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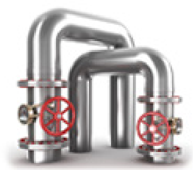

Court Addresses Formation of Accidental Partnerships in Long-Awaited Enterprise v. Energy Transfer Appeal

By: David E. Harrell Jr., Chris Verducci and Chris Dove

The Dallas Court of Appeals today issued its opinion in Enterprise Products Partners, L.P. v. Energy Transfer Partners, L.P. , in which the court reversed a judgment of more than $500,000,000 rendered after a jury returned a verdict in ETP's favor. The court's opinion addressed difficult questions regarding formation of general partnerships in Texas and the application of the Texas Business Organizations Code's five-factor test to determine partnership formation. The court ultimately reasoned that a written agreement between Enterprise and ETP prevented the formation of a partnership between them.

The case began when Enterprise and ETP agreed to work together to explore the viability of building a pipeline to carry crude oil south from Oklahoma to Houston, Texas. To that end, they signed three agreements: a confidentiality agreement, a letter agreement about "entering discussions" concerning the pipeline that included a term sheet for the potential transaction, and a reimbursement agreement that called for the future reimbursement by ETP of engineering-design costs incurred by Enterprise related to the pipeline. The companies then began to solicit potential shippers for the proposed pipeline. When interest from potential shippers was less than necessary to make the project economically viable, Enterprise terminated its participation in the project.

While the parties were working together to solicit shippers, Enterprise separately met with Enbridge (US) Inc. and discussed building a pipeline from Oklahoma to Houston, similar to the project with ETP. The pipeline built with Enbridge would extend Enbridge's already-existing network that ran from Alberta to Oklahoma. Enterprise did not disclose those conversations to ETP. After Enterprise terminated its project with ETP, Enterprise and Enbridge built and operated a pipeline from Oklahoma to Houston.

ETP then sued Enterprise for breach of joint enterprise and breach of fiduciary duty. ETP claimed that it formed a partnership with Enterprise to "market and pursue a pipeline from Cushing, Oklahoma to the Texas Gulf Coast." ETP claimed that construction of a pipeline from Oklahoma to Houston constituted a business opportunity of its partnership with Enterprise, which Enterprise had usurped. It contended that Enterprise had breached its duty of loyalty to ETP and owed ETP half of the profits that Enterprise would receive from the Enbridge project.

The jury found that Enbridge did not conspire with Enterprise to breach Enterprise's duty of loyalty to Energy Transfer, but it did find that Enterprise and ETP created a partnership and Enterprise failed to comply with its duty of loyalty to Energy Transfer. The trial court rendered judgment awarding ETP $319 million in actual damages and disgorgement of $150 million in profits, plus prejudgment interest

On appeal, Enterprise argued that the written agreements with ETP contained specific prohibitions against forming a partnership unless certain conditions precedent were met, including express approval by each company's board of directors and the execution and delivery of definitive agreements:

> Neither this letter nor the JV Term Sheet create any binding or enforceable obligations between the Parties and . . . *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 agreement memorializing the terms and conditions of the Transaction have been negotiated, executed and delivered by both of the Parties.* Unless and until such definitive agreements are executed and delivered by both of the Parties, either [Enterprise] or ETP, for any reason, may depart from or terminate the negotiations with respect to the Transaction at any time without any liability or obligation to the other, whether arising in contract, tort, strict liability or otherwise.

Noting that under Section 152.051(b) of the Texas Business Organizations Code, parties can form a partnership without intending to do so, the court turned to the question of whether the parties' agreements created a condition precedent to forming a partnership. It held that there were two conditions: approval by the respective boards of directors and execution and delivery of definitive agreements.

ETP acknowledged that the conditions were not met, but it argued that the five-factor test in Section 152.052 of the Business Organizations Code exclusively controls whether the parties formed a partnership. Those factors are sharing in the profits of the business, expressing an intent to be partners, participating in control of the business, agreeing to share losses or liabilities for third party claims, and, agreeing to contribute money or property to the business. ETP argued that the conditions precedent related to only one of the five factors, "expression of an intent to be partners," so that the jury could have considered all of the evidence an concluded that evidence of the other four factors indicated that the parties formed a partnership.

The court disagreed and held that Section 152.052 is not the sole source of rules for determining partnership formation; instead, partnership formation only "includes" those five factors, which are not exclusive. Section 152.003 states that "principles of law and equity" supplement the statutory partnership provisions, and those principles of law include the law of conditions precedent. The conditions were not met, so the parties did not form a partnership.

ETP also argued that the conditions precedent did not apply because the jury found a different partnership than the one described in the letter agreement. The written agreements that contained the conditions precedent involved a partnership to construct and operate a pipeline, ETP argued, but the jury found a partnership to "market and pursue" a pipeline project. According to ETP, "market and pursue" meant the first phase of a pipeline project, in which the parties determine whether the project is viable by determining the potential revenue required to cover construction costs, and then seeking shippers for the project. Enterprise terminated the partnership before it could reach Phase 2, which ETP argued was actual construction and operation of the pipeline. ETP suggested that the partnership related solely to Phase 1. The Court rejected that argument, holding that if all of the revenue from the project would be earned in Phase 2 (the construction and operation phase), then an arrangement to explore the viability of that project cannot be a partnership because it does not "carry on a business for profit." Tex. Bus. Org. Code § 152.051(b). Without evidence that the exploratory phase would earn revenue, there was no evidence that it constituted a partnership.

ETP also contended that the parties could have waived the conditions precedent, but the court of appeals held that waiver must be pleaded and proved, and ETP had not obtained a jury finding that those conditions were waived. Accordingly, the judgment in ETP's favor could be affirmed only if ETP had established waiver as a matter of law. To that end, ETP argued that the parties' reimbursement agreement, executed and amended after they signed the letter agreement, created binding and enforceable obligations without definitive agreements or approval by the respective boards of directors; consequently, the parties must have waived those conditions. The court

dismissed that contention, noting that the express terms of the documents limited any inconsistency to the requirements that Enterprise conduct engineering-design work and that ETP reimburse half of those costs. The reimbursement agreement did not conclusively establish that the parties intended to abandon the conditions precedent in the letter agreement and form a partnership without definitive agreements or express approval of their respective boards.

Judging from the attention the case has received from commentators and amici, and the size of the judgment at issue, this case will likely be appealed to the Texas Supreme Court. Nevertheless, the appellate court's opinion confirms that conditions precedent have meaning, and the Texas five-factor test for partnership formation must be applied using principles of law and equity. For litigation, it underscores the importance of securing jury findings supporting the theories in the case. For transactional practice, it provides guidance regarding partnership formation and the role of disclaimers, limiting language, and conditions precedent in letters of intent and letter agreements.

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