

CAPITAL

Editor: Kate Glaze



2015 Issue Three

General Partners Beware - Texas Supreme Court Allows Suit Against General Partner Fifteen Years After Conduct at Issue



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When entrepreneurs decide to embark upon a new endeavor, they must first decide the form of entity to be used in conducting their business. Do they want to incorporate the business, and if so should they elect Subchapter S status? Would they be better served by forming a limited liability company, a limited liability partnership, or a general partnership? Each of these entities has its own beneficial characteristics when considering tax consequences, ease of operation, and potential liabilities of the individual entrepreneurs. If a general partnership is the vehicle chosen, the individual partners understand that they have personal liability for the debts of the business, which is one of the drawbacks to operating as a general partnership. A recent Texas Supreme Court decision added a further disadvantage to this known personal exposure. In *American Star Energy and Minerals Corp. v. Stowers*, 457 S.W.3d 427 (Tex. 2015) the supreme court held that individual partners may be held liable for a partnership debt more than a decade after the debt was incurred, long after partners may have expected such claims to be barred by the statute of limitations.

In reaching its decision, the court reviewed the general principles regarding partnership formation. Under Texas law, a partnership is a separate entity from the individual partners who control its operations. Consequently, the partnership as a separate entity may enter into contracts, own property, and sue and be sued all in its own name. If the partnership fails to honor its contractual obligations or otherwise incurs a liability, it is the partnership itself that initially must make good on that obligation. If the partnership's assets are insufficient to satisfy the obligation, however, the individual partners can then be called upon to pay the debt because they are jointly and severally liable for all obligations of the partnership. *American Star Energy* dealt with the question of when a suit can be brought to enforce this obligation of an individual partner.

Although Texas law allows a party to sue both the partnership and the individual partners in the same action, the plaintiff in *American Star Energy* chose not to add any of the individual partners as parties to its case against the partnership. After extensive litigation, including two separate appeals, judgment was ultimately rendered against the partnership, whose assets were inadequate to satisfy the judgment. Even though it had been approximately 15 years since the plaintiff had first asserted its claims, the plaintiff then brought an action against the partners individually. Because claims for breach of contract must be brought within 4 years of the date a claim accrues under the statute of limitations governing contract actions, the individual partners asserted that the claims were time-barred. Although the lower courts agreed, the Texas Supreme Court reached the opposite result.

Relying on Texas statutes, the Supreme Court noted that although a partner is jointly and severally liable for the obligations of the partnership, a creditor may not attempt to collect from an individual partner on a judgment entered against the partnership until after 90 days have passed without the partnership satisfying the debt. Consequently, it is only after a judgment is entered against the partnership and the 90 days have passed that the claim accrues against the individual partner. The plaintiff in *American Star Energy* thus was not required to bring its claim against the individual partners until after the judgment became final at the conclusion of 15 years of litigation. Because the claim was asserted within 4 years of that point in time, it was not time barred.

For those entrepreneurs who elect to utilize a general partnership as their vehicle for conducting business, it is essential to monitor any potential liability for partnership debt on pending claims against the partnership no matter how long those claims have been pending. Partners should keep abreast of the conduct of that litigation even if they are no longer involved

in the business. If an adverse judgment is entered against the partnership because the case is poorly litigated, the individual partner will not have a second chance to litigate the merits of the dispute if the partnership cannot pay and the creditors sue the partner individually. In that later case against the partner, the only issues will be whether the individual was a general partner in the partnership and whether the judgment is unpaid. If the answers to both questions are yes, the individual partner will be found liable. Add this potential “springing” liability to the list of factors that should be considered when choosing your form of business organization. ■