Texas Supreme Court Update

by Nick Guinn

Hallmark Marketing Co. v. Hegar,
(April 15, 2016).

Quick and dirty statement of facts:

- Hallmark filed a franchise-tax protest suit against the state comptroller.
- The Tax Code provides that "only the net gain" from the sale of investments should be included in a key component of the statutory franchise-tax formula. The comptroller, however, adopted a rule requiring businesses to include net gain or a net loss. As a result, Hallmark paid more than $200,000 in taxes than it believes was required, so it sued the comptroller for a refund.
- In its simplest form, franchise-tax liability is calculated by multiplying a business's taxable margin by the applicable franchise-tax rate. Taxable margin is determined by multiplying a business's total margin by an apportionment factor designed to limit the franchise tax to revenue attributable to business conducted in Texas. The apportionment factor numerator consists of receipts from business conducted in Texas and the denominator consists of receipts from all business anywhere, including Texas.

- In implementing Texas' statutory franchise-tax liability scheme, the comptroller adopted a rule providing that "[i]f the combination of net gains and losses results in a net loss, the taxable entity should net the loss against other receipts, but not below zero." Accordingly, after auditing Hallmark's 2008 franchise-tax report, the comptroller concluded Hallmark miscalculated its apportionment factor by failing to include a net loss of more than $628 million from the sale of investments.

Appellate procedural posture:

- The lower courts deferred to the comptroller's rule. The Supreme Court, however, agreed with Hallmark that "only the net gain" necessarily excludes a net loss.

Issue(s):

- "[C]an net gain sometimes mean net loss if losses outstrip gains?"

Holding(s):

- The statute requires inclusion of "only the net gain," and under no reading can "net gain" include a net loss. Accordingly, the Court disagreed with the comptroller's rule requiring inclusion of a net loss in Hallmark's apportionment-factor denominator because it conflicts with the plain language of Tax Code section 171.105(b).
- Reversed and remanded.

Editorial take:

- The net gain identified under Tax Code section 171.105(b) is limited to net gains, and does not include a net loss.

In re M-I L.L.C.,

(May 20, 2016).

Quick and dirty statement of facts:

- M-I L.L.C. d/b/a M-I Swaco (M-I) and National Oilwell Varco, L.P. (NOV) are competitors providing equipment and services to the energy industry. Both companies' businesses involve mesh screens that filter solid matter. These screens allow expensive drilling fluids to be reused, and thus lower the overall cost of drilling.
- Jeff Russo, formerly employed by M-I, obtained vast knowledge of proprietary information of M-I. Russo left for NOV.
- M-I sent a demand letter to Russo, stating it would file suit against him and seek a restraining order.
- Russo filed a declaratory action, and M-I counterclaimed for breach of Russo's non-compete agreement, breach of fiduciary duty, misappropriation of trade secrets, and tortious interference. M-I also asserted third-party claims against NOV for misappropriation of trade secrets and tortious interference. M-I sought both declaratory and injunctive relief.
- At the temporary injunction hearing, M-I asked the court to exclude everyone except certain individuals, namely the parties' counsel, their experts, and Russo. The court denied

the request as a violation of due process. M-I indicated it would seek mandamus relief, and asked to make an offer of proof.

- NOV proposed M-I submit its offer of proof through affidavit, and the trial court instructed M-I to "submit whatever you have."

Appellate procedural posture:

- As an offer of proof, M-I submitted *in camera* to the court of appeals (not the trial court) an affidavit detailing the testimony M-I was prepared to offer at the temporary injunction hearing. Defendants objected to the affidavit as an *ex parte* communication and moved for access to it in the court of appeals. The court of appeals denied their motion for access, along with M-I's mandamus petition.
- Russo and NOV moved the trial court to compel M-I to produce the affidavit submitted *in camera* to the court of appeals, arguing it was a discoverable witness statement under Texas Rule of Civil Procedure 194.2. The trial court heard Russo and NOV's motion and ordered the affidavit disclosed without reviewing it. M-I then petitioned the Supreme Court for mandamus relief.
- Shortly thereafter, M-I moved the Court to seal the affidavit, which the Court granted over NOV's opposition. NOV subsequently filed a motion to strike portions of the mandamus record, including the affidavit, and an emergency motion for access to the affidavit. The Court denied NOV's emergency motion for access without resolving NOV's motion to strike.

Issue(s):

- "[W]hether the trial court abused its discretion by summarily refusing the plaintiff's request to conduct portions of a temporary injunction hearing involving alleged trade secrets outside the presence of the defendant's designated representative."
- "[W]hether the trial court abused its discretion by ordering the production of an affidavit purportedly involving these alleged trade secrets without conducting an in camera review of the affidavit."

Holding(s):

- When a trial courts adjudicates dueling private interests—pursuant to the U.S. Constitution's Fourteenth Amendment Due Process Clause—three competing factors are balanced:

  > (1) the private interests affected by the official action;
  > (2) the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and
  > (3) the interest of the [opposing] party . . . with . . . due regard for any ancillary interest the government may have in providing the procedure or forgoing the added burden of providing greater protections.

- The record was clear that the trial court did not balance the competing interests. . . . If the trial court conducted the required balancing, it may have been within its discretion to decide that due process required NOV's designated representative to be present. However, the trial court was required, at a minimum, to conduct that balancing.

- NOV argued that the trial court did not abuse its discretion by failing to balance the competing interests because the exclusion of its designated representative from portions of the temporary–injunction hearing would be inconsistent with various parts of Texas constitutional, statutory, and common law.
- The affidavit was never submitted to the trial court. . . . Because the affidavit itself was the only evidence that could substantiate whether it did, in fact, contain trade secrets, the trial court had no choice but to review it *in camera* . . . . Without knowing what the Moore affidavit contained, the trial court could not have possibly known how M-I's interests would be affected by its disclosure and consequently what protective measures were required.
- Writ of mandamus conditionally granted as to both issues.

Editorial take:

- Practitioners should aid the trial court in conducting this balance so as to avoid mandamus. The Court acknowledged that disclosure could have very well been appropriate had the balance been performed.

Centerpoint Builders GP v. Trussway, Ltd.,
(June 17, 2016).

Quick and dirty statement of facts:

- Glenmont hired Centerpoint as its general contractor.

Centerpoint hired multiple subcontractors to do, among other things, install wooden roof trusses. Centerpoint purchased the trusses directly from their manufacturer, Trussway.

- Fernandez, an independent contractor, stepped onto a truss that had not been installed above the second story. The truss broke and Fernandez fell, rendering him paraplegic. Fernandez sued for several tort claims and ultimately settled with all defendants.
- Centerpoint filed a cross-action against Trussway for statutory indemnity, alleging that Trussway, the truss manufacturer, was legally required to indemnify Centerpoint, the truss seller.

Procedural posture:

- The trial court held Centerpoint was a seller under chapter 82 of the CPRC, but otherwise summary judgment. The trial court certified its order for interlocutory appeal.
- The court of appeals reversed in part, holding that Centerpoint did not fit the statutory definition of a seller and was not eligible to seek indemnity.

Issue(s):

- "[W]hether the general contractor qualifies as a truss seller under chapter 82" of the Texas Civil Practice and Remedies Code.

Holding(s):

- The Act defines "seller" as "a person who is engaged in the business of distributing or otherwise placing, for any commercial purpose, in the stream of commerce for use or consumption a product or any component part thereof."

- The statute does not define the phrase “engaged in the business of.”
- One is not “engaged in the business of” selling a product if providing that product is incidental to selling services. Applying that standard here requires the conclusion that Centerpoint is not a truss “seller” entitled to seek indemnity from the manufacturer. To that end, whether Centerpoint technically sold trusses to Glenmont does not make it “engaged in the business of” commercially distributing that product. Centerpoint did not set prices on the materials to achieve a gain or profit; it was effectively reimbursed for the cost of materials that were necessary to complete construction.
- While some contractors may engage in the business of selling both products and services, the record is devoid of evidence that Centerpoint was doing so here.

Editorial take:

- It is unlikely a contractor for construction services who happens to procure and “sell” components will meet the chapter 82 definition of seller. Such a contractor will likely need to demonstrate that selling the component(s) is a significant party of its business.

Ochsner v. Ochsner,

(June 17, 2016).

Quick and dirty statement of facts:

- A child-support order required Preston Ochsner to make

certain payments to his daughter's school, and when she switched schools, to make payments through a registry. When the daughter switched schools, Preston instead paid the new school directly, with payments totaling more than $20,000 beyond what the original order contemplated.
- After almost a decade under this arrangement, his ex-wife Victoria sued to recover the balance that was not paid through the registry.

Appellate procedural posture:
- The trial court held that the direct tuition payments more than satisfied Preston's child support obligation.
- The court of appeals reversed, holding that failure to satisfy the payment particularities specified in the order meant the trial court could not consider payments that discharged the tuition obligation Victoria had incurred for their daughter's benefit.
- The Supreme Court reversed the court of appeals' judgment and rendered judgment for Preston.

Issue(s):
- Whether a trial court in a child-support enforcement proceeding may consider evidence of direct payments like those that were undisputedly made here when confirming the amount of arrearages.

Holding(s):
- "Our interpretive focus is on section 157.263, the central

provision of the child-support enforcement statute . . . . [T]he trial court is not merely to ***confirm the arrearages***; rather it must ***confirm the amount of arrearages***."

- The statute does not require that payments made voluntarily, as opposed to payments withheld from income, must be made through a state registry.
- The structure of the enforcement statute allows the trial court to consider direct payments that discharge the obligee's own obligation to provide the funds.
- Nevertheless, tuition payments do not always qualify as child support. But for the reasons discussed, Preston's direct payments discharged his child-support obligation.

Editorial take:

- The Supreme Court did not set forth a hard and fast rule for discharge of child support obligations through tuition payments. However, the Court made clear that a trial court in a child-support enforcement proceeding may consider evidence of direct payments.

Southwest Royalties, Inc. v. Hegar,

(June 17, 2016).

Quick and dirty statement of facts:

- Southwest Royalties, Inc. purchased and paid sales taxes on equipment, materials, and associated services related to its oil and gas exploration and production operations.

- Southwest sought a tax refund on the basis that the equipment separated the hydrocarbons into their component substances, while bringing them to the surface.
- Southwest sued the Comptroller and the Attorney General after his requested tax refund was denied. The Comptroller denied relief on the basis that the type of equipment in question was used for transportation, not manufacturing.

Appellate procedural posture:

- The trial court found that the company did not prove it was entitled to the exemption. Both the court of appeals and Supreme Court affirmed.

Issue(s):

- "[W]hether an oil and gas exploration and production company proved that its purchases of casing, tubing, other well equipment, and associated services were exempt from sales taxes under a statutory exemption."

Holding(s):

- The statute provides that the sales tax exemption applies to tangible personal property used in the actual manufacturing, processing, or fabrication of tangible personal property.
- It was undisputed that hydrocarbons undergo physical changes as they move from underground reservoirs to the surface; the disagreement was about the role Southwest's equipment plays in those changes.
- Southwest argued that the casing and tubing system both

begins and continues the ‘processing’ of hydrocarbons into separate substances of oil, gas, and condensates. But the direct causes of the changes in the hydrocarbons were pressure and temperature changes, while the equipment was only an indirect cause of them.
- Thus, Southwest was not entitled to an exemption from paying sales taxes on purchases of the equipment.

Editorial take:

- The changes in the hydrocarbons due to the equipment was indirect and insufficient to satisfy the definition of “processing” as required for the statutory exemption for tax refund. Perhaps a dispute over equipment further downstream in oil and gas production (e.g., heating, separation columns) would have resulted differently.

Union Pacific R.R. Co. v. Nami,

(June 24, 2016).

Quick and dirty statement of facts:

- Nami, a long term employee of Union Pacific, was operating a tamping machine—a very large piece of equipment, similar in size to a railroad boxcar. The tamper was parked near the main track around Sweeny, Texas.
- Sweeny swarmed with mosquitoes. Driving to work, Nami passed a sign calling Sweeny the “mosquito capital of the world.” The railroad right-of-way was narrow and covered

in weeds and high grass and sometimes pools of water. Nami was regularly bitten repeatedly as he worked on the tamper. Nami complained to his superiors of these conditions to no avail. Union Pacific knew about the mosquito problem and knew that mosquitoes could carry the virus.

- Union Pacific started warning employees in 2002 about the risk of West Nile virus, explained the nature of the virus, the fact that it was spread by mosquitoes and warned employees to use mosquito repellent. Union Pacific did not furnish mosquito repellent to its employees and did not mow the right-of-way or spray it with pesticide.
- Nami began suffering flu-like symptoms, and later diagnosed with West Nile virus.
- Nami sued Union Pacific under FELA for failing to provide a safe workplace.

Appellate procedural posture:

- A jury found that both Union Pacific negligently caused his disease, and awarded Nami $752,000 in damages.
- The court of appeals affirmed.
- The Supreme Court reversed the judgment of the court of appeals and rendered judgment for the Railroad.

Issue(s):

- "[W]hether the common-law doctrine of *ferae naturae* provides an exception to the duty to provide a safe place to work, and how that doctrine applies in this case."

Holding(s):

- FELA imposes on railroads the duty to use reasonable care in providing their employees a safe workplace. The basis for such liability is in common law negligence, not the fact that injuries occur.
- An employer's duty to provide a safe workplace always exists, and with regard to premise conditions, the duty is identical to that owed by property owners to invitees.
- A property owner is not generally liable for harm caused by indigenous wild animals—such as mosquitos—on the property.
- Nothing about Nami's job made him more susceptible to contracting West Nile virus than any other person who worked outside all day. Union Pacific did nothing to increase the risk to him. There was no evidence that it could have reduced the risk.

Editorial take:

- A private railroad is not *ipso facto* liable for the injuries of its employees under the FELA. An employee must establish liability under common law negligence principles.