

Daily Journal

www.dailyjournal.com

THURSDAY, NOVEMBER 13, 2014

PERSPECTIVE

A state's regulatory wingspan

By Donald M. Falk

Few, if any, states regulate the conduct of their citizens and businesses more comprehensively than California. Compliance with thousands of pages of legislation spread across 29 separate codes is a fact of life for those who live or operate here. But can California legislate the standards for conduct in other states? And if so, when and for whom? These are recurring issues for state and federal courts applying California statutes.

Under traditional concepts of sovereignty, legislative power stopped at the sovereign's borders. California could no more regulate conduct in Ohio than the United States could dictate India's legal standards. As recently as 2003, the U.S. Supreme Court described the prospect of allowing state statutes "to operate beyond the jurisdiction of that State" as "throwing down the constitutional barriers by which all the States are restricted within the orbits of their lawful authority and upon the preservation of which the Government under the Constitution depends." *State Farm Mut. Auto Ins. Co. v. Campbell*, 538 U.S. 408, 421, 422 (2003).

But the precise standards and limits of extraterritorial power are far from clear. The Supreme Court has provided indistinct guidance. The decision in *Healy v. Beer Institute Inc.*, 491 U.S. 324 (1989), clarified that a state could not regulate prices charged in other states (there, by requiring sellers to affirm that the in-state prices were no higher than the lowest prices charged in a neighboring state). The court upheld a state law requiring drug manufacturers to negotiate rebates for in-state sales even though the need to provide those rebates might affect out-of-state transactions between manufactur-

ers and distributors who sold into the state. See *Pharmaceutical Research & Mfrs. of Am. v. Walsh*, 538 U.S. 644 (2003).

The California Supreme Court

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had no difficulty applying California's telephone privacy laws — which, unlike most such laws, prohibit recording certain telephone conversations unless both parties consent — to telephone call centers anywhere in the U.S. that accept calls placed from California. See *Kearney v. Salomon Smith Barney*, 39 Cal. 4th 95 (2006). By calling an out-of-state number, a Californian extended California's legal standards to whomever picked up the phone at the other end.

In *Sullivan v. Oracle Corp.*, 51 Cal. 4th 1191 (2011), the same court reaffirmed territorial limits. California wage and hour laws applied to nonresident employees for work performed in California, and those violations could be redressed through the California Unfair Competition Law. But nonresidents could not use the UCL to get restitution based on alleged violations of federal wage and hour laws for work performed outside California. Two recent federal district court cases addressing claims by drivers for the Uber and Lyft services similarly declined to allow out-of-state drivers to sue under the California Labor Code or the UCL. See *O'Connor v. Uber Techs. Inc.*, 2014 WL 4382880 (N.D. Cal. Sept. 4,

2014); *Cotter v. Lyft Inc.*, 2014 WL 3884416 (N.D. Cal. Aug. 7, 2014).

Now the 9th U.S. Circuit Court of Appeals is going en banc — at the sua sponte urging of a panel that heard argument but did not render a decision — to decide whether the California Resale Royalty Act, which requires payment to the artist of 5 percent of the resale price of his or her artwork, may apply to sales of art taking place outside California if the seller resides in California. When several out-of-state artists sued New York auction houses seeking CRRA payments, the Central District of California held that the statute violated the commerce clause of the U.S. Constitution because it regulated an out-of-state transaction between an out-of-state auction house and an out-of-state buyer for the benefit of an out-of-state artist. An en banc panel of the 9th Circuit now will decide whether the statute may be constitutionally applied to transactions where the only nexus with California is the residence of the seller. See *Sam Francis Found. v. Christie's Inc.*, 2014 WL 5486475 (Oct. 30, 2014).

Kearney applied California law to the defendant's out-of-state conduct only with regard to California residents, not residents of other states. The plaintiffs in *Sam Francis* seek to extend California law to an out-of-state party's out-of-state transaction with out-of-state residents — but only when the out-of-state seller is the agent for a California owner. Arguably, the CRRA merely imposes a 5 percent tax on the sale of certain artworks by California residents, while requiring the payment to be made by the sellers' out-of-state agents.

Under one aggressive reading of *Healy* and *Walsh*, a state can regulate all aspects of the extraterritorial conduct if it does not directly

affect out-of-state prices. The only limit on state regulations of out-of-state conduct is the one recognized in *Healy*. This position seems fragile. A state cannot directly regulate nonprice conduct beyond its borders just as surely as it lacks the power to dictate prices charged in other jurisdictions. That does not mean that a state lacks the power to impose regulations that may indirectly alter the nonprice conduct of out-of-state actors. California cannot set manufacturing standards for Michigan, but it may require that products sold in California reflect certain processes or meet certain standards even if made in Michigan. A Michigan manufacturer may change its conduct to sell into California.

The CRRA also raises interesting questions as California's legitimate state interests in projecting its standards beyond its borders. Many, if not most, beneficiary artists are not California residents. The asserted state interest penalizes resident art owners while requiring income transfers to out-of-state private parties (unless the artists cannot be found, in which case the California Arts Commission gets the money).

However it is decided — and it will be argued Dec. 15 — the *Sam Francis* Foundation case is likely to deepen rather than resolve the debate over how far one state's laws may extend into other states.

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