

**Case No.: 08-0477**

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**IN THE SUPREME COURT OF TEXAS**

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**IN RE LAKOTA RESOURCES, INC. AND GILBERT BURCIAGA,  
INDIVIDUALLY AND AS PRESIDENT  
OF LAKOTA RESOURCES, INC.,**

**Relators**

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Respondent: The Honorable Bill Burke, 189<sup>th</sup> Judicial District of  
Harris County, Texas arising out of Cause No. 2007-02397

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**REAL PARTY IN INTEREST PATHEX PETROLEUM, INC.'S  
RESPONSE TO RELATORS' BRIEF ON THE MERITS**

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TO THE HONORABLE SUPREME COURT OF TEXAS:

Real Party in Interest Pathex Petroleum, Inc. (“Pathex”) files this Response to the Brief on the Merits filed by Relators Lakota Resources, Inc. and Gilbert Burciaga (hereinafter collectively referred to as “Relators”), and in support thereof would respectfully show the Court the following:

#### STATEMENT OF THE CASE

This original proceeding involves the production of Relators’ tax returns—not for any net worth issues—but to determine whether Relators deducted unpaid operating expenses as “ordinary and necessary” business expenses that they now dispute as improper and unreasonable in the underlying action. Relators seek extraordinary relief, asking this Court to issue a writ of mandamus commanding the Honorable Bill Burke, presiding judge of the 189<sup>th</sup> Judicial District Court of Harris County, to vacate his May 2, 2008 order compelling Relators to produce certain tax returns. In spite of the fact that the trial court ordered *in camera* review at the Relators’ request, Relators ask this Court to decide whether mandamus should issue against Respondent before Relators even submit responsive documents for *in camera* inspection.

Pathex filed the underlying lawsuit against Relators to collect unpaid operating expenses for approximately 80 natural gas wells in the McCourt Field in Nebraska. R7 at 3. Relators refused to pay their monthly share of operating expenses on the ground that the expenses are “improper” and “not authorized” by the Joint Operating Agreement for those wells. Relevant to whether Relators admitted in their tax returns that the operating

expenses are reasonable and owed, Pathex sought to compel production of certain tax filings of Lakota and Gilbert Burciaga, Lakota's president and sole shareholder, to determine whether the currently disputed expenses have been claimed and deducted as "ordinary and necessary" business expenses on their United States and Nebraska income tax returns.

Respondent granted Pathex's motion to compel but also granted Relators' request for an *in camera* inspection to separate the relevant and non-relevant documents. Respondent stated that he would only order production of tax documents/portions of tax documents related to the McCourt Field. R7 at 9-11; R8. Pathex agreed that no production would occur before the court completed its inspection. R7 at 10. Without participating in the *in camera* review they requested, Relators instigated mandamus proceedings. Relators petitioned the court of appeals on May 16, 2008 for relief. A panel of the Court of Appeals for the Fourteen District consisting of Justices Frost, Seymore, and Guzman denied Relators' petition for mandamus in a per curiam memorandum opinion issued May 27, 2008. Relators filed their petition for mandamus with this Court on June 17, 2008.

#### **STATEMENT CONCERNING JURISDICTION**

The Supreme Court of Texas is statutorily authorized to exercise jurisdiction in original proceedings. TEX. GOV'T CODE ANN. § 22.002(a) (Vernon 2007) ("The supreme court...may issue writs of...mandamus agreeable to the principles of law regulating those writs..."). Before it may issue the extraordinary writ of mandamus, this Court must have subject matter jurisdiction. *See Patterson v. Planned Parenthood of Houston*, 971

S.W.2d 439, 442 (Tex. 1998) (citations omitted) (“Ripeness, like standing, is a threshold issue that implicates subject matter jurisdiction, and like standing, emphasizes the need for a concrete injury for a justiciable claim to be presented.”). The central concern in determining whether a controversy is ripe for adjudication, is whether the case involves uncertain or “contingent future events that may not occur as anticipated, or indeed may not occur at all.” *Perry v. Del Rio*, 66 S.W.3d 239, 249 (Tex. 2001) (quoting *Texas v. United States*, 523 U.S. 296, 300 (1998)).

Relators ask this Court to decide whether the trial court’s order compelling production of certain tax documents is a clear abuse of discretion that cannot be adequately remedied by appeal. *See Walker v. Packer*, 827 S.W.2d 833, 840 (Tex. 1992) (orig. proceeding) (clarifying the standard for mandamus review). Relators attempt to dispense with three facts which undermine this Court’s jurisdiction: (1) counsel for Relators asked for *in camera* review at the hearing, (2) the trial court agreed to conduct an *in camera* review, and (3) counsel for Pathex conceded that it would not seek any documents until the court conducted its review. R7 at 9-11. As articulated in Section III-A, *infra*, Real Party in Interest Pathex requests that this Court decline to issue a writ of mandamus before providing the trial court an opportunity to conduct the *in camera* review Respondent ordered during the May 2, 2008 hearing on Pathex’s motion to compel.

This matter is premature. No production may ultimately occur. Relators complain solely about a contingent, hypothetical situation.

## I. STATEMENT OF FACTS

### A. **Pathex proved that deductions on Relators' tax returns and supporting tax documents are relevant and unavailable from other sources.**

#### *1. Underlying Issues in the Pending Cause of Action*

Pathex is the operator of approximately 80 natural gas wells in the McCourt Field. In 1998, Relators acquired approximately a 17% working interest in the wells and approximately a 19% working interest in the McCourt Field gathering system pursuant to a Purchase and Sale Agreement ("PSA"). The PSA, the McCourt Field Joint Operating Agreement (the "JOA"), and the Council of Petroleum Accountant Societies ("COPAS") Accounting Provision attached thereto all require that Relators pay their percentage share of monthly operating costs. R7 at 8.

Despite these contractual obligations, Relators have failed to pay or underpaid their share of expenses; Pathex filed the underlying action to collect the unpaid expenses. R7 at 3. The lawsuit is styled "*Pathex Petroleum, Inc. and Dernick Resources, Inc. v. Lakota Resources, Inc., and Gilbert Burciaga, individually and as president of Lakota Resources, Inc.,*" and is pending as Cause Number 2007-02397 in the 189<sup>th</sup> Judicial District Court in Harris County.

Relators do not deny that they are required to pay their share of operating expenses under the PSA, JOA, and COPAS provisions. Rather, their defense in this lawsuit is that the unpaid operating expenses are "improper" and/or "not authorized" by the JOA and, therefore, Relators are not obligated to pay them. R7 at 3, 8. Among other things, Relators claim that they are not liable for the following charges:

1. items “not authorized” by the JOA, including District Expense;<sup>1</sup>
2. 100% of costs associated with the Hinrichs 13-12b well;
3. compressor expenditures;
4. attorneys’ fees Pathex has incurred to collect Relators’ unpaid bills (despite express language in the JOA allowing Pathex to recover such fees); and
5. interest on charges that are allegedly “not due.”

R5 at 2-3; R7 at 3-4. Relators have not paid *any* expenses since December 2006<sup>2</sup> and currently owe Pathex over \$700,000 plus interest and attorneys’ fees. R5 at 1.

## *2. Pathex’s Discovery Requests*

On November 21, 2007, Pathex served Relators with requests for production pursuant to TEXAS RULE OF CIVIL PROCEDURE 196. Because Relators repeatedly refused to pay their operating expenses on the ground that they were “improper” and/or “not authorized,” thirteen of Pathex’s requests sought Relators’ United States and Nebraska income tax returns—in an effort to determine whether Relators declared such expenses “ordinary and necessary” business expenses.<sup>3,4</sup> After Relators objected, Pathex moved to compel production pursuant to TEXAS RULE OF CIVIL PROCEDURE 215.1. R5.

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<sup>1</sup> “District expense” is the operator’s expense for operating a field production office serving several properties.

<sup>2</sup> The December 2006 payment was a partial payment of August, September and October 2006 invoices.

<sup>3</sup> Pathex’s request for production sought Relators’ United States and Nebraska income tax returns, related work papers, schedules and forms. R1, 2.

<sup>4</sup> As described in Section III-C(2), listing an expense as “ordinary and necessary” on their income tax returns has significant ramifications as it relates to the propriety of an expense, a party’s acknowledgement of liability for an expense, and a party’s intent to pay for an expense.

**B. The Trial Court correctly placed the burden on Pathex.**

Having previously heard lengthy oral argument in this case on other disputed motions, Respondent was well aware of the issues in this case at the time of his ruling, and he properly placed the burden on Pathex.

Pathex satisfied its burden to show it is entitled to “production in accordance with the request[s]” by presenting the discovery responses sought, controlling jurisprudential authorities, and arguments in support of compelling production. *See* TEX. R. CIV. P. 215.1 (b); R5 at 2-3; R7 at 3-6. Pathex established that the tax returns were relevant and material. As Pathex argued in its motion and at the hearing, Relators’ tax documents will show that Relators have deducted the very same expenses *that they have not paid and claim are improper charges*, as well as categories of expenses that Relators may have paid all or part of in the past but now claim are “improper” or “not authorized.” R5 at 2-3; R7 at 3-6. Pathex cited cases in which this Court and other Texas courts of appeals have held that statements in tax returns are admissible for purposes of impeachment, as party admissions, and as evidence of a material fact. R7 at 5; R5 at 2. Thus, Pathex proved that the tax documents are relevant to show that Relators’ defense that the charged expenses are improper or unauthorized is a sham.

With respect to materiality, Pathex demonstrated that the tax documents themselves are the only source from which Pathex can determine which expense items, and the amount of each item, Relators have sworn are proper by deducting them on their tax returns. R5 at 3-4; R7 at 6. The documents are the only evidence containing Relators’ admissions that the disputed charges are reasonable, appropriate, and “ordinary

and necessary” business expenses. R5 at 2-4, 5-6, Ex. E at 4; R7 at 3-6. The trial judge did not ask Relators to respond until after Pathex met its burden. R7 at 6.

**C. The Trial Court agreed to conduct an *in camera* review.**

In camera review was ordered but has not occurred. Counsel for Relators suggested *in camera* review, the trial court announced that he would conduct such review, and counsel for Pathex agreed to the procedure. R7 at 9-10. The trial court expressly stated that he would order production of only those portions of the tax documents that relate to the McCourt Field and that he would first conduct an *in camera* review to determine which documents should be produced to Pathex:

THE COURT: . . . They have got a right to trust you buy [sic], but verify what he says about his tax returns. ***I’m not going to order the things produced wholesale.*** I order that part of the tax return that deals with –

MR. MCCALL: To the extent you are going to order tax returns, ***I would like an in camera inspection first***, and another hearing before we turn that over to the plaintiffs on the issue of what you found in an in-camera inspection that you thought was relevant and material.

\* \* \*

THE COURT: ***If that’s the safe way to do it, I will examine them in camera***, but I want everybody here that wants me to do that has to come down here and sit with me while I’m doing it. So we don’t just kind of, hey, let’s just make the judge do it.

MS. SILVER: ***That’s fine. We are okay with that. We are not interested in charitable deductions and things like that.***

THE COURT: I wouldn’t think there would be any ***on the part of the return dealing with this operating property***, unless he has given his money away through whatever the name of that field is.

*What I did is I signed the order compelling discovery, but if you all want me to do an in-camera inspection, is that what I'm hearing?*

MR. MCCALL: *I think that would be* – because we don't know if the deductions have been made. If they have not been made, there is no reason to allow these tax returns to be produced.

THE COURT: *All right.* I've got here, "Signed order compelling discovery. Parties may want in-camera inspection." You all go look at it and tell me if you want it. And if you do, bring them back and I will look at it.

R7 at 9-11 (emphasis added). Even though Respondent granted Relators' request to conduct *in camera* review, Relators chose to file this mandamus action rather than the responsive documents to the court for inspection.

## II. SUMMARY OF THE ARGUMENT

Relators' mandamus action is premature and seeks an impermissible advisory opinion. Relators tenaciously argue that the district court abused its discretion by ordering production of the tax returns without an *in camera* inspection of the documents. Petition at 6, 13-15. However, Relators, not the trial court or Pathex, are the parties inhibiting *in camera* inspection to determine what documents, if any, should be produced. Respondent agreed to conduct such an inspection, and Pathex agreed that it would not seek Relators' tax returns until the trial court completed its inspection. R7 at 9-11. This Court should refrain from issuing a writ of mandamus on the grounds of estoppel and ripeness.

Mandamus also should be denied on the merits. This case is not a typical "discoverability of tax returns" mandamus because it has absolutely nothing to do with

net worth. Instead, this mandamus concerns whether Relators deducted as “ordinary and necessary” business expenses the same operating expenses they now dispute and refuse to pay. If Relators deducted the disputed expenses, then they have admitted under penalty of perjury that they are liable for the charges and that the charges are reasonable. Unlike net worth cases, where other financial documents provide the necessary evidence, there is no alternate form of discovery that would obviate the need to review Relators’ tax filings. The tax returns themselves, and what was claimed therein, are the necessary proof. The pursuit of justice outweighs Relators privacy interests where materiality and relevance are demonstrated.

### III. ARGUMENT AND AUTHORITIES

#### A. There is no ripe issue or controversy for the Court to decide.

This action is not ripe for adjudication. Ripeness is a threshold issue of a court’s subject matter jurisdiction that concerns when an action may be heard. *See Patterson v. Planned Parenthood of Houston*, 971 S.W.2d 439, 442 (Tex. 1998) (citations omitted). Ripeness asks whether the facts have developed sufficiently so that an injury is concrete and justiciable. *Id.* Where the case involves uncertain or “contingent future events that may not occur as anticipated, or indeed may not occur at all,” a proceeding is not ripe for adjudication. *Perry v. Del Rio*, 66 S.W.3d 239, 249-50 (Tex. 2001) (quoting *Texas v. United States*, 523 U.S. 296, 300 (1998)). A judicial decision reached without a case or controversy is an advisory opinion, barred by the separation of powers provision of the Texas Constitution. *Brooks v. Northglenn Association*, 141 S.W.3d 158, 164 (Tex. 2004) (citing TEX. CONST. art. II, § 1).

The material issues this Court is asked to consider are contingent upon the results of the *in camera* review the Relators requested. At the hearing, Relators' attorney asked the trial court to conduct an *in camera* review before any documents are turned over to Pathex. R7 at 9 ("MR. MCCALL: ...I would like an *in camera* inspection first."). The trial judge agreed to an *in camera* review was prudent and ordered *in camera* inspection; counsel for Pathex immediately agreed. R7 at 9-10 ("THE COURT: I'm not going to order the things produced wholesale.... If that's the safe way to do it, I will examine them *in camera*... MS. SILVER: That's fine. We're okay with that...."). None of the parties is opposed to the court reviewing the documents *in camera* to "separate the relevant and material parts" of Relators' returns from the immaterial parts. *See Maresca v. Marks*, 362 S.W.2d 299, 301 (Tex. 1962) (orig. proceeding). Relators filed a petition for mandamus with the court of appeals only fourteen days after the hearing rather than submit to the review it requested.

How can Relators demonstrate a right to mandamus relief when the tax filings have not been produced and *may never be produced to Pathex* depending on the result of the *in camera* inspection? How can Relators demonstrate that the prospect of disclosure is more than speculative or hypothetical?

Moreover, this Court should not reward Relators' attempt to delay the underlying proceedings after the Respondent agreed to Relators' suggestion of *in camera* review. The doctrine of judicial estoppel "precludes a party from adopting a position inconsistent with one that it maintained successfully in an earlier proceeding." *Pleasant Glade Assembly of God v. Schubert*, 264 S.W.3d 1 at \* 6 (Tex. 2008). Relators requested an *in*

*camera* review; the court agreed. R7 at 9-10 (“MR. MCCALL: To the extent you are going to order tax returns, I would like an *in camera* inspection first... THE COURT: I will examine them *in camera*...”). Yet Relators asked the Fourteenth Court of Appeals and now asks this Court to grant the extraordinary writ of mandamus vacating Respondent’s order. When Relators’ counsel successfully sought *in camera* review, the doctrine of judicial estoppel surfaced, precluding Relators’ right to seek mandamus before the *in camera* review occurs.

**B. Mandamus Standard As Applied in Different Types of Tax Return Cases**

“Mandamus issues only to correct a clear abuse of discretion or the violation of a duty imposed by law when there is no other adequate remedy by law.” *Walker v. Packer*, 827 S.W.2d 833, 839 (Tex. 1992) (orig. proceeding). “A trial court clearly abuses its discretion if ‘it reaches a decision so arbitrary and unreasonable as to amount to a clear and prejudicial error of law.’” *Id.* With respect to discovery-related orders, the trial court’s decision will only be a clear abuse of discretion where the court “clear[ly] fail[s]... to analyze or apply the law correctly.” *Id.* at 840. Mandamus is intended to be an extraordinary remedy, available only in limited circumstances. *Id.*

This Court has consistently stated as a fundamental principle that a writ of mandamus will not issue in cases where the party seeking the writ has another adequate remedy. *Id.*; *In re Prudential Ins. Co. of Am.*, 148 S.W.3d 124, 136 (Tex. 2004). “Appellate courts cannot afford to grant interlocutory review of every claim that a trial court has made a pre-trial mistake.” *In re McAllen Med. Ctr., Inc.*, --S.W.3d--, 2008 WL 4051053, \*1 (Tex. 2008). While this Court has frequently used mandamus relief in cases

wherein the very act of proceeding to trial would defeat a party's substantive right, it has not consistently protected claims of error in discovery disputes. See *id.* at \*8-9; *Prudential* at 136.

This Court has been understandably cautious with respect to tax returns in net worth cases. In such cases, this Court has issued the writ due to concerns that the “disclosure of federal income tax statements in addition to the annual reports is unnecessarily duplicative,” and would lead to “uncontrolled and unnecessary discovery of federal income tax returns.” *Sears Roebuck & Co. v. Ramirez*, 824 S.W.2d 558, 559 (Tex. 1992). Thus, in a net worth case, it is an abuse of discretion to require production of tax returns where a party “already produced its annual reports...” *Id.* Orders requiring production of tax returns have been actionable by mandamus only because tax returns are not necessarily indicative of net worth and because net worth evidence is obtainable from other documentary sources, such as certified annual reports. *Hall v. Lawlis*, 907 S.W.2d 493, 495 (Tex. 1995) (orig. proceeding) (citing *Chamberlain v. Cherry*, 818 S.W.2d 201, 205-06 (Tex.App.— Amarillo 1991, orig. proceeding) (noting that income tax returns are not necessarily indicative of net worth)).

This original proceeding does not involve net worth. Rather Pathex seeks Relators' tax returns to prove liability and damages. Tax returns are discoverable for these purposes. “[I]ncome tax returns are not wholly privileged but are subject to discovery to the extent of relevancy and materiality which must be shown.” *Maresca v. Marks*, 362 S.W.2d 299, 300 (Tex. 1962); see also *Hall* at 494. “[F]ederal income tax returns of our citizens...” are discoverable because “the *pursuit of justice between*

*litigants outweighs protection of their privacy.” Maresca at 301 (emphasis added).* Despite Relators’ protestations, this Court has never held that tax returns are off-limits for discovery or require mandamus where their relevance and materiality are shown.

**C. Respondent Did Not Abuse His Discretion**

**1. *Relevance and Discoverability of Tax Returns.***

Pathex met its burden to show that the tax returns sought are relevant to the issues in the underlying suit. Relevant evidence is that evidence having any tendency to make the existence of a fact of consequence more probable or less probable than it would be without the evidence. *See* TEX. R. EVID. 401. Relevancy exists in relation between the item of evidence and matters which are properly provable in the case. *See* FED. R. EVID. 401 Adv. Comm. n. The fact to be proved may be ultimate, intermediate, or evidentiary; regardless of the type, the evidence is relevant so long as it aids in the determination of a material issue in the action. *Id.*

Discovery is broader than admissibility. TEX. R. CIV. P. 192.3 (defining the scope of discovery to include all matters not privileged and which are relevant, including matters which may not be admissible at trial). Relators seem to have it backwards. Relators’ Reply in Support of Petition at 5 (“Pathex cites a laundry list of cases in support of its notion that tax returns **can be** ‘admissible as affirmative evidence of a material fact, for impeachment purposes, and as admissions against interest.’ These cases...involve **admissibility**, not discoverability.”) (emphasis in original).<sup>5</sup> Texas jurisprudence

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<sup>5</sup> Rather than serving a blanket objection where an objection is not appropriate, the Texas Rules of Civil Procedure direct a party to seek protection from a discovery request to move for protection within

unquestionably recognizes that “[i]ncome tax returns are discoverable to the extent they are relevant and material to the issues presented in the lawsuit.” *Hall* at 494.

Tax returns are admissible as affirmative evidence of a material fact and as admissions against interest. *American Mfg. Co. of Texas v. Witter*, 343 S.W.2d 943, 948-49 (Tex. Civ. App.—Fort Worth 1961, no writ) (holding portions of income tax returns and worksheets showing the amount of royalty set up by appellant as due under the contract for three year period were properly admitted as admissions against interest; documents were relevant and material to the principal issue in the case; *i.e.*, whether appellant was indebted to plaintiffs for royalties for the years in question); *Miller v. Gann*, 1988 WL 3984, \*1 (Tex. App.—Houston [1<sup>st</sup> Dist.] 1988, writ denied) (partnership income tax returns were evidence that land was owned by partnership rather than by the partners individually); *Curran v. Unis*, 711 S.W.2d 290, 292-97 (Tex. App.—Dallas 1986, no writ) (holding that trial court erred in excluding partnership tax returns [for failure to lay proper predicate] offered to prove that party was a partner in the partnership); *Womack v. First Nat’l Bank of San Augustine*, 613 S.W.2d 548, 556 (Tex. App.—Tyler 1981, no writ) (partnership income tax returns admitted for the purpose of proving partnership existed in 1974); *City of Houston v. Priester*, 302 S.W.2d 948, 952 (Tex. Civ. App.—Galveston 1957, no writ) (“Tax returns in which the owner states the value of his property for purpose of taxation are received as admissions against him; . . .”) (quoting Orgel of Valuation under Eminent Domain, Vol. 2, p. 259); *Letsos v. H.S.H.*,

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the time permitted by discovery and comply with the request to the extent protection is not requested. See Tex. R. Civ. P. 192.6 (Protective Orders).

*Inc.*, 592 S.W.2d 665, 668 (Tex. Civ. App.—Waco 1980, writ ref’d n.r.e.) (tax renditions of property submitted by party to tax assessor properly admitted as a party’s admission of the property’s market value; such “admission is not only admissible for impeachment purposes but may also be received as affirmative evidence of a material fact”) (citations omitted).

Similarly, tax returns are admissible as affirmative evidence for impeachment purposes. *Sherwin-Williams Co. v. Perry Co.*, 424 S.W.2d 940, 947-48 (Tex. Civ. App.—Austin 1968, writ ref’d n.r.e.) (holding tax returns were “highly relevant for the purposes of impeachment” and “are certainly direct evidence as to losses from appellee’s manufacturing business and are admissible as rebuttal evidence or as admissions against interests”); *see also El Paso Devel. Co. v. Berryman*, 769 S.W.2d 584, 589 (Tex. App.—Corpus Christi 1989, (writ denied) (“[T]ax returns are admissible as party admissions and for impeachment.”)).

Moreover, deductions a party lists on his or her tax returns constitute a sworn admission against him or her. *Combs v. Gent*, 181 S.W.3d 378, 385 (Tex. App.—Dallas 2006, no pet.) (in a breach of fiduciary duty action, court properly admitted tax returns filed by trustee; by signing return listing certain attorney fees as reasonable, trustee made a sworn admission that could properly be admitted against her).

Federal courts, other state courts, and secondary sources have all acknowledged that statements on tax returns may be discovered and admitted at trial for impeachment and as admissions against interest. 8 C.J.S. EVIDENCE § 520 (2008) (“[R]eturns for taxation, being statements of a party to be affected under circumstances in which it is

incumbent on him or her to disclose the truth, are regarded by the great weight of authority as admissions... even on the question of value.”); M.L. CROSS, DISCOVERY AND INSPECTION OF INCOME TAX RETURNS IN ACTIONS BETWEEN PRIVATE INDIVIDUALS, 70 A.L.R. 2d 240 (Supp. 2008) (“By the great weight of authority, state as well as federal, a court in which a civil action is pending may require one party to produce a copy of a federal or state income tax return for inspection by an adverse party under the rules or statutes which deal with discovery procedures.”); *Haseltine v. Haseltine*, 203 Cal. App.2d 48, 59 (1962) (statement on husband’s tax return that his once separate asset was community property was an admission, sufficient to support wife’s allegation of a transmutation agreement); *Murdoch v. United States*, 160 F.2d 358, 362 (8th Cir. 1947) (in a condemnation action, the landowner’s tax return was admissible as an admission against interest); *Reddington v. Thomas*, 262 S.E.2d 841, 843 (N.C. App. 1980) (the filing of a partnership tax return used to impeach and as substantive evidence of defendant’s intent to enter into a partnership); *Puzich v. Pappas*, 314 N.E.2d 795, 796-97 (Ind. App. 1974) (evidence that sisters and brothers filed partnership income tax return for eight years, listing sister as an equal partner constituted an admission against interest); *C-4 Corp. v. E.G. Smith Contr. Products*, 894 S.W.2d 242 (Missouri 1995) (tax return prima facie evidence of partnership); *In re Needleman*, 204 B.R. 524, 527 (Bankr. S.D. Ohio 1997) (partnership tax returns admissible as admission against that partnership under Ohio law); *United States v. Soloman*, 825 F.2d 1292, 1299 (9th Cir. 1987) (individual’s tax returns were relevant and admissible in tax fraud case to show business deductions taken by individual limited partners and scheme to defraud).

**2. *Pathex met its burden to show that the tax returns are relevant to the issues in this lawsuit.***

The central issue in the pending action is whether the operating expenses, interest, and attorneys' fees which Pathex sought and which Relators refused to pay are just and due. Pathex seeks tax documents that will show whether Relators have deducted all or any portion of the disputed expenses on their tax returns. The United States Internal Revenue Code permits the deduction of "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."<sup>6</sup> *Comm'r v. Lincoln Sav. & Loan Ass'n*, 403 U.S. 345, 353 (1971). Therefore, in order "to be deductible, a business expense must be both ordinary and necessary."<sup>7</sup> R5 at 3; R5, Ex. E at 3. "An ordinary expense is one that is common and accepted in your industry. A necessary expense is one that is helpful *and appropriate* for your trade or business." R5, Ex. E at 3 (emphasis added). "The term 'ordinary' also demands that the expenditure is of a reasonable amount." *Seminole Thriftway, Inc. v. United States*, 42 Fed. Cl. 584, 587-88 (1998) (citing *Limericks, Inc. v. Commissioner*, 165 F.2d 483, 484 (5th Cir. 1948)).

The income tax returns and related schedules and working papers requested by Pathex will show charges related to the McCourt Field that Relators have deducted on their tax returns as "ordinary and necessary" business expenses. Relators 2005 and 2006 tax returns, showing deductions sworn to be reasonable and appropriate but now disputed as improper or unauthorized, emphatically tends to make the existence of a fact of

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<sup>6</sup> 26 U.S.C. § 162(a).

<sup>7</sup> R5, Ex. E at 3 (INTERNAL REVENUE SERVICE, U.S. DEP'T OF THE TREASURY, PUBL'N NO. 535, BUSINESS EXPENSES, (2006), *available at*, <http://www.irs.gov/pub/irs-pdf/p535.pdf>).

consequence more probable or less probable than it would be without the evidence. *See* TEX. R. EVID. 401. The tax returns are, therefore, relevant to this case because they will show the amounts and types of charges that Relators have sworn, under penalty of perjury, constitute ordinary and necessary charges with respect to the McCourt Field.<sup>8</sup>

Relators also have taken the position that attorneys' fees are not recoverable in this action. The tax returns will show whether Relators have taken a contrary position under oath by deducting, as business expenses, the attorneys' fees that Pathex has incurred (and charged to Relators) to collect payment for the unpaid invoices. Similarly, the requested tax returns will show whether Relators have deducted any interest that has accrued on disputed charges owed to Pathex. This information is relevant because any such deductions made by Relators constitute sworn admissions (1) that the charges are "ordinary and necessary" expenses, **(2) that Relators are legally liable for the charges and corresponding interest**, and (3) that Relators intend to pay the charges.<sup>9</sup>

If Relators have deducted any of the disputed charges, the tax returns will be admissible as evidence of liability (that Relators admit they owe each such charge) and damages (because the returns will show the amounts and types of charges that Relators

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<sup>8</sup> *See* R5, Ex. F (sample U.S. Individual Income Tax Return Form 1040 and U.S. Income Tax Return for an S Corporation Form 1120S in which the taxpayer swears as follows: "Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete."). Relators argue in their Reply in Support of Petition for Writ of Mandamus that Relators can only deduct expenses that they have paid. *See* Reply at 4. However, the rule for ordinary and necessary business expenditures covers charges "paid or incurred" during the previous year.

<sup>9</sup> R5, Ex. E at 12 (explaining that taxpayer can only deduct interest as a business expense if he is legally liable for the debt upon which the interest deduction is being made and intends to repay the debt).

have sworn, under penalty of perjury, constitute ordinary and necessary expenses of operating the McCourt Field). As such, the tax documents are relevant to this litigation.

**3. Pathex showed that the tax documents are material.**

Tax returns are only material if the information cannot be obtained from another source. *See El Centro del Barrio, Inc. v. Barlow*, 894 S.W.2d 775, 780 (Tex. App.—San Antonio 1994, orig. proceeding). This case differs from the cases Relators cite. In those cases, a party requested tax returns as evidence of either net worth<sup>10</sup> or a party's sources of income.<sup>11</sup>

Here, the tax documents contain Relators' sworn admissions that the disputed charges are legitimate and that Relators are liable to pay them. Only the actual tax documents will contain Relators' sworn admissions regarding the propriety of the charges Relators dispute in this case. No other source exists.

At the hearing, Defense counsel suggested that Pathex could simply ask Mr. Burciaga in a deposition whether he had deducted a particular expense. R7 at 8. This is unrealistic for several reasons. First, it assumes that Mr. Burciaga would be able to testify as to each specific charge deducted and the amount deducted. *See* FED. R. EVID. 1001 ADV. COMM. N. (by requiring an original or duplicate, the best evidence rule affords

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<sup>10</sup> *See, e.g., Wal-Mart Stores, Inc. v. Alexander*, 868 S.W.2d 322, 331 (Tex. 1993) (Gonzalez, J., concurring) (information regarding net worth could be ascertained by other financial reports); *Sears, Roebuck & Co. v. Ramirez*, 824 S.W.2d 558, 599 (Tex. 1992) (orig. proceeding; per curiam) (information regarding net worth already produced in certified annual report); *Chamberlain v. Cherry*, 818 S.W.2d 201, 206 (Tex. App.—Amarillo 1991, orig. proceeding) (holding tax returns not shown to be relevant to determination of defendant's net worth).

<sup>11</sup> *See, e.g., In re Patel*, 218 S.W.3d 911, 918-19 (Tex. App.—Corpus Christi 2007, orig. proceeding) (holding trial court abused its discretion in ordering production of income tax returns where there was no indication that the financial records requested from third parties and the records already produced would not provide information regarding party's financial condition and sources of income).

substantial guarantees against inaccuracies and fraud). Second, even assuming that Mr. Burciaga could testify to the precise figures, he would have to review the tax documents in order to give the testimony and would need to refer to the documents while testifying. Pathex is entitled to review the documents and have them analyzed by an expert without having to rely on Mr. Burciaga's recollection and interpretation of Relators' tax deductions. *See* TEX. R. EVID. 1002 (the original or duplicate is required to prove the contents of a writing); TEX. R. CIV. P. 192.6 (a party seeking protection from the manner of discovery must move for protection within the time permitted for response). Third, as the trial judge noted, without the documents, Pathex would have no way to verify the accuracy of Mr. Burciaga's testimony. R7 at 8-9 ("You're not going to take somebody's word about whether he deducted something or not.... Ronald Reagan said trust b[ut] verify. They have got a right to trust you...but verify what he says about his tax returns."). Finally, Relators likely would refuse to answer deposition questions about the deductions based on their claim that the contents of Relators' tax returns are privileged. These concerns underlie the primary purpose of the "best evidence" rule. J. Weinstein, M. Berger and J. McLaughlin, WEINSTEIN'S EVIDENCE ¶ 1002[02] (1995).

In their brief, Relators argue for the first time that Pathex already has documents that contain "the information." Petition at 12. Relators claim that Pathex has documents showing "what expenses *have been paid* by Lakota, and thus, what charges Lakota believes are 'proper and authorized.'" Petition at 12 (emphasis added). This argument fails for two reasons. First, it assumes that Relators have only deducted expenses they have paid. Pathex believes this assertion is false and seeks the tax documents to prove it.

26 U.S.C. § 162 allows “as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year,” not simply those paid. Any taxpayer on the accrual accounting system would take deduction when the expense is incurred, not when it is paid. *See* R5, Ex. E at 4. Second, simply paying a bill is not the same as swearing under oath that a particular charge is legitimate. Relators have previously paid certain categories of expenses they now claim are “improper” and/or “not authorized” by the JOA. Relators no doubt will seek to explain away their inconsistent behavior from previous years and certainly will argue that prior payment of an expense item does not constitute an admission that the expense category is proper. Only the tax documents contain Relators’ sworn admissions that the expenses deducted are ordinary and necessary/proper expenses. These admissions simply do not exist elsewhere. Testimony, which may or may not be available in the future, is no substitute for documentary evidence. *See Atl. Pipe Line Co. v. Fields*, 256 S.W.2d 940, 945 (Tex. Civ. App.—San Antonio 1953, writ ref’d n.r.e.) (testimony of two witnesses, including the appellee, excluded as immaterial to determine value of land; documentary evidence as to value was material). Contrary to Relators’ assertion, the unavailability of information from other sources can be established without useless additional discovery requests. Pathex established the materiality of the tax documents sought.

#### **4. Mr. Burciaga’s Tax Returns**

Relators claim that Mr. Burciaga’s tax returns are “decidedly off limits.” Mr. Burciaga claims to be the president, sole director, and sole shareholder of Lakota. Relators cite Texas Business Organizations Code § 21.223 for the proposition that a

shareholder cannot be held liable under an alter ego theory or sham to perpetrate a fraud theory in a non-tort case without proof of actual fraud. (Vernon 2008). Pathex believes Mr. Burciaga has used Lakota, his subchapter S Corporation, to commit actual fraud, and Pathex is also investigating whether Mr. Burciaga is liable (1) for violations of the Texas Uniform Fraudulent Transfer Act, and (2) in his capacity as a director, for wrongful distributions which made Lakota insolvent. *See* TEX. BUS. & COM. CODE ANN. § 24.001 et. seq. (Vernon 2008); TEX. BUS. ORG. CODE ANN. § 21.316 (Vernon 2008).

Mr. Burciaga's tax returns and supporting documents are relevant because Lakota's tax return flows through to Mr. Burciaga's tax return. Lakota is an "S" Corporation; it is a "pass through entity." Therefore, Lakota's income and expenses are reported in schedules attached to and incorporated in Mr. Burciaga's tax returns. Mr. Burciaga is the ultimate taxpayer, not Lakota.

Furthermore, as with Lakota's tax returns, everyone has agreed that the trial judge will conduct an *in camera* review of Mr. Burciaga's returns to separate the relevant and material documents from those that are not relevant and material. R7 at 9-11. Therefore, the only portions of Mr. Burciaga's returns that will be produced are those portions that relate to the McCourt Field and the disputed operating expenses.

As the district court correctly discerned, Relators' admissions cannot be obtained from any source other than the Relators' tax returns and supporting documentation. The record shows that the district court did not order production or agree to conduct an *in camera* review until after Pathex showed that the documents are relevant and material. R7 at 3-6.

**D. The District Court agreed to limit production to documents related to the McCourt Field and to conduct an *in camera* review before any documents are produced.**

The district court judge stated that he would not order Relators to produce their entire tax returns; he limited production to documents related to the McCourt Field and agreed to conduct an *in camera* inspection to determine what documents should be produced, all of which was agreed to by Pathex. R7 at 9-11 (“I’m not going to order the things produced wholesale . . . I will examine them *in camera* . . .”).

The record clearly shows that the district court judge agreed to review the documents *in camera* and to limit production to information related to the McCourt Field. R7 at 9-11. The record also shows that Pathex agreed to an *in camera* inspection. R7 at 10; *see also* R5 at 2. The parties and the trial judge have all agreed that the judge will conduct an *in camera* review and separate the relevant and material information from any irrelevant or immaterial information. R7 at 9-11. This review will safeguard Relators’ privacy rights by limiting disclosure solely to the discoverable information to which Pathex is entitled. *See Maresca*, 362 S.W.2d at 301 (suggesting lower court should separate relevant and material parts of tax returns from the irrelevant and immaterial parts thereof). Thus, there is no controversy about whether an *in camera* review will be performed before Relators produce documents to Pathex and no risk that tax documents unrelated to the McCourt Field will be ordered produced. Relators’ Petition should be denied.

**CONCLUSION AND PRAYER**

Pathex proved that the requested tax documents are relevant and material to this litigation. Pathex satisfied its burden and the Respondent applied the proper guiding legal principles. Furthermore, the parties and the district court judge all agreed that the judge will conduct an *in camera* review to ensure that only documents related to the McCourt Field will be produced. Thus, there is no controversy for this Court to decide.

For all of the foregoing reasons, Pathex Petroleum, Inc. respectfully prays that the Court decline to issue the extraordinary Writ of Mandamus.

Respectfully submitted,

**JACKSON WALKER L.L.P.**

BY: \_\_\_\_\_

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**ATTORNEYS FOR REAL PARTY IN  
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INC.**

**VERIFICATION OF MANDAMUS RESPONSE**

COUNTY OF HARRIS     §

                                  §

STATE OF TEXAS       §

Before me, the undersigned authority, personally appeared Kathrine M. Silver, who being by me personally known and by me duly sworn, upon oath deposed as follows:

“My name is Kathrine M. Silver. I am over the age of twenty-one years, have never been convicted of a felony or a crime of moral turpitude, and am competent to make this verification. I have read the foregoing response to the petition for writ of mandamus in this original proceeding, and each of the factual statements contained therein are true and within my personal knowledge, as counsel for Pathex Petroleum in this matter.”

FURTHER AFFIANT SAYETH NOT.

\_\_\_\_\_  
Kathrine M. Silver

Subscribed to before me, the undersigned authority, on this the 12<sup>th</sup> day of December 2008.

\_\_\_\_\_  
Notary Public – State of Texas

**CERTIFICATE OF SERVICE**

I hereby certify that a true and correct copy of the foregoing ***Real Party In Interest Pathex Petroleum, Inc.'s Response to Relators' Brief on the Merits*** was served upon the following via certified mail, return receipt requested and/or hand delivery on this 15<sup>th</sup> day of December, 2008.

David B. McCall (*via certified mail, return receipt requested*)

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Kendall M. Gray (*via hand delivery*)

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The Honorable Bill Burke (*via certified mail, return receipt requested*)

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**Kathrine M. Silver**