



ST. MARY'S
UNIVERSITY

Digital Commons at St. Mary's University

Faculty Articles

School of Law Faculty Scholarship

2011

Limited Partnership Status and the Imposition of Fiduciary Duties in Texas

Colin P. Marks

St. Mary's University School of Law, cmarks@stmarytx.edu

Follow this and additional works at: <https://commons.stmarytx.edu/facarticles>



Part of the [Law Commons](#)

Recommended Citation

Colin P. Marks, Limited Partnership Status and the Imposition of Fiduciary Duties in Texas, 63 *Baylor L. Rev.* 126 (2011).

This Article is brought to you for free and open access by the School of Law Faculty Scholarship at Digital Commons at St. Mary's University. It has been accepted for inclusion in Faculty Articles by an authorized administrator of Digital Commons at St. Mary's University. For more information, please contact egoode@stmarytx.edu, sfowler@stmarytx.edu.

LIMITED PARTNERSHIP STATUS AND THE IMPOSITION OF FIDUCIARY
DUTIES IN TEXAS

Colin P. Marks*

I.	Introduction.....	126
II.	General and Limited Partnerships in Texas	128
III.	Duties of Limited Partners Under Texas Law	130
	A. Fiduciary Duties Under the Texas Business Organizations Code	130
	B. Cases Finding No Fiduciary Duty	132
	C. Cases Finding the Existence of a Fiduciary Duty	136
III.	The Fifth Circuit’s Interpretation of Texas Law	140
	A. The Duties of Limited Partners Under <i>McBeth v.</i> <i>Carpenter</i>	140
	B. Harmonizing <i>McBeth</i> and Texas Law	142
V.	Conclusion	145

I. INTRODUCTION

It is a longstanding rule that partners in a general partnership can each be held personally liable for the obligations of the partnership.¹ To avoid

*Professor of Law, St. Mary’s University School of Law. J.D., University of Houston Law Center; B.S. University of Missouri–Columbia. I would like to thank Professor Douglas Moll of the University of Houston Law Center and Professor Mark Cochran of St. Mary’s University School of Law for their valuable feedback on this article. I would also like to thank and acknowledge the hard work and assistance of my research assistants Rusty Hoermann, Craig Jacobs, Matt Johnson and Sarah Minter, in researching and writing this article. Finally, I would like to thank my wife Jill, daughter Savannah, and son George for their love and support.

¹*See* *Danning v. United States (In re Matter of Montgomery)*, 532 F.2d 725, 726 (9th Cir. 1976) (recognizing “the general rule that a general partner is personally liable for the debts of the partnership”); *First N.M. Bank v. Bruton (In re Bruton)*, Bankr. No. 7-09-13458 JA, 2010 WL 2737201, at *5 (Bankr. D.N.M. July 12, 2010) (writing that, in a general partnership, “all partners are jointly and severally liable for the debts incurred by any one of the general partners”); *Teamsters Pension Trust Fund of Phila. & Vicinity v. Malone Realty Co. (In re Malone)*, 74 B.R.

liability, many investors in a partnership prefer the structure of a limited partnership, which generally insulates the limited partners from liability by creating a two-tier structure with a general partner and limited partners. The limited partners are at risk of losing only their investment so long as they are not acting as general partners. However, a question which frequently arises in this structure is: what duties are owed between the various partners? In a general partnership, all partners are fiduciaries to each other.² The statutes governing limited partnerships make clear that general partners in a limited partnership continue to owe fiduciary duties to the limited partnership³ but what of limited partners? Do limited partners owe duties to the limited partnership itself or to each other? In *McBeth v. Carpenter*, the Fifth Circuit Court of Appeals stated quite boldly, “With respect to fiduciary duties . . . Texas law recognizes such obligations between limited partners, applying the same partnership principles that govern the relationship between a general partner and limited partners.”⁴ Taken at face value, the *McBeth* decision appears to answer the question of duties owed; however, a closer look at the cases relied upon by the *McBeth*

315, 319 (Bankr. E.D. Pa. 1987) (“As a rule, general partners are personally liable for partnership debts. At the same time, each partner has a right to have the partnership’s property applied to the payment of the partnership debt.”); *Kelly v. Fla. Dep’t of Ins.*, 597 So. 2d 900, 902 (Fla. Dist. Ct. App. 1992) (noting that under Florida law, “[i]t is . . . well established that each general partner is personally liable for all partnership obligations”).

² See REVISED UNIF. P’SHIP ACT § 404 (amended 1997), 6 U.L.A. 143 (2001).

³ See, e.g., FLA. STAT. ANN. § 620.1408(1) (West 2007) (“The only fiduciary duties that a general partner has to the limited partnership and the other partners are the duties of loyalty and care”); TEX. BUS. ORGS. CODE ANN. § 152.204(a) (West Supp. 2010) (“A partner owes to the partnership, the other partners, and a transferee of a deceased partner’s partnership interest as designated in Section 152.406(a)(2): (1) a duty of loyalty; and (2) a duty of care.”); See *Wallace ex rel. Cencom Cable Income Partners II, L.P. v. Wood*, 752 A.2d 1175, 1182 n.23 (Del. Ch. 1999) (“[I]t is well settled that, unless limited by the limited partnership agreement, the general partner of a Delaware limited partnership and the directors of a corporate General Partner who control the partnership, like directors of a Delaware corporation, have the fiduciary duty to manage the partnership in the partnership’s interests and the interests of the limited partners.”); *Boxer v. Husky Oil Co.*, 429 A.2d 995, 997 (Del. Ch. 1981) (“When the provisions of the Uniform Partnership Act and the Uniform Limited Partnership Act are read together, it is clear that the general partner in a limited partnership owes a fiduciary duty to the limited partners The duty of the general partner in a limited partnership to exercise the utmost good faith, fairness, and loyalty is . . . required both by statute and common law. This fiduciary duty of partners is often compared to that of corporate directors”); *Red River Wings, Inc. v. Hoot, Inc.*, 751 N.W.2d 206, 219 (N.D. 2008) (“The statute imposes upon partners the duties of loyalty and care and the obligations of good faith and fair dealing.”).

⁴ 565 F.3d 171, 177 (5th Cir. 2009).

court, other Texas opinions, and the facts of the *McBeth* case itself reveals that such a broad statement may be misleading and inaccurate.

This article examines the question of what duties are owed among limited partners in a limited partnership. Part II discusses both the uniform and Texas statutes governing limited partnerships and their interplay with the law of general partnerships. Part III focuses specifically upon the duties owed by partners under both a general and limited partnership under Texas law. Part IV examines the *McBeth* decision, concluding that though the decision's outcome is correct, the rule that should be extracted from the case is much more nuanced than the broad statement that limited partners owe fiduciary duties to one another. The article concludes that though Texas jurisprudence has failed to articulate a clear rule, it is consistent with the cases decided thus far and the nature of a limited partnership to only create a fiduciary duty in certain equitable circumstances, such as when the limited partner is exercising control over the limited partnership or is also acting in the role of a general partner.

II. GENERAL AND LIMITED PARTNERSHIPS IN TEXAS

Under the Texas Business Organizations Code's general partnership provisions, which substantially follow the Revised Uniform Partnership Act (RUPA), the default status of two or more individuals entering into a joint enterprise with the intention of making a profit is a general partnership.⁵ No filing with the state is required to obtain general partnership status, but the entity does have legal consequences. For instance, unless specified

⁵ See TEX. BUS. ORGS. CODE ANN. § 152.051(b) (“[A]n association of two or more persons to carry on a business for profit as owners creates a partnership, regardless of whether: (1) the persons intend to create a partnership; or (2) the association is called a “partnership,” “joint venture,” or other name.”); REVISED UNIF. P’SHIP ACT § 101(6) (amended 1997), 6 U.L.A. 60 (2001) (similarly defining a partnership to mean “an association of two or more persons to carry on as co-owners a business for profit formed under Section 202, predecessor law, or comparable law of another jurisdiction”). Section 202 of RUPA also provides that “[e]xcept as otherwise provided in subsection (b), the association of two or more persons to carry on as co-owners a business for profit forms a partnership, whether or not the persons intend to form a partnership.” REVISED UNIF. P’SHIP ACT § 202. This is true under Texas law as well. See *Howard Gault & Son, Inc. v. First Nat’l Bank of Hereford*, 541 S.W.2d 235, 237 (Tex. Civ. App.—Amarillo 1976, no writ) (“The statement in one of the agreements that the farming operation was not a partnership is not conclusive on the question of partnership. It is the intent to do the things that constitute a partnership that determines that the relationship exists between the parties, and if they intend to do a thing which in law constitutes a partnership, they are partners whether their expressed purpose was to create or avoid the relationship.”).

otherwise in the partnership agreement, the partners in a general partnership split profits equally, regardless of capital contributions.⁶ General partners are also jointly and severally liable to third parties for partnership liabilities.⁷ Thus, if A and B form a partnership to run a taco stand, and a customer, C, becomes ill eating food from the stand, both A and B can be held personally liable for the injury to C.

To avoid this result, many would-be partners opt instead to form a limited partnership, or L.P. Unlike a general partnership, an L.P. must be registered with the state. An L.P. has a two-tiered structure with a general partner and at least one limited partner. Under the Revised Uniform Limited Partnership Act (RULPA), which has also been adopted by Texas, the limited partner is generally insulated from the liabilities of the L.P. beyond its investment in the L.P.⁸ The general partner, however, remains personally liable for the liabilities of the partnership just as it would in a general partnership.⁹ The general partner is also charged with managing the L.P., though RULPA does not explicitly prohibit limited partners from taking part in and managing the L.P.¹⁰ However, RULPA does provide that limited partners can lose their insulation from liability in some circumstances if they are in fact controlling the L.P.¹¹ The Texas Business Organizations Code, which follows RULPA, provides:

(a) A limited partner is not liable for the obligations of a limited partnership unless:

(1) the limited partner is also a general partner; or

⁶TEX. BUS. ORGS. CODE ANN. § 152.202(c).

⁷*Id.* § 152.303.

⁸REVISED UNIF. LTD. P'SHIP ACT § 303 (amended 1985), 6 U.L.A. 505 (Supp. 1995).

⁹*Id.* § 403.

¹⁰*See id.*

¹¹*Id.* Section 303 states:

Except as provided in subsection (d), a limited partner is not liable for the obligations of a limited partnership unless he [or she] is also a general partner or, in addition to the exercise of his [or her] rights and powers as a limited partner, he [or she] participates in the control of the business. However, if the limited partner participates in the control of the business, he [or she] is liable only to persons who transact business with the limited partnership reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner.

Id. § 303.

(2) in addition to the exercise of the limited partner's rights and powers as a limited partner, the limited partner participates in the control of the business.¹²

Thus, a limited partner who takes too active of a role in the management of the L.P. could risk personal liability, but this liability is limited to those individuals who reasonably believe the limited partner is a general partner.¹³ The Texas Business Organizations Code and RULPA also contain a laundry list of activities that, in and of themselves, do not mean the limited partner is in "control" of the L.P., such as "acting as: (A) a contractor for or an officer or other agent or employee of the limited partnership; (B) a contractor for or an agent or employee of a general partner; (C) an officer, director, or stockholder of a corporate general partner;"¹⁴ "consulting with or advising a general partner on any matter, including the business of the limited partnership;"¹⁵ or "calling, requesting, attending, or participating in a meeting of the partners or the limited partners."¹⁶ The end result of these provisions is that a limited partner who is a passive investor will be able to reap the benefits of a profitable L.P without worrying about personal liability, but even a limited partner who takes a larger role in the L.P. can remain insulated from liability.

III. DUTIES OF LIMITED PARTNERS UNDER TEXAS LAW

A. *Fiduciary Duties Under the Texas Business Organizations Code*

Both RULPA and Texas law rely on a concept referred to as "linkage" to fill in gaps in the limited partnership acts. This means that where the limited partnership act does not address an issue, the law of the general partnership act fills in the gap. This concept is important in the realm of duties as both RULPA and Texas law refer simply to the general partnership acts with regard to the duties of the general partner in a limited partnership. The Texas Business Organizations Code (TBOC) Section 153.152 provides that:

¹²TEX. BUS. ORGS. CODE ANN. § 153.102(a) (West Supp. 2010).

¹³See *id.* § 153.102(b).

¹⁴*Id.* § 153.103(1)(A-C).

¹⁵*Id.* § 153.103(3).

¹⁶*Id.* § 153.103(5); REVISED UNIF. LTD. P'SHIP ACT § 303.

(a) Except as provided by this chapter, the other limited partnership provisions, or a partnership agreement, a general partner of a limited partnership:

(1) has the rights and powers and is subject to the restrictions of a partner in a partnership without limited partners; and

(2) has the liabilities of a partner in a partnership without limited partners to the partnership and to the other partners.

(b) Except as provided by this chapter or the other limited partnership provisions, a general partner of a limited partnership has the liabilities of a partner in a partnership without limited partners to a person other than the partnership and the other partners.¹⁷

Thus, a general partner owes fiduciary duties to the limited partnership and the limited partners.¹⁸ However, though it is clear that a general partner owes fiduciary duties to the limited partners, what is less clear is whether limited partners also owe such duties to the limited partnership itself and to the other limited partners simply by virtue of their status as limited partners within the same company.¹⁹

This uncertainty stems from this same concept of linkage. TBOC Section 153.003(a) provides that “[e]xcept as provided by Subsection (b), in a case not provided for by this chapter and the other limited partnership provisions, the provisions of Chapter 152 governing partnerships that are not limited partnerships and the rules of law and equity govern.”²⁰ As the TBOC does not explicitly negate the creation of fiduciary duties running from a limited partner to the other limited partners, an argument can be made that the duties owed in a general partnership also apply to limited

¹⁷TEX. BUS. ORGS. CODE ANN. § 153.152; REVISED UNIF. LTD. P’SHIP ACT § 403.

¹⁸See *Hughes v. St. David’s Support Corp.*, 944 S.W.2d 423, 425–26 (Tex. App.—Austin 1997, writ denied) (“Furthermore, in a limited partnership, the general partner stands in the same fiduciary capacity to the limited partners as a trustee stands to the beneficiaries of a trust.”).

¹⁹See 19 ROBERT W. HAMILTON ET AL., TEX. PRACTICE SERIES: BUSINESS ORGANIZATIONS § 14.33 (2d ed. 2004) (“There is some uncertainty with regard to whether limited partners owe fiduciary duties to the partnership or other partners.”).

²⁰TEX. BUS. ORGS. CODE ANN. § 153.003(a).

partners.²¹ However, the TBOC goes on to provide that the “powers and duties of a limited partner shall not be governed by [rules applicable to general partnerships] that would be inconsistent with the nature and role of a limited partner.”²² It also states that a “limited partner shall not have any obligation or duty of a general partner solely by reason of being a limited partner.”²³ Given that one of the main purposes of entering into a limited partnership is to avoid personal liability, it therefore seems more logical to conclude that an individual’s mere status as a limited partner should not impose fiduciary duties. This has prompted at least one commentator to declare that “[t]he TBOC makes it clear that limited partners, as limited partners, generally do not owe fiduciary duties to the partnership or to other partners.”²⁴

Sadly, despite the clarity of this statement, Texas case law has not been as clear on this point. While there is limited case law on the topic, at least two Texas cases have come down on the side of finding no such duty simply by virtue of limited partner status, while two other opinions have indicated that such a duty does exist. As will be explored, however, the cases finding that such a duty does exist are more nuanced than a simple statement that every limited partner owes a fiduciary duty to the other partners and the limited partnership itself.

B. Cases Finding No Fiduciary Duty

Only two Texas cases addressing the duties owed by limited partners to other partners have concluded that a partner’s status as a mere limited partner does not necessarily give rise to a fiduciary duty. However, neither case was reported and thus both lack precedential value.²⁵ The reasoning of the courts is nonetheless instructive as they seem to align with the implications of Sections 153.003(a) & (b) of the TBOC in finding no such duty.

²¹ See 19 HAMILTON ET AL., *supra* note 19, at § 14.33.

²² TEX. BUS. ORGS. CODE ANN. § 153.003(b).

²³ *Id.* § 153.003(c).

²⁴ Byron F. Egan, *Fiduciary Duties of Corporate Directors and Officers in Texas*, 43 TEX. J. BUS. L. 45, 341 (2009). Mr. Egan goes on to note that limited partners *can* have such duties imposed upon them when “a limited partner actually has or exercises control in management matters (e.g., because of control of the general partner, contractual veto powers over partnership actions or service as an agent of the partnership).” *Id.*

²⁵ See TEX. R. APP. P. 47.7(b) (noting that court of appeals opinions in civil cases have no precedential value if issued before January 1, 2003 and designed as “do not publish”).

In *Crawford v. Ancira*, Michelle Crawford sued Ernesto Ancira and others for alleged misrepresentations made in connection with Crawford's acquisition of a limited partnership called Designer Cartel, Ltd. (Cartel).²⁶ Eighty percent of Cartel was owned by Ancira as a limited partner and twenty percent by M.M. Thomas, Inc., which acted as the general partner.²⁷ Under the terms of a 1989 agreement, Crawford acquired M.M. Thomas, Inc. and another thirty percent of Ancira's interest making her the fifty percent owner of Cartel.²⁸ As part of the agreement, Crawford made a \$40,000 loan to Cartel and directed M.M. Thomas to make another \$5,000 loan.²⁹ In a subsequent 1991 agreement, Crawford then acquired Ancira's remaining interest in Cartel for ten dollars.³⁰ Crawford subsequently sued Ancira, among others, for making fraudulent misrepresentations regarding both the 1989 and 1991 agreements.³¹ Crawford claimed that Cartel had outstanding debts, contrary to the assertions of Ancira that Cartel had no debts and that Ancira claimed he would pay any outstanding debts should they exist.³² Unfortunately for Crawford, these alleged misrepresentations were contrary to the terms of the 1989 and 1991 agreements, which provided that the money loaned in 1989 would go toward paying outstanding debts and that Crawford would release Ancira from any of Cartel's debts.³³

Crawford admitted that she did not read the agreements but asserted that she relied upon the representations of Ancira in entering into the contract.³⁴ The Fourth Court of Appeals was unsympathetic to her claim, noting that in an arm's-length transaction, "[A] party who fails to read a contract may not avoid the effect of the contract on the ground that she did not know what she was signing."³⁵ However, the court noted that, if Ancira was in a fiduciary relationship with Crawford, her reliance on Ancira's statements

²⁶No. 04-96-00078-CV, 1997 WL 214835, at *4 (Tex. App.—San Antonio April 30, 1997, no writ) (not designated for publication).

²⁷*See id.* at *1.

²⁸*See id.*

²⁹*See id.*

³⁰*See id.*

³¹*See id.* at *1–2.

³²*See id.* at *4.

³³*See id.*

³⁴*See id.*

³⁵*Id.*

would amount to fraud.³⁶ Thus, the court reviewed whether Ancira's status as a limited partner gave rise to a fiduciary duty owed to other limited partners.³⁷ The court noted that though general partners owe such a duty to the limited partners, limited partners lack the managerial powers that a general partner wields.³⁸ The court concluded that:

limited partners do not necessarily have a duty to act for or give advice for the benefit of the other partners or a duty to subordinate their own interests to the interests of the other partners. . . . [A] person's mere status as a limited partner is insufficient to create fiduciary duties.³⁹

The court therefore affirmed the grant of summary judgment in favor of Ancira.⁴⁰

The other case which espouses this same statement of the law is factually more complicated. In *AON Properties, Inc. v. Riveraine Corp.*, two individuals, William Signet and H.C. Smith, formed a limited partnership in 1990 called Riveraine Development Ltd. (RDL) for the purpose of renovating apartment complexes in Houston, Texas.⁴¹ The general partner in RDL was Riveraine Corporation (who owned a one percent interest in RDL), and the limited partners were Signet, Cope Smith, CanAmerican Holdings, Inc. (a company controlled by individual David Lobb) and Hemisphere Management, Inc. (a company controlled by Cope Smith).⁴² After acquiring some of the necessary properties, RDL was in need of additional capital and entered into a joint venture with AON Properties, Inc. called Beechnut South Partnership (BSP).⁴³ The project continued to move forward.⁴⁴ However, in 1992 AON claimed there was a shortfall in RDL's initial capital contribution.⁴⁵ Also, Signet fell behind on payments on a loan which had been required for some of the initial capital

³⁶ *See id.*

³⁷ *See id.* at *4–5.

³⁸ *See id.* at *5.

³⁹ *Id.*

⁴⁰ *See id.* at *6.

⁴¹ No. 14-96-00229-CV, 1999 WL 12739, at *1 (Tex. App.—Houston [14th Dist.] Jan. 14, 1999, no pet.) (not designated for publication).

⁴² *Id.*

⁴³ *See id.* at *2.

⁴⁴ *See id.* at *3.

⁴⁵ *See id.*

contribution of RDL.⁴⁶ Subsequently, AON offered to buy-out RDL's interest in BSP for \$1.8 million.⁴⁷ However, CanAmerican blocked the buy-out under a provision in the RDL partnership agreement that required its approval for any sale in excess of \$100,000.⁴⁸

After the failed buy-out attempt, Riveraine lost its corporate charter causing it to become ineligible as the general partner.⁴⁹ This event precipitated a vote by the limited partners to dissolve RDL and elect CanAmerican to wind up RDL's affairs.⁵⁰ Signet and Riveraine opposed this move.⁵¹ Eventually, by court-order, Lobb (who controlled CanAmerican) was substituted as the wind-up trustee of RDL.⁵² In 1994, Lobb was forced to sell off RDL's interest in BSP to AON.⁵³ Riveraine and Signet then brought suit against AON, Lobb, and CanAmerican for breach of a fiduciary duty.⁵⁴ A jury found in favor of Riveraine and Signet on their breach of fiduciary duty cause of action, but the trial court granted a judgment notwithstanding the verdict on these claims.⁵⁵ Riveraine and Signet appealed.

As neither AON nor Lobb were parties to the limited partnership, the court of appeals held that they owed no fiduciary duty to Riveraine or Signet.⁵⁶ As to CanAmerican, Riveraine and Signet contended that CanAmerican's failure to vote in favor of the initial buy-out agreement, and its actions to remove Riveraine as general partner, somehow amounted to a breach of a fiduciary duty.⁵⁷ The court of appeals began its analysis of this issue by reviewing what it viewed as a misleading jury instruction.⁵⁸ The trial court instructed that limited partners owed "each other a fiduciary duty

⁴⁶ *See id.*

⁴⁷ *See id.* at *4.

⁴⁸ *See id.*

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.*

⁵³ *See id.* at *5.

⁵⁴ *Id.* at *1.

⁵⁵ *See id.* at *1, *23.

⁵⁶ *See id.*

⁵⁷ *See id.* They also contended that CanAmerican lost its limited-partner status when it was briefly made the general partner; however, all of the actions complained about were taken by Lobb rather than CanAmerican. *Id.*

⁵⁸ *See id.* at *8.

as a matter of law,” but, as the court of appeals correctly noted, there existed no authority under Texas case law at that time for such a proposition.⁵⁹ The court did not go so far as to say that no such duty can ever exist between limited partners, but instead took its lead from other jurisdictions which had found that no such duty exists unless the limited partner “actively engages in control over the operation of the business so as to create duties that otherwise would not exist.”⁶⁰ The court then found that though CanAmerican had voted against the initial buy-out offer by AON, such actions were protected under the safe harbor provisions of the Texas limited partner act, which provided that “a limited partner does not participate in the control of the business by voting on the sale of an asset or assets of the limited partnership or by voting on the admission, removal or retention of the general partner.”⁶¹ Thus, like *Crawford*, the *AON Properties* court placed some emphasis on the lack of control of a typical limited partner in holding that no fiduciary duty exists simply by virtue of limited partnership status.⁶² However, the *AON Properties* court went slightly further in exploring the control issue by linking it to the safe harbor provisions of the Texas Revised Limited Partnership Act that govern when a limited partner is in control for reasons of liability to third parties.⁶³

C. Cases Finding the Existence of a Fiduciary Duty

There have been two reported decisions exploring the duties owed by limited partners to the limited partnership.⁶⁴ Both have found that such a duty existed.⁶⁵ However, a review of the facts from both cases reveals that the limited partners at issue were more than simple passive investors.

In *Dunnagan v. Watson*, three men, Dunnagan, Watson, and Lawley, formed a limited partnership, Parker County’s Squaw Creek Downs, L.P.

⁵⁹ See *id.* at *7.

⁶⁰ *Id.* at *23.

⁶¹ *Id.* (quoting Act of May 28, 1997, 75th Leg., R.S., ch. 375, § 96, 2003 Tex. Gen. Laws 1516, 1588 (expired Jan. 1, 2010)). These same provisions were carried forward in the TBOC and can be found in the RULPA. See TEX. BUS. ORGS. CODE ANN. § 153.103 (West Supp. 2010); REVISED UNIF. LTD. P’SHIP ACT § 303 (amended 1985), 6 U.L.A. 505 (Supp. 1995).

⁶² See *AON Props.*, 1999 WL 12739, at *23.

⁶³ See *id.*

⁶⁴ See generally *Dunnagan v. Watson*, 204 S.W.3d 30 (Tex. App.—Fort Worth 2006, pet. denied); *Zinda v. McCann St., Ltd.*, 178 S.W.3d 883 (Tex. App.—Texarkana 2005, pet. denied).

⁶⁵ See *Dunnagan*, 204 S.W.3d at 47; *Zinda*, 178 S.W.3d at 890.

(Downs, LP), for the purpose of acquiring and operating a racetrack.⁶⁶ All three men were limited partners with Dunnagan owning 49% interest and Watson and Lawley each owning 24.5%.⁶⁷ The remaining 2% was owned by Parker County III, Inc., a corporation formed by the three men to serve as the general partner.⁶⁸ All three men also served as officers in the corporation, with Watson serving as President.⁶⁹ The shares of the corporation were apportioned 50% to Dunnagan and 25% each to Watson and Lawley.⁷⁰

Downs, LP had purchased a racetrack but was without a racing license.⁷¹ While waiting to obtain one, Watson and Lawley proposed opening a restaurant at the track.⁷² As Dunnagan opposed such a venture, Watson and Lawley agreed to take on the expense of the restaurant themselves, until such time as a license was obtained at which point the restaurant could be taken over by Downs LP.⁷³ The restaurant opened with Watson's parents running the operation.⁷⁴ Despite the agreement that Watson and Lawley would take on the expenses, Downs, LP ultimately ended up paying for the utilities and other rental items and the restaurant paid no rent to Downs LP.⁷⁵

Eventually, the Racing Commission denied Downs, LP's application for a racing license and disputes began to arise between the partners.⁷⁶ Ultimately, Lawley offered his interest in Downs, LP and the corporation to Watson, but Watson purchased only some of Lawley's shares.⁷⁷ Dunnagan purchased the remainder.⁷⁸ Further disputes gave rise to litigation in which Watson sued Dunnagan to maintain the status quo of Downs, LP, and Dunnagan brought a cross-suit alleging, *inter alia*, that Watson breached his

⁶⁶ *Dunnagan*, 204 S.W.3d at 35.

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *See id.*

⁷⁰ *Id.*

⁷¹ *See id.*

⁷² *Id.*

⁷³ *See id.*

⁷⁴ *See id.*

⁷⁵ *See id.*

⁷⁶ *See id.* at 36.

⁷⁷ *See id.* at 36–37.

⁷⁸ *See id.* at 37.

fiduciary duties to Downs, LP.⁷⁹ Specifically, Dunnagan alleged that Watson had caused Downs, LP to allow his private restaurant venture to operate rent free and take on expenses of the restaurant in violation of the fiduciary duties owed by Watson.⁸⁰ The case went to trial, and the jury agreed with Dunnagan's claim.⁸¹

The Fort Worth court of appeals reviewed the sufficiency of the evidence to support Dunnagan's breach of fiduciary duty claim.⁸² The context of the claim was, what duties does a limited partner owe when that partner also happens to be the president and a major shareholder in the general partner corporation?⁸³ Thus, this was not a case of a passive investor in Downs, LP but a rather active partner. The court began its analysis by citing the Texas Supreme Court case of *Insurance Company of North America v. Morris*, as to when fiduciary duties arise.⁸⁴ The relevant language from the *Morris* case reads, "Fiduciary duties arise as a matter of law in certain formal relationships, including attorney-client, partnership, and trustee relationships."⁸⁵ The court's reliance on this passage is somewhat suspect, however, as the *Morris* case was not analyzing the duties of limited partners, but rather whether a duty was owed by a surety to investors in a limited partnership who had relied on misrepresentations of a general partner about the surety's review of the investment.⁸⁶

Despite the court's misplaced reliance on *Morris*, a closer look at the court's analysis reveals that, to find a duty, it drew not from general partnership law but from corporate law.⁸⁷ Indeed, the court followed the *Morris* language with a further qualification that the term fiduciary generally applies "to any person who occupies a position of peculiar confidence towards another," refers to 'integrity and fidelity,' and contemplates 'fair dealing and good faith.'⁸⁸ Noting that the jury had been instructed on the fiduciary duties owed by officers and directors of a

⁷⁹ See *id.* at 37.

⁸⁰ See *id.*

⁸¹ See *id.*

⁸² See *id.* at 44.

⁸³ See *id.* at 37, 44.

⁸⁴ See *id.* at 46.

⁸⁵ *Ins. Co. of N. Am. v. Morris*, 981 S.W.2d 667, 674 (Tex. 1998).

⁸⁶ *Id.* at 670–71, 674.

⁸⁷ See *Dunnagan*, 204 S.W.3d at 46.

⁸⁸ *Id.* (citing *Daniel v. Falcon Interest Realty Corp.*, 190 S.W.3d 177, 185 (Tex.App.—Houston [1st Dist.] 2005, no pet.)).

corporation, the court conducted its analysis, recognizing that Watson and his parents had incurred debt in the name of Downs, LP and also did not pay rent for use of Downs, LP's facilities. The court concluded that the evidence was sufficient to support a finding that Watson had placed his own personal interests ahead of Downs, LP in violation of his fiduciary duties, but the holding rested on an instruction given to the jury which relied upon corporate fiduciary duties.⁸⁹ In other words, it appears that the fiduciary duty arose, not by virtue of Watson's status as a limited partner but by virtue of his position as an officer in the corporate general partner.

In *Zinda v. McCann Street, Ltd.*, Zinda, who was a limited partner in McCann Street Ltd., sued the other limited partners, Kyle Smith, Trey Smith, and Cheyenne Smith, as well as the general partner, McCann Street General, Inc., for breach of fiduciary duties relating to the foreclosure of his partnership interest.⁹⁰ The corporate general partner was also controlled by Kyle and Trey Smith.⁹¹ Zinda lost at trial, but on appeal only the general partnership and Kyle and Trey Smith were named as appellees because Zinda failed to appeal the directed verdict in favor of Cheyenne Smith.⁹² Thus, the only limited partners whose conduct was at issue were those also in control of the limited partnership's corporate general partner. The *Zinda* court, however, did not make this distinction when it quoted the law regarding when a fiduciary relationship arises.⁹³ Citing to the same language in *Morris* that the *Dunagan* court relied upon, the *Zinda* court asserted that partners owe fiduciary duties to one another, but found that in the case before them, those duties had been met.⁹⁴ Given that the limited partners also controlled the general partner, it is not necessarily true, however, that this duty would have applied to a passive limited partner.

⁸⁹ See *id.* at 46–47.

⁹⁰ 178 S.W.3d 883, 887 (Tex. App.—Texarkana 2005, pet. denied).

⁹¹ See *id.*

⁹² See *id.*

⁹³ See *id.* at 890 (stating that “[f]iduciary duties arise as a matter of law in certain formal relationships, including attorney-client, partnership, and trustee relationships”) (quoting *Ins. Co. of N. Am. v. Morris*, 981 S.W.2d 667, 674 (Tex. 1998)).

⁹⁴ *Id.* at 890–91.

III. THE FIFTH CIRCUIT'S INTERPRETATION OF TEXAS LAW

A. *The Duties of Limited Partners Under McBeth v. Carpenter*

In *McBeth v. Carpenter*, a limited partnership called StoneLake Ranch, L.P. was formed for the purpose of acquiring property in Travis County.⁹⁵ The general partner was StoneLake Management, L.L.C., and Sandra McBeth and James Reynolds were two of the limited partners in the partnership.⁹⁶ James Carpenter, who had induced McBeth and Reynolds into entering the partnership, was the president of the general partner, StoneLake Management, as well as the general partner in two limited partnerships, Texas Water Solutions (TWS) and Texas Water Management (TWM), which were themselves limited partners in the StoneLake Ranch partnership.⁹⁷ Ultimately, Carpenter purchased the same Travis County property with other investors, but not McBeth or Reynolds, and was able to resell the land at a profit.⁹⁸ McBeth and Reynolds then sued Carpenter, as well as TWS and TWM, for common law fraud and breach of fiduciary duty.⁹⁹ A jury found in favor of McBeth and Reynolds, and the defendants appealed, among other things, the jury's verdict that a fiduciary duty was breached.¹⁰⁰

On appeal, TWS and TWM argued that, as limited partners, they did not owe a fiduciary duty to the other limited partners in the limited partnership.¹⁰¹ In support for their argument, TWS and TWM cited *Crawford v. Ancira*¹⁰² and *AON Properties, Inc. v. Riveraine Corp.*,¹⁰³ two cases which acknowledged that limited partners do not owe fiduciary duties to each other.¹⁰⁴ The Fifth Circuit dismissed the precedential value of these

⁹⁵ 565 F.3d 171, 175 (5th Cir. 2009).

⁹⁶ *Id.*

⁹⁷ *Id.* All told there were five limited partners, McBeth, Reynolds, Texas Water Solutions (of which Carpenter was the general partner), Texas Water Management (of which Carpenter was also the general partner), and two unnamed individuals. *Id.*

⁹⁸ *See id.*

⁹⁹ *See id.*

¹⁰⁰ *See id.*

¹⁰¹ *See id.* at 177.

¹⁰² *Crawford v. Ancira*, No. 04-96-00078-CV, 1997 WL 214835, at *5 (Tex. App.—San Antonio April 30, 1997, no writ) (not designated for publication).

¹⁰³ *AON Props., Inc. v. Riveraine Corp.*, No. 14-96-00229-CV, 1999 WL 12739, at *12 (Tex. App.—Houston [14th Dist.] Jan. 14, 1999, no pet.) (not designated for publication).

¹⁰⁴ *McBeth*, 565 F.3d at 178, n.1.

cases, however, because they were unpublished.¹⁰⁵ The court instead turned to what it purported was Texas law, stating that “Texas law recognizes such [fiduciary] obligations between limited partners, applying the same partnership principles that govern the relationship between a general partner and limited partners.”¹⁰⁶ Relying on *Morris*, *Zinda*, and *Dunnagan*, the Fifth Circuit held that Texas courts make no distinction between the fiduciary duties owed in a general partnership and a limited partnership.¹⁰⁷ The court thus affirmed the verdict against TWS and TWM.¹⁰⁸ Although the court could have simply relied on the existence of their limited partner status, the court went further in explaining the source of the duty:

While [TWS] and [TWM] argue that there was no evidence at trial to show that a fiduciary relationship existed, the jury was entitled to find otherwise in light of evidence that Carpenter exerted control over StoneLake not just as general partner of StoneLake Management but also in his capacity as President of both Texas Water Solutions and Texas Water Management. Notably, Carpenter’s trial testimony indicated that he was often unable to identify “which hat” he was wearing when performing various acts related to StoneLake.¹⁰⁹

Thus, it appears that if the court truly felt Texas law required only the existence of a limited partnership to establish a fiduciary duty, it was not confident enough in such an assertion to leave that as the naked basis of its holding.

This reluctance is understandable from a review of the cases relied upon by the Fifth Circuit. Though the court cited to *Morris*, *Zinda*, and *Dunagan*, only *Zinda*, an appellate court case, truly goes so far as to say limited partners owe a heightened fiduciary duty to each other. However, based on the facts of each case, all three could be viewed as supporting a

¹⁰⁵ *Id.* The Court did acknowledge, however, that even under *AON Props., Inc.*, TWS and TWM would not prevail because that case acknowledged that limited partners who engage in control over the operation of the limited partnership can owe fiduciary duties to the limited partnership. *See id.*

¹⁰⁶ *Id.* at 177.

¹⁰⁷ *Id.* at 177–78.

¹⁰⁸ *Id.* at 179.

¹⁰⁹ *See id.* at 178–79.

more limited view of when such a duty arises, which is more in accord with the spirit of TBOC and RULPA.

McBeth primarily relies upon the Texas Supreme Court decision of *Insurance Company of North America v. Morris*,¹¹⁰ to support its contention that Texas law makes no distinction between general partnerships and limited partnerships with regard to fiduciary duties. The folly of *Dunnagan*'s reliance on this phrase has been discussed above.¹¹¹ *McBeth*'s reliance has been similarly criticized:

The court noted parenthetically that *Insurance Co. of North America v. Morris* was a case evaluating claims involving limited partnerships, implying that the supreme court's statement regarding partner fiduciary duties was intended to encompass limited partners; however, *the supreme court did not discuss or analyze the duties of limited partners in that case*.¹¹²

Given the facts present in *Morris*, it is likely that the statement regarding fiduciary duties is more a case of the Texas Supreme Court loosely referring to general partnerships as partnerships, and no inference should be made that the term also should have included limited partnerships. This distinction is important as *McBeth*, *Dunnagan*, and *Zinda* all rely on this phrase.

B. Harmonizing *McBeth* and Texas Law

Though the *McBeth* court phrased Texas law as being polarized between the two unreported cases of *Crawford* and *AON Properties* and the two reported cases of *Dunnagan* and *Zinda*, the court's ultimate ruling is in line with the holdings of both pairs of cases. Though the *Crawford* and *AON* courts found no fiduciary duty existed in their respective cases, the holdings fall short of finding that no duty can ever exist. Indeed, *AON Properties* looked to the issue of control to help buttress its holding that the limited partner owed no such duty. But, in *Dunnagan* and *Zinda*, the limited partners were in fact also in control of the limited partnership. Thus, just as

¹¹⁰981 S.W.2d 667, 674 (Tex. 1998).

¹¹¹See *supra* notes 84-86.

¹¹²19 HAMILTON, ET AL., *supra* note 19 at § 14.33 (2d ed. 2009) (emphasis added). As an aside—the language appears to have been lifted due to its appearance in a head note from the *Morris* case.

the limited partners could have been found liable to third parties, the courts found that this degree of control also gave rise to fiduciary duties owed to the other limited partners, just as if the defendants were the general partners (which happened to be the case in *Zinda* and *McBeth*). *McBeth*'s holding is in conformity with both sets of cases as the defendant at issue was also, in effect, the general partner.

The rule that should be gleaned from Texas law, therefore, is not that there is an absolute rule that all limited partners owe fiduciary duties toward the other partners and the partnership; nor is the rule that limited partners never owe fiduciary duties. Rather, the inquiry should be a case-by-case analysis of whether the limited partner is exercising a degree of control sufficient to give rise to a fiduciary duty. Just as a shareholder in a corporation does not automatically owe fiduciary duties to the other shareholders, a passive investor in a limited partnership should likewise be free from such duties. Further, just as the safe harbor provisions insulate certain limited partner activities from giving rise to liability to third parties, no fiduciary duties should arise from the limited partners taking part in such activities as simply voting on matters or advising general partners.

Such an approach is consistent with approaches taken in other jurisdictions, including Delaware.¹¹³ Indeed, the court in *Bond Purchase, L.L.C. v. Patriot Tax Credit Properties, L.P.*, faced a similar confusion over the duties owed by limited partners in a limited partnership.¹¹⁴ There, an assignee¹¹⁵ of a limited partnership interest, Bond Purchase, L.L.C. (Bond), sued the limited partnership, Patriot Tax Credit Properties, L.P. (Patriot), after Patriot refused to hand over a list of its investors which Bond sought to initiate a mini-tender offer to buy up to 4.9% of the outstanding shares.¹¹⁶ Patriot countered that Bond's attempted mini-tender offer was adverse to

¹¹³ See *Williamson v. Kay (In re Villa W. Assocs.)*, 146 F.3d 798, 806–07 (10th Cir. 1998); *Herzog v. Leighton Holdings, Ltd. (In re Kids Creek Partners, L.P.)*, 212 B.R. 898, 936–37 (Bankr. N.D. Ill. 1997); *Tri-Growth Ctr. City, Ltd. v. Silldorf, Burdman, Duignan & Eisenberg*, 265 Cal. Rptr. 330, 335 (Cal. Ct. App. 1989) (“While a limited partner normally would not be involved in the management or otherwise participate in the partnership . . . so as to incur fiduciary obligations to other partners, we believe there can be factual scenarios where a limited partner might be involved in the partnership in such a manner—for example, allowing him access to confidential information—so as to create fiduciary duties.”).

¹¹⁴ See 746 A.2d 842, 863–64 (Del. Ch. 1999).

¹¹⁵ See *id.* at 847. While the assignee was not a full limited partner, assignees retained all of the economic rights and most of the ownership rights except record ownership and the right to vote directly on matters before the limited partnership. *Id.* at 847.

¹¹⁶ See *id.* at 848.

the interests of the limited partnership and the other investors and therefore was a violation of the fiduciary duty owed by Bond, as a limited partner, to the other investors.¹¹⁷ In doing so, Patriot relied upon the same linkage issue with general partnership law that has seemingly caused some confusion under Texas law.¹¹⁸ The Delaware Chancery Court clarified, however, that a finding of such a fiduciary duty on the part of a limited partner had only been established under Delaware law in those limited circumstances “in which a ‘partnership agreement empowers a limited partner discretion to take actions affecting the governance of the limited partnership.’”¹¹⁹ The court noted that the partnership agreement granted Bond no such governance powers or a right to manage or control the partnership and thus Bond owed no fiduciary duties.¹²⁰ In coming to this conclusion, the court analogized the situation to that of a minority shareholder in a corporation stating, “Bond’s mini-tender offer is akin to a minority shareholder making a mini-tender offer for a corporation’s stock—an action to which fiduciary duties would not normally apply.”¹²¹

Similar to the result in *Bond Purchase, L.L.C.*, the Texas cases which have found a duty was owed appear to rely upon factual scenarios in which the limited partner exerted a greater degree of control than one would expect from a passive investor. Thus, the results avoid running afoul of the TBOC’s provisions that the “powers and duties of a limited partner shall not be governed by [rules applicable to general partnerships] that would be inconsistent with the nature and role of a limited partner”¹²² and the further provision that a “limited partner shall not have any obligation or duty of a general partner solely by reason of being a limited partner.”¹²³ This is not to say that control is the only means by which a limited partner could owe a fiduciary duty. Certainly scenarios that implicate agency law could give rise to liability and the *Dunnagan* court’s analysis seems to leave the door open for liability to arise by virtue of status as an officer in a corporate general partner.¹²⁴ However, such other theories are beyond the scope of

¹¹⁷ *See id.* at 863.

¹¹⁸ *See id.*

¹¹⁹ *See id.* at 864 (quoting *KE Prop. Mgmt. Inc. v. 275 Madison Mgmt. Corp.*, 1993 WL 285900, at *9 (Del. Ch. July 27, 1993) (not designated for publication)).

¹²⁰ *See id.*

¹²¹ *See id.*

¹²² TEX. BUS. ORGS. CODE ANN. § 153.003(b) (West Supp. 2010).

¹²³ *Id.* at § 153.003(c).

¹²⁴ Due to the language used in *Dunnagan* and the reliance on a jury instruction, it is unclear

this article. For present purposes, it is clear that limited partner status alone does not create fiduciary duties under Texas law.

V. CONCLUSION

The bold pronouncement of the *McBeth* court coupled with the loose citations by Texas courts to the Texas Supreme Court case of *Morris* have led to an unfortunate and inaccurate statement of Texas law with regard to limited partners' fiduciary duties. No doubt a number of attorneys will read the easily quoted language and assume liability exists without carefully examining the cases upon which *McBeth* relied or the factual scenarios that have led to liability. However, a review of the case law reveals that, rather than limited partner status *per se* leading to fiduciary duties, the Texas rule is far more nuanced. Fiduciary duty liability *can* attach to a limited partner, but the rule that is to be taken from Texas case law is that such liability arises when the limited partner exerts control over the limited partnership to justify extending such liability. In determining whether a limited partner's actions rise to such a level as to impose a fiduciary duty, the safe harbor provisions of the TBOC for when a limited partner will be liable to third parties may be instructive.¹²⁵ Such an approach is more consistent with the provisions of the TBOC and the expectations of the parties in forming a limited partnership.

whether the decision indicates an adoption of such liability. Such a theory would be based upon the following reasoning: as the officers and directors of a corporation owe fiduciary duties to the corporation and as the general partner corporation itself owes fiduciary duties to the limited partners and the limited partnership, the officers and directors thus also owe fiduciary duties to the limited partners and limited partnership. See *In re USACafes, L.P. Litig.*, 600 A.2d 43, 48–49 (Del. Ch. 1991) (relying by analogy, in part, on the law of trusts to find such a fiduciary duty).

¹²⁵ See TEX. BUS. ORG. CODE ANN. § 153.103.