argument that the firm should be allowed to represent itself pro se, stating that LLPs cannot appear pro se and must be represented by counsel.