

Business Law

REPORTER

Volume 30 / Number 1

July 2008

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HIGHLIGHTS

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James E. Topinka	
The lesson of <i>Azure, Ltd. v I-Flow Corp.</i> is that when a corporation transfers shares to the State of California under the Unclaimed Property Law, the corporation will be protected only if it strictly complies with the law's requirements.	
In <i>Postal Instant Press v Kaswa Corp.</i> , the court of appeal rejected the so-called third party reverse piercing theory, a variation on the traditional alter ego doctrine.	
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After reviewing comments received, and in light of continuing actions by federal regulators, the Commissioner has withdrawn proposed hedge fund regulation changes.	
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In <i>Department of Revenue v Davis</i> , the U.S. Supreme Court upheld a state income tax exemption for local bonds. Did political reality trump tax theory?	
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Robert M. Cassel	
Mr. Cassel's column this issue deals with two situations not commonly encountered in California employment law decisions: <i>Caso v Nimrod Productions, Inc.</i> deals with the special employment relationship that arises with "loaned" employees, and <i>McCarther v Pacific Telesis Group</i> considers the "kin care" protections of Labor Code §§233-234.	
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William J. "Zak" Taylor	
Mr. Taylor's column discusses two recent antitrust decisions by the Ninth Circuit dealing with the issue of standing: <i>Delaware Valley Surgical Supply, Inc. v Johnson & Johnson</i> and <i>Gerlinger v Amazon.com, Inc.</i>	
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<i>Statutory Development:</i> California has acted rapidly to conform its franchise sales law to the amended FTC Franchise Rule.	
<i>Case Law Development:</i> Although the victor in <i>Gueyffier v Ann Summers, Ltd.</i> was the franchisee, the California Supreme Court's holding will primarily benefit franchisors.	

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Constitution requires that taxpayers first pay any taxes assessed before any claim may be heard. Cal Const art XIII, §32. The court further held that the taxpayer could not invoke the collateral estoppel doctrine under the common law and CCP §1908 to maintain its action because the constitutional provision took precedence over the collateral estoppel doctrine. The court then dismissed the suit with prejudice.

The appellate court affirmed, holding that the California Constitution is the supreme law of the state and that the doctrine of collateral estoppel could not take precedence over §32 to require courts to provide relief specifically prohibited by the constitution. Thus, the constitutional requirement that a taxpayer first pay any assessed taxes before an objection may be heard takes precedence over a business's contention that the state was estopped by earlier determinations (that the drivers were not employees, but rather independent contractors) from claiming to the contrary. The court explained that civil litigants do not have an absolute right to the application of the collateral estoppel doctrine; the legislature may limit the doctrine for public policy purposes. See Cal Const art III, §1. The court opined that if the legislature is empowered to limit the doctrine, then a constitutional provision can certainly do so. The case of *Calfarm Ins. Co. v Deukmejian* (1989) 48 C3d 805, 258 CR 161, established the breadth of §32's proscription against prepayment review, holding that even a suit seeking to invalidate a tax statute as unconstitutional does not justify an exception. Thus, even if the collateral estoppel doctrine were rooted in the constitution, it would not justify this exception. Although §32's ban on prepayment judicial review must yield to the requirements of the federal Constitution, this exception is extremely narrow and does not encompass claims based on the state constitution alone. The appellate court expressly did not decide whether §32 deprives courts of subject matter jurisdiction or whether it simply deprives courts of jurisdiction to award certain types of relief.

Finally, the appellate court held that taxpayers have no federal due process right to judicial review of a tax liability before payment. See *Modern Barber Colleges, Inc. v California Employment Stabilization Comm'n* (1948) 31 C2d 720, 725, 732, 192 P2d 916. The court rejected the plaintiff's argument that the "pay first, litigate later" rule violated its federal constitutional right to due process by effectively depriving it of an opportunity for judicial review, because the plaintiff relied on the earlier adjudications in conducting its business and could not afford to pay the assessment to proceed with its challenge. The court emphasized the importance of prompt payment of taxes to the public welfare. Thus, the idea that every taxpayer is entitled to the delays of litigation is unreasonable.

Federal Taxation

Marilyn Barrett

Income

U.S. Supreme Court upholds state income tax exemption for local bonds.

Department of Revenue v Davis (2008) ___ US ___, 170 L Ed 2d 685, 128 S Ct 1801

In this decision, issued May 19, 2008, the U.S. Supreme Court considered whether the State of Kentucky is allowed to exempt interest on bonds issued by it or its political subdivisions from Kentucky state income tax, even though interest on out-of-state municipal bonds is not exempt.

The case explores the application of the so-called dormant commerce clause—a legal doctrine that the U.S. Supreme Court has inferred from the commerce clause—to such state tax exemptions. The commerce clause expressly grants Congress the power to enact legislation that affects interstate commerce. The dormant commerce clause prohibits a state from passing legislation that improperly burdens or discriminates against interstate commerce. The premise of the doctrine is that the U.S. Constitution reserves for the U.S. Congress some degree of exclusive power “to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.” US Const art I, §8, cl 3.

Petitioners George and Catherine Davis were Kentucky residents who paid state income tax on interest from out-of-state municipal bonds. They sued the Kentucky Department of Revenue on a refund claim, asserting that Kentucky's differential taxation of municipal bond income impermissibly discriminated against interstate commerce in violation of the commerce clause. The trial court held in favor of the government, relying in part on the “market-participation” exception to the dormant commerce clause. The “market participation” exception applies when the state is acting in the market like a business or customer, rather than as a market regulator. For example, when a state is contracting for the construction of a building or selling maps to state parks, rather than passing laws governing such construction or dictating the price of state park maps, it is acting in the market. Like any other business in such cases, a state may favor or shun certain customers or suppliers.

The court of appeals reversed the trial court, ruling that Kentucky's differential tax scheme did indeed run afoul of the commerce clause.

Justice Souter delivered the Court's opinion in a 7–2 decision. The Court looked to its recent decision in *United Haulers Ass'n v Oneida-Herkimer Solid Waste Mgt. Auth.* (2007) ___ US ___, 167 L Ed 2d 655, 127 S Ct 1786, as its basis for reversing the court of appeals decision and upholding Kentucky's differential tax