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CLIENT MEMORANDUM

Texas Appellate Court Reverses Jury Award of $535 Million; Finds that Preliminary Agreements Negated Formation of Joint Venture Partnership

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In *Enterprise Products Partners, L.P. and Enterprise Products Operating L.L.C. v. Energy Transfer Partners, L.P. and Energy Transfer Fuel, L.P.*, No. 05-14-01383-CV (Tex. App. 2017), a decision with wide ramifications for energy exploration businesses, the Court of Appeals for the Fifth District of Texas at Dallas overturned a trial court jury award of $535 million and its findings that a general partnership was formed between two energy companies, Energy Transfer Partners, L.P. ("ETP") and Enterprise Products Partners, L.P. ("Enterprise"), and that Enterprise had subsequently breached its duty of loyalty as a partner. In holding that no partnership was formed, the court stated that the conditions precedent contained in the pre-relationship agreement between the companies controlled and that the five-factor test contained in § 152.052 of the Texas Business Organizations Code (the "TBOC") was not determinative.

The Facts

In 2011, Enterprise desired to construct a pipeline to carry crude oil from Cushing, Oklahoma to Houston, Texas. Enterprise approached ETP about the possible conversion of its existing Old Ocean Pipeline for such purposes. ETP agreed to work with Enterprise on formulating a pipeline project through a joint venture. Enterprise and ETP signed three agreements: (1) a Confidentiality Agreement, (2) a Letter Agreement with a Term Sheet and (3) a Reimbursement Agreement.

To determine the economic viability of the potential pipeline, Enterprise and ETP decided to conduct an “open season” where oil shippers would commit to ship oil using the pipeline. Two weeks before the open season ceased, Enterprise entered into talks with Enbridge (US) Inc. to pursue a pipeline if the open season failed to secure commitments. ETP was not informed of these communications. Under the open season, only one shipper agreed to commit to the pipeline and the companies learned that their proposed rates were higher than those of other midstream companies with similar plans. Enterprise terminated its participation in the project with ETP and agreed to work with Enbridge on another pipeline.

ETP sued Enterprise for breach of joint enterprise and breach of fiduciary duty in the 298th Judicial District Court in Dallas County, Texas. The jury found that Enterprise entered into a general partnership with ETP and that Enterprise breached its duty of loyalty as a partner. The trial court awarded ETP actual damages of $319,375,000, interest and disgorgement of $150 million.

The Court of Appeals heard the case to review the sufficiency of the jury verdict on whether Enterprise and ETP formed a partnership. Enterprise argued that a partnership was never formed, as conditions precedent in the Letter Agreement were never met, while ETP maintained that a partnership was formed pursuant to the five-factor test contained in the TBOC.

<u>The Decision</u>

The court held that a general partnership was not established between Enterprise and ETP. The court disagreed with ETP’s argument that the five-factor test was dispositive of the existence of a partnership because the TBOC provides both that such a determination should merely “include” consideration of such factors and that “principles of law or equity” should supplement such a determination unless provided otherwise by the TBOC. The court stated that one such principle of law was the law of conditions precedent and that the Letter Agreement between Enterprise and ETP contained conditions that placed an impediment on their ability to create any binding or enforceable obligations. Therefore, these conditions needed to be performed before Enterprise and ETP formed a partnership. The Letter Agreement contained two conditions precedent for a partnership: (1) approvals of the transaction by both parties’ boards of directors and (2) the execution and delivery of definitive agreements. The court determined that these conditions precedent did not occur such that a partnership was never formed between Enterprise and ETP.

The court disagreed with ETP’s contention that the conditions precedent only applied to the proposed Old Ocean Pipeline rather than any pipeline because the Letter Agreement defined “Transaction” to encompass any pipeline built or used to transport oil from Cushing to Houston, not just ETP’s Old Ocean Pipeline. The court also disagreed with ETP’s argument that the partnership’s purpose was to “market and pursue” a pipeline project since, pursuant to the TBOC, a partnership is an “association . . . to carry on a business for profit.” ETP was referencing phase one of the pipeline project, which was only a feasibility study and not an income-generating endeavor. Phase two was never entered into due to the parties’ failure to receive commitments during the open season.

The court also noted that, under *Trevino v. Allstate Ins. Co.*, 651 S.W.2d 8, 11 (Tex. App. 1983), ETP had to allege and prove either the performance or waiver of the conditions precedent in order to prevail. ETP did not plead satisfaction of the conditions precedent, nor did it request a jury finding on the waiver of the conditions precedent, thus barring ETP from recovery on its claims. The court held that there was no partnership between Enterprise and ETP since the conditions precedent were not met and ETP did not otherwise prove a waiver of the conditions precedent.

Lastly, although the Reimbursement Agreement, which required ETP to reimburse Enterprise for expenses related to design and engineering plans for the potential pipeline, did purport to impose binding obligations on the parties without approval of their respective boards of directors, this was not in and of itself enough to abandon the conditions precedent contained in the Letter Agreement. Instead, the court noted that the Reimbursement Agreement contained a no-partnership provision, demonstrating that the parties did not intend to waive the "no binding or enforceable obligations" clause of the Letter Agreement beyond the reimbursement provisions specifically contained therein.

Key Takeaways

The *Enterprise* decision is particularly important for businesses in the energy industry, especially businesses that focus on oil and gas exploration, where joint ventures are a common way of doing business. The *Enterprise* decision strengthens the ability of parties to rely on private contractual arrangements and other principles of law and equity when attempting to limit obligations and liabilities resulting from potential joint ventures. The *Enterprise* decision also reinforces that parties seeking to enforce partnership duties should be prepared to show joint engagement in a profit-making enterprise and that the undertaking of initial feasibility studies alone is unlikely to be enough to support the existence of a partnership as a matter of law.

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