EXPLORING THE BROAD APPLICATION OF PRINCIPLES OF LAW AND EQUITY TO BUSINESS ASSOCIATIONS

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Contracting out of partnership is an interesting concept.[1] As a recent Business Associations student, the fundamentals of partnership law are fresh on my mind. This essay offers commentary on the Supreme Court of Texas's interpretation of a statute that is similar to § 104(a) of the Revised Uniform Partnership Act (the RUPA).[2] That section reads: "[u]nless displaced by particular provisions of this [Act], the principles of law and equity *supplement* this [Act]."[3]

Business Associations is very different from the courses that I took during my first year of law school. Contracts, Torts, and Property, for example, focused primarily on common law, so it took a bit of practice to rewire my brain to look first to the statutes when analyzing legal issues under business associations law. There is a predictable hierarchy of rules that applies to the analysis of legal issues involving business entities, and one must look to, and apply, the statutes before applying common law principles.[4] Accordingly, if a statute provides for something, one must

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[1] This was the core subject of Professor Douglas K. Moll's presentation, *Contracting Out of Partnership*.

[2] TEX. BUS. ORGS. CODE ANN. § 152.003 (West 2006) ("The principles of law and equity and the other partnership provisions supplement this chapter unless otherwise provided by this chapter or the other partnership provisions.").

[3] REV. UNIF. P'SHIP ACT § 104(a) (1997) (emphasis added).

[4] Professor of Business Associations at the University of Tennessee College of Law, Joan Heminway gives her students a handout at the beginning of the semester entitled "The Heminway Principle." According to "The Heminway Principle," the associations statute is at the top of the hierarchy, while general common law (including, e.g., contract law) is at the bottom. There are, of course, times when decisional law interprets the statutory law. The chart dictates that judicial opinions of this kind are considered together with the statutory principles they interpret—at the top of the chart. The point, however, is that a lawyer exercising competent legal reasoning should look to the statute first in applying legal rules to issues arising under business associations law.

follow the statute.[5] If the statute—read in light of a judicial decision interpreting its meaning—does not address the issue, then one may look to the common law.[6] The statutory law governing partnerships is clear on this point. It expressly provides that "the principles of law and equity supplement this [Act]."[7] The statute does not permit the use of common law principles to negate or supplant rules that are clearly laid out in the statute; one is only allowed to *supplement* the rules.[8]

That is why the *Energy Transfer Partners* case is so surprising. The Texas Supreme Court held that the "principles of law and equity"—in this case, freedom of contract principles—could be applied to negate what otherwise would be considered the formation of a partnership under the Texas statute.[9] According to the court, the partnership formation rules are simply the rules that operate by default; they may be modified by contract.[10] Freedom of contract is a virtue in Texas and is woven throughout the state's common law.[11] It is a matter of public policy that is reinforced "virtually every Court Term."[12]

I wonder whether this line of reasoning—using principles of law and equity to negate statutory provisions—could be applied to partnership law in general, allowing business venturers to circumvent many of the other bright line rules outlined in the statute. For example, RUPA § 103(b) sets

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[5] REV. UNIF. P'SHIP ACT § 104(a) (1997).

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] Energy Transfer Partners, L.P. v. Enter. Prods. Partners, L.P., 593 S.W.3d 732, 740 (Tex. 2020) ("Section 152.003 expressly authorizes supplementation of the partnership-formation rules of Chapter 152 with 'principles of law and equity', and perhaps no principle of law is as deeply ingrained in Texas jurisprudence as freedom of contract. We hold that parties can contract for conditions precedent to preclude the unintentional formation of a partnership under Chapter 152 and that, as a matter of law, they did so here.").

[10] *Id.*

[11] *See* Gym-N-I Playgrounds, Inc. v. Snider, 220 S.W.3d 905, 912 (Tex. 2007) ("Our conclusion that the implied warranty of suitability may be contractually waived is also supported by public policy. Texas strongly favors parties' freedom of contract." (citing BMG Direct Mktg, Inc. v. Peake, 178 S.W.3d 763, 767 (Tex. 2005))); Wood Motor Co. v. Nebel, 238 S.W.2d 181, 185 (Tex. 1951) ("[Y]ou are not lightly to interfere with this freedom of contract." (citing Printing and Numerical Registering Co. v. Sampson, 19 L.R., Equity, 462, 465)); St. Louis Sw. Ry. Co. of Tex. v. Griffin, 171 S.W. 703, 704 (Tex. 1914) ("The citizen has the liberty of contract as a natural right which is beyond the power of the government to take from him.").

[12] *Energy Transfer Partners*, 593 S.W.3d. at 738.

forth certain rights, duties, and obligations that partners are not allowed to contract away.[13] Among other things, the partnership agreement may not eliminate the duty of loyalty, unreasonably reduce the duty of care, or eliminate the obligation of good faith and fair dealing.[14] However, if a Texas court applies RUPA § 104(a) as the Texas Supreme Court did in *Energy Transfer Partners*, then it may allow partners to shape their partnership agreements however they see fit. After all, Texas wants to encourage freedom of contract.

Going even further with this line of reasoning, why not use common law tort principles to strip away the liability protections afforded by some of the other business entity forms?[15] Uniform limited partnership and limited liability company statutes include similar provisions allowing principles of law and equity to supplement (but not negate or supplant) the provisions of those statutes.[16]

In sum, I find *Energy Transfer Partners* to be a fascinating and thought-provoking case—one that has the potential to upend business entity law as we know it, or at least in Texas. While I certainly understand and sympathize with the court's desire to support Texas public policy and encourage freedom of contract, its holding seems to be very unusual. Perhaps the Texas Supreme Court's opinion in *Energy Transfer Partners* is an outlier. If not—if it represents or catalyzes a national trend—then *Energy Transfer Partners* has the potential to rewrite both well-accepted interpretations and applications of business associations law and key elements of business associations textbooks. Thankfully, I will have already passed the class (and the bar examination) by then.

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[13] *See* REV. UNIF. P'SHIP ACT § 103(b)(3)–(5) (1997) (providing that among other things, the partnership agreement may not eliminate the duty of loyalty, unreasonably reduce the duty of care, or eliminate the obligation of good faith and fair dealing).

[14] *Id.*

[15] *See* REV. UNIF. P'SHIP ACT § 306(c) (1997) (providing limited liability for partners in a limited liability partnership); UNIF. LTD. P'SHIP ACT § 303 (2001) (providing limited liability for limited partners in a limited partnership); UNIF. LTD. LIAB. COMP. ACT § 304 (2006) (providing limited liability for members and managers in a limited liability company).

[16] UNIF. LTD. P'SHIP ACT § 107(a) (2001) ("Unless displaced by particular provisions of this [Act], the principles of law and equity supplement this [Act]."); UNIF. LTD. LIAB. COMP. ACT § 107 (2006) ("Unless displaced by particular provisions of this [act], the principles of law and equity supplement this [act].").