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Spring 2021

Commentary to Professor Moll's Presentation

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Recommended Citation
Krumm, Brian, "Commentary to Professor Moll's Presentation" (2021). *Scholarly Works*. 585.
https://ir.law.utk.edu/utklaw_facpubs/585

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Citations:

Bluebook 21st ed.
Brian Krumm 22 Transactions: TENN. J. Bus. L. 259 (2021).

ALWD 7th ed.
Brian Krumm, , 22 Transactions: Tenn. J. Bus. L. 259 (2021).

APA 7th ed.
Krumm, B. (2021). Transactions: The Tennessee Journal of Business Law, 22(2), 259-266.

Chicago 17th ed.
Brian Krumm, "," Transactions: The Tennessee Journal of Business Law 22, no. 2 (Spring 2021): 259-266

AGLC 4th ed.
Brian Krumm, '' (2021) 22(2) Transactions: The Tennessee Journal of Business Law 259

OSCOLA 4th ed.
Brian Krumm, '' (2021) 22 Transactions: Tenn J Bus L 259

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COMMENTARY TO PROFESSOR MOLL'S PRESENTATION

Brian Krumm

Good morning, my name is Brian Krumm, I am the director of the Business Clinic and the Coach for the Closer and LawMeets® transactional competition teams at the University of Tennessee College of Law. I mention this because I tend to read cases from more of a practice perspective than a doctrinal one. I have often felt that teaching law students doctrine primarily from appellate decisions does not provide the adequate context to allow them to fully appreciate the business decisions and the lawyering that goes on in the deal process itself, as well as in the courts below.

The 2020 decision of *Energy Transfer Partners, L.P. v. Enterprise Products Partners, L.P.*,[1] provides just such an example. From a doctrinal perspective, Professor Moll's legal analysis is spot on and raises some intriguing questions potentially impacting the future of partnership law. From a practice perspective, I view this case as not as much as one focused on "contracting out of partnership" but as one of "preparing to enter into a business relationship." While admittedly I have not reviewed the underlying transactional documents, pleadings, discovery and appellate briefs in this case, the text of the opinion can lend some insight into the facts and circumstances surrounding the dispute, and which I feel are crucial to understanding the context upon which the Supreme Court of Texas rendered their decision. The following is a brief description of the contemplated business transaction taken from the opinion.

PROVIDING CONTEXT

Because of increased oil production in the Dakota's and Canada, a need arose to have pipeline capacity to carry oil from the traditional depot in Cushing, Oklahoma to the south. Enterprise Products Partners, L.P. (Enterprise) initially explored potential joint ventures with ConnocoPhillips and Enbridge Energy to develop such a capability

[1] 593 S.W.3d 732 (Tex. 2020).

without result.[2] In March 2011, Enterprise approached Energy Transfer Partners (ETP) to convert the natural gas pipeline owned by ETP to carry oil and extending it the rest of the way to Cushing.[3] The parties agreed to explore the viability of the project. The parties entered into three written agreements all of which reiterated their intent that neither party be bound to proceed until each company's board of directors had approved the execution of a formal contract.[4] A Confidentiality Agreement was signed in March 2011, stating that Enterprise and ETP were entering into discussions with each other to explore a possible transaction involving a joint venture to provide crude oil transportation from Cushing to Houston. The agreement laid out the parties' rights and responsibilities with respect to confidential information exchanged during the discussions and then stated:

> The Parties agree that unless and until a definitive agreement between the Parties with respect to the Potential Transaction has been executed and delivered, and then only to the extent of the specific terms of such definitive agreement, no Party hereto will be under any legal obligation of any kind whatsoever with respect to any transaction by virtue of this Agreement or any written or oral expression with respect to such a transaction by any Party or their respective Representatives, except, in the case of this Agreement, for the matters specifically agreed to herein . . . .[5]

In April, 2011, the parties signed a Letter Agreement with an attached "Non-Binding Term Sheet." The Letter Agreement indicated that the parties were entering discussions regarding a proposed joint venture transaction involving the construction and/or conversion and operation of a pipeline to move crude oil from Cushing to Houston, and that the letter was intended only to set forth the general terms of the transaction between the parties, and attached a non-binding joint venture term sheet. The letter stated:

> Neither this letter nor the JV Term Sheet create any binding or enforceable obligations between the Parties and, except for the Confidentiality Agreement ..., no binding or enforceable

[2] 593 S.W.3d at 734.

[3] *Id.*

[4] *Id.*

[5] 593 S.W.3d at 735.

> obligations shall exist between the Parties with respect to the Transaction unless and until the Parties have received their respective board approvals and definitive agreements 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.[6]

The Non-Binding Term Sheet sketched out the basic features of the potential transaction and envisioned that a "mutually agreeable Limited Liability Company Agreement would be entered into" to govern the joint venture, in the event that both Boards agreed to move forward with the project.7

Finally, in April the parties also signed a Reimbursement Agreement that provided the terms under which ETP would reimburse Enterprise for half the cost of the project's engineering work.[8] That agreement, like the other two, recognized that the parties were "in the process of negotiating mutually agreeable definitive agreements" for the project and stated that nothing in it would "be deemed to create or constitute a joint venture, a partnership, a corporation, or any entity taxable as a corporation, partnership or otherwise."[9] ETP's pleadings acknowledge that "as of the date of [these agreements] . . . the parties had not yet formed a partnership."[10]

By May, the parties had formed an integrated team to pursue the feasibility of the project. The biggest piece of the puzzle was obtaining sufficient shipping commitments. To do so, the parties needed to convince shippers that their pipeline would be the first to market. During the spring and summer of 2011, they marketed the project to potential customers as a "50/50 JV" and prepared engineering plans for the project.[11]

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[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *Id.*

[11] *Id.* The parties also explored the possibility of building a new pipeline from scratch rather than retrofitting ETP's natural gas pipeline, but they continued to market the natural gas pipeline conversion to potential customers. *Id.*

A Federal Energy Regulatory Commission rule governing new interstate pipelines requires an "open season" of 30 to 45 days in which shippers are asked to commit to daily barrel volumes and tariffs. For the project to be viable, the parties needed shipping commitments of at least 250,000 barrels a day for ten years at a tariff of $3.00 per barrel. The initial open season was unsuccessful.[12] Enterprise ended its relationship with ETP orally on August 15 and then in writing a few days later.[13]

ConocoPhillips announced that it would sell its interest in the Seaway pipeline a month later and Enbridge purchased the interest, making it co-owner of the pipeline with Enterprise.[14] Enterprise and Enbridge obtained an anchor shipper commitment from Chesapeake, which resulted in their securing many additional commitments during the open season. Enterprise and Enbridge invested billions to reverse the direction of the pipeline and make other modifications needed to move oil from Cushing to the Gulf.[15] The new pipeline was a financial success.

ETP sued Enterprise and its theory at trial was that despite the disclaimers in the parties' written agreements, they had formed a partnership to "market and pursue" a pipeline through their conduct, and Enterprise breached its statutory duty of loyalty by pursuing the project with Enbridge.[16] The jury found that "ETP and Enterprise [had] create[d] a partnership to market and pursue a pipeline project to transport crude oil from Cushing, Oklahoma to the Gulf Coast" and also found that Enterprise had not complied with its duty of loyalty. The court awarded ETP $535,794,777.40 plus post judgment interest.[17]

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[12] 593 S.W.3d at 736 Some shippers complained that the tariff was too high, others that the real need was for a pipeline running all the way from Alberta to the Gulf Coast. The parties extended the open season twice more. On the last day of the second extended open season, August 12, Chesapeake Energy Corp. committed to ship 100,000 barrels daily. ETP was hopeful that Chesapeake's commitment would draw in other shippers who had been holding out. But days earlier, Enterprise had begun preparing its exit by resuming negotiations with Enbridge. *Id.*

[13] *Id.*

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *Id.* The court found that $319,375,000 would compensate ETP for its damages and that the value to Enterprise of the benefit gained as a result of its misconduct was $595,257,433. The trial court reduced the disgorgement award to $150 million. *Id.* ETP also sued Enbridge. However, the jury failed to find that Enbridge was part of a conspiracy to breach Enterprise's duty of loyalty to ETP and as a result the jury did not award a judgment against Enbridge. *Id.* at 742 n.5.

The court of appeals reversed and rendered judgment for Enterprise.[18] The court concluded that the Texas Business Organizations Code (TBOC)[19] allows parties to contract for conditions precedent to partnership formation; that the Letter Agreement in particular created two conditions that were not met (1) execution of definitive agreements memorializing the terms and conditions of the Transaction and (2) approval of each party's respective boards. ETP had the burden to either obtain a jury finding that the conditions were waived or to prove waiver conclusively, which it failed to do.

The Supreme Court of Texas affirmed the court of appeals and found that "parties can conclusively negate the formation of a partnership under Chapter 152 of the TBOC through contractual conditions precedent."[20] The Court held that ETP and Enterprise had as a matter of law entered into such agreements and there was no evidence presented that Enterprise had waived the conditions precedent to the formation of a partnership.[21]

A PRACTICE PERSPECTIVE

I would like to start off by acknowledging the seriousness of this inquiry. Having worked with a multitude of small start-up companies, and also subsequently representing these start-ups in more complex business relationships, I recognize the potential dangers of allowing unsophisticated parties to "contract out of partnership" and consequently out of the default rules that were designed to protect not only the participating parties, but also third parties that assume by the parties' conduct that a partnership exists.

However, based on the facts that were presented at trial in this case, these were sophisticated parties, represented by competent counsel, who freely entered a series of contracts with each other to explore a projects potential. Both parties clearly did not want to be bound together in a partnership while they undertook the due diligence necessary to determine if a joint venture was feasible. Much like other types of business transactions between two companies such as an asset or stock purchase agreements, the parties entered into a confidentiality and a non-binding term sheet to determine if the project made financial sense before

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[18] *Id.*

[19] TEX. BUS. ORGS. CODE ANN. § 152.205 (West 2006).

[20] 593 S.W.3d at 742.

[21] *Id.*

agreeing to create a limited liability company to undertake the contemplated joint venture. There is also no mention of a "no-shop provision"[22] being included in any of the agreements or any other language that would prevent either party to contemporaneously explore potential project opportunities to transport oil with other companies.

During the due diligence process, it became clear that the project simply was not going to be profitable. After three attempts to acquire enough commitments to transport oil to justify the project as required by the Federal Energy Regulatory Commission,[23] Enterprise notified ETP that they were no longer interested in pursuing the project.[24] Soon thereafter, Enterprise reentered discussing with Enbridge, a Canadian company that recently acquired a half interest in an oil pipeline half owned by Enterprise.[25] The two companies spent billions of dollars retrofitting and extending the pipeline.[26] The new pipeline was a financial success.[27]

ETP became disgruntled with the realization that their competitor ETP found a new partner to attempt to bring much needed capacity to transport oil south to the refineries in Texas. This put ETP at a competitive disadvantage in the industry. ETP filed suit against Enterprise alleging breach of loyalty and conspiracy to breach Enterprise's duty of loyalty to ETP.[28] I speculate that since effective contract remedies[29] were not available because of the nature and language of the written agreements, ETPs lawyers, being good advocates, resorted to pursuing the only theory available to them, partnership law and breach of fiduciary duty.

At trial, ETP argued that the TCOB's totality-of the circumstances test[30] controls partnership formation at the exclusion of both the common

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[22] A no shop provision in this situation would be a contract clause which would affirmatively state that the parties agree not to entertain other potential partners during the term of the agreement to transport oil.

[23] 593 S.W.3d at 736.

[24] *Id.*

[25] *Id.*

[26] *Id.*

[27] *Id.*

[28] *Id.* at 740 n3. The trial court did not find that Enbridge was part of a conspiracy to breach Enterprise's duty of loyalty to ETP. *Id.*

[29] Contract remedies for breach of contract and tortious interference of contractual relations by all indications were not pursued in this action.

[30] "The submission of the case to the jury reflects this theory. Question 1 instructed the jury on the rule of § 152.051(b) that parties can form a partnership even if they do not intend to and on the multi-factor test in § 152.052(a). Question 1 also told the jury

law and the intent of the parties. They also argued that parties through contract language cannot avoid the creation the conduct that establishes the inadvertent partnership under the statute.[31] Enterprise argued that unless parties were free to contract to protect themselves from unwanted partnership formation, there would be an increase in litigation to resolve disputes as well as negative societal economic consequences.[32] These were very difficult legal and policy issues for the jury to decide. As the Texas Supreme Court noted,[33] amicus briefs were submitted by academics and industry representatives on both sides of this issue, why should we expect a lay jury to accurately weigh both the law and the policy decisions that were presented on appeal.

In this particular fact scenario, a financially viable solution to transport oil from Canada and the Midwest to Texas would not have occurred without reliance on a contract that clearly spelled out the nature of the limited fact finding relationship which was established by contract between ETP and Enterprise. Billions of dollars were spent on the Enterprise/Enbridge Project not only positively effecting the Texas economy, but also to the local economies throughout the path of the pipeline. If the Court of Appeals had not held, and the Texas Supreme Court had not affirmed that opinion, it is my belief that ETP would have been unjustly enriched in excess of $535 million dollars. ETP contributed nothing the to the Enterprise/Enbridge project, yet they would be rewarded by ignoring the agreed upon terms of the agreements, and claiming inadvertent partnership.

While I agree with Professor Moll and others[34] who are concerned about the potential negative effects of this decision could have on unsophisticated parties, I am equally as concerned about two sophisticated parties attempting to avoid a bargained for agreement, by claiming inadvertent partnership. The appellate process in this case applying the

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that "[n]o single fact may be stated as a complete and final test of partnership." It then asked the jury whether a partnership was created." 593 S.W.3d at 740.

31 *Id.*

32 *Id.*

33 *Id.*

34 *See generally* Joseph K. Leahy, *An LLC is the Key: The False Dichotomy Between Inadvertent Partnerships and Freedom of Contract*, 42 TEX. TECH L. REV. 243 (2020).

principles of law and equity came to the correct result. I believe that this is one of those instances where hard facts make good law.[35]

[35] This expression was first coined by the legal scholar Professor Arthur Corbin to describe instances where the stated rule of law works an injustice in some cases. Corbin describes how concepts of equity improves the law through the appeals process to arrive at an equitable result. Arthur Linton Corbin, *Hard Cases Make Good Law*, 33 YALE L.J. 78–82 (1923).