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## Franchise Tax Board of California v. Hyatt, 133 Nev. Adv. Op. 102 (Dec. 26, 2017)

Rebecca L. Crooker

*University of Nevada, Las Vegas -- William S. Boyd School of Law*

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*Franchise Tax Board of California v. Hyatt*, 133 Nev. Adv. Op. 102 (Dec. 26, 2017)<sup>1</sup>

CIVIL PROCEDURE: APPELLATE; DISCRETIONARY-FUNCTION IMMUNITY

### **Summary**

The Court determined that discretionary-function immunity does not apply to intentional tort and bad faith claims. Under comity principles, the Franchise Tax Board was entitled to the \$50,000 statutory cap that would extend to Nevada businesses under NRS 41.035(1).<sup>2</sup> The Court additionally recognized false light invasion of privacy as a tort cause of action distinct from other privacy torts, and adopted the Restatement's sliding-scale approach in determining the amount of evidence necessary to establish a claim for intentional infliction of emotional distress.

### **Background**

In 1993, a tax auditor for the Franchise Tax Board (FTB) read a newspaper article discussing Gilbert Hyatt's lucrative computer-chip patent and decided to review Hyatt's 1991 tax returns. Hyatt's tax return did not claim moving expenses, but showed that he resided in California for nine months in 1991 before relocating to Las Vegas, Nevada. Only 3.5 percent of Hyatt's income was reported on the California return, and none of his patent's licensing payments were reported as taxable income. Based on the discrepancies, FTB opened a tax audit on Hyatt's 1991 state income tax return.

FTB sent Hyatt notice that they were auditing him, including with the notice an information request form requiring Hyatt to provide information related to his connections to California and Nevada and the facts regarding his move to Las Vegas. The information request form contained a privacy notice stating that "The Information Practices Act of 1977 and the federal Privacy Act require the Franchise Tax Board to tell you why we ask you for information. The Operations and Compliance Divisions ask for tax return information to carry out the Personal Income Tax Law of the State of California."<sup>3</sup> Additionally, the notification stated that Hyatt could expect "Courteous treatment by FTB employees, Clear and concise requests for information from the auditor assigned to your case, Confidential treatment of any personal and financial information that you provide to us, Completion of the audit within a reasonable amount of time."<sup>4</sup>

During the audit, FTB requested information and documents directly from Hyatt as well as conducting interviews and receiving signed statements from Hyatt's ex-wife, brother and daughter—all estranged from Hyatt during the audit period. Hyatt provided FTB with names of un-estranged relatives, including his son, but FTB did not interview those individuals. Additionally, FTB sent over 100 letters demanding information to third parties including two Japanese companies that held licenses to Hyatt's patent, utility companies, newspapers, banks, and medical providers. Many of the letters contained Hyatt's home address, social security number, or both.

Upon conclusion of the audit, FTB determined that Hyatt had staged the September 1991 move to Nevada, and had actually moved in April 1992. Based on these findings, FTB concluded that Hyatt owed California \$1.8 million in state income taxes plus penalties amounting to \$1.4 million and an additional \$1.2 million in interest, totaling \$4.5 million dollars.

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<sup>1</sup> By Rebecca L. Crooker.

<sup>2</sup> NEV. REV. STAT. § 41.035(1) (2011).

<sup>3</sup> Opinion at 8.

<sup>4</sup> Opinion at 8.

Based on the finding that Hyatt moved to Nevada in 1992 rather than 1991, FTB commenced a second audit of Hyatt's 1992 California income taxes. Hyatt, alleging he was a resident of Nevada in 1992, had not filed a California tax return. FTB used the information gathered from the 1991 audit and sent a solitary request for information to Hyatt regarding patent-licensing payments received in 1992. This second audit showed that Hyatt owed California over \$6 million in taxes and interest for 1992, plus additional penalties.

Hyatt initiated formal challenges to the audits' conclusions by filing two protests with FTB which it handled simultaneously. FTB reviews protests for accuracy and the need for changes. After 11 years and 3 different FTB auditors, the protests upheld the audits and Hyatt initiated challenges in California and Nevada courts.

Hyatt filed the Nevada lawsuit in 1998. The complaint included a claim for declaratory relief regarding the timing of his move from California to Nevada as well as a claim for negligence and seven intentional torts: invasion of privacy; intrusion upon seclusion; invasion of privacy; publicity of private facts; invasion of privacy; false light; intentional infliction of emotional distress; fraud; breach of confidential relationship and; abuse of process. Hyatt alleged that FTB committed the intentional torts during the 1991 and 1992 audits.

FTB filed a motion for partial summary judgment, challenging the Nevada district court's jurisdiction of Hyatt's declaratory relief. The district court agreed that the timing of Hyatt's move to Nevada and whether FTB had properly assessed taxes should be decided through the California administrative process, and granted partial summary judgment in favor of FTB. Accordingly, the remaining litigation was conducted with the stipulation that any determinations as to the audits' accuracy were not part of Hyatt's tort action, and the jury could not make any findings as to audits' conclusions or the timing of Hyatt's move to Nevada.

FTB also filed a motion for partial summary judgment to prevent Hyatt from pursuing alleged economic damages. FTB, during the 1991 audit, sent letters and copies of licensing agreements to two Japanese companies that held licenses to Hyatt's patent. Hyatt alleged that the contents of the licensing agreements were confidential and that FTB's demand letters notified that Japanese companies that Hyatt was under investigation—leading the Japanese companies to cease business dealings with Hyatt.

Hyatt's evidence supporting his allegations included the fact that FTB sent the letters to the two businesses, the businesses sent responses to FTB, and after their responses Hyatt received no further patent-licensing income. Hyatt also provided expert testimony that the Japanese business culture supported the alleged chain of events. The district court found that Hyatt had no admissible evidence to support his allegations and granted partial summary judgment in favor of FTB.

Additionally, FTB filed two writ petitions in 2000 asserting that it was entitled to complete immunity in Nevada, identical to the immunity enjoyed under California law. FTB based this argument under either sovereign immunity, the full faith and credit clause, or comity. The Court decided that FTB was not entitled to complete immunity under either principal, but under comity, should be granted partial immunity identical to what a Nevada government agency would receive. Because of this ruling, the Court held that FTB was immune from the negligence cause of action, but was not immune to the intentional tort causes of action.<sup>5</sup>

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<sup>5</sup> Franchise Tax Bd. of Cal. v. Hyatt (2014 Opinion), 130 Nev., Adv. Op. 71, 335 P.3d 125, 131 (2014) (Hyatt I), *vacated by*, Franchise Tax Bd. of Cal. v. Hyatt, U.S. (2016).

FTB appealed this ruling to the U.S. Supreme Court, and the Court upheld the decisions that FTB was not entitled to complete immunity, but under comity was entitled to partial immunity, and accordingly Hyatt could continue to pursue his claims for intentional torts.

After a four-month jury trial, the jury found in favor of Hyatt on all the intentional tort causes of action with damages of \$85 million for emotional distress, \$52 million for invasion of privacy, \$1,085,281.56 as special damages for fraud in addition to \$250 million for punitive damages and prejudgment interest on the awarded damages for emotional distress, invasion of privacy, and fraud. Hyatt then moved the district court for costs, and the district court assigned the motion to a special master. After 15 months of discovery, the special master recommended that Hyatt be awarded \$2.5 million in costs, a recommendation adopted by the district court.

FTB appealed from the district court's final judgment and award of costs. Hyatt cross-appealed the district court's partial summary judgment that he could not seek alleged economic damages.

FTB petitioned the United States Supreme Court for certiorari and the Court agreed to decide two questions: 1) whether to overrule *Nevada v. Hall*,<sup>6</sup> holding that holding, "that one State. . . can open the doors of its courts to a private citizen's lawsuit against another State without the other State's consent,"<sup>7</sup> and 2) "[w]hether the Constitution permits Nevada to award damages against California agencies under Nevada law that are greater than it could award against Nevada agencies in similar circumstances."<sup>8</sup>

In response to the first question, the Court split 4-4, affirming Nevada's exercise of jurisdiction over a California agency. In response to the second question, the Court held that subjecting a California agency to higher damages than a Nevada agency "violate[d] the Constitution's requirement that Full Faith and Credit shall be given in each State to the public Acts, Records and judicial Proceedings of every other State."<sup>9</sup> The Court remanded the decision to the Supreme Court of Nevada for further consideration in light of its decision.

## **Discussion**

The court began by discussing FTB's appeal and whether it was entitled to discretionary-function immunity, barring Hyatt's causes of action. The court concluded that FTB was not immune from suit because it was the tort was intentional and with other immunities, based on public policy, and turned to each of Hyatt's intentional tort causes of action and Nevada's statutory cap on damages. The discussion concluded by discussing Hyatt's cross appeal challenging the district court's partial summary judgment precluding Hyatt from attempting to recover for alleged economic losses.

*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*

Nevada has waived traditional sovereign immunity from tort liability, with some exceptions which include discretionary-function immunity. Discretionary-function immunity arises under NRS 41.031 and states that no action can be brought against the state or its employee "based upon the exercise or performance or the failure to exercise or preform a discretionary function or duty on the part of the State... or of any... employee... , whether or not the discretion involved is abused."<sup>10</sup> This immunity is designed

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<sup>6</sup> Nevada v. Hall, 440 U.S. 410 (1979).

<sup>7</sup> Franchise Tax Bd. of Cal. v. Hyatt, \_U.S.\_ (2016) (Hyatt II).

<sup>8</sup> *Id.* at \_.

<sup>9</sup> *Id.* at \_.

<sup>10</sup> NEV. REV. STAT. § 41.032(2) (1987).

to prevent the judicial branch from “second-guessing,” in a tort action, legislative and executive branch decisions that are based on “social, economic, and political policy.”<sup>11</sup>

FTB argued that the principle of comity requires that Nevada extend its discretionary-function immunity for Hyatt’s intentional tort claims. Comity is a legal principle whereby a forum state may give effect to the laws and judicial decisions of another state based in part on deference and respect for the other state, but only so long as the other state’s laws are not contrary to the policies of the forum state.<sup>12</sup> This principle is intended to foster good will between states, but the forum state has total discretion whether to invoke comity. Because FTB would receive full immunity from tort actions arising from an audit in California, it contended that it should receive the same immunity in Nevada, provided the immunity does not violate Nevada’s public policies.

#### *Discretionary-function immunity in Nevada*

Nevada’s test for whether to grant a government entity or its employee discretionary-function immunity has changed over time,<sup>13</sup> and an exception to discretionary-function immunity for intentional torts and bad-faith conduct was recognized in *Falline v. GNLV Corp.*<sup>14</sup> The current test was adopted from the federal *Berkovitz-Gaubert* two-part test. Under this test, discretionary-function immunity applies if the government actions “(1) involve an element of individual judgment or choice and (2) [are] based on considerations of social, economic, or political policy.”<sup>15</sup> Nevada’s adoption of the *Berkovitz-Gaubert* test dispensed with earlier tests, but whether the *Falline* exception still applied was not addressed by the Nevada Supreme Court at that time.

In response to FTB’s writ petitions, the Court applied *Falline* to determine that FTB was entitled to immunity for the negligence cause of action, but not the intentional tort causes of action. Since that decision, the law of discretionary-function immunity changed and thus needed to be re-applied to Hyatt’s intentional tort causes of action.

FTB argued that the adoption of the federal test overruled the *Falline* exception, while Hyatt contended that the adoption of the federal test made no changes to the *Falline* exception and that discretionary-function immunity does not apply to bad-faith misconduct. The court in *Falline* viewed the exception to discretionary immunity broadly, determining that bad faith differs from an abuse of discretion. An abuse of discretion occurs when a person acts without justification within their scope of authority, while bad faith “involves an implemented attitude that completely transcends the circumference of authority granted’ to the actor.”

In *Martinez v. Maruszczak*, Nevada adopted the federal two-part test for determining whether discretionary-function immunity applies. The first step is determining whether the government conduct involves judgment: if a regulation or policy leaves the employee with no option but to comply with a directive and the employee fails to comply, the discretionary-immunity exception does not apply to the action because the employee acts without individual judgment or choice.<sup>16</sup> If, however, the employee is

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<sup>11</sup> *Martinez v. Maruszczak*, 123 Nev. 433, 446, 168 P.3d 720, 729 (2007).

<sup>12</sup> *See Miannecki v. Second Judicial Dist. Court*, 99 Nev. 93, 98, 658 P.2d 422, 424—25 (1983).

<sup>13</sup> *See, e.g., Arnesano v. State ex rel. Dep’t of Transp.*, 113 Nev. 815, 823—24, 942 P.2d 139, 144—45 (1997). (applying planning-versus operational test to government action), *abrogated by Martinez*, 123 Nev. at 443—44, 168 P.3d at 726—27; *State v. Silva*, 86 Nev. 911, 913—14, 478 P.2d 591, 592—93 (1970) (applying discretionary-versus-ministerial test to government conduct), *abrogated by Martinez*, 123 Nev. at 443—44, 168 P.3d at 726-27.

<sup>14</sup> *Falline v. GNLV Corp.*, 107 Nev. 1004, 1009 & n.3, 823 P.2d 888, 892 & n.3 (1991).

<sup>15</sup> *Martinez*, 123 Nev. at 446-47, 168 P.3d at 729.

<sup>16</sup> *United States v. Gaubert*, 499 U.S. 315, 322 (1991).

free to exercise discretion when implementing a government directive, the test's second step examines whether the conduct is a policy-making decision. If “the challenged actions are not the kind of conduct that can be said to be grounded in the policy of the regulatory regime,’ discretionary-function immunity will not bar the claim.”<sup>17</sup>

Hyatt argued that an intentional tort fails to meet the two-part test because such conduct cannot be policy-based or discretionary. FTB contended that the federal test abolished the *Falline* exception because the federal test is objective rather than subjective.

Courts in other jurisdictions have reached different results, with some concluding that allegations of bad-faith misconduct are irrelevant to determining whether immunity applies because the employee's subjective intent should not be a factor whatsoever. Other courts focus on whether the employee's conduct can be considered a policy-based decision—holding that intentional torts are not policy-based conduct. These courts do not allow discretionary-function immunity with intentional torts if the government action is unrelated to any possible policy purpose. The Court further considered other jurisdictions' decisions for their analysis.

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

In *Franklin Savings Corp. v. United States*,<sup>18</sup> the Tenth Circuit Court of Appeals addressed whether a bad-faith claim precluded application of discretionary-function immunity. The court focused on the second part of the federal test, considering whether intentional misconduct barred discretionary-function immunity under the federal test. The *Franklin Savings* court noted that the Supreme Court “repeatedly insisted ... that [tort] claims are not vehicles to second-guess policymaking,”<sup>19</sup> and observed that when *Berkovitz* was modified in *Gaubert*, the inclusion into considering whether the challenged conduct was “susceptible to policy analysis[,] . . . served to emphasize that courts should not inquire into the actual state of mind or decision-making process of federal officials charged with performing discretionary functions.”<sup>20</sup>

The court decided that discretionary-function immunity bars claims that are dependent on an employee's state of mind in performing “facially authorized acts,”<sup>21</sup> concluding that the immunity could not otherwise effectively function. However, the court noted that their holding created the “potentially troubling effect”<sup>22</sup> of creating an irrebuttable presumption that all government employees perform discretionary functions in good faith. The holding created the potential to prevent relief in the case of an official intentionally committing malicious conduct. However, the potential for preclusion of bad-faith claims was outweighed by the benefit of providing immunity to employees to allow them to act without fear of litigation.

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

Conversely, in *Coulthurst v. United States*,<sup>23</sup> the Second Circuit Court of Appeals concluded that conduct that did not involve judgment or was based on policy considerations was not shielded by discretionary-function immunity.

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<sup>17</sup> *Id.* at 324-25.

<sup>18</sup> *Franklin Savings Corp. v. United States*, 180 F.3d at 1127, 1134-42 (10th Cir. 1999).

<sup>19</sup> *Id.* at 1134.

<sup>20</sup> *Id.* at 1135.

<sup>21</sup> *Id.* at 1140.

<sup>22</sup> *Id.* at 1141.

<sup>23</sup> *Coulthurst v. United States*, 214 F.3d 106 (2nd Cir. 2000).

Nevada's Supreme Court explained that the difference between the *Franklin Savings* and *Coulthurst* decisions stems from how broadly each court applied the statement in *Gaubert* that "[t]he focus of the inquiry is not on the agent's subjective intent in exercising the discretion conferred. . . , but on the nature of the actions taken and on whether they are susceptible to policy analysis." *Franklin Savings* broadly interpreted this statement to prevent any consideration of whether the questionable conduct was done with malicious intent. *Coulthurst* used a narrow interpretation to conclude that a complaint alleging a nondiscretionary decision that caused the injury was not grounded in public policy.

The Nevada Supreme Court concluded that *Falline* was most consistent with *Coulthurst's* holding that intentional torts are acts "unrelated to any plausible policy objective" and that such acts do not involve the kind of judgment that is intended to be shielded from "judicial second-guessing." The Court confirmed that NRS 41.032 does not shield government employees from intentional torts. Because a Nevada agency would not receive immunity in identical circumstances, the Court declined to extend immunity to FTB under comity principles, to avoid contravening Nevada policy.

#### *Hyatt's intentional tort causes of action*

Hyatt brought claims for intrusion upon seclusion, publicity of private facts, false light, breach of confidential relationship, abuse of process, fraud, and intentional infliction of emotional distress. The Court reviewed each of these de novo.

#### *Invasion of privacy causes of action*

The tort of invasion of privacy is comprised of four different actions: "(a) unreasonable intrusion upon the seclusion of another; or (b) appropriation of the other's name or likeness; or (c) unreasonable publicity given to the other's private life; or (d) publicity that unreasonably places the other in a false light before the public."<sup>24</sup> Hyatt's claim involved intrusion upon seclusion, public disclosure of private facts, and false light invasion of privacy, with a jury awarding him \$52 million for these torts. Because intrusion upon seclusion and public disclosure of private facts overlap, the Court discussed the two claims together.

#### *Intrusion upon seclusion and public disclosure of private facts*

Intrusion upon seclusion and public disclosure of private facts require an objective expectation of privacy. One defense to invasion of privacy torts, the "public records defense" arises if the defendant can show that the information disclosed was contained in a court's official records, and thus, are public facts.

Hyatt contended that FTB disclosed his name, address, and social security number to various individuals and entities. FTB argued that the information had been disclosed in prior public records.

Hyatt's name, address and social security number did appear in court documents from his divorce and a probate case that occurred prior to the audits. Hyatt additionally disclosed this information in business license applications completed long before the FTB disclosures occurred. Although Hyatt argued that the earlier public disclosures occurred so long ago that his objective expectation of privacy was preserved, the court has never allowed the length of time between public disclosure and the invasion of privacy to limit the application of the public records defense.

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<sup>24</sup> Restatement (Second) of Torts § 652A (Am. Law Inst. 1977); *PETA v. Bobby Berosini, Ltd.*, 111 Nev. 615, 629, 895 P.2d 1269, 1278 (1995), *overruled on other grounds by* *City of Las Vegas Downtown Redev. Agency v. Hecht*, 113 Nev. 644, 650, 940 P.2d 134, 138 (1997).

The court concluded that under the public records defense, Hyatt lacked an objective expectation of privacy and therefore could not meet the requirements necessary to prevail upon the intrusion upon seclusion and public disclosure of private facts causes of action, and the district court's judgment was reversed.

*False light invasion of privacy*

Hyatt asserted that FTB portrayed him in a false light by depicting him as a "tax cheat." FTB, however, asserted that Hyatt lacked any evidence to support his claim. The false light invasion of privacy tort had never been explicitly recognized in Nevada, so the court turned to whether to adopt the cause of action.

*Adopting the false light invasion of privacy tort*

The Restatement specifies that an action for false light arises when

[o]ne who gives publicity to a matter concerning another that places the other before the public in a false light . . . if

(a) the false light in which the other was placed would be highly offensive to a reasonable person, and

(b) the actor had knowledge of or acted in reckless disregard as to the falsity of the publicized matter and the false light in which the other would be placed.<sup>25</sup>

The courts that have declined to adopt the tort of false light invasion of privacy have done so because of the similarity to the tort of defamation. Most courts that have adopted the false light tort have done so after determining that defamation and false light have distinct differences: defamation protects an objective interest in one's reputation while false light protects one's subjective interest in "freedom from injury to the person's right to be left alone." The protection provided by false light extends to situations where false portrayal could be harmful, but does not rise to the level of defamation.

Conversely, courts that have declined to adopt the false light tort have done so because of the substantial overlaps with defamation—both in the conduct and protected interests. Because the policy behind tort law is to deter "socially wrongful conduct," torts must be clearly defined. A tort that lacks clarity could potentially chill First Amendment activities. These courts view defamation, appropriation, and intentional infliction of emotional distress as adequate to protect privacy interests.

Having considered the various approaches, the Court determined that a false light tort is necessary to protect privacy interests, officially adopting it as a cause of action in Nevada. After recognizing false light invasion of privacy, the Court turned to the analysis of Hyatt's claim.

*Hyatt's false light claim*

Hyatt argued that FTB portrayed him in a false light by depicting him as a "tax cheat" through the inclusion of his case on FTB's litigation roster. The litigation roster was a publicly available roster identifying the audit cases in which the protest and appeal process had been completed as well as the cases

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<sup>25</sup> Restatement (Second) of Torts § 652E (Am. Law Inst. 1977).



being currently litigated in court. FTB asserted that Hyatt failed to present evidence that anyone believed he was a “tax cheat.”

FTB began to include Hyatt’s case on its litigation roster after Hyatt initiated litigation. Because Hyatt was involved in litigation with FTB and failed to prove that the litigation roster contained any false information, no evidence supported the jury’s conclusion that FTB portrayed Hyatt in a false light. Therefore, the district court’s judgment was reversed.

#### *Breach of confidential relationship*

*Perry v. Jordan* set forth a breach of confidential relationship cause of action which arises “by reason of kinship or professional, business, or social relationships between the parties.”<sup>26</sup> FTB argued that Hyatt could not establish that a confidential relationship existed, and thus could not prevail on a claim for breach of a confidential relationship. Hyatt argued that a confidential relationship existed because FTB promised to protect his confidential information, and that FTB’s position in relation to Hyatt during the audits established the requisite confidential relationship.

*Perry* recognized that “a confidential relationship exists when a party gains the confidence of another party and purports to advise or act consistently with the other party’s interest,”<sup>27</sup> and “[w]hen a confidential relationship exists, the person in whom the special trust is placed owes a duty to the other party similar to the duty of a fiduciary, requiring the person to act in good faith and with due regard to the interests of the other party.”<sup>28</sup>

FTB argued that the relationship between a tax auditor and the auditee does not create the confidential relationship set forth in *Perry*. Hyatt argued that FTB expressly promised to protect Hyatt’s confidential information and failed to keep that promise.

The Court, however, determined that FTB’s duty was to protect the state of California’s interests rather than Hyatt’s, rejecting Hyatt’s broad interpretation of the relationships which meet the *Perry* requirement. Because Hyatt and FTB did not have the requisite confidential relationship, the cause of action failed as a matter of law and the district court’s judgment was reversed.

#### *Abuse of process*

The plaintiff in an abuse of process claim must show “(1) an ulterior purpose by the defendants other than resolving a legal dispute, and (2) a willful act in the use of the legal process not proper in the regular conduct of the proceeding.”<sup>29</sup> A successful claim shows “that the defendant ‘willfully and improperly used the legal process to accomplish’ an ulterior purpose other than resolving a legal dispute.”<sup>30</sup>

FTB argued that it was entitled to judgment as a matter of law on the abuse of process claim because it never sought to judicially enforce compliance with the audit process. Hyatt responded that FTB committed abuse of process when it sent demand for information forms to both companies and individuals in Nevada who were not subject to California law.

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<sup>26</sup> *Perry v. Jordan*, 111 Nev. 943, 947, 900 P.2d 335, 337 (1995).

<sup>27</sup> *Id.* at 947, 900 P.2d at 338.

<sup>28</sup> *Id.* at 947, 900 P.2d at 338.

<sup>29</sup> *LaMantia v. Redisi*, 118 Nev. 27, 30, 38, P.3d 877, 879 (2002) (quoting *Posadas v. City of Reno*, 109 Nev. 448, 457, 851 P.2d 438, 444—45 (1993)).

<sup>30</sup> *Id.* at 31, 38 P.3d at 880.

The Court held that FTB did not use any judicial compliance when demanding information or otherwise completing the audit, and Hyatt therefore could not establish an abuse of process claim. Thus, FTB was entitled to judgment as a matter of law and the district court's judgment was reversed.

### *Fraud*

To prevail on a claim of fraud, the plaintiff must show “the defendant made a false representation that the defendant knew or believed was false, that the defendant intended to persuade the plaintiff to act or not act based on the representation, and that the plaintiff had reason to rely on the representation and suffered damages.”<sup>31</sup>

Upon the commencement of Hyatt's audit, FTB informed him that Hyatt could expect courteous treatment from FTB employees, that the auditor would clearly and concisely request information, that information provided would be treated by FTB as confidential, and that the audit would be completed within a reasonable period of time.

FTB argued that these statements were insufficient to form the basis for a fraud claim, and even if they were sufficient representations, no evidence showed that FTB knew the representations were false when made. Further, FTB argued that Hyatt failed to prove reliance on the statements because his compliance with the audit was required whether he relied on the statements or not. Hyatt contended that FTB knowingly misrepresented its promises to protect his private information and treat him fairly.

The Court held that a reasonable person could determine that FTB made representations to Hyatt, intending that Hyatt rely on them, and which FTB did not intend to fulfill. Although FTB told Hyatt it would treat his information confidentially, Hyatt presented evidence at trial that FTB exposed his social security number and the fact he was being audited to numerous individuals and entities. FTB furthermore sent letters to multiple doctors with the same last name, believing one of the doctors provided treatment to Hyatt, but failing to determine the treating physician before sending the letters. Furthermore, FTB took eleven years before resolving Hyatt's protest of the two audits resulting in an accrual of \$8,000 in interest per day for the outstanding taxes owed to California. During trial, Hyatt also presented evidence that the main auditor on Hyatt's audit made disparaging comments about Hyatt and his religion and was intent on imposing an assessment against Hyatt. Additional evidence showed that FTB promoted a culture in which tax assessments were the end goal of every audit.

The Court concluded that the evidence showed that FTB had improper motives in conducting Hyatt's audits and a reasonable person could conclude that FTB knowingly made fraudulent representations with the intention Hyatt would rely on them. Because evidence supported each fraud element, FTB was not entitled to judgement as a matter of law.

### *Fraud damages*

In 1993, the time that Hyatt suffered his injuries, NRS 41.035<sup>32</sup> set a statutory cap on damages of \$50,000. Initially, the Nevada Supreme Court held that FTB was not entitled to the statutory damages cap for the fraud claim. This decision was overturned by the United States Supreme Court which held that “[w]ith respect to damages awards greater than \$50,000, the ordinary principles of Nevada law do not conflict with California law, for both laws would grant immunity. Similarly, in respect to such amounts, the policies underlying California law and Nevada's usual approach are not opposed; they are consistent.”<sup>33</sup>

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<sup>31</sup> *Bulbman, Inc. v. Nev. Bell*, 108 Nev. 105, 111, 825 P.2d 588, 592 (1992).

<sup>32</sup> NEV. REV. STAT. § 41.035 (2011).

<sup>33</sup> *Hyatt II*, at \_.

Despite requiring immunity for FTB in amounts over \$50,000, the complete immunity from recovery that California would provide is inconsistent with Nevada law.

The Nevada Supreme Court reversed the fraud damages with instructions for the district court to enter the damages award in the amount of \$50,000, and reversed the award for prejudgment interest because it would cause the total award to exceed \$50,000. Because the statutory cap does not include awards for attorney fees, upon remand the district court must make a determination as to fees and costs.

#### *Intentional infliction of emotional distress*

To recover on a claim for intentional infliction of emotional distress, a plaintiff must prove “(1) extreme and outrageous conduct on the part of the defendant; (2) intent to cause emotional distress or reckless disregard for causing emotional distress; (3) that the plaintiff actually suffered extreme or severe emotional distress; and (4) causation.”<sup>34</sup> The plaintiff must prove this by setting forth “objectively verifiable indicia” to establish that the plaintiff “actually suffered extreme or severe emotional distress.”<sup>35</sup>

Hyatt refused to disclose his medical records during discovery, and was accordingly precluded from presenting medical evidence of severe emotional distress at trial. However, Hyatt did present evidence of emotional distress including testimony from his son and friends describing the changes they observed in Hyatt’s behavior and health over the course of the audits. The jury found in favor of Hyatt, awarding him \$82 million in damages for emotional distress.

FTB argued that without medical evidence, Hyatt lacked objectively verifiable evidence to establish severe emotional distress. Hyatt responded that testimony from his friends and family sufficed as objective proof of the severe emotional distress, specifically because of the severity of the treatment he endured from FTB.

The Restatement provides for a sliding-scale approach where an IIED claim with an increased severity of conduct requiring less proof that emotional distress was suffered.<sup>36</sup> In many cases, outrageous conduct can serve as strong evidence that emotional distress existed. Nevada previously impliedly recognized the sliding-scale approach, but formally adopted it here.

Under this approach, medical evidence is one method of establishing severe emotional distress under an IIED claim, but other objectively verifiable evidence is acceptable when the defendant’s conduct is more extreme. The more egregious the conduct, the less evidence of physical injury is required.

Here, Hyatt presented evidence of FTB’s extreme conduct: the evidence that the auditor made disparaging comments about Hyatt and was determined to impose assessments upon him, the disclosure of Hyatt’s personal information which it had promised to keep confidential, the delay of proceedings for eleven years—resulting in daily interest charges of \$8,000. The Court concluded that these facts show that the case was at the extreme end of the sliding scale, warranting less information necessary to prove Hyatt’s emotional distress. Hyatt’s testimony from three different individuals as to how FTB’s treatment affected Hyatt both physically and emotionally sufficed as evidence from which a jury could reasonably determine that Hyatt suffered severe emotional distress.

#### *Trial errors at district court*

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<sup>34</sup> *Miller v. Jones*, 114 Nev. 1291, 1299-1300, 970 P.2d 571, 577 (1998); *see also* *Barnettler v. Reno Air, Inc.*, 114 Nev. 441, 447, 956 P.2d 1382, 1386 (1998).

<sup>35</sup> *Id.* at 1300, 970 P.2d at 577.

<sup>36</sup> The Restatement (Second) of Torts § 46 (Am. Law Inst. 1977), in comments j and k.

FTB argued that the trial court committed multiple evidentiary and jury instruction errors, and that consequently the jury's award should be reversed. FTB claimed that the district court permitted evidence and a jury instruction which allowed a determination as to whether the audits were properly decided. The Court reviewed the admissibility of evidence as well as the jury instructions for an abuse of discretion.

*Evidence improperly permitted challenging audits' conclusions*

FTB argued that the district court erred in allowing Hyatt to present witnesses that focused on whether the audits' determinations were correct. Both Hyatt's tax accountant and tax attorney who represented him during the audits testified as to their cooperation with the audit process. Additionally, an expert tax attorney witness testified that Hyatt's representatives cooperated during the investigations. An expert witness also testified about the lifestyles of wealthy people in order to refute FTB's allegations that it was "implausible" that Hyatt lived in a low-income apartment in Las Vegas without security. Finally, an expert witness and former FTB agent testified regarding audit procedures, specifically discussing how FTB analyzed the information obtained the audits and challenging the results reached by FTB. FTB also argued that Hyatt's assertions regarding an alleged calculation error about the amount of taxable income was an explicit attempt to challenge the conclusions of the audits. Hyatt asserted that rather than challenging the audits, his evidence showed that the audits were conducted in bad faith and to extort a settlement.

The Court held that while much of Hyatt's evidence was within the parameters set, several instances violated the restriction against considering the audits' determinations. These included the aforementioned testimony challenging aspects of the fraud penalties, evidence challenging an alleged mathematical error in the amount of income taxed, testimony challenging whether an auditor improperly weighted the credibility of estranged family members, and testimony questioning whether the auditor correctly determined certain information was not relevant.

Without first establishing that the audits' determinations were incorrect, the expert testimony regarding fraud and FTB's alleged bad faith conduct had no utility. The testimony instead went to the audits' correctness, and it was thus an abuse of discretion for the district court to permit its admittance.

*Jury instruction permitting consideration of audits' determinations*

FTB argued that the district court erroneously instructed the jury to improperly consider FTB's audit determinations. Although an early version of the jury instructions told the jury not to consider the appropriateness of the audits' results, the final instruction was somehow altered with the revised version stating:

*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. There is nothing in Jury Instruction No. 24 that would prevent Malcolm Jumulet<sup>37</sup> from rendering an opinion about the appropriateness or correctness of the analysis conducted by FTB employees in reaching its residency determinations and conclusions.*

The Court held that this instruction violated the jurisdictional limit imposed by the district court and allowed the jury to consider the "appropriateness or correctness of the analysis conducted by the FTB employees in reaching its residency determination and conclusion." Thus, the district court abused its discretion in giving this jury instruction.

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<sup>37</sup> The former FTB agent who testified regarding audit procedures.

### *Exclusion of evidence to rebut adverse inference*

FTB also challenged the district court's exclusion of evidence which was intended to rebut an adverse inference sanction for spoliation of evidence. In 1999, during the litigation's pendency, FTB changed email servers—subsequently destroying backup tapes. FTB sent emails to employees prior to the change, requesting that they print or save any emails related to Hyatt's case. FTB did make backup tapes of some emails which, at some point, were overwritten. When Hyatt requested discovery of the backup tapes and found they had been deleted, he filed a pretrial motion requesting sanctions against FTB. The district court ruled in favor of Hyatt and determined it would give an adverse jury instruction allowing the jury to infer that evidence negligently destroyed by a party would have been harmful to that party.

FTB attempted to rebut the adverse inference by introducing evidence explaining it had taken steps to preserve relevant emails prior to the server change. Hyatt argued that this was a mere attempt to reargue the evidence spoliation, and that in order to rebut the inference FTB must show that the destroyed evidence was not harmful. The district court agreed with Hyatt and excluded the evidence.

A district court may either impose a rebuttable presumption when evidence was willfully destroyed, where the burden shifts to the spoliating party to show that the destroyed evidence was not unfavorable. If the party fails to rebut this presumption, the jury may assume the evidence was not favorable to the destroying party. A district court may also impose a permissible adverse inference when evidence was negligently destroyed. This lesser inference does not shift the burden of proof and allows the fact-finder to determine, based on other evidence, that a fact exists.

Here, because the district court concluded that FTB's destruction of the evidence was negligent, the lesser adverse inference was applicable, and the burden did not shift to FTB. However, FTB should have been allowed to rebut the adverse evidence by explaining the steps it took to preserve the relevant emails and thus demonstrate that the destroyed information was not harmful to FTB. Therefore, the district court abused its discretion in excluding the evidence and the court reversed the ruling.

### *Other evidentiary errors*

FTB also challenged the district court's exclusion of evidence regarding Hyatt's audit by the IRS and the loss of his patent through a legal challenge to the validity of the patent, both of which occurred during the period for which Hyatt claimed intentional infliction of emotional distress. Hyatt asserts that the district court's exclusion was proper as the evidence was more prejudicial than probative.

The Court concluded that the information excluded was not unfairly prejudicial, and the probative value as to the IIED claim outweighed the prejudicial value. Therefore, the district court abused its discretion in excluding this evidence.

### *Evidentiary and jury instruction errors do not warrant reversal*

After determining that the district court abused its discretion in the aforementioned evidentiary and jury instructions, the Court turned to whether the errors warranted reversal and remand on the IIED claim.

Based on the newly-implemented sliding-scale approach, the Court concluded that FTB failed to show that but for the trial errors, a different result could have been reached as to liability. The evidence supported a damages award up to the \$50,000 damages cap. The award was reversed with instructions for the district court to enter a damages award for Hyatt's IIED claim in the amount of \$50,000. This amount was the maximum allowed by law, and Hyatt was therefore not entitled to prejudgment interest.

On the question of punitive damages, the district court allowed the issue to go to the jury who found in favor of Hyatt, awarding him \$250 million. Punitive damages are intended to punish a defendant's wrongful conduct, but are not allowed in Nevada against government entities unless expressly authorized by statute. FTB argued that it is entitled to immunity from punitive damages because of comity principles, while Hyatt maintained that punitive damages are allowable against an out-of-state government entity because Nevada has a statute allowing such damages.

Under comity principles, the court extended FTB the protections of California immunity to the same degree it would provide immunity to Nevada government entity. Therefore, FTB was immune from punitive damages and this portion of the district court's judgment was reversed.

### *Costs*

After reversing judgments on several of Hyatt's tort causes of action, the district court's cost awards were also reversed. The costs issue was remanded for determination which party prevailed and as to the proper amount of costs to award.

FTB also challenged the procedure used by the district court in awarding costs. After trial, Hyatt moved for costs and the district court assigned the issue to a special master who issued a recommendation of a \$2.5 million costs award after fifteen months of discovery. FTB argued that Hyatt was improperly allowed to submit documentation regarding his costs after the deadline. The court held that the five-day time limit under NRS 18.110<sup>38</sup> is not jurisdictional because the statute allows for "such further time as the court or judge may grant" to submit the costs documentation.<sup>39</sup> Thus, the Court rejected FTB's assertion that Hyatt was improperly allowed to submit his costs memorandum.

FTB also challenged the district court's refusal to allow FTB to file an objection to the special master's recommendation. The district court used NRCP 53(e)(3)<sup>40</sup> to determine that no challenge to the recommendation was permitted because there was a jury trial. However, although there was a jury trial, the costs issue was not placed before a jury and therefore NRCP 53(e)(2)<sup>41</sup> applied. Thus, the district court erred in refusing to allow FTB to file an objection.

The issue was remanded to the district court to determine whether Hyatt is still entitled to costs. If so, the district court must allow FTB to file an objection to the report prior to entering a cost award.

### *Hyatt's cross-appeal*

The final issue concerned Hyatt's cross-appeal challenging the district court's summary judgment ruling preventing him from seeking economic damages as part of his recovery for the intentional tort claims.

Hyatt argued that FTB sent letters to two Japanese companies with whom Hyatt had patent-licensing agreements which then alerted the businesses to the audits. Hyatt theorized that this disclosure caused millions of dollars in potential licensing revenue because the Japanese market ceased to do further business with him. The district court granted FTB's motion for summary judgment precluding Hyatt from seeking economic loss damages, agreeing that Hyatt lacked sufficient evidence to present to the jury.

Hyatt wished to set forth a chain of events, established only by circumstantial evidence. However, Hyatt offered only inferences to support each step, rather than evidence proving each step in the chain

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<sup>38</sup> Nev. Rev. Stat. § 18.110 (1977).

<sup>39</sup> *Eberle v. State ex rel. Nell J. Redfield Trust*, 108 Nev. 587, 590, 836 P.2d 67, 69 (1992).

<sup>40</sup> Nev. R. Civ. P. 53(e)(3).

<sup>41</sup> Nev. R. Civ. P. 53(e)(2).

occurred. Because Hyatt did not properly support his claim for economic damages with circumstantial evidence, summary judgment was proper, and the district court's decision was affirmed.

### **Conclusion**

While discretionary-function immunity does not apply to intentional torts, FTB was entitled to judgment as a matter of law on all Hyatt's causes of action except for fraud and IIED. Evidence supported a judgment of \$50,000 on Hyatt's IIED claim, but he cannot recover for prejudgment interest as it would exceed the statutory cap. Hyatt also was precluded from recovering for punitive damages. The district court's judgement was affirmed in part and reversed in part. The cost awards were reversed and remanded for a new determination of attorney's fees and costs. The district court's prior summary judgement on Hyatt's cross-appeal was also affirmed.