

LEGAL UPDATES

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Service

Corporate

‘Partnership by Ambush’ Ruled Out of Bounds by Dallas Court of Appeals

On July 18, 2017, the Dallas Court of Appeals reversed a 2014 landmark verdict against Enterprise Products Partners in which Energy Transfer Partners (ETP) convinced a jury that the conduct of the two companies had created a partnership to build a pipeline. The decision reassured the midstream energy sector and other contracting parties in Texas that the factors set forth in Section 152.052 of the Texas Business Organizations Code (the Code) are not the sole measure of whether a partnership exists.

In *Enterprise Products Partners, L.P. v. Energy Transfer Partners, L.P.*, ETP convinced the trial court jury that Enterprise was in breach when it terminated their pipeline agreement to build a similar pipeline with a third party. The Court of Appeals reversed, holding that the unfulfilled conditions precedent set forth in the agreements between the two parties precluded the formation of a partnership, and vacated the \$535.8 million judgment against Enterprise.

Texas Partnership Formation

The Texas Business Organizations Code defines a partnership as “an association of two or more persons to carry on a business for profit as owners.” Section 152.052 of the Code states that the relevant factors *include* the persons’:

- 1) receipt or right to receive a share of profits of the business;
- 2) expression of an intent to be partners in the business;
- 3) participation or right to participate in control of the business;
- 4) agreement to share or sharing (a) losses of the business; or (b) liability for claims by third parties against the business; and

5) agreements to contribute or contributing money or property to the business.

Texas courts interpret the statute as requiring review of the five factors under the totality of the circumstances. However, courts note the difficulty of applying the test as it considers a multitude of potential facts and a balancing of evidence on either side. To add to the challenge, conclusive evidence of one factor is insufficient to establish a partnership, while conclusive evidence of all the factors establishes a partnership as a matter of law.

The Background

In 2011, Enterprise and ETP agreed to explore the opportunity of incorporating one of ETP's pipelines into a larger pipeline to transport crude oil from Oklahoma to Texas. Enterprise and ETP executed a confidentiality agreement, a letter agreement, a reimbursement agreement and a term sheet laying out two conditions precedent to partnership formation. One condition provided that during open season, the companies' marketing executives must secure a certain commitment level from oil shippers before they would begin building the pipeline. When the companies failed to secure the required commitments, Enterprise terminated its participation in the agreement and contracted with a third party to operate a similar pipeline.

ETP brought an action against Enterprise for breach of joint enterprise and breach of fiduciary duty. The jury found that Enterprise and ETP had created a partnership under the five factors in Section 152.052 of the Code. The jury further found that Enterprise failed to comply with its duty of loyalty when it entered a similar agreement with a third party.

Enterprise appealed the judgment on the basis that the parties' written agreements contained unperformed conditions precedent that precluded the formation of a partnership as a matter of law. Enterprise argued that ETP attempted to create a "partnership by ambush."

The Decision

The appeals court agreed with Enterprise and held that the factors listed in Section 152.052 of the Code were not the sole source for determining partnership formation. Because Section 152.052 states that formation of a partnership should "include" the listed factors, the legislative intent was that the factors themselves were not exclusive. Further, Section 152.003 of the Code states that "principles of law and equity," such as conditions precedent, supplement the partnership provisions. The court noted that when a contract contains conditions precedent to the formation of a partnership, a partnership cannot be formed unless those conditions are satisfied or waived.

According to the appeals court, ETP had the burden to prove that either the conditions in the letter agreement were satisfied or that Enterprise had waived them in their course of business. Because it was undisputed that the conditions were not met and ETP did not request a jury instruction on waiver

of the conditions by Enterprise, the appeals court reversed the trial court's judgment and ordered ETP to take nothing on its claims.

What This Means To You

Contracting parties in Texas can rest assured that Texas courts will continue to honor express contractual terms, including provisions containing conditions precedent to the obligations of the parties. This is of particular importance to the midstream oil and gas sector, where transporters have long entered into agreements with conditional, non-binding provisions while the parties explore the viability of a long-term business relationship.

There are a few other important takeaways. First, the issue is not completely settled, as ETP has 45 days from the date of the decision to appeal the judgment to the Texas Supreme Court. Second, contracting parties should ensure that conditional or non-binding provisions in their contracts are clearly drafted to achieve the desired result, particularly language that places conditions precedent on the obligations of the parties. Finally, to avoid an unintentional waiver of a contractual condition, the parties should include language providing that conditions can be waived only in writing. Absent such a provision, the parties must be mindful of their conduct to avoid inadvertently waiving conditional provisions that could materially alter the nature of the contractual relationship.

Contact Us

For more information about how this decision may impact your business, contact Chauncey M. Lane or another member of Husch Blackwell's Corporate group.