Actions Speak Louder Than Words or Partnership by Ambush?: Formation of Partnerships in Texas after *ETP v. Enterprise*

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On March 4, 2014, a Dallas jury awarded Energy Transfer Partners, L.P. ("ETP") $319 million in damages after finding that Enterprise Products Partners, L.P. ("Enterprise") had formed a binding partnership with ETP to build a pipeline from Cushing, Oklahoma to the Gulf of Mexico, and then breached its duty of loyalty by exiting the project and building a pipeline along the same route with a different company. The jury reached its verdict despite the fact that ETP and Enterprise had executed a letter agreement at the beginning of their relationship disclaiming any intent to become partners, and setting specific conditions precedent to formation of a partnership. That verdict casts a spotlight on the challenges faced by even the most sophisticated entities who wish to explore business opportunities with other parties without becoming partners and acquiring unwanted fiduciary obligations under Texas law. While the *ETP* verdict will likely be appealed, it serves as a reminder that companies should carefully police both their preliminary agreements and their conduct in furtherance of those agreements if they do not intend to establish a partnership. After briefly exploring Texas partnership law and the *ETP* case, this article offers practical guidance on how to structure preliminary relationships to avoid forming unwanted and unintended partnerships.

Partnership Formation under Texas Law

Partnership formation in Texas is governed by a five-factor test set forth in the Texas Business Organizations Code ("TBOC"). Those factors, which were borrowed from the common law, include sharing of profits; expressions of intent to become partners; an agreement to share liability or losses; an agreement to contribute money or property; and shared control.[1] In its 2009 opinion in *Ingram v. Deere*,[2] the Texas Supreme Court provided detailed guidance on how to apply the TBOC factors.[3] At issue in *Ingram* was whether a psychiatrist and a psychologist had formed a partnership when the parties entered into an oral agreement for the psychiatrist to serve as the medical director for the psychologist's clinic. The Court began its analysis by noting that partnership formation under Texas common law required proof of all five common law factors, with a "prime element" being evidence of the parties' intent.[4] The Court held, however, that the statutory code required a different, "less formalistic and more practical approach" than the common law.[5]

The Court identified two key differences between the common law and the statutory approach to partnership formation. First, under the statutory approach, direct proof that the parties intended

[1] Tex. Bus. & Org. Code § 152.052(a).
[2] 288 S.W.3d 886 (Tex. 2009).
[3] *Id.* at 895. The code at issue in *Ingram* was the Texas Revised Partnership Act ("TRPA"), which preceded the TBOC. However, the Court found that the TRPA's and the TBOC's "rules for determining partnership formation are substantially the same." *Id.* at 894 n. 4.
[4] *Id.* at 894 (quoting *Coastal Plains Dev. Corp. v. Micrea, Inc.*, 572 S.W.2d 285, 287 (Tex. 1978)).
[5] *Id.* at 895.

to form a partnership is not required.[6] Indeed, the TBOC defines 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 ...."[7] Second, under the statutory approach, proof of all five factors is unnecessary for a partnership to exist. Instead, courts must apply a "totality-of-the-circumstances" test to determine whether a partnership has been formed.[8] In an effort to give some measure of definition to this test, the Court noted that conclusive evidence of all five factors would establish a partnership as a matter of law, while conclusive evidence of no factors or only one factor would be insufficient in most cases.[9] The Court found that the "challenge of the totality-of-the-circumstances test will be its application between these two points on the continuum."[10]

In the wake of *Ingram*, courts frequently have employed a detailed, factor-by-factor analysis to determine whether a partnership has been formed.[11] Courts have also developed rules concerning the quality and type of evidence that will satisfy each factor. For instance, to meet the "expression of intent" factor, parties must introduce evidence—such as public statements, business letterhead, or other expressions of intent—that are not probative of any of the other factors.[12] Moreover, an agreement to share losses is "not necessary to create a partnership."[13] Thus, while such an agreement will help to establish a partnership, its absence will not count against partnership formation. These rules reinforce the need for courts to conduct granular, fact-by-fact inquiries when assessing partnership formation. By describing the test for partnership as one dependent upon the totality of the circumstances, the Supreme Court emphasized the fact-bound, and oftentimes subjective, nature of partnership formation in Texas, and set the stage for *ETP v. Enterprise*.

ETP v. Enterprise and "Partnership by Conduct"

The *ETP* case arose from an agreement between ETP and Enterprise to explore the possibility of constructing and operating a pipeline between Cushing and the Gulf Coast. Like many sophisticated entities wishing to explore the possibility of a joint venture before actually forming one, ETP and Enterprise entered into a series of preliminary agreements, all of which disclaimed any intent by the parties to form a partnership. The parties executed a letter agreement on April 21, 2011, with an attached "non-binding" term sheet setting forth the outlines of the proposed joint venture. The letter agreement stated that neither it "nor the JV Term Sheet create any binding or enforceable obligations ... between the Parties." The letter agreement further provided that no binding obligations would arise "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." The parties also executed a confidentiality agreement and a preliminary reimbursement agreement

[6] *Id.* at 895.
[7] Tex. Bus. & Org. Code § 152.051(b)(1).
[8] *Ingram*, 288 S.W.3d at 896.
[9] *Id.* at 898.
[10] *Id.*
[11] *See, e.g., Reagan v. Lyberger*, 156 S.W.3d 925 (Tex. App.–Dallas 2012, no pet.); *Hoss v. Alardin*, 338 S.W.3d 635 (Tex. App.–Dallas 2011, no pet.).
[12] *Ingram*, 288 S.W.3d at 900.
[13] Tex. Bus. & Org. Code § 152.052(c).

governing division of expenses during the investigative stage. Those agreements likewise disclaimed any intent by the parties to form a partnership.

Throughout the spring and summer of 2011, the parties worked together to assess the technical requirements, design, engineering, and proposed route of the pipeline, prepared joint marketing materials (some of which indicated that the parties had already formed a "50/50 JV"), and made presentations to potential shippers. The parties also secured a commitment from Chesapeake to ship oil through the pipeline. In August 2011, Enterprise notified ETP that it would not move forward with the project because the lack of sufficient commitments rendered it not commercially viable, and issued a press release to that effect. One month later, Enterprise announced that it was pursuing a project with Enbridge (US) Inc. to build a pipeline from Cushing to the Gulf Coast. ETP filed suit against Enterprise the next day asserting various claims, including breach of fiduciary duty arising from a partnership relationship.[14]

Throughout over two years of litigation, Enterprise maintained that it had not entered into a partnership with ETP because the parties had expressly disclaimed any intent to do so, and because the parties' agreed-upon conditions precedent to a partnership—board approval and execution of final deal documents—never occurred. According to Enterprise, sophisticated parties may privately order their business affairs and contractually define the terms and conditions under which they will enter into a partnership. ETP, on the other hand, asserted that the parties' statements of intent in their preliminary documents were not dispositive, but rather evidence to be considered under the totality-of-the-circumstances test. ETP pointed to evidence of the parties' conduct, including their close working relationship, joint marketing efforts, and public references to their "50/50 JV," to demonstrate that the parties formed a partnership notwithstanding their preliminary statements to the contrary.

The court rejected Enterprise's motion for summary judgment and motion for directed verdict, and denied Enterprise's request for a jury instruction that "[w]hen parties agree to become partners only upon a contingency or condition, there can be no partnership until the happening of the contingency." Instead, the court submitted a jury question in which it restated the five TBOC factors, and asked the jury to determine whether a partnership had been formed based on those factors in light of all the evidence. The jury said "yes," and then awarded damages for breach of fiduciary duties arising from that relationship.

Practical Advice to Avoid an Inadvertent Partnership

While the *ETP* case is likely not over, and the final result unknown, the verdict offers several lessons to companies wishing to enter into preliminary arrangements. First, statements disclaiming intent to form a partnership may not be dispositive; instead, they will be viewed as part of the totality of the evidence and may be counterbalanced and overcome by the parties' subsequent actions. Second, the *ETP* verdict suggests that even express conditions in preliminary documents may not escape the gravitational pull of the totality-of-the-circumstances test.

[14] ETP also sued Enbridge for tortious interference. The jury rejected that claim.

Faced with these uncertainties, companies seeking to enter into preliminary relationships without forming partnerships or joint ventures should consider taking the following practical steps when preparing initial documents defining the relationship:

- In preliminary letter agreements, terms sheets, and other documents, expressly state an intention not to become partners. While this statement may not be dispositive, it constitutes some evidence under the totality-of-the-circumstances test.
- Clearly state conditions precedent establishing when the partnership begins. Conditions should not sound like introductory or boilerplate contract language and should be as specific as possible. While the weight of such conditions remains an open question in light of *ETP*, they are at the very least evidence of intent, and may constitute a legal bar if Enterprise prevails on appeal.
- Establish an automatic drop-dead date for termination of discussions if no definitive agreement is reached by that date. This should be set with an eye to guarding against uninterrupted activities over a lengthy span of time that might be viewed as an intent to form a partnership.
- Make clear that any activities involving third parties (*e.g.* open season for pipeline transportation commitments) do not constitute partnership activities and do not give rise to a partnership or joint venture.
- Include a waiver of the right to bring a legal claim for partnership formation, and include a covenant not to sue for breach of fiduciary obligations. In addition, if the drafters are concerned about how a jury might view the situation, consider use of an arbitration clause.

After a preliminary relationship has been formed, the parties may take additional steps to prevent their actions from overriding the stated intent in their documents:

- Train transactional, investor relations, marketing, and operational teams on how to conduct business during the LOI phase of a prospective relationship. In particular, educate them that they should not present to the public that a prospective deal is done when it is not.
- Be true to the preliminary documents—if the initial documentation expressly states that there is no partnership, conduct business accordingly.
- Be mindful of conduct and communications directed at third parties. Beware of representing that the parties are in a partnership or joint venture, or that the parties "shall" or "will" undertake partnership activities. In all public announcements, take care to reiterate the preliminary and tentative nature of the relationship.

While the vagaries of the totality-of-the-circumstances test ensure that no formulaic approach can be developed that will avoid a finding of partnership in every instance, adherence to the guidelines discussed above provides a good starting framework within which parties can negotiate preliminary relationships. In the meantime, parties seeking further legal guidance on the TBOC factors should closely watch the *ETP* case on appeal.