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## ***In Search of Consensus on “Net Worth”***

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### **INTRODUCTION**

Twenty-two years ago, the Supreme Court of Texas held that a defendant’s net worth is relevant to exemplary damages and therefore discoverable. *Lunsford v. Morris*, 746 S.W.2d 471, 471 (Tex. 1988). By dissent, Justice Raul Gonzalez argued the court “should adopt some guidelines and/or make rule changes in order to avoid some of the practical problems that will arise as the bench and bar struggle to implement this decision.” *Id.* at 474 (Gonzalez, J., dissenting). In the twenty-two years since *Lunsford* was written, the bench and bar have struggled mightily. Practitioners now have some additional guidelines in the form of statutes and court decisions. However, a uniform definition of “net worth” has not yet been realized, and courts disagree on what discovery is appropriate on net worth. Further, the point in time at which net worth should be measured is not always clear. In addition, there is no standardized answer as to whether any predicate pleading or evidentiary showing is needed before discovery of net worth is permitted. This article attempts to catalogue how far the Legislature and the intermediate courts have come in attempting to answer *Lunsford’s* unanswered questions.

### **I. Intermediate Appellate Courts Have Adopted an Accountant’s Definition of “Net Worth”**

“Net worth” is presently used in two contexts. Texas Civil Practice and Remedies Code section 41.011 lists “net worth” as one of six factors a jury should consider in determining the amount of an exemplary damage award. TEX. CIV. PRAC. & REM. CODE ANN. § 41.011(a)(6) (Vernon 2008). Appellate practitioners encounter “net worth” in determining the amount of security needed to suspend execution on a money judgment during an appeal. See *Id.* at § 52.006(b)(1) (Vernon 2008); TEX. R. APP. P. 24.2. “Net worth” is not defined in either of these contexts.

The absence of a net worth definition is surprising given the requirements of Texas Rule of Appellate Procedure 24. When a judgment debtor’s affidavit of net worth is challenged, rule 24.2(c)(3) requires the trial court to issue an order stating the net worth of the judgment debtor and stating “with particularity” the factual basis for the determination. TEX. R. APP. P. 24.2(c)(3). A trial court abuses its discretion if it fails to find the debtor’s net worth or to state with particularity the factual basis for the determination. *In re Smith*, 192 S.W.3d 564, 568 (Tex. 2006). Courts have been left to comply with these requirements in a definitional vacuum.

Five courts of appeal have adopted a formulaic definition of net worth. These five courts have held that net worth is calculated as the difference between total assets and total liabilities as determined by generally accepted accounting principles (GAAP). *Newsome v. N. Tex. Neuro-Science Ctr., P.A.*, No. 08-09-00025-CV, 2009 Tex. App. LEXIS 8628, at \*9 (Tex. App.—El Paso Nov. 9, 2009, no pet.); *In re Jacobs*, 300 SW.3d 35, 46 n.11 (Tex. App.—Houston [14th Dist.] 2009, orig. proceeding); *Enviropower, LLC v. Bear, Stearns & Co.*, 265 SW.3d 1, 5 (Tex. App.—Houston [1st Dist.] 2008, pet. denied) (en banc); *G.M. Houser, Inc. v. Rodgers*, 204 SW.3d 836, 840 (Tex. App.—Dallas 2006, no pet.).

## **II. How to Seek Review of Supersedeas Net Worth Determinations and Overbroad Discovery Orders Concerning Net Worth**

To complain of a trial court's net worth determination in connection with setting a supersedeas bond amount, a party must file a motion in the court of appeals. TEX. R. APP. P. 24.4. A petition for writ of mandamus is the proper vehicle to present a complaint in the Supreme Court of Texas. *In re Smith*, 192 SW.3d at 566. (treating a motion for review as petition for writ of mandamus). To complain of a trial court's order requiring over-broad discovery of sensitive financial information, a party can file a petition for writ of mandamus in the court of appeals. *See, e.g., In re Jacobs*, 300 SW.3d at 47. Alternatively, a complaint can be raised by appeal after final judgment, but it is unlikely that such an appeal would afford an adequate remedy after-the-fact.

## **III. Using GAAP as a Yardstick for Assets and Liabilities**

### **A. Many Questions Are Open for Debate**

If "assets minus liabilities" is the defining formula for net worth, the focus of debate shifts to defining and measuring assets and liabilities. Using GAAP, appellate courts have rejected other proposed evidence or measures of net worth, including tax returns, *LMC Complete Auto, Inc. v. Burke*, 229 SW.3d 469, 486 (Tex. App.—Houston [1st Dist.] 2007, no pet.); projected revenues, *Enviropower, LLC*, 265 SW.3d at 5; market value or market capitalization, *Id.* at 5 & n.4; *see Ramco Oil & Gas, Ltd. v. Anglo Dutch (Tenge) LLC*, 171 SW.3d 905, 912 (Tex. App.—Houston [14th Dist.] 2005, no pet.); and a debtor's ability to make payroll as evidence that the debtor is not insolvent, *see LMC Complete Auto*, 229 SW.3d at 485-86 (rejecting trial court's contrary conclusion).

While GAAP provides some answers and some helpful information, some issues involving what will count as an asset or a liability are still not resolved by GAAP. Expert testimony may be required, and court rulings to resolve disputes are still needed. For example, it is sometimes difficult to determine whether to treat a debt from a loan as a

liability or the proceeds thereof as an asset. The answer may depend upon timing. One court concluded that loan proceeds should not be added back into the net worth equation as assets. In *Texas Custom Pools, Inc. v. Clayton*, 293 S.W.3d 299, 314 (Tex. App.—El Paso 2009, no pet.), the judgment creditor argued that application of the loan proceeds constituted a fraudulent conveyance. Without commenting on the propriety of the fraudulent conveyance argument, the court of appeals concluded that there was legally insufficient evidence of a fraudulent transfer and therefore the trial court abused its discretion in treating the paid-out loan proceeds as an asset. *Id.*

In the supersedeas context, one court held that a trial court did not abuse its discretion by excluding the judgment itself from the judgment debtor's liabilities. See *Montelongo v. Exit Stage Left, Inc.*, 293 S.W.3d 294, 299 (Tex. App.—El Paso 2009, no pet.). However, the appellate court went on to state that the outcome might be different if case law or expert testimony is presented. *Id.* In the same case, the court also held that the trial court did not abuse its discretion by including the individual debtor's homestead as an asset. *Id.* Again, however, the appellate court observed that the outcome might be different if case law or expert testimony is presented. *Id.*

Corporations face issues different from individuals insofar as measuring net worth. For example, the alter ego doctrine applies in a supersedeas proceeding. *In re Smith*, 192 S.W.3d at 568. With respect to related companies, one court implicitly rejected the argument that proof of net worth requires a consolidated balance sheet for companies. See *LMC Complete Auto*, 229 S.W.3d at 484, 486. Another court held that distributions owed or paid to shareholders of a corporation should be treated as liabilities as long as the obligation is a valid one. *Tex. Custom Pools*, 293 S.W.3d at 309, 310.

## **B. When to measure “net worth”**

One recurring issue is the point in time at which “net worth” should be measured. The answer might well be different depending upon whether the issue comes up in connection with exemplary damages or supersedeas bonds. Appellate Rule 24.2 expressly refers to “current net worth.” TEX. R. APP. P. 24.2(a)(1)(A). Of course, what is “current” may change over the course of an appeal.

In the exemplary damage context, at least three courts of appeal have concluded that only *current* net worth is relevant, and those courts precluded discovery of older balance sheets. See *In re Ameriplan Corp.*, No. 05-09-01407-CV, 2010 Tex. App. LEXIS7, at \*2 (Tex. App.—Dallas Jan. 6, 2010, orig. proceeding); *In re Jacobs*, 300 S.W.3d at 44-45; *In re House of Yahweh*, 266 S.W.3d 668, 673 (Tex. App.—Eastland 2008, orig. proceeding). The *Jacobs* Court set the following parameters for net worth discovery:

- only *current* net worth is relevant
- “current” is defined as net worth as of the time the discovery is responded to
- net worth must be supplemented to the extent the net worth changes materially between the service of the response and the time of trial.

*Jacobs*, 300 S.W.3d at 44 n.9.

#### IV. Discovery of Net Worth

Discovery of net worth is permissible in both the exemplary damage context and the supersedeas context. *Lunsford* resolved this question for exemplary damages. 746 S.W.2d at 473. Texas Rule of Appellate Procedure 24.2(c)(2) expressly allows a judgment creditor to conduct reasonable discovery concerning the judgment debtor’s net worth. TEX. R. APP. P. 24.2(c)(2); *In re Smith*, 192 S.W.3d at 569; *Enviropower*, 265 S.W.3d at 3. Opinions addressing net worth should be scrutinized to determine if the decision relates to discovery of net worth relating to supersedeas issues, or to discovery of net worth relating to proof of exemplary damages. One court has pointed out that Texas Civil Practice and Remedies Code section 41.011 discusses evidence “relating to” net worth, whereas the Texas Rules of Appellate Procedure simply refer to “current net worth.” *Ramco Oil & Gas*, 171 S.W.3d at 916. Thus, discovery and proof under section 41.011 might be broader than what is permissible in connection with supersedeas practice. *See id.*

Certainly, discovery of assets owned by a judgment debtor is proper discovery under either scenario. *In re Smith*, 192 S.W.3d at 569. But several intermediate courts of appeal have taken a restrictive approach to net worth discovery to protect against harassing and overbroad requests for sensitive financial information. These courts have flatly refused to allow discovery of documents that “would not necessarily evidence net worth,” most notably, income statements. *See, e.g., In re Garth*, 214 S.W.3d 190, 193-94 (Tex. App.—Beaumont 2007, orig. proceeding). The Eastland Court of Appeals has further limited net worth discovery by refusing to allow discovery of any of the following: property lists, bank statements, stock ownership statements, income tax returns, asset lists, income and budget forecasts, evaluations of financial performance and correspondence relating to profitability. *In re House of Yahweh*, 266 S.W.3d at 673-74. The *Jacobs* Court held that a defendant cannot be forced to create documents that do not exist in order to respond to net worth discovery. *In re Jacobs*, 300 S.W.3d at 46-47.

The *Jacobs* Court also imposed limits on deposition inquiries. The Court held that deposition questions must be limited to questions as to the net worth and the facts and methods used to calculate the net worth. *Id.*

In the exemplary damages context, questions persist as to whether a party seeking net worth discovery must meet some predicate pleading or proof threshold before being permitted to conduct net worth discovery. The *Lunsford* Court held that a party seeking discovery of net worth information should not be required to make a prima facie showing of a right to recover before discovery is permitted, although the Court expressly acknowledged a trial court's authority to rein in invasive or harassing discovery. *Lunsford*, 746 S.W.2d at 473.

One question *Lunsford* did not address, however, is whether a plaintiff must meet some pleading threshold in order to be able to conduct net worth discovery. Some Texas appellate courts have imposed a pleading predicate on parties who seek discovery of net worth information. *In re Jacobs*, 300 S.W.3d at 43-44; *Delgado v. Kitzman*, 793 S.W.2d 332, 333 (Tex. App.—Houston [1st Dist.] 1990, orig. proceeding); *Al Parker Buick Co. v. Touch*, 788 S.W.2d 129, 131 (Tex. App.—Houston [1st Dist.] 1990, orig. proceeding). The *Al Parker Buick* Court held that “[e]xemplary damages are special damages that must be supported by express allegations of willfulness, malice, or gross negligence that go beyond the allegations necessary in a petition seeking recovery of compensatory damages.” 788 S.W.2d at 130; see also *Wal-Mart Stores, Inc. v. Alexander*, 868 S.W.2d 322, 332 (Tex. 1993) (Gonzalez, J., concurring) (proposing that plaintiffs be required to demonstrate a “factual basis” for a punitive claim to avoid discovery in “every garden-variety fender bender case”). But other courts appear to accept bare-bones pleadings as adequate. See, e.g., *In re Jacobs*, 300 S.W.3d at 43-44 (including the word “knowingly” to existing allegations of negligence was sufficient to allege gross negligence for which exemplary damages could be recovered); *Garth*, 214 S.W.3d at 192 (holding plaintiff’s pleadings were sufficient to notify defendants that she sought to hold them liable for punitive damages through conspiracy theory); *In re W. Star Trucks US, Inc.*, 112 S.W.3d 756, 763-64 (Tex. App.—Eastland 2003, orig. proceeding) (holding allegations in petition that defendant had engaged in fraudulent and malicious conduct were sufficient to permit discovery of net worth); *Delgado*, 793 S.W.2d at 333 (holding plaintiff’s pleading alleging defendant was “consciously indifferent” to safety of others was sufficient to entitle plaintiff to discovery of net worth information).

## V. Proving net worth

Questions about the burden of proof and strength of the evidence needed to show a judgment debtor’s net worth are still unsettled. When a judgment debtor files

an affidavit of net worth, the affidavit is prima facie evidence of net worth. TEX. R. APP. P. 24.2(c)(1). But the judgment creditor may challenge the affidavit. *Id.* at R. 24.2(c)(2). The burden of proof in a hearing to contest an affidavit of net worth is on the judgment debtor. *LMC Complete Auto*, 229 S.W.3d at 483. The nature of proof required to satisfy the judgment debtor's initial burden varies.

The Houston First District Court of Appeals concluded that a balance sheet for a corporate judgment debtor met the debtor's initial burden of proof. *Id.* at 486. In *Ramco Oil & Gas*, 171 S.W.3d at 911-12, the court accepted a combination of audited and unaudited financial statements in satisfaction of the judgment debtor's burden of proof. However, not all courts allow judgment debtors to meet their burden so easily. In *Newsome*, No. 08-09-00025-CV, 2009 Tex. App. LEXIS 8628, at \*9, the trial court dismissed the judgment debtor's evidence as "not credible." Under the circumstances of the case, the El Paso Court of Appeals concluded that while a judgment debtor should not be required to account for every penny spent, the trial court did not abuse its discretion in failing to make a net worth finding. The admitted evidence showed a \$600,000 disparity between what the judgment debtor earned and her expenses, and there were variances between two affidavits filed and between the value she placed on personal property compared to the amounts of insurance obtained on the same property.

As one might expect, courts admit a wide range of evidence to prove net worth in an exemplary damage context. Interestingly, most of the cases addressing these evidentiary matters are two decades old. In *Southland Corp. v. Burnett*, 790 S.W.2d 828, 830 (Tex. App.—El Paso, 1990, no writ), the court held that it was reversible error to admit evidence of gross sales or gross receipts because such evidence does not equate with net worth. By contrast, in *Browning-Ferris Indus. v. Lieck*, 845 S.W.2d 926, 944 (Tex. App.—Corpus Christi 1992), *rev'd on other grounds*, 881 S.W.2d 288 (Tex. 1994), the court rejected the contention that it was error to admit evidence of the defendant's cash flow in connection with proof as to exemplary damages. In *Wal-Mart Stores v. Alexander*, 827 S.W.2d 420, 424 (Tex. App.—Corpus Christi 1992), *rev'd on other grounds*, 868 S.W.2d 322, 332 (Tex. 1993), the court of appeals held that admission of evidence of gross sales was cumulative of other financial information and its admission was harmless. In *K-Mart Corp. v. Pearson*, 818 S.W.2d 410, 417 (Tex. App.—Houston [1st Dist.] 1991, no writ), the court considered evidence of K-Mart's sales, its net after-tax income, and its net worth in concluding that an award of exemplary damages was not excessive.

## CONCLUSION

Since *Lunsford* was decided, practitioners have seen many legislative and judicial changes imposing restraints on recovery of exemplary damages. Many now believe *Lunsford* should be revisited in light of these changes in the law relating to exemplary damages. See, e.g., *In re Jacobs*, 300 S.W.3d at 48-51 (Sullivan, J., concurring). Twelve years ago, the Texas Supreme Court appeared poised to reevaluate *Lunsford*, but two cases raising this issue settled, and the Court rejected a third case. See *In re Jerry Chevrolet-Buick, Inc.*, 977 S.W.2d 565, 566 (Tex. 1998) (Gonzalez, J., dissenting). Recently the Court requested full briefing on the merits in a case involving precisely this issue. [\*In re Jacobs, No. 09-0942\*](#). Thus, it appears that the Court may finally revisit *Lunsford* in light of existing exemplary damage law and practice and put to rest some of the persistent questions that have plagued practitioners in the wake of *Lunsford*.