Texas Pipeline Ruling Offers Confidence On Partnership Law

By **Kenneth Held, Daniel Mayerfeld and Christian-Lloyd Adriatico** (February 25, 2020, 2:37 PM EST)

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On Jan. 31, the Supreme Court of Texas clarified the law of partnership formation in the closely watched case of Energy Transfer Partners LP v. Enterprise Products Partners LP.[1] 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 laid the confusion to rest: When parties contract for certain conditions precedent to 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.[2]

This article addresses takeaways for legal practitioners who deal with Texas partnership law and commercial contracts generally in the wake of Energy Transfer Partners.

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 approached Energy Transfer Partners, or ETP, to discuss constructing a new pipeline to the Gulf Coast near Houston. The parties' letter of intent, or LOI, 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 the definitive agreements as contemplated by the LOI, 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. Notwithstanding the clear conditions precedent set forth in the letter of intent, 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 into 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 formal 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 Section 152.052(a):

- Receipt, or right to receive a share, of profits of the business;
- Expression of an intent to be partners in the business;
- Participation or right to participate in control of the business;
- Agreement to share or sharing:
    - Losses of the business; or
    - Liability for claims by third parties against the business; and
- Agreement to contribute or contributing money or property to the business.

ETP argued that the conditions precedent were only evidence of one of the five factors under Section 152, namely "expression of an intent to be partners in the business."

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 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.[3] The court explained that ETP and Enterprise sufficiently contracted for certain conditions precedent to preclude the unintentional formation of a partnership under Section 152.052(a).[4] Because the conditions precedent were not met, the parties did not form a partnership.[5]

The court clarified that "where waiver of a condition precedent to partnership formation is at issue, only evidence directly tied to the condition precedent is relevant."[6] The court further stated that

"[e]vidence that would be probative of expression of intent under Section 152.051(a) — such as 'the parties' statements that they are partners, one party holding the other party out as a partner on the business's letterhead or name plate, or in a signed partnership agreement' — is not relevant."[7] Otherwise, a party could claim waiver in every case.

Key Takeaways

Deference to Contracting Parties' Freedom of Contract

Energy Transfer Partners follows suit with a long line of Texas cases that have honored parties' freedom of contract, even when the contractual provision at issue is designed to fend off liability. For instance, Texas courts have allowed parties to expressly disclaim their fiduciary duties in the context of partnerships and to disclaim liability for fraudulent inducement.[8] Such contractual language is often dispositive if litigation arises.

Carefully Drafting Language to Create Enforceable Conditions Precedent

The court in Energy Transfer Partners did not specify what exact language is sufficient to create conditions precedent to prevent inadvertent partnership formation, but the court found the following language sufficient to link the condition precedent and the conditional obligation: "[N]o binding or enforceable obligations shall exist ... unless and until the Parties have received their respective board approvals and definitive agreements."[9]

Prior case law regarding conditions precedent provides additional helpful guidance. For example, while no particular words are necessary to create a condition precedent, "such terms as 'if,' 'provided that,' on condition that,' or some other phrase that conditions performance, usually connotes an intent for a condition."[10]

Other courts have found that "shall" and "upon approval" were "not those associated with a condition precedent."[11] Regardless of the specific language used, the "conditional language must connect the condition precedent to the conditional obligation."[12]

Explicitly Identifying Conditions for Partnership Formation

Parties should explicitly identify what conditions must be met before a partnership is formed. For instance, when entering into LOIs and other agreements, parties should expressly state that board approval must be obtained, that additional documents must be executed, or that particular funding must be secured before any partnership is created.

Creating a Clear Record of Nonwaiver of Conditions Precedent

Enterprise, the defendant in Energy Transfer Partners, demonstrated that waiver can be avoided by simply stating that certain actions do not constitute waiver. For instance, a reimbursement agreement between Enterprise and ETP executed after the LOI stated that nothing in the reimbursement agreement would "be deemed to create or constitute a joint venture, a partnership, or otherwise."[13]

Parties should consider making similar, explicit statements in any subsequent agreements and substantive communications to avoid a finding of waiver of conditions precedent to partnership formation. Additionally, the LOI should state that any waiver of conditions precedent must be in writing and signed by the waiving party.[14]

Disputes About Partnership Formation Arising Under Other States' Laws

The jury in Energy Transfer Partners found an unintentional partnership through five-factor test in Section 152.052(a). Because Energy Transfer Partners found that freedom of contract supplements the statutory factors, the five-factor test cannot be used to create a partnership by surprise in Texas.

But some states' statutes, including Delaware and others that are based upon Section 202 of the Revised Uniform Partnership Act, provide that a partnership can be formed "whether or not the persons intend to form a partnership."[15] In Delaware, the "creation of a partnership is a question

of intent," but the relevant intent is not the intention to create a partnership, but rather "whether the purported partners intended to share losses and profits, control, and ownership."[16] To determine intent, courts look at "the parties' actions, prior dealings and admissions."[17]

The risk of inadvertent partnerships is real. In Grunstein v. Silva, the plaintiffs alleged an oral partnership agreement. The Delaware Court of Chancery found that defendant had not "made an unequivocal statement that a written executed contract was a condition precedent to an agreement,"[18] which suggests that the court would have found that such an unmet condition precedent would have precluded partnership formation.

In the absence of such a condition precedent, the court examined the parties' conduct and understandings, and ultimately concluded after trial that the parties had not agreed on all material terms sufficient to form a partnership.[19] In making this determination, the court's assessment relied heavily on its assessment of the credibility of the witnesses (including one plaintiff who was convicted of perjury for testimony he provided in a related case).

Similarly, in Ramone v. Lang, the plaintiff alleged that a partnership had formed after the parties failed to negotiate a final limited liability company agreement to govern their proposed business venture.[20] Ultimately the Delaware Court of Chancery found (after a full trial on the merits) that the parties had not agreed on the material terms of their business relationship, and that no partnership had been created; all that existed was a nonbinding "agreement to agree."[21] Explicit conditions precedent in LOIs should provide protection against inadvertent partnership formation, but parties should be careful in drafting them.

In light of Energy Transfer Partners, parties in Texas should take extra precaution to avoid a partnership they have no intention of entering into, by carefully crafting conditions precedent, and avoiding waiver by making explicit statements that the conditions precedent are not waived by subsequent actions.

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[1] Energy Transfer Partners LP et al. v. Enterprise Products Partners LP, No. 17-0862, 2020 WL 622763 (Tex. Jan. 31, 2020).

[2] Id. at *8.

[3] Id. at *5, 8.

[4] Id. at *6.

[5] Id. at *8.

[6] Id. at *7.

[7] Id.

[8] See Strebel v. Wimberly, 371 S.W.3d 267, 282-83 (Tex. App. — Houston [1st Dist.] 2012) (finding that a party properly disclaimed fiduciary duties in an LP agreement); Schlumberger Tech. Corp. v. Swanson, 959 S.W.2d 171, 181 (Tex. 1997) (finding that a disclaimer of reliance negates the element of reliance in a claim for fraudulent inducement).

[9] Energy Transfer Partners, 2020 WL 622763, at *2.

[10] Hohenberg Bros. Co. v. George E. Gibbons & Co., 537 S.W.2d 1, 3 (Tex. 1976).

[11] Schwarz-Jordan Inc. v. Delisle Constr. Co., 569 S.W.2d 878, 880-81 (Tex. 1978) (finding insufficient the language "Contractor shall install suspension members for curved section and 10 feet of straight section in one concourse and install the pans. Upon approval of the installation work may proceed per schedule").

[12] Great Western Drilling Ltd. v. Pathfinder Oil & Gas Inc., 2020 WL 373096, at *9 (Tex. App. — Eastland Jan. 23, 2020, no pet. h.) (citations omitted) (finding no condition precedent where the plaintiff's working interest on mineral lease was not conditioned on a specific obligation).

[13] Energy Transfer Partners, 2020 WL 622763, at *2.

[14] See TCI Cablevision of Texas Inc. v. S. Texas Cable Television Inc., 791 S.W.2d 269, 272 (Tex. App. — Corpus Christi 1990, writ denied) (finding no waiver in purchase agreement that required waiver to be in writing).

[15] See Del. Code Ann. tit. 6, § 15-202.

[16] Grunstein v. Silva, 2014 WL 4473641, at *16 (Del. Ch. Sept. 5, 2014), aff'd, 113 A.3d 1080 (Del. 2015) ("Because the evidence does not reveal any explicit statement conditioning an agreement on a written executed agreement, the question turns [on] the parties' 'understandings'").

[17] Id.

[18] Id. at 18.

[19] Id. at 30.

[20] Ramone v. Lang, 2006 WL 905347, at *14 (Del. Ch. Apr. 3, 2006).

[21] Id. at 13.