Texas High Court Lays Partnership Formation Questions to Rest

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On Friday, January 31, 2020, the Supreme Court of Texas clarified the law of partnership formation in the closely watched case of *Energy Transfer Partners, L.P. et al. v. Enterprise Products Partners, L.P. et al*. The case addressed whether parties can unintentionally form a partnership despite having unmet contractual preconditions to formation. Debate around this question has been churning since 2014, when a jury found that a partnership was formed by conduct alone, regardless of the unmet conditions precedent. The Dallas Court of Appeals reversed this decision in 2017, restoring some clarity for contracting parties.

The Supreme Court of Texas has now resolved the debate: When a contract between parties states that certain conditions must be met before they form a partnership, those conditions will be enforced under Texas law and will preclude courts from finding that the parties unwittingly entered into a partnership through nebulous post-contract behavior.

The Underlying Events and Lower Court Decisions

In 2011, a glut of crude oil sat in Cushing, Oklahoma. To transport the oil, Enterprise Products Partners, L.P. approached Energy Transfer Partners, L.P. (ETP) to discuss constructing a new pipeline to the Gulf Coast near Houston. The parties' letter agreement contained the following conditions precedent:

> [N]o binding or enforceable obligations shall exist between the Parties with respect to the Transaction unless and until the Parties have received their respective board approvals and definitive agreements memorializing the terms and conditions of the Transaction have been negotiated, executed and delivered by both of the Parties.

While the parties negotiated as contemplated by the letter of intent, work on the project continued. The parties created a project team, marketed the proposed pipeline to potential shippers and asked shippers to commit to daily barrel volumes and rates. Enterprise eventually terminated the project and entered into a new pipeline project with Enbridge Inc. to transport oil to the Gulf Coast. The Enbridge/Enterprise pipeline, called Wrangler, opened in June 2012 and was a financial success.

ETP then sued Enterprise for breach of joint enterprise and breach of fiduciary duty. ETP argued that the parties formed a partnership through their conduct and that ETP was therefore entitled to an accounting of the profits from the Wrangler pipeline. A jury agreed and awarded ETP $535 million plus post-judgment interest.

The jury verdict ignited a firestorm in the Texas business and legal communities. Businesses routinely enter nonbinding term sheets intended to allow the parties to explore and prepare for possible transactions without requiring them to enter into a transaction. If the nonbinding nature of those types of agreements is no longer enforceable, then parties cannot predict what sorts of actions can be interpreted after the fact as creating a business relationship. The resulting compliance risk is that a company cannot take steps to comply with duties that it doesn't think it owes to another party.

At the court of appeals, ETP did not deny that the parties' agreement contained conditions precedent, but argued that the question of whether a partnership was formed is controlled by the five-factor test set out in Texas Business Organizations Code (TBOC) Section 152.052(a). ETP argued that the conditions precedent were only evidence of one of the five factors under Section 152, "expression of an intent to be partners in the business."

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The court of appeals overturned the jury verdict, holding that unperformed conditions precedent prevent partnership formation unless the parties waive performance of the conditions precedent. The court explained that the five-factor test under TBOC Section 152.052(a) is not the only source of rules for determining partnership formation, but that the principles of law and equity supplement the statutory partnership provisions.

The Supreme Court of Texas Decision

Relying on the deeply ingrained legal principle of freedom of contract, the Supreme Court of Texas affirmed the appellate court's ruling. The court explained that ETP and Enterprise sufficiently contracted for certain conditions precedent to preclude the unintentional formation of a partnership under TBOC Section 152.052(a). Because the conditions precedent were not met, the parties did not form a partnership.

The court clarified that where the alleged waiver of a condition precedent to the formation of a partnership is at issue, only evidence linked to the waiver itself is relevant — evidence relating only to whether the parties intended to form a partnership is irrelevant. Otherwise, a party could claim waiver in every case.

Key Takeaways

- When entering into letters of intents or similar agreements, parties should explicitly identify what conditions must be met before a partnership is formed.
- Once the parties enter into such an agreement, they should avoid doing anything that could be interpreted as a waiver of any conditions precedent. Instead, parties should create a clear record that they are not waiving the conditions precedent.