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Franchise Tax Bd. v. Hyatt, 133 Nev. Adv. Op. 57 (Sept. 14, 2017)

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CIVIL APPEAL: TORT LIABILITY

Summary

The Court found that discretionary-function immunity does not apply to intentional bad-faith tort claims. The Court also expressly adopted the false light invasion of privacy right of action in order to fully protect privacy interests. The Court also adopted the sliding scale approach for evaluating IIED claims, holding that increased severity of conduct will require less evidence to prove emotional distress.

Background

In 1993, following news coverage of Hyatt's lucrative computer-chip patent, the Franchise Tax Board (FTB) opened an audit on Hyatt's 1991 California state income tax return which claimed that Hyatt moved to Las Vegas in September of 1991. Following an in-depth audit, the FTB concluded that Hyatt lied about the date of his move to Las Vegas in order to avoid state income tax liability on his patent licensing, and that he owed a total of \$4.5 million in state income taxes, penalties, and interest. Based largely on the 1991 audit findings, the FTB also determined that Hyatt owed over \$6 million in taxes and interest for 1992.

Hyatt formally challenged the audits by filing two protests, and later filed suit in Nevada in 1998 while the protests were still underway. Hyatt's complaint included claims for declaratory relief regarding the timing of his move to Nevada, a claim for negligence, and seven intentional tort causes of action.

In response, FTB filed a motion for partial summary judgment over Hyatt's declaratory relief claim. The Court granted partial summary judgment and, as such, the jury was not to make any findings related to the date of Hyatt's move to Nevada, nor the validity of the audits' conclusions. FTB also moved for partial summary judgment to preclude Hyatt from seeking recovery for alleged economic damages. The Court granted partial summary judgment finding that Hyatt's evidence was speculative and did not adequately support his claim that the FTB's actions destroyed his patent licensing business in Japan.

At trial, the jury found in favor of Hyatt on all intentional tort causes of action and awarded him \$85 million for emotional distress, \$52 million for invasion of privacy, \$1,085,281.56 for fraud, and \$250 million in punitive damages. Hyatt then moved the district court for costs and, following 15 months of discovery and other motion practice with a special master, the district court awarded Hyatt \$2.5 million in costs.

The FTB appealed from the district court's final judgment and post-judgment award of costs. Hyatt cross appealed, challenging the court's ruling that he could not seek economic damages for damage to his patent licensing business overseas.

¹ By Carmen Gilbert.

Discussion

FTB is not immune from suit under comity because discretionary-function immunity in Nevada does not protect Nevada's government or its employees from intentional torts and bad-faith conduct

Under NRS § 41.031, Nevada has waived sovereign immunity from tort liability, with a small number of exceptions.² One exception is that of discretionary-function immunity under NRS § 41.032(2) which states that action cannot be brought against the state or its employee “based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of the state... whether or not the discretion is involved is abused.”³

Discretionary-function immunity in Nevada

Previously, the Court consistently held that this discretionary-function immunity did not apply to bad-faith misconduct.⁴ However, the Court's subsequent adoption of the two-part federal test⁵ has since thrown the *Falline* exception's validity into question. Under the two-part test, discretionary-function immunity applies when government actions in controversy “(1) involve an element of individual judgment or choice and (2) [are] based on considerations of social, economic, or political policy.”⁶ FTB argued that this test abolished the *Falline* exception because the federal test is purely objective. Hyatt, however, argued that *Falline* is still applicable since an intentional bad faith tort cannot be discretionary or policy-based, and thus does not meet the requirements of the federal test.

Courts that decline to recognize bad-faith conduct that calls for an inquiry into an employee's subjective intent

Some courts have concluded that bad-faith is not a relevant consideration in this test, since this is an inappropriate evaluation of the employee's subjective intent.⁷ In *Franklin*, the Tenth Circuit Court of Appeals determined that the federal test's focus on policy analysis makes inquiry into employee state of mind or decision making processes inappropriate.⁸ As such, claims that allege bad faith in the performance of facially authorized acts are automatically barred under discretionary-function immunity.⁹ This approach protects government employees from second guessing every decision and working in constant fear of litigation.¹⁰ To hold otherwise, the court posited, would render discretionary-function immunity largely ineffective.¹¹

² NEV. REV. STAT. §§ 41.031 (2017).

³ NEV. REV. STAT. §§ 41.032(2) (2017).

⁴ *Falline v. GNLV Corp.*, 107 Nev. 1004, 1009 & n. 3, 823 P.2d 888, 892 & n.3 (1991).

⁵ *Martinez v. Maruszczak*, 123 Nev. 433, 444–47, 168 P.3d 720, 727–29 (2007).

⁶ *Id.* at 446-447, 168 P.3d at 729.

⁷ *See Franklin Sav. Corp. v. United States*, 180 F.3d 1124, 1135 (10th Cir. 1999).

⁸ *Id.*

⁹ *Id.* at 1140.

¹⁰ *Id.* at 1141–1142.

¹¹ *Id.* at 1140–1141.

Courts that consider whether an employee subjectively intended to further policy by his or her conduct

Other courts, however, have concluded that actions made in bad faith cannot possibly be related to “any plausible policy objective.”¹² In *Coulthurst*, the Second Circuit Court of Appeals held that actions involving laziness, haste, or inattentiveness did not involve judgment, choice or policy considerations, and that in such instances, discretionary-function immunity should not attach to shield the government from a lawsuit.¹³

The Court here evaluated both approaches and found that *Falline* is consistent with the reasoning in *Coulthurst*, and affirmed their holding in *Falline* that NRS 41.032 does not protect the government from claims related to intentional torts or bad faith misconduct.¹⁴ Further, since a Nevada agency would not receive immunity from these claims, then neither does FTB under comity principles.

Hyatt’s intentional tort causes of action

Since FTB could not invoke discretionary-function immunity, the Court then evaluated each of Hyatt’s intentional tort claims under a de novo standard of review.

Invasion of privacy causes of action

Intrusion upon seclusion and public disclosure of private facts

Hyatt’s invasion of privacy claims centered on FTB’s disclosure of his name, address and social security number to third parties throughout the audit investigation. In evaluating claims based upon intrusion upon seclusion and public disclosure of private facts, the plaintiff must actually have an expectation of privacy, and that expectation must be reasonable.¹⁵ Further, the disclosure of a private fact must be offensive and objectionable to an ordinary person.¹⁶ Here, the Court found that the public records defense¹⁷ precluded Hyatt from recovering for intrusion upon seclusion and public disclosure of private facts since his name, address, and social security number were already publicly available in court documents. Therefore, Hyatt did not have a reasonable expectation of privacy, and FTB’s disclosures were not offensive.

Hyatt argued that the public records in question were from long ago and should not be considered part of the public domain. The Court rejected this argument noting that the public records defense had never been limited based upon the time elapsed from public disclosure and subsequent alleged invasion of privacy. Accordingly, the Court reversed the lower court’s judgment based on the jury verdict in Hyatt’s favor.

¹² *Coulthurst v. United States*, 214 F.3d 106, 111 (2d Cir. 2000).

¹³ *Id.* at 109–111.

¹⁴ NEV. REV. STAT. §§ 41.032 (2017).

¹⁵ *PETA v. Bobby Berosini, Ltd.*, 111 Nev. 615, 631, 895 P.2d 1279, 1278 (1995).

¹⁶ *Montesano v. Donrey Media Grp.*, 99 Nev. 644, 649, 668 P.2d 1081, 1084 (1983).

¹⁷ See *Id.* at 649, 668 P.2d at 1085.

False light invasion of privacy

Hyatt argued that FTB's actions throughout the audit portrayed him as a "tax cheat" and thus portrayed him in a false light. While only previously recognized impliedly, here the Court expressly adopted the false light invasion of privacy right of action. The Court noted that while false light and defamation are similar causes of action, many courts have deemed the false light cause of action as necessary to provide a remedy to individuals who face situations (being falsely portrayed as a crime victim, being falsely portrayed as destitute or ill) that do not rise to level of defamation.¹⁸ Courts that do not recognize false light have done so due to the similarity between the two causes of action, and the belief that defamation, appropriation, and IIED are adequate to protect and provide remedies to plaintiffs.¹⁹ After weighing both approaches, the Court ultimately concluded that the false light cause of action is necessary to fully protect privacy interests.

Hyatt's false light claim

The Court determined that Hyatt failed to present evidence that FTB's actions portrayed him in a false light. Rather, the actions taken by FTB (inclusion of Hyatt on a factually true litigation roster and interactions with third parties regarding Hyatt's finances and business dealings) were shown to be in line with routine audit investigation procedure. Accordingly, the Court reversed the district court's judgment in Hyatt's favor on this claim.

Breach of confidential relationship

A confidential relationship is established through "kinship or professional, business or social relationships between the parties."²⁰ In *Perry*, a confidential relationship is recognized when one party gains the confidence of another party and claims to act consistently in their interest.²¹ Hyatt argued that because FTB promised to keep certain information private during the audit, and because of FTB's position over him during the audit process, there was a confidential relationship as defined in *Perry*. However, FTB argued that the relationship between tax auditor and taxpayer does not meet the confidential relationship standard and cited to *Johnson v. Sawyer*, a case in which the Fifth Circuit held that Johnson and the IRS could not be in a confidential relationship due to the adversarial nature of their relationship.²² Here, the Court rejected Hyatt's expansive interpretation of what constitutes a confidential relationship and found, like in *Johnson*, that FTB's duty was to proceed in the state's, not Hyatt's, best interest. Thus, the Court reversed the lower court's judgment in Hyatt's favor on his breach of confidential relationship claim.

¹⁸ See *Welling v. Weinfeld*, 866 N.E.2d 1051, 1055-57 (Ohio 2007); *West v. Media Gen. Convergence, Inc.*, 53 S.W.3d 640, 646 (Tenn. 2001).

¹⁹ *Denver Publ'g Co. v. Bueno*, 54 P.3d 893, 903 (Colo. 2002).

²⁰ *Perry v. Jordan*, 111 Nev. 943, 947, 900 P.2d 335, 337 (1995).

²¹ *Id.* at 947, 900 P.2d at 338.

²² 47 F.3d 716, 738 & n.47 (5th Cir. 1995).

Abuse of process

To prevail on an abuse of process claim, the plaintiff must show that the other party used the legal process in a willful and improper manner to accomplish something other than legal resolution.²³ Since FTB did not use any legal processes within the court system, Hyatt could not meet the requirements for an abuse of process claim and the Court reversed the lower court's judgment in Hyatt's favor on his abuse of process claim.

Fraud

To prove fraud it must be shown that (1) the defendant made a false representation, (2) that this false representation was intended to persuade the plaintiff to act or not act in a certain way, and (3) that the plaintiff had reason to rely and thereby suffered damages.²⁴ FTB told Hyatt that he could expect the FTB employee's to treat him with courtesy throughout the audit process, that needed information would be clearly and concisely requested, that his personal and financial information would be kept confidential, and that the audit would be completed within a reasonable amount of time.

Hyatt presented evidence that, contrary to the promises made, FTB disclosed his personal information and that he was being audited to numerous third parties; that FTB sent information related to the audit to individuals without first verifying their identity; that the audit ultimately took over 11 years, and that this delay resulted in significant interest accrual; and that FTB employees made disparaging remarks about the case and Hyatt. The Court found that based on this evidence "a reasonable mind could conclude that the FTB made specific representation to Hyatt that it intended for Hyatt to rely on, but which it did not intend to fully meet." Further, the Court found that it was reasonable for the jury to conclude that these interactions did lead Hyatt to proceed differently in the audit process than he would have otherwise, and that this was to Hyatt's detriment. Thus, the Court concluded that the FTB was not entitled to judgment as a matter of law on this cause of action.

Fraud damages

NRS § 41.035 sets out a statutory cap on liability damages in tort actions against a state entity.²⁵ At the time of Hyatt's injury in 1993, this cap was set at \$50,000. The U.S. Supreme Court disagreed with the Nevada Supreme Court's previous decision that FTB was not entitled to these statutory damages caps, and stated that refusal of the cap would be "a special and discriminatory rule."²⁶ As such, FTB is entitled to the cap on damages that a similarly situated Nevada agency would receive, and Hyatt's awards on each successful tort claim must be capped at this amount. This cap does not apply to awards for prejudgment interest or attorney's fees and costs.

²³ *LaMantia v. Redisi*, 118 Nev. 27, 31, 38 P.3d 877, 880 (2002).

²⁴ *Bulbman, Inc. v. Nev. Bell*, 108 Nev. 105, 111, 825 P.2d 588, 592 (1992).

²⁵ NEV. REV. STAT. §§ 41.035 (2017).

²⁶ *Franchise Tax Bd. of Cal. V. Hyatt (Hyatt II)*, ___ U.S. ___, ___, 136 S. Ct. 1277, 1281–1282 (2016).

Intentional infliction of emotional distress

During discovery, Hyatt refused to disclose his medical history and records, and was thus barred from presenting medical evidence related to his claims of IIED at trial. However, Hyatt presented other evidence, mostly in the form of witness testimony, to demonstrate his emotional distress stemming from FTB's actions. FTB argued that this witness testimony was insufficient to prove Hyatt's claim, and that medical evidence is necessary to meet the standard that plaintiff provide "objectively verifiable indicia" to prove emotional distress.²⁷ The Court had not previously specifically addressed whether medical evidence is required to establish a claim for IIED, however a sliding scale approach in which increased severity of conduct will require less evidence to prove emotional distress, had impliedly been recognized in the past.²⁸

Here, the Court explicitly adopted the sliding scale approach to prove an IIED claim, and held that the severity of FTB's conduct meant that less proof regarding Hyatt's emotional distress was necessary to support his claim. Further, it is reasonable that a jury presented with the witness testimony Hyatt provided would determine that he suffered IIED. On the intentional infliction of emotional distress cause of action, the Court concluded that the FTB was not entitled to judgment as a matter of law.

Trial Errors at district court

The FTB argued that the jury's award should be reversed due to several errors committed by the trial court. The court reviewed both claims under an abuse of discretion standard of review.

Evidence improperly permitted challenging audits' conclusion

FTB argued that the district court allowed certain evidence which required the jury to make findings on Hyatt's residency and the accuracy of the audit's findings, in contravention of the prior summary judgment ruling in FTB's favor. The Court found that certain pieces of evidence related to alleged mathematical errors, auditor behavior, and testimony related to fraud penalties were presented to challenge the audit's quality, and it was an abuse of discretion for the district court to permit this evidence.

Jury instruction permitting consideration of audits' determinations

FTB also challenged the district court's use of a revised jury instruction which included the following language:

There is nothing in the correct Jury Instruction No. 24 that would prevent you during your deliberations from considering the appropriateness or correctness of the analysis conducted by the FTB employees in reaching its residency determination and conclusion.

²⁷ Miller v. Jones, 114 Nev. 1291, 1300, 970 P.2d 571, 577 (1998).

²⁸ Nelson v. City of Las Vegas, 99 Nev. 548, 555, 665 P.2d 1141, 1145 (1983).

The Court found that this jury instruction violated the jurisdictional limit imposed on the case, and that the district court abused its discretion in giving this instruction.

Exclusion of evidence to rebut adverse inference

FTB also challenged the district court's exclusion of evidence it sought to introduce to rebut an adverse inference sanction for spoliation of evidence. FTB changed an email server in 1999 and subsequently overwrote the backup tapes on which the emails were stored. Hyatt requested discovery of the tapes and then filed for sanctions when he discovered the emails were deleted. The Court ruled in favor of Hyatt and decided to give an adverse inference jury instruction, allowing the jury to infer that negligently destroyed evidence by FTB would have been harmful to them.²⁹

A court may impose a permissible adverse inference when evidence is negligently, not willfully destroyed.³⁰ This lesser adverse inference does not shift the burden of proof to the spoliating party to show that the destroyed evidence was not unfavorable, but rather allows the fact finder, based on other evidence, to determine whether a fact exists.³¹ Since FTB's spoliation was negligent, they should have been allowed to present to the jury their efforts to preserve the emails in order to demonstrate that there was nothing unfavorable to them therein. Exclusion of this evidence was an abuse of discretion, and the Court reversed the district court's ruling on this issue.

Other evidentiary errors

Finally, the Court held that the court below abused its discretion in excluding evidence relating to Hyatt's patent loss and federal tax audit since it was more probative than unfairly prejudicial.

Evidentiary and jury instruction errors do not warrant reversal

Despite these errors, the Court found that FTB failed to show that, if not for these errors, a different result may have been reached regarding liability. However, the Court did find that but for the errors, a different result would have been reached regarding damages, and that the evidence supports a \$50,000 damage award (the statutory cap) on the IIED claims.

Punitive damages

NRS § 41.035(1) provides that awards for damages in a tort action against a government entity may not include exemplary or punitive damages.³² Under comity principles, the Court thus affords FTB immunity from punitive damages.

²⁹ See, e.g., *Bass-Davis v. Davis*, 122 Nev. 442, 446, 452, 134 P.3d 103, 106, 109 (2006).

³⁰ *Id.* at 447–48, 134 P.3d at 106–07.

³¹ *Id.* at 448–449, 134 P.3d at 107.

³² NEV. REV. STAT. §§ 41.035(1) (2017).

Costs

Since the Court reversed the judgments on several tort causes of action, the district court's award of costs must also be reversed and the case remanded to allow the district court to determine which party now prevails.³³

The Court also took the opportunity to address FTB's challenge to the district court's procedure in awarding fees, and held that the acceptance of Hyatt's documents to support costs sought after the statutory deadline was not improper since the statute allows filing to take place for "such further time as the court or judge may grant."³⁴ However, the Court held that the district court did err in refusing FTB to file an objection to the master's report and recommendation on costs since the cost issue was not placed before a jury, and NRC 53(e)(2) allows written objection to a master's report.³⁵ On remand, the district court must allow FTB to file objections to a master's report before a cost award is entered.

Hyatt's Cross Appeal

Hyatt challenged the district court's summary judgment ruling which prevented him from seeking economic damages based on the theory that he lost significant income related to potential licensing revenue in Japan due to the FTB audit. Hyatt presented testimony from experts detailing what they believe would happen based upon their familiarity with Japanese business culture and practices. The district court found this evidence to be "speculative and insufficient." Here, the Court affirmed the district court's grant of summary judgment after determining that Hyatt failed to prove that any of the steps in his proposed hypothetical actually occurred.

Conclusion

As a threshold matter, the Court found that discretionary-function immunity does not apply to intentional and bad-faith tort claims. Since FTB was not immune to suit, the Court then considered respondent's tort causes of action individually and found that (1) appellant was entitled to judgment as a matter of law on all tort causes of action except for fraud and IIED claims, (2) the district court's evidentiary and jury instruction errors were harmless, (3) damages for fraud and IIED are subject to NRS § 41.035(1) statutory cap, and (4) recovery of punitive damages precluded. The Court remanded prejudgment interest and cost awards, and affirmed the district court's prior grant of summary judgment in FTB's favor regarding Hyatt's claim for economic damages.

³³ See *Bower v. Harrah's Laughlin, Inc.*, 125 Nev. 470, 494–95, 215 P.3d 709, 726 (2009).

³⁴ *Eberle v. State ex rel. Nell J. Redfield Trust*, 108 Nev. 587, 590, 836 P.2d 67, 69 (1992).

³⁵ NEV. R. CIV. P. 53(e)(2).