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Oil and Gas Partnership by Ambush: The Challenges of Disclaiming a Partnership or Joint Venture in Texas

By Scott Fletcher, Josh Fuchs, Basheer Ghorayeb, and Will Taylor – (October 29, 2014) – Do two companies form a joint venture if they discuss forming one, 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?

Scott Fletcher

A Texas jury in Dallas recently answered this question in *Energy Transfer Partners, L.P. v. Enterprise Products Partners, L.P.*

The plaintiff claimed that the parties' agreements were ambiguous and that their subsequent conduct was sufficient to create a joint venture. After a five-week trial, the jury agreed and awarded the plaintiff $319 million in damages, finding that despite express contractual disclaimers, Energy Transfer Partners (ETP) and Enterprise Products (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: whether companies can effectively disclaim the existence of a joint venture or partnership—and the fiduciary obligations these relationships entail—or whether Texas courts will disregard these disclaimers and look to the parties' course of conduct.

As *ETP v. Enterprise* demonstrates, parties relying on disclaimers need to be aware that their subsequent conduct—and particularly how they hold themselves out to third parties—may support an allegation that a joint venture or partnership existed and lead to a finding that fiduciary duties were breached.

Without clear disclaimers, careful monitoring and some control over subsequent conduct, a company may expose itself to costly and protracted litigation.

ETP v. Enterprise

In the spring of 2011, ETP and Enterprise began discussing the construction and operation of a proposed crude oil pipeline that would run from Cushing, Oklahoma to the Houston, Texas market. ETP and Enterprise eventually memorialized these initial discussions in three agreements, all of which contained language disclaiming various legal obligations between the parties unless and until the parties received board approval and executed final agreements.

Josh Fuchs

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. Approximately one month later, Enterprise announced that it was jointly pursuing a different project with Enbridge (US) Inc. involving a potential crude oil pipeline from Cushing, Oklahoma.


Basheer Ghorayeb

ETP sued Enterprise and Enbridge the next day.

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.

The trial court eventually entered judgment on the verdict by ordering Enterprise to pay the $319 million in damages along with $150 million in disgorgements and interest, for a final judgment totaling more than $500 million.

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).

The Texas Supreme Court has 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 under TEX. BUS. ORGS. CODE ANN. § 152.052 (2013):

(1) Receipt or right to receive a share of profits of the business;
(2) Expression of an intent to be partners in the business;
(3) Participation or right to participate in control of the business;
(4) Agreement to share or sharing:
  (A) Losses of the business; or
  (B) Liability for claims by third parties against the business; and
(5) Agreement to contribute or contributing money or property to the business.

In the *Ingram* decision, 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."

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 (1) received approval from their respective boards; and (2) negotiated, executed and delivered definitive agreements memorializing the proposed transaction.


Will Taylor

Enterprise argued in its summary judgment motion 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 further argued that the parties' post-contract conduct should not trump the unambiguous executed agreements.

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 agreements 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.

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 the court found that a joint venture existed in this case.

A notice of appeal was filed on October 24, 2014, and we may get some guidance from the Fifth Court of Appeals on this issue. Until then, *ETP v. Enterprise* 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 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. 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.

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."

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 multi-faceted, 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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