

COURTS: NEVADA SUPREME COURT HEARS ORAL ARGUMENTS IN FRANCHISE TAX BOARD'S APPEAL OF HYATT CASE

The Nevada Supreme Court heard oral arguments May 7 in the Franchise Tax Board's appeal of a Nevada jury's decision to award inventor Gilbert Hyatt \$396 million in damages because of the misconduct of FTB auditors during a residency audit in the mid-1990s.

On May 11, the court issued an order scheduling additional oral argument for June 18. "This court has determined that additional oral argument would assist in the resolution of this matter," the order stated.



While the justices peppered both sides' attorneys with questions during this month's hour-long arguments, the nature of the questions did not reveal any hint of how the court will rule when a decision is handed down later this year.

Patricia Lundvall, a private attorney representing the FTB, said in her opening statement that if this \$490 million (with interest) judgment was against the Nevada Department of Revenue instead of the California tax agency, the court would reverse it "in a heartbeat." Comity between the states dictates that the FTB is "not to be treated worse than a Nevada agency," she said.

Ms. Lundvall argued that the FTB has the right to gather evidence in a residency case, and cannot be sued for discretionary choices made during audits. Questioned by Justice Michael Douglas about how this position squares with the jury's ruling that FTB employees engaged in fraud and acted in bad faith, Ms. Lundvall responded that "the FTB used its judgment" in gathering and weighing evidence.

She also argued that a court cannot award punitive damages against a government agency. Justice James Hardesty asked whether this would extend to a police officer who beats a person for no reason, and Ms. Lundvall said the situation would be different, because the beating would be against the law and would not be discretionary.

In other comments, Ms. Lundvall said California residency requirements are very broad, and that the authority to define residency and to determine the methods of investigating residency have been delegated to the FTB by the Legislature. She said 42 FTB employees were involved in the Hyatt residency investigation and protest.

Peter Bernhard, representing Mr. Hyatt, noted that the Nevada Constitution states that "Government is instituted for the protection, security and benefit of the people," and said the state has a duty to protect its citizens. The only recourse a Nevada resident has against other states is in court, he said, as Nevadans cannot vote in other states to make changes in their legislative or executive branches.

If Nevada gives up its sovereignty and accepts the FTB's argument that Nevada residents can't sue for mistreatment at the hands of out-of-state government agents, he said, the message to all the other states will be: "Nevada citizens are fair game."

Mr. Bernhard said Mr. Hyatt's privacy was violated, and confidential information was sent to Japanese corporations with whom he was doing business, causing his licensing income from those companies to dry up. The attorney added that when the FTB was seeking evidence to support its claim regarding when Mr. Hyatt moved, the agency obtained an affidavit from his ex-wife, from whom he had been divorced for 18 years, but did not interview his son, who helped him move.

The attorney noted that during a four-month trial, jurors heard extensive testimony on these issues and others – including testimony that FTB auditors were instructed to use fraud penalties as bargaining chips, and that an FTB auditor made statements indicating she was going after Mr. Hyatt because he is Jewish – and ruled that the FTB employees committed intentional torts, not simple acts of negligence. "The jury has spoken," he said.

Justice Mark Gibbons said it sounded as if the auditor "had a vendetta" against Mr. Hyatt, but Ms. Lundvall downplayed the auditor's comment that she was "going to get that Jew bastard," saying it was presented to the jury "pretty much for its shock value."

Mr. Bernhard said the FTB is not repentant for the fact that it did wrong, and added that the agency is arguing that it had – and still has – the authority to do everything it did to Mr. Hyatt.

In a discussion of how the FTB tries to keep its actions against taxpayers secret, Mr. Bernhard said the agency's manuals instruct auditors not to contact the Washoe County assessor during residency audits in the Reno area, because the assessor would advise taxpayers of the contact.

The court, meeting in Carson City, was comprised of six justices rather than the usual seven, as Justice Nancy Saitta voluntarily recused herself (because she sat in district court proceedings in the case) and was not replaced.

This case has taken a long and winding road through the court system. Mr. Hyatt sued the FTB in 1998, and the FTB argued that it was immune from suits for intentional torts, which led to five years of litigation over whether the suit could be filed. In 2003, the U.S. Supreme Court unanimously upheld the Nevada Supreme Court's ruling that Mr. Hyatt could proceed with his action in Nevada, and in late 2008 the jury reached its verdict in his favor. The FTB then appealed.

At the same time, the FTB continues to seek income taxes from Mr. Hyatt based on the results of the auditors' work. Mr. Hyatt has appealed the FTB's tax determination to the Board of Equalization, but the BOE has not yet heard the appeal.

Ms. Lundvall, of the Las Vegas-based law firm of McDonald Carano Wilson LLP, represented the FTB during the jury trial, and has been handling the agency's appeal of that loss. Mr. Bernhard is from the law firm of Kaempfer Crowell Renshaw Gronauer & Fiorentino.