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COMMENTARY

OIL AND GAS PARTNERSHIP BY AMBUSH: THE CHALLENGES OF DISCLAIMING A PARTNERSHIP OR JOINT VENTURE IN TEXAS

Do two companies form a joint venture if the companies preliminarily discuss forming one, but never enter into a formal joint venture agreement and execute contracts expressly disclaiming any formation of a joint venture or any binding obligation to do so? A Texas jury recently answered this question in *Energy Transfer Partners, L.P. v. Enterprise Products Partners, L.P.*, No. 11-12667 (298th Dist. Ct., Dallas County, Tex.). The plaintiff in that case alleged that the parties' agreements were ambiguous and that the parties' subsequent conduct was sufficient to create a joint venture relationship. After a five-week trial, the jury agreed and awarded the plaintiff $319 million in damages, finding that despite the express contractual disclaimers, plaintiff Enterprise Transfer Partners, L.P. ("ETP") and defendant Enterprise Products Partners, L.P. ("Enterprise") had in fact formed a joint venture to build a crude oil pipeline from Oklahoma to Texas.

This case squarely addresses an important issue for companies: whether companies can effectively disclaim the existence of a joint venture or partnership, and the fiduciary obligations that these relationships entail, or whether Texas courts will disregard these disclaimers and look to the parties' course of conduct. As the *ETP v. Enterprise* case demonstrates, companies relying on disclaimers need to be aware that their subsequent conduct, particularly with respect to how the companies hold themselves out to third parties, may support an allegation that a joint venture or partnership existed and that the attendant fiduciary duties between the parties were violated. While the jury verdict is likely to be appealed, the case demonstrates that without clear disclaimers and, more importantly, careful monitoring and control of subsequent conduct, a company can be subject to costly and protracted fact-based litigation that may be difficult to defeat on summary judgment.

ETP V. ENTERPRISE

In the spring of 2011, ETP and Enterprise entered into discussions regarding the construction and operation of a proposed crude oil pipeline that would run from Cushing, Oklahoma to the Houston, Texas market. The initial discussions culminated in the execution of three agreements, all of which had language disclaiming various legal obligations.

The April 21, 2011 Letter Agreement: This agreement attached a proposed joint venture term sheet but expressly stated the parties were "entering discussions regarding a proposed joint venture transaction." The agreement went on to state that "[n]either this letter nor the JV Term Sheet create any binding or enforceable obligations between the Parties and, except for the Confidentiality Agreement … no 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."

The March 10, 2011 Confidentiality Agreement: This agreement stated that "[t]he Parties agree that unless and until a definitive agreement between the Parties with respect to the Potential Transaction has been executed and delivered, and then only to the extent of the specific terms of such definitive agreement, no Party hereto will be under any legal obligation of any kind whatsoever with respect to any transaction by virtue of this Agreement or any written or oral expression…." The agreement goes on to state that "[a] Party shall be entitled to cease disclosure of Confidential Information hereunder and any Party may depart from negotiations at any time for any reason or no reason without liability to any party hereto."

The April 27, 2011 Letter Agreement: This agreement related to funding of preliminary design work and contained similar language as the above agreements, but also expressly stated that "[n]othing herein shall be deemed to create or constitute a joint venture, a partnership, a corporation, or any entity taxable as a corporation, partnership or otherwise."

Throughout the spring and summer of 2011, ETP and Enterprise gave joint presentations to potential shippers in an effort to obtain commitments for the pipeline. The companies also circulated joint marketing materials. Some of these materials stated that "Enterprise and [ETP] have formed a Joint Venture LLC to construct the pipeline between Cushing and Houston" and described the venture as a "50/50 JV." In addition to marketing activities, Enterprise and ETP worked together on various design, engineering, and property issues relating to the proposed pipeline. The parties purportedly agreed to split the costs of these activities.

In August 2011, the potential deal fell apart after Enterprise informed ETP that it would not be moving forward with the project. According to Enterprise, the project was not commercially viable because the parties had been unable to secure sufficient commitments and had "only one signed conditional commitment" from a shipper. ETP disputed this characterization and described the shipper as an "anchor shipper" and a "significant achievement." Approximately one month later, on September 29, 2011, Enterprise announced that it was jointly pursuing a different project with Enbridge (US) Inc. ("Enbridge") involving a potential crude oil pipeline from Cushing, Oklahoma. ETP sued Enterprise and Enbridge the next day.

ETP asserted multiple claims against Enterprise, including breach of contract and breach of fiduciary duty. ETP also asserted claims against Enbridge for tortious interference with existing contract and prospective business relations, conspiracy, and aiding and abetting breach of fiduciary duty. Enterprise filed a motion for summary judgment, relying heavily on the argument that the parties contractually agreed there was no joint venture unless and until two conditions precedent were satisfied: receiving approval from the parties' respective boards and executing and delivering definitive agreements memorializing the transaction.

The court denied Enterprise's and Enbridge's respective motions for summary judgment without commentary, and the case proceeded to trial. The jury found that a partnership was created and awarded ETP $319 million in damages in a 10–2 decision. Enbridge, however, was not found liable for any of ETP's damages.

LEGAL BACKGROUND–FORMATION OF A JOINT VENTURE OR PARTNERSHIP

A "joint venture" is a legal relationship in the nature of a partnership, but its operation is typically limited to a single transaction. *See In re Marriage of Louis,* 911 S.W.2d 495, 496 (Tex. App.—Texarkana 1995, no writ). When a joint venture is formed, the parties owe each other fiduciary duties, including a duty of the utmost good faith and scrupulous honesty and an obligation to make good faith disclosures of all facts relevant to the joint venture transaction. *See Kirby v. Cruce,* 688 S.W.2d 161, 165 (Tex. App.—Dallas 1985, writ ref'd n.r.e.). Generally, a joint venture is governed by the rules applicable to partnerships. *Smith v. Deneve*, 285 S.W.3d 904, 913 (Tex. App.—Dallas 2009, no pet.).

Texas courts have traditionally found that a joint venture requires four 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. *Smith v. Deneve,* 285 S.W.3d 904, 913 (Tex. App.—Dallas 2009, no pet.). However, the Texas Supreme Court stated that "[w]e see no legal or logical reason for distinguishing a joint venture from a partnership on the question of formation." *Ingram v. Deere*, 288 S.W.3d 886, 894, n. 2 (Tex. 2009). Accordingly, many Texas courts look to the following statutory factors for partnership formation found in the Texas Business Organizations Code:

- 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.

Tex. Bus. Orgs. Code Ann. § 152.052 (2013). The Texas Supreme Court, in analyzing an earlier statute containing partnership factors that are "substantially the same" as those found in the Texas Business Organizations Code, stated that while "[t]he common law required proof of all five factors to establish the existence of a partnership," the statutory test "contemplates a less formalistic and more practical approach to recognizing the formation of a partnership." *Ingram v. Deere,* 288 S.W.3d 886, 895 (Tex. 2009). The Texas Supreme Court emphasized that the statute "does not require direct proof of the parties' intent to form a partnership," and the parties' sharing of profits and control over the business are likely the most important factors to be considered. *Id.*

THE EFFECT OF DISCLAIMING THE CREATION OF A PARTNERSHIP OR JOINT VENTURE

The parties in *ETP v. Enterprise* executed contracts that expressly recognized the potential formation of a joint venture but stated that such formation would not occur "unless and until" the parties (i) received approval from their respective boards; and (ii) negotiated, executed, and delivered definitive agreements memorializing the proposed transaction. Enterprise argued that these two requirements were conditions precedent that had not been satisfied, and, therefore, ETP's claims relating to the creation of a joint venture were barred as a matter of law. Enterprise relied on cases such as *Willis v. Harvey,* 349 S.W.2d 323, 326 (Tex. Civ. App.—Houston 1961, writ ref'd n.r.e.), which held that "[a]n executory contract to form a partnership does not create the relation of partners between the parties until it is consummated or executed and where the agreement provides a condition precedent to the formation of the partnership, then it will not come into existence until the condition has been met."

Enterprise further argued that the parties' post-contract conduct did not create a partnership. According to Enterprise, the parties' conduct should not trump the unambiguous executed agreements that acknowledged they were in preliminary discussions, contemplated that they would conduct further activities to evaluate the project, and expressly stated that their preliminary activities did not create a legally binding relationship. In support of this argument, Enterprise cited cases such as *COC Servs. Ltd. v. CompUSA, Inc.,* 150 S.W.3d 654 (Tex. App.—Dallas 2004, pet. denied), which considered whether parties who executed a letter of intent ("LOI") intended to be bound by an unexecuted master franchise agreement ("MFA"). The *CompUSA* court held that

the parties' partial performance of work in connection with the MFA did not abrogate the "no-further obligation" provision of the LOI. *Id.* at 670. Accordingly, the court held that, as a matter of law, the parties did not agree to be bound to the MFA. *Id.* ETP argued that *CompUSA*, along with several other cases cited by Enterprise, did not involve the issue of whether a partnership had been formed, but only involved questions of contract interpretation.

ETP's argument primarily focused on the Texas Supreme Court's opinion in *Ingram v. Deere*, which analyzed the five factors for partnership formation under Texas law. Emphasizing the statute's "less formalistic and more practical approach to recognizing the formation of a partnership," ETP argued that the conditions precedent found in the April 21, 2011 letter agreement related only to the "intent" factor and that, under the terms of the statute, the parties could have formed a partnership even though there was an express contractual disclaimer of any intent to do so. In support of this proposition, ETP looked to cases like *Stephanz v. Laird,* 846 S.W.2d 895, 899-900 (Tex. App.—Houston [1st Dist.] 1993, writ denied), which held that "[p]ersons who intend to do the things that constitute a partnership are partners whether their expressed purpose was to create or avoid a partnership."

Because the trial court did not give specific reasons for denying Enterprise's motion for summary judgment and the case went to a jury verdict, we do not know the precise reasons why a joint venture was found to exist in this case. The verdict is likely to be appealed, and we may get some clarity on the parties' arguments when appellate decisions are issued. Until then, the *ETP v. Enterprise* case stands as a cautionary warning for parties considering a joint venture, executing letters of intent, and engaging in preliminary steps on a proposed project.

TAKEAWAYS

The *ETP v. Enterprise* jury verdict demonstrates the difficulty of securing a pre-trial dismissal of breach of fiduciary duty claims by establishing or disproving the existence of a partnership as a matter of law. The Texas Supreme Court has to date provided only limited guidance on this issue, noting in *Ingram* that (i) an absence of any evidence of the statutory factors precludes the recognition of a partnership; (ii) conclusive evidence of only one factor is normally insufficient to establish a partnership's existence; and (iii) conclusive evidence of all five factors establishes the existence of a partnership as a matter of law. 288 S.W.3d at 898. The Texas Supreme Court emphasized that the five factors should be made by examining the totality of the circumstances in each case, with no single factor being either necessary or sufficient to prove the existence of a partnership. *Id.* at 903-04. This leaves a lot of room for development of the law in subsequent cases and creates some uncertainty for contracting parties until the law is further developed.

The facts of *ETP v. Enterprise* are particularly interesting because the case involved not only a limited disclaimer of the existence of a joint venture or partnership, but also a contractual recognition that a joint venture may be formed at some point in the future when certain conditions precedent were met. In denying Enterprise's motion for summary judgment, the court did not just look beyond a boilerplate disclaimer; the court also looked beyond carefully crafted agreements contemplating the preliminary marketing activities, future contract negotiations, and cost-sharing activities of the parties—all of which contained specific disclaimer and condition precedent language stating that such activities did not create a partnership or joint venture. The court apparently treated these lengthy, explicit disclaimers as only one piece of evidence relating to a single factor in the five-pronged statutory test. Assuming the case is appealed, the decisions coming out of the appeal should provide some real guidance.

The case is also noteworthy as a potent reminder that companies should closely monitor their preliminary activities when evaluating a proposed transaction. ETP presented substantial evidence at trial that Enterprise and ETP presented themselves to third parties in marketing materials as "50/50 JV" parties who had "formed a joint venture." ETP compared this to a common-law marriage, but there are limits to how far statements made to third parties can be used to demonstrate formation of a joint venture. In an effort to avoid "gotcha" claims for parties who pursue projects together, the Texas Supreme Court has stated that the "terms used by the parties in referring to the arrangement do not control … and 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." *Ingram*, 288 S.W.3d at 900. The court has also stated, however, that "the same terms could constitute legally significant evidence of expression of intent when made in a circumstance that indicates significance to the business endeavor." *Id.*

Although companies need to be cognizant that a court may scrutinize its post-contract conduct when determining whether a partnership or joint venture was created, there are some contract-based strategies that companies may employ to mitigate the potential risk of a "partnership by ambush."

- As a general matter, parties often execute several different agreements when contemplating a transaction. Companies should consider including comprehensive, consistent disclaimers in *all* relevant agreements.
- In each disclaimer, companies may want to specifically state that the conduct contemplated by the particular agreement will not be used as evidence of a joint venture or partnership by any party. Such language should be drafted to capture as much conduct as possible, but companies may want to highlight activities similar to those at issue in *ETP v. Enterprise,* such as joint marketing, engineering, design, legal, or real estate activities.
- In addition to disclaiming the parties' intent to form a partnership in their agreements, parties should consider including provisions requiring separate payment of expenses for preliminary activities, such as marketing or engineering work. This may help avoid allegations that the parties agreed to contribute money to or even share losses of a purported joint venture or partnership.
- Finally, companies may want to expressly address the "participation or right to participate in control of the business" factor in the preliminary agreements by specifically delineating the parties' roles, rights, and obligations with respect to each other, including the ability to monitor and approve all communications to third parties before they are sent.

Companies seeking to disclaim the existence of a joint venture or partnership need to be cognizant of the possibility that even comprehensive disclaimers may be viewed by a Texas court as just one piece of evidence in a multifaceted, fact-based determination of whether a partnership or joint venture exists. The *ETP v. Enterprise* case suggests that monitoring representations made to third parties in circumstances that have "significance to the business endeavor" can be a particularly important factor and may be the best way to protect against claims that a partnership or joint venture exists. Companies should avoid stating in marketing materials that there is a joint venture or partnership, but should instead consider stating that the parties may enter or are contemplating entering into a joint venture or partnership. At least for now, a company that fails to monitor its subsequent conduct for loose talk of joint ventures or partnership could be exposing itself to protracted litigation that it will be unable to resolve through summary judgment, subjecting itself to the potential of an adverse jury verdict with substantial damages.

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