Case No. S241471

IN THE SUPREME COURT OF CALIFORNIA

Michael McClain, Avi Feigenblatt
and Gregory Fisher,
Plaintiffs, Appellants and Petitioners,

vs.

Sav-On Drugs, et al.,
Defendants and Respondents.

PETITIONERS' OPENING BRIEF ON THE MERITS

After a Decision of the Court of Appeal
Second Appellate District, Division 2
Case Nos. B265011 and B265029
Affirming a Judgment Of Dismissal Following
An Order Sustaining Demurrer Without Leave to Amend
Los Angeles County Superior Court, Case Nos. BC325272 and BC327216
Honorable John Shepard Wiley

Service on the Attorney General and the Los Angeles District Attorney
Required by Bus. & Prof. Code § 17209 and
Cal. Rules of Court, Rule 8.29(a), (b), and (c)(1)

---

*Taras Kick (SBN 143379)
Robert J. Dart (SBN 264060)
THE KICK LAW FIRM, APC
201 Wilshire Blvd
Santa Monica, CA 90401
Telephone: (310) 395 2988
Facsimile: (310) 395 2088
Email: taras@kicklawfirm.com

*Bruce R. Macleod (SBN 57674)
Shawna L. Ballard (SBN 155188)
MCKOOL SMITH HENNIGAN P.C.
255 Shoreline Drive, Suite 510
Redwood Shores, California 94065
Telephone: (650)394-1386
Facsimile: (650) 394-1422
Email: bmacleod@mckoolsmith.com

Attorneys for Plaintiffs and Petitioners
Michael McClain, Avi Feigenblatt and Gregory Fisher

Case No. S241471

IN THE SUPREME COURT OF CALIFORNIA

Michael McClain, Avi Feigenblatt
and Gregory Fisher,
Plaintiffs, Appellants and Petitioners,
vs.
Sav-On Drugs, et al.,
Defendants and Respondents.

PETITIONERS' OPENING BRIEF ON THE MERITS

After a Decision of the Court of Appeal
Second Appellate District, Division 2
Case Nos. B265011 and B265029
Affirming a Judgment Of Dismissal Following
An Order Sustaining Demurrer Without Leave to Amend
Los Angeles County Superior Court, Case Nos. BC325272 and BC327216
Honorable John Shepard Wiley

Service on the Attorney General and the Los Angeles District Attorney
Required by Bus. & Prof. Code § 17209 and
Cal. Rules of Court, Rule 8.29(a), (b), and (c)(1)

---

*Taras Kick (SBN 143379)
Robert J. Dart (SBN 264060)
THE KICK LAW FIRM, APC
201 Wilshire Blvd
Santa Monica, CA 90401
Telephone: (310) 395 2988
Facsimile: (310) 395 2088
Email: taras@kicklawfirm.com

*Bruce R. Macleod (SBN 57674)
Shawna L. Ballard (SBN 155188)
MCKOOL SMITH HENNIGAN P.C.
255 Shoreline Drive, Suite 510
Redwood Shores, California 94065
Telephone: (650)394-1386
Facsimile: (650) 394-1422
Email: bmacleod@mckoolsmith.com

Attorneys for Plaintiffs and Petitioners
Michael McClain, Avi Feigenblatt and Gregory Fisher

Table Of Contents

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

I. ISSUES PRESENTED

1. Does the Court of Appeal's opinion *de facto* overrule this Court's opinions in *Loeffler v. Target Corp.* (2014) 58 Cal.4th 108 ("*Loeffler*") and *Javor v. State Board of Equalization* (1974) 12 Cal.3d 790 ("*Javor*") by creating prerequisites to pursuing a *Javor* remedy which are by definition impossible to fulfill, not only for the three million California diabetics in this action, but for all California consumers regarding any sales tax issue?

2. In rewriting the presumption in California Civil Code §1656.1 from "rebuttable" to "irrebuttable," does the Court of Appeal cause California's sales tax scheme to violate this Court's direct holding in *National Ice & Cold Storage Co. v. Pacific Fruit Express Co.* (1938) 11 Cal.2d 283 ("*National Ice*"), and by escheating money with no recourse, to violate the U.S. Constitution's Due Process and Takings Clauses?

Fairly included within the above constitutional issues is whether the issues can be resolved on statutory or other narrower grounds. (*Loeffler* at 1102-1103 ["Our jurisprudence directs that we avoid resolving constitutional questions if the issue may be resolved on narrower grounds . . . that . . .'eliminates doubts as to the statute's constitutionality.'"]. (Citations omitted.)

II. INTRODUCTION.

These two lawsuits[1] were brought on behalf of millions of California diabetics who use blood glucose test strips and skin puncture lancets to monitor their blood sugar levels to determine when they need to use insulin. While California law exempts these medically essential products from taxation, Respondent retailers have nonetheless collected "sales tax

[1] Separate lawsuits were brought for test strips and lancets, resulting in separate appeals. Briefing was consolidated in the courts below as well as here.

reimbursement" from customers on almost every sale and remitted the proceeds to Respondent California State Board of Equalization ("SBE"). The SBE has refused to even consider refunding the wrongfully collected sums, resulting in the State being unjustly enriched by tens of millions of dollars.

The trial court sustained demurrers to Petitioners' operative Fourth Amended Complaint without leave to amend and the Second District Court of Appeal affirmed. (*McClain v. Sav-On Drugs* (2017) 9 Cal. App. 5th 684.) ("*McClain*"). The *McClain* Court *correctly* held that "the chief issue in this appeal is not the merits, but where and by whom they may be litigated." (*Id.* at 702.) However, the *McClain* Court *incorrectly* held that customers who are charged sales tax reimbursement on tax-exempt sales have no standing to recover the improper charges: not against the retailers who overcharged them and not against the State which is unjustly enriched.

The *McClain* Court apparently believed that this result was preordained by this Court's decision in *Loeffler*.[2] However, *Loeffler* did not involve the two causes of action at issue in this appeal. Petitioners' First Cause of Action alleges that the retailers breached the express or implied contractual agreement with their customers for the collection of sales tax

---

[2] *See McClain* at 704:

> Further, our Supreme Court in *Loeffler* —although silent on this point — noted no constitutional impediment to its ruling that left consumers with no direct remedy for a refund and instead relegated them to urging Board inquiry and to filing claims or actions under the Administrative Procedure Act. (*Loeffler, supra*, 58 Cal.4th 1081.) Were we to come to a contrary conclusion, we would effectively overrule *Loeffler*, something we are not allowed to do except in narrow circumstances not present here.

(Emphasis added.)

reimbursement (such an agreement being required by Civil Code §1656.1). Petitioner's Fifth Cause of Action alleges that Petitioners are entitled to the equitable remedy devised by this Court in *Javor*. Under that decision, each of the Respondent retailers would be compelled by the Superior Court to file refund claims with the SBE, and the SBE would be compelled to pay such amounts into court for distribution to the class members.

Neither of those causes of action was alleged in *Loeffler*, and indeed, the SBE was not even named as a party in *Loeffler*. Nevertheless, this Court went out of its way in *Loeffler* to confirm the continued utility of the *Javor* remedy. (*See Loeffler* at 1133 ["The integrity of the tax system and avoidance of unjust enrichment, possibly of the retailer, but more probably of the state, in certain circumstances may support a *Javor*-type remedy for consumers."].). Moreover, Justice Liu, writing for the three dissenters in *Loeffler*, warned courts to not overread *Loeffler* as precluding all consumer cases involving a sales tax issue: (*Id.* at 1142 ["The court's ruling...need not be read to broadly establish that a consumer action may never go forward if it involves a tax issue."].)

The *McClain* opinion is the first appellate decision interpreting *Javor* since this Court's decision in *Loeffler*. Despite *Loeffler's* affirmation of the *Javor* remedy and Justice Liu's warning, the *McClain* Court read *Loeffler* so broadly as to abolish all legal recourse for consumers who are charged excess sales tax reimbursement on tax-exempt sales. (*See* n.2, *supra.*) Specifically, two holdings of the *McClain* opinion extended this Court's decision in *Loeffler* to mean:

(Holding 1) that customers — who statutorily cannot file refund claims themselves — also cannot bring an action in the Superior Court to compel a retailer to file a refund claim with the SBE, notwithstanding that this Court approved such a remedy for the State's unjust enrichment in *Javor* (*McClain* at 700-701), and

(Holding 2) that two Tax Code provisions (§6905 and §6901.5) create a "safe harbor" that insulates a retailer from liability for any breach of Civil Code §1656.1's requirement of an express or implied agreement between retailer and customer regarding "whether a retailer may add sales tax reimbursement to the sales price." (*McClain* at 701-702.)

The *McClain* Court reached its first holding by interpreting supposed "prerequisites" for the *Javor* remedy in a manner that no case, not even *Javor* itself, could possibly satisfy, making the *Javor* remedy definitionally impossible. The *McClain* Court's decision therefore amounts to a *de facto* overruling of this Court's opinions in both *Javor* and *Loeffler* (insofar as *Loeffler* affirmed the continued utility of the *Javor* remedy at 1133). Moreover, although the *Javor* remedy has rarely been employed, for 43 years it has served a vital purpose of protecting California's sales tax reimbursement scheme from unconstitutionality. By effectively abolishing the *Javor* remedy and leaving customers with no recourse, the *McClain* Court renders California's sales tax reimbursement scheme unconstitutional under the Due Process and Takings Clauses of the U.S. Constitution.

The *McClain* Court's second holding effectively re-writes Civil Code §1656.1's rebuttable presumption – of consumer consent to the addition of "sales tax reimbursement to the sales price" — into its opposite, an *ir*rebuttable presumption. That is contrary to at least three of this Court's decisions: *Javor*, *Loeffler,* and *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal. 4th 163 ("*Cel-Tech*"). It also destroys the consensual constitutional basis for sales tax reimbursement recognized by this Court in *National Ice*. *McClain* thereby creates a constitutional crisis for the sales tax reimbursement system that has been the foundation of California's sales tax since its inception 84 years ago.

This Court should therefore reverse *McClain* by reinstating Petitioners' First and Fifth Causes of Action and by ordering that Petitioners be granted leave to amend to state a cause of action for "just compensation" under the Takings Clause of the U.S. Constitution.

III. THE PROCEEDINGS BELOW

A. Relief Sought In The Trial Court.

Petitioners have limited their appeal to the trial court's dismissal on demurrer of two of their seven causes of action:

(1) Petitioners' Fifth Cause of Action for a *Javor* remedy against all defendants. This cause of action seeks to compel each defendant retailer to file refund claims with the SBE for all amounts that it remitted to the SBE on the sale of glucose test trips and lancets, and to compel the SBE to pay such amounts into court for distribution to the class members. (AA 083-085)

(2) Petitioners First Cause of Action against the retailer defendants for breach of the contractual agreement required by Civil Code §1656.1 in order for a retailer to collect sales tax reimbursement. This cause of action seeks equitable relief and damages from each defendant retailer for collecting sales tax reimbursement on tax-exempt sales of test strips and lancets in breach of its contractual agreement (required by Civil Code §1656.1), including the implied covenant of good faith and fair dealing. (AA 077-078.) Petitioners do not seek to enjoin the collection of any sales tax.

In addition, Petitioners appeal the trial court's denial of their request for leave to amend to allege a constitutional Takings Clause claim against the SBE for "just compensation." (AA 622; RT 643:19-644:3; AOB 59-62.)

B. The Judgment Appealed From.

At the beginning of the 2/24/2015 demurrer hearing, the trial court announced a tentative basis for sustaining the demurrers:

> It's very hotly in dispute, this taxability of the two items in question, strips and lancets.
>
> ****
>
> This case is more like *Loeffler* than *Javor*. So *Loeffler* governs across the board for all causes of action for the reasons the moving parties state.
>
> I agree with Mr. Berry's reply ... that, "The binding Supreme Court decisions in *Loeffler* and *Javor* fully [dispose] of all of Plaintiffs' claims."
>
> ... I also completely agree with this sentence [by retailer defendants]: "What made *Javor* unique is, unlike *Loeffler* or the case at Bar, the SBE has already made its taxability determination using its own statutory procedures." So the Court's forced refund order could not interfere with the exclusive powers of the SBE to rule on tax questions.

(RT 605:1-26.)

At the end of the hearing, the trial court confirmed its tentative ruling. (RT 646:6.) It also denied Petitioners' request for leave to amend to add a constitutional claim for "just compensation" under the Takings Clause. (RT 646:7-10.) The trial court did not issue a written opinion.

On 4/15/2015 the trial court entered final judgment of dismissal without leave to amend. (AA 613.) On 6/11/2015 Petitioners' filed timely Notices of Appeal. (AA 619, 621.)

IV. LEGAL AND FACTUAL BACKGROUND.

A. The Statutory Origins Of California Sales Tax And Sales Tax Reimbursement.

The basic structure of California's retail sales tax has always been dogged by constitutional concerns arising from the Legislature's initial decision[3] in 1933 to impose the sales tax on retailers rather than purchasers (as many other states have done[4]). If California had imposed the sales tax on purchasers and tasked retailers with the responsibility of collecting the tax and remitting the proceeds to the SBE, the collection and payment of sales tax would have been much the same as it is now but with one major difference—purchasers would be called "taxpayers" with standing to directly file and prosecute tax refund claims against the SBE. This would be consistent with Code of Civil Procedure ("C.C.P.") §367's public policy favoring real-parties-in-interest. ("Every action must be prosecuted in the name of the real party in interest, except as otherwise provided by statute").

But there was a countervailing consideration. Prior to enactment of the Retail Sales Tax Act of 1933 ("1933 Act"), all banks located in California — both state and nationally chartered — were subject to a franchise tax based upon annual net income *that was in lieu of all other taxes* except those upon real property. (Former Cal. Const. Art. XIII, §16, adopted 11/6/1928.)[5] Likewise, insurance companies doing business in

---

[3] "[I]t would have been within the power of the legislature to have imposed a tax upon either the retailer or the purchaser...." (*National Ice & Cold Storage Co. v. Pacific Fruit Express Co.* (1938) 11 Cal.2d 283, 290 ("*National Ice*").)

[4] *See, e.g. Washington Rev. Code.* (ARCW) § 82.08.050; *Utah Code Ann,.* § 59-12-103; *Utah Administrative Code*, R865-19S-2.

[5] "California adopted the in lieu tax on net income and made it applicable to all banks located within the state because tax-rate parity between national

California were subject to an annual tax on gross premiums that was in lieu of all other taxes. (Former Cal. Const. Art. XIII, §14, as amended 11/2/1926). Additionally, the State was precluded from directly taxing the federal government and certain of its agencies by *McCulloch v. Maryland* (1819) 17 U.S. 316 ("*McCulloch*") and its progeny. A retail sale to any of those entities would be exempt from a sales tax levied on the purchaser, but might be subject to a tax levied on the non-exempt retailer.

Accordingly, in order to maximize sales tax collections, "[w]hen the Legislature enacted the California Retail Sales Tax Act, it intended that the incidence of the tax be on the retailer, not upon the consumer." (*See* AA 410 [" One of the primary reasons for drafting the sales tax law as a tax on the retailer rather than the consumer was to provide for uniform application of tax to sales of all consumers, including those consumers who would be exempt were the tax imposed directly on the consumer. These consumers include certain agencies of the federal government and national banks, exempt under federal law, and state banks and insurance companies exempt under state law." (Emphasis added.)].

The Legislature therefore levied the sales tax on retailers "for the privilege of selling tangible personal property." (1933 Act, §3, currently Tax Code §6051.) However, the 1933 Act also provided that, "The tax hereby imposed shall be collected by the retailer from the consumer in so far as the same can be done..." (1933 Act, §8 ½, codified as former Tax

---

and state banking institutions was a prerequisite for any tax upon national banks." *Hibernia Bank v. State Bd. of Equalization* (1985) 166 Cal. App. 3d 393, 398. The prerequisite was created by former U.S. Rev. Stat. §5219 as amended on March 25, 1926, which "required that any such tax comply with certain conditions, principally designed to prohibit discrimination against national banks." (*American Bank and Trust Company v. Dallas County* (1983) 463 U.S. 855, 861 at n.3.")

Code §6052.) This provision was the origin of California's sales tax reimbursement scheme.

B. The Differences Between Sales Tax And Sales Tax Reimbursement

Sales tax *reimbursement* is quite different than sales *tax*. Retailers must file sales tax returns and pay sales tax on their gross taxable sales, generally quarterly for the preceding quarter (Tax Code §§6451–6459), regardless of whether they were reimbursed by customers for the tax liability at the point of sale.

Sales tax reimbursement, on the other hand, is a private contractual payment by the customer that "depends solely upon the terms of the agreement of sale." (Civil Code §1656.1.) Sales tax reimbursement is typically collected by the retailer from the customer at the point of sale, but that is *not* legally required as the retailer may absorb the tax instead. (*Loeffler* at 1117.) When the retailer collects more sales tax reimbursement on a transaction than is owed by the retailer on that transaction, the difference is referred to as "excess sales tax reimbursement." If the sale is legally tax exempt, as is the case with respect to pharmacy sales of test strips and lancets, *any amount* collected as "sales tax reimbursement" is "excess sales tax reimbursement" (Cal. Code Regs., tit. 18, §1700, subd. (b)(1)) and may be returned to the customer by the retailer under Tax Code §6901.5 or by the SBE under Tax Code §6901.[6] This case involves what happens when they neglect or refuse to do so.

---

[6] Tax Code §6901 was amended in 1963 to insert the words "from whom the excess amount was collected or by whom it was paid under this part." That amendment empowered the SBE to return excess sales tax reimbursement directly to customers (the persons "from whom the excess amount was collected") However, the SBE does not acknowledge that power in Reg. §1700, subd. (b)(2). Instead, as here, the SBE retains for the State's coffers all excess sales tax reimbursement remitted by retailers by

C. The Constitutional Basis For Retailers Collecting Sales Tax Reimbursement.

In 1938 this Court was faced with the following question: By what legal principle is it constitutional for the Tax Code to obligate a purchaser to reimburse a retailer for sales taxes that are legally levied upon the retailer alone? This Court answered that question by holding that there is no such legal principle, and that Section 4 of the 1933 Act was unconstitutional for lack of due process:

> [T]o baldly legislate that without, and in the absence of either due or any process of law, a legal debt that is owed by one person must be paid by another, is quite at variance with ordinary notions of that which may be termed the administration of justice. . . [A]ny . . .provision of the statute ... which purports either directly or indirectly to authorize the retailer to collect from or to charge to the purchaser ... the tax imposed upon its retailer ... is unconstitutional and consequently invalid.

(*National Ice* at 291-292, emphasis added.)

However, this Court threw the SBE a lifeline by which it could avoid unconstitutionality in future cases:

> However, such declaration of the law is not intended to indicate the illegality of authority which may be lodged in a retailer to "pass on" the tax to a purchaser with the latter's consent thereto, either expressly or impliedly given. That sort of arrangement between interested parties in such a sale is not here involved.

(*National Ice* at 292, emphasis added.)

Thus, the presence of customer consent "either expressly or impliedly given" became the cornerstone for retailers' right to "pass on" sales taxes to their customers as sales tax reimbursement. In 1978 that

---

never "certify[ing] or"ascertain[ing] under Tax Code §§6901, 6901.5 or Reg. 1700(b)(2) that a retailer has collected excess tax reimbursement.

concept was incorporated into Civil Code §1656.1, which makes that right "depend[] solely upon the terms of the agreement of sale." (*See* p. 13, *infra.*)

Absent customer consent, retailer collection of sales tax reimbursement would be no more constitutional than if the Legislature decreed that buyers of real property must reimburse their seller for capital gains taxes that the seller incurs on the sale. Such shifting of the seller's tax liability to the buyer might be acceptable as a negotiated term of the agreement of sale, but a statute to that effect would be a deprivation of property without due process of law. *See, e.g., Oksner v. Superior Court of Los Angeles County* (1964) 229 Cal. App. 2d 672, 684 ("Due process forbids the seizure of one man's property for satisfaction of the debt of another.")

D. Background on Civil Code §1656.1.

A consensual agreement by customers to pay sales tax reimbursement becomes even more necessary as a result of *Diamond National v. State Equalization Bd.* (1976) 425 U.S. 268 ("*Diamond*"). In a brief *per curiam* opinion, the U.S. Supreme Court reversed the California Court of Appeal on the authority of *First Agricultural Nat'l Bank v. State Tax Commissioner* (1968) 392 U.S. 339, 346-48 ("*First Agricultural*").

In *First Agricultural*, the Court had held unconstitutional Massachusetts' attempt to tax a retailer on sales to a national bank that was tax-exempt under *McCulloch* (except for "in lieu" and other forms of permitted taxation enumerated in former 12 U.S.C. §548). The Court reasoned that the Massachusetts law created a "sales tax which by its terms must be passed on to the purchaser." (*First Agricultural* at 347.) Several provisions of the Massachusetts Act had analogs in California's sales tax law. It is therefore not surprising that the Supreme Court in *Diamond* held

that in California, as in Massachusetts, the incidence of the sales tax was on purchasers, not retailers, notwithstanding that Tax Code §6052 said the opposite. (*See Diamond* at 268 ["We are not bound by the California court's contrary conclusion and hold that the incidence of the state and local sales taxes falls upon the national bank as purchaser and not upon the vendors."].)

The Legislature responded to the potential loss of tax base by enacting 1978 Senate Bill 472 as Stats. 1978, ch. 1211, which attempted to eliminate any implication that California's law created a "sales tax which by its terms must be passed on to the purchaser:"

> When a federal decision found that the California sales tax fell on a bank as a purchaser *(see Diamond)*, the revision was considered necessary. The 1978 enactment clarified that the tax fell on the retailer "by *removing* from the code those provisions of law which have characteristics of laws which impose the *tax upon the consumer.*' . . . . All of these repealed provisions evidently were thought to create a danger that they might support the view that consumers bore the economic burden of the tax and therefore were the actual taxpayers.
>
> In their place, the Legislature added Civil Code section 1656.1, described above, permitting but not requiring the addition of reimbursement charges, designating the charges as a matter for a contractual agreement between seller and buyer, and permitting the retailer to absorb the tax.

(*Loeffler* at 1116-1117, original italics, underscore added.)

Thus, the Legislature's goal in 1978 was to remove the State and the SBE from any role in determining whether a retailer may add sales tax reimbursement to the sales price by making it "a matter for a contractual agreement between seller and buyer." To further disentangle the SBE from sales tax reimbursement, the Legislature put the critical replacement statute in the Civil Code rather than the Tax Code. Thus, Civil Code §1656.1 was

enacted as the only statutory authority for retailers to collect sales tax reimbursement from customers.

The reduction in California's sales tax base as a result of *Diamond* was of great concern for the State and the SBE, so §1656.1 was carefully crafted to achieve a delicate balance between the rights of retailers and the rights of consumers. It begins by stating:

> Whether a retailer may add sales tax reimbursement to the sales price of the tangible personal property sold at retail to a purchaser depends solely upon the terms of the agreement of sale.

(Emphasis added.)

However, §1656.1 then creates a presumption in favor of the existence of an agreement by the customer to pay sales tax reimbursement "if . . .sales tax reimbursement is shown on the sales check or other proof of sale." (*Id.,* Sub. (a)(3).) But in the final adjustment, the last subsection states: "The presumptions created by this section are rebuttable presumptions." (*Id.* Sub. (d).)

Why did the Legislature enact a presumption at all? Why not just say "A retailer may add sales tax reimbursement to the sales price… if… sales tax reimbursement is shown on the sales check or other proof of sale"? The answer is that would result in a "sales tax which by its terms must be passed on to the purchaser," exactly what condemned the sales taxes in *First Agricultural* and *Diamond.* So instead, the Legislature made the presumption in Civil Code §1656.1 "rebuttable" in an attempt to establish that a customers' agreement to pay reimbursement is consensual (and not State imposed as in *First Agricultural* and *Diamond*).

That same logic and rebuttable presumption did double duty by ensuring that the constitutional justification for retailers' ability to "pass on" the sales tax to their customers in the form of sales tax reimbursement

—*i.e.* purchaser agreement "either expressly or impliedly given" as per *National Ice* – would always be deemed consensual rather than State-imposed. But the *McClain* opinion would now make the carefully constructed rebuttable presumption of §1656.1 instead *ir*rebuttable.

E. The Tax Exemption For Pharmacy Sales Of Consumable Supplies Used In Treating Diabetes.

Because of its life-saving importance, insulin has never required a prescription, and therefore never fit within the general California sales tax exemption for *prescription* medicines. Nevertheless, the Legislature amended Tax Code §6369 in 1963 to specifically make insulin "furnished by a registered pharmacist without prescription" exempt from sales tax. (AA 166; Tax Code §6369 (former subsection d)/(current subsection e).)

The following year, the SBE promulgated Annotation 425.0460 to make clear that "Sales of insulin by druggists for treatment of diabetes will be presumed to be furnished upon the direction of a physician so as to fall within the exemption provided by section 6369 in the absence of evidence to the contrary." (AA 169.) That presumption is consistent with the 1963 advice of the SBE to the Governor that "patients using insulin are uniformly under the care of physicians." (AA 166). In that same communication, the SBE advised the Governor of another purpose for the legislation: to "relieve doctors and public agencies of burdensome distinctions which seem to have little basis for existence." (AA 167.)

Tax Code §6369 was amended in 1982 to extend the tax exemption to insulin syringes. (Tax Code § 6369(e).) In advance of each of the 1963 and 1982 amendments, the Legislature estimated that 100% of the sales tax revenues from the product would be lost if the proposed exemption were enacted. (AA 070-71 ¶27(a).) This establishes the Legislature's intent that all pharmacy sales of insulin and insulin syringes would be covered by the

tax exemption, not just a portion of the sales depending upon how the sale was made.

Test strips are medically necessary for diabetics to determine the timing of insulin injections. (AA 278 ["current medical opinion stresses that regardless of treatment, people who have diabetes need to monitor their disease and use of blood glucose monitors is the only method for doing that."].). The cost of test strips is the largest health maintenance expense for diabetic patients. ((*Id.*) ["The major cost to diabetics is for the test strips."].) Therefore, in 1999 the SBE considered whether the 1982 amendment to Tax Code §6369(e) – which extended the tax exemption for insulin to cover insulin syringes —also indicated a legislative intention to make other consumable supplies used in the administration of insulin, namely test strips and lancets, tax exempt.

The SBE went through the same tax loss revenue estimation process as the Legislature had gone through for insulin and insulin syringes. The estimate (dubbed "Alternative 1') showed that the tax revenue loss from the proposed exemption would be 100%. (AA 071 ¶27(b); 282; 284.)

However, the SBE's staff recommended "Alternative 2," which would not have interpreted the tax emption to cover tests strips and lancets, so the tax revenue loss would be 0.0% (AA 282 ["Alternative 2:...The staff recommendation has no revenue effect."].)

Nevertheless, the SBE's publicly elected Board overrode the staff's recommendation, and adopted Alternative 1 as SBE Regulation 1591.1(b)(5) [18 Cal. Code Regs. Tit. 18, §1591.1(b)(5)] effective March 10, 2000, as follows:

> Glucose test strips and skin puncture lancets furnished by a registered pharmacist that are used by a diabetic patient to determine his or her own blood sugar level and the necessity for and amount of insulin and/or other diabetic control medication needed to treat the disease in accordance with a

> physician's instructions are an integral and necessary active part of the use of insulin and insulin syringes or other anti-diabetic medications and, accordingly, are not subject to sale or use tax pursuant to subsection (e) of Revenue and Taxation Code section 6369.

In doing so, the Board necessarily concluded that the tax exemption covered all sales of test strips and lancets, just as was true with respect to all sales of insulin and insulin syringes. The Board explained the basis for its new Regulation in its "Final Statement of Reasons":

> [T]hese items [test strips and lancets] are so integrated with the operation of insulin and insulin syringes (the syringes cannot be used until the patient has first tested his blood sugar using the lancets and strips) that the Legislature intended that their sales be exempt from tax as part and parcel of the exemption for sales of insulin syringes under section 6369(e)."

(AA 200; 068-071 ¶¶24-27(b).)

Nevertheless, for over a decade Respondent retailers have been collecting millions of dollars in tax reimbursement from California's diabetics on sales of these tax exempt products. (AA 071-072 ¶¶27(b) and 28.)

F. A 2003 SBE Staff Letter To California Pharmacies Caused Them To Disregard The Tax Exemption For Sales Of Test Strips And Lancets.

A 2003 letter (AA 210) to 13,000 California pharmacies (AA 003, 014, 027, 039, 052 at ¶6 of each) from SBE "Program Planning Manager" Charlotte Paliani imposed three unauthorized conditions on tax exemption for test strips and lancets:

> [T]he customer must provide a copy of the [physician's] instructions [for their use] to the pharmacy,
>
> The pharmacy must maintain a copy of the instructions in its record, (Regulation 1591(g)) as support for the exemption,

> If the glucose test strips and skin puncture lancets are dispensed by anyone other than a registered pharmacist, the sale is subject to tax. (Regulation 1591(a)(3))... [I]f your customers are able to remove the items directly off the shelf and pay for them at your store's registers, without a pharmacist's intervention, the sales are subject to tax.

(AA 210.)

The letter's phrasing is indicative of a command or order. The word "must" is used with respect to the first two conditions, and the third condition imperatively declares that "the sale is subject to tax" if not complied with.

As Petitioners ultimately learned during this appeal, the Paliani letter was never authorized by the Board. But even if it had been, it would be void because it did not satisfy the requirements of the Administrative Procedures Act for a validly issued "regulation:"

> A regulation subject to the APA ... has two principal identifying characteristics. First, the agency must intend its rule to apply generally, rather than in a specific case. The rule need not, however, apply universally; a rule applies generally so long as it declares how a certain class of cases will be decided. Second, the rule must 'implement, interpret, or make specific the law enforced or administered by [the agency], or ... govern [the agency's] procedure.

(*Morning Star Co. v. State Bd. of Equalization* (2006) 38 Cal.4th 324, 333-34, citations omitted, emphasis added.)

The Paliani letter qualifies as a "regulation subject to the APA" because it purports to both (1) "declare[] how a certain class of cases will be decided," and (2) "implement, interpret, or make specific the law enforced or administered by [the agency]." The Paliani letter therefore had to be adopted in conformity with APA's "basic minimum procedural requirements that are exacting" (*Morning Star* at 333). One of the most important procedural requirements is that "those persons or entities whom a

regulation will affect have a voice in its creation, as well as notice of the law's requirements so that they can conform their conduct accordingly." (*Id.*, citations omitted.) But diabetics received no notice of the Paliani letter to California pharmacies. The Paliani letter and the new conditions for tax exemption stated therein would therefore be void even if they had been approved by the publicly elected Board. (*Tidewater Marine Western Inc. v. Bradshaw (*1996) 14 Cal.4th 557, 574, 575 [interpretive regulation issued without going through APA process is void]; *Reilly v. Superior Court* (2013) 57 Cal. 4th 641, 642-646, 649 ["any regulation not properly adopted under the APA is considered invalid."].)

But, in fact, the SBE now admits that the Paliani letter and its restrictive conditions for tax exemption were never decided upon by the Board, nor has the Board ever disagreed with Petitioners' claim that all sales of test strips and lancets are exempt from the sales tax:

> Appellants interpret Regulation 1591.1 to mean that all sales of glucose test strips or skin puncture lancets are exempt from sales tax.
>
> However, there has been no binding determination by the Board that Appellants' interpretation is correct. The Board could well come to a different conclusion, ruling that sales of skin puncture lancets and glucose test strips are nontaxable only if the products are furnished by an individual registered pharmacist (and not picked up off the shelf or dispensed by an employee who is not a registered pharmacist) and only if the customer presents documentation to show that the products are purchased pursuant to the instructions of a physician to control diabetes (such as a prescription or a copy of the written instructions). . [n.9] Because the taxability issue in this case has not been decided by the Board, the Superior Court properly dismissed the lawsuit. . [n.10]
>
> > Fn 9 A staff member of the Board has prepared an opinion letter that comes to this conclusion. (1 AA 210.) While such letters do not constitute the binding determination of the Board, (*Yamaha Corp. of America*

> *v. State Board of Equalization* (1998) 19 Cal.4th 1, 6-8), the letter proves that Appellants are wrong when they argue that the taxability issue is undisputed.]

(SBE's Respondents Brief at 33-34.)

Thus, the Board's only decision with respect to the taxability of pharmacy sales of test strip and lancets is encompassed in Regulation 1591.1(b)(5). As noted, that regulation was intended by the Board to exempt all pharmacy sales of test strips and lancets. (*See* pp. 15-16, *supra.*)

Moreover, while the trial court stated in the demurrer hearing that taxability was "very hotly in dispute" between the parties (RT 605:1-2), that hearing occurred before the SBE's admissions in its Respondent's Brief. Those admissions establish that there was no dispute between Petitioners' and the Board regarding taxability. A dispute with a SBE staff employee who has issued a general directive to retailers without Board authority and without following the APA procedures for issuing a "regulation" does not constitute a dispute with the Board.[7]

The conditions for tax exemption stated in the Paliani letter are also contrary to applicable statutes, regulations, and legislative and administrative history of the sales tax exemptions. For example, the tax revenue loss estimation process showed the State would lose 100% of the tax revenue from test strips and lancets by adopting Regulation 1591.1. (*See* p. 15, *supra.*) This establishes that, contrary to the Paliani letter, the Board intended Regulation 1591.1 to exempt all pharmacy sales of test strips and lancets, regardless of how they are purchased.

---

[7] Even if there were a dispute between Board and Petitioners, Board agreement that a refund is due is not a prerequisite for a *Javor* remedy. (*See* pp. 27-28, *infra.*) On the contrary, the *Javor* remedy is most necessary when there is an intractable dispute with the Board, since *Javor* is the only mechanism by which a customer can compel a Board ruling that is judicially reviewable under Tax Code §6933.

Similarly, in the Final Statement of Reasons, which were required under Govt. Code §11346.9 for the adoption of Regulation 1591.1, the Board stated that that "the Legislature intended that [test strips and lancets] sales be exempt from tax as part and parcel of the exemption for sales of insulin syringes under section 6369(e)." (AA 200; 068-071 ¶¶24-27(b), emphasis added.) But the Paliani letter says nothing about applying the three new conditions to sales of insulin syringes, further establishing that neither the Legislature nor the Board intended such conditions at all.

The Paliani letter attributes to Regulation 1591(g) the authority for requiring written physician instructions for the use of test strips and lancets. But that regulation merely states that the "acceptable documentation" consists of "name of purchaser, name of doctor, date of sale, items sold, and sale price." Diabetics can easily state their own name and that of their doctor. Requiring them to obtain written instructions from their physician for the use of test strips and lancets — products that they use two to four (or more) times per day during their entire lifetime (AA 282) — is as inconvenient and expensive to obtain and update as it is pointless. That is why for 53 years the SBE has held that evidence of physician instructions are unnecessary for the tax exemption of insulin. (*See* SBE Annot. 425.0460 discussed at p. 14, *supra.*)

Likewise, the Paliani letter's supposed condition that tests strips and lancets be personally "dispensed" by a registered pharmacist (or involve personal "intervention" by a registered pharmacist in removing the items from open aisle shelving) ignores SBE Annotation 425.0135 that "the term 'registered pharmacist' in the statute includes a licensed pharmacy." (AA 193; 208; 071-072 ¶27(c).)

Moreover, "dispensed" by a registered pharmacist is presumed whenever a consumable product for the treatment of diabetes is "furnished" by a registered pharmacist. (Tax Code §6369(e); Regulation 1591.1(b)(5).)

"Furnished" is statutorily defined by the Pharmacy Law (Business and Professions Code ("B&PC") §4026) and by SBE Reg. 1591(a)(3)1591, to mean "supply by any means, by sale or otherwise." Thus, even if the term "registered pharmacist" did not mean "licensed pharmacy" (as the SBE's Annotations have long-advised), "supply by any means, by sale or otherwise" does not imply that any personal involvement by a pharmacist in the sale is required as a condition for tax exemption. A contrary interpretation would read the phrases "by any means" and "by sale or otherwise" out of the statutory and regulatory definition of "furnish."

Additionally, one of the supposed Paliani conditions on tax exemption — that tests strips and lancets must be personally "dispensed" or involve personal "intervention" by a registered pharmacist — would violate B&PC §4007(b), which bars the Pharmacy Board from requiring "that a pharmacist personally perform any function for which the education, experience, training, and specialized knowledge of a pharmacist are not reasonably required." Ringing up the sale of nonprescription, non-hazardous, pre-packaged products — such as test strips or lancets — hardly requires the "education, experience, training, and specialized knowledge of a pharmacist." A contrary interpretation would mean that not even an Intern Pharmacist (B&PC §4030), a Pharmacy Technician (B&PC §4115), a Pharmacy Technician Trainee (B&PC §4115.5(a)) or other "non-licensed personnel" (Cal. Reg. 1793.3) — could ring up the sale of these non-prescription products without forfeiting the tax exemption.

When the Paliani letter was received, Respondent retailers surely realized that the requisite procedures under the APA had not been followed. But that did not result in them refusing to apply the Paliani conditions. On the contrary, Respondent retailers all allege that the June 18, 2003 Paliani letter "accurately states and reflects how the SBE interprets, applies and enforces Sales and Use Tax Regulation 1591.1 in connection with...

California pharmacy retailers' sale of blood glucose test strips and skin-puncture lancets." (AA 003; 014; 027-28; 039; 052-53 each at ¶7.) Two of the retailers directly admit to applying the letter's conditions to deny tax exemption for purchases of test strips and lancets. (AA 014-015; 039-040 each at ¶8.)

The unavoidable impact of requiring pharmacies to maintain written physician's instructions or provide personal involvement of the registered pharmacist in dispensing the pre-packaged products is to encourage pharmacies to disregard the sales tax exemption entirely, and to charge sales tax on nearly every sale of test strips and lancets so as to entirely avoid the obvious administrative costs. That is what is alleged to have occurred:

> Defendants have continued to charge sales tax on sales of glucose test strips and skin puncture lancets in almost every transaction. As a result, a sales tax exemption which was intended to benefit millions of California diabetics has instead benefitted almost nobody.

(AA 072 ¶28,)

G. Respondent Retailers And The SBE Have No Incentive To Refund Excess Sales Tax Reimbursement.

For the price of a postage stamp any retailer may file a claim for refund with the SBE. The only requirement is that "Every claim shall be in writing and shall state the specific grounds upon which the claim is founded." (Tax Code §6904).

But while retailers could easily request a refund from the SBE, they have no incentive to do so. (*See Loeffler* at 1115 ["[b]ecause the retailer cannot retain the excess tax amount for itself, but must undertake some procedure to make refunds to customers, it may have no particular interest in pursuing a tax refund"]; *accord Javor* at 801.)

Likewise, the SBE staff could initiate procedures to "ascertain" the amounts of improperly collected sales taxes and refund those amounts directly to the retailers' customers' under Tax Code §6901. (*See* n.6, *supra*). But as this Court acknowledged in *Javor* and *Loeffler*, the SBE has no incentive to refund money, or to take on additional work, no matter how unjust the State's enrichment may be:

> [T]he *Board* may lack incentive to examine returns on its own initiative to determine whether retailers have remitted excess taxes to it — that is, whether taxes have been *overpaid*. We observed that the Board "is very likely to become enriched at the expense of the customer to whom the amount of the excessive tax actually belongs."

(*Loeffler* at 1115, quoting *Javor* at 802, original italics.)

Thus, the SBE's staff and retailers rarely, if ever, initiate proceedings for the Board to adjudicate sales "taxability" issues. Instead, they oppose efforts by consumers to initiate such an adjudication, including opposing the *Javor* remedy. By avoiding having the publicly elected Board make a decision on "taxability," they also avoid any judicial review under Tax Code §6933.

Such dereliction of duty by the SBE staff is graphically demonstrated here. An SBE staff member torpedoed the tax exemption in 2003 by sending a letter on Board stationary to almost 13,000 California pharmacies setting forth conditions for tax exemption of test strips and lancets that were never authorized by the Board. Furthermore, not later than February 24, 2006 (the date of the retailer defendants' cross-complaints against the SBE), the SBE staff knew that pharmacies throughout the State of California were either mistakenly regarding that letter as authoritative or yielding to it anyway, and applying the unauthorized conditions so as to collect sales tax reimbursement on sales of test strips and lancets. (*See* pp. 21-22, *supra.*) Yet, armed with that

knowledge, for over eleven years the SBE staff has taken no steps to (1) retract the letter and notify California pharmacies and diabetics that the conditions for tax exemption stated in the letter are unauthorized and void, nor (2) initiate a Board determination of whether to adopt such additional conditions for tax emption of test strips and lancets. Instead, for over eleven years the SBE's staff has remained mum, while the SBE has collected and retained in the State's coffers tens of millions of dollars of supposed taxes that it knew were being reimbursed to retailers by customers who had no knowledge of the retailers' lack of legal authority for imposing such charges.

V. ARGUMENT.

A. Petitioners Fifth Cause Of Action Alleges An Actionable Claim Under *Javor* To Remedy The State's Unjust Enrichment.

1. By Creating Prerequisites To Pursuing A *Javor* Remedy Which Are By Definition Impossible To Fulfill, *McClain* De Facto Overrules *Loeffler* And *Javor* .

Although they advocate against it now, prior to *Loeffler*, the Respondent retailers argued that Petitioner should be allowed to pursue a *Javor* remedy:

> The appropriate remedy for a consumer who has erroneously overpaid sales tax to a retailer, who has in turn paid the taxes to the Board, is to join the Board as a party to his suit for recovery against the retailer, so that the Board may be required to respond to refund applications by the retailer and pay the refunds into court .... [Citing *Javor*.]

(Respondents Walmart and Sav-on / Albertson's Separate Mem. ISO Demurrer to First Amended Complaint, both filed on or about April 19, 2005 (emphasis added), quoted at AA 496.)

Loeffler likewise expressly confirmed the continued utility of the *Javor* remedy in order to preserve the integrity of the tax system and avoid unjust enrichment to the state. (*Loeffler* at 1133.) *Loeffler* noted that "such a remedy invokes, rather than avoids, tax code procedures." (*Id.* at 1101.) But, because plaintiffs in *Loeffler* declined to pursue a *Javor* remedy, *Loeffler* left open the question of what circumstances are needed for a *Javor* remedy. (*Id.* at 1133-34.)

But now, although *Javor* has never been overruled, the *McClain* Court interpreted *Javor* in such a manner as to effectively abolish the *Javor* remedy. It did so by imposing supposed "prerequisites" that by definition no case, not even *Javor* itself, could possibly ever satisfy.

McClain begins by acknowledging that "customers do not have a statutory right to directly file for a refund of the sales tax from the Board. . . . " (*McClain* at 700.) *McClain* nevertheless holds that customers "are not remedy-less because they have several other remedies available to them," pointing first to Tax Code §§ 6481, 6483 and 7054. (*Id.*) But those tax code sections all pertain to "deficiency determinations:" *i.e.* that the retailer remitted too little to the SBE, not — as the customers contend — too much. Moreover, those sections apply to deficiency determinations with respect to every sales tax return. If the mere existence of those sections disqualifies a customer from a *Javor* remedy, then no customer can ever qualify. Indeed, the *Javor* plaintiffs themselves could not have qualified for the remedy because all three sections were enacted prior to the Supreme Court's 1974 decision in *Javor*, and have remained materially unchanged since that time.

McClain next contends that customers "may urge the Board to initiate an audit of the retail pharmacies' practices in collecting sales tax." (*McClain* at 700.) But *McClain* acknowledges that the SBE has neither the incentive nor the obligation to grant such a customer request for an audit,

making it "the practical equivalent of allowing [customers] to tug (albeit persistently) at the Board's sleeve." (*Id.* at 706.) Of course, sleeve-tugging would have been available in *Javor*, yet *Javor* crafted a remedy that could be enforced by consumers. And in fact, the SBE's staff rarely, if ever, investigates customer complaints of *over*-collection of sales tax reimbursement. (*See* n.6, *supra* and pp. 23-24, *supra.*)

McClain next identifies Government Code §§11340.6 and 11350 as being the source of "other remedies," namely to petition the Board under the APA to compel the Board to "adopt, amend or repeal" Regulation 1591.1(b)(5), or to sue the Board for declaratory relief "as to the validity of" Regulation 1591.1. (*McClain* at 700-701.) Not only do these "other remedies" not allow customers to recover amounts they have already overpaid, but, again, they would be present in every case to block every potential claim for a *Javor* remedy. Further, Regulation 1591.1(b)(5) is the Board Regulation that exempts sales of glucose test strips and lancets from the sales tax, and is a cornerstone of Petitioners' case. Amending or repealing Regulation 1591.1(b)(5) is not Petitioners' strategy.

McClain next holds that Tax Code §6905, which bars a tax refund claim that is not timely filed, is inconsistent with *Javor*. (*McClain* at 701.) A *Javor* remedy only arises when the retailer must be judicially compelled to file a claim for a tax refund, so the risk that a retailer might in the meantime potentially forfeit the refund claim under §6905 is present in every *Javor* case. If *McClain* is correct that the existence of §6905 bars the *Javor* remedy, then *Javor* is a dead letter in every case. Indeed, even the *Javor* plaintiffs could not have qualified for the remedy because §6905 was enacted in 1941, prior to this Court's 1974 decision in *Javor,* and has remained materially unchanged since that time.

McClain next holds that Tax Code §6901.5 implies a "safe harbor" that is inconsistent with a *Javor* remedy and, indeed, blocks the first step in

the *Javor* process:

> If consumers can sue retailers to compel them to seek a refund from the Board, then the "safe harbor" from suit erected by section 6901.5 is no safe harbor at all.

(*McClain* at 701-702.)

A *Javor* remedy against the SBE only arises when a customer claims that a retailer has collected excess sales tax reimbursement and remitted it to the SBE under §6901.5. Therefore, by definition, §6901.5 is involved in every case under *Javor*, so no customer could ever qualify for a *Javor* remedy under *McClain*. Moreover, *Javor* expressly authorizes a customer to join the SBE as a party on a *Javor* claim with his suit for recovery against the retailer. (*Javor* at 802 ["a customer . . . may join the Board as a party to his suit for recovery against the retailer" (*See also* pp. 39-40, *infra.*)].). For both of these reasons, *McClain*'s "safe harbor" ruling directly contradicts this Court's decision in *Javor.*

McClain also holds that a prerequisite to the *Javor* remedy is that the Board already has determined that "the person seeking the new tax refund remedy is entitled to a refund." (*McClain* at 690, 700.) The *McClain* logic is circular. If consumers are not entitled to pursue a *Javor* remedy unless the Board already has determined that they are entitled to a refund, but absent a *Javor* remedy there is no procedure to compel the Board to make such a determination, then the *Javor* remedy will be unavailable in every case.

Moreover, the *Javor* Court's primary concern was that the State not be unjustly enriched. (*Javor* at 802 ["The integrity of the sales tax requires not only that the retailers not be unjustly enriched. but also that the state not be similarly unjustly enriched]".) This Court gave even more emphasis to that concern in *Loeffler*: "The integrity of the tax system and avoidance of unjust enrichment, possibly of the retailer, but more probably of the state,

in certain circumstances may support a *Javor*-type remedy for consumers" (*Loffler* at 1133-34, emphasis added).) With this Court's concern to avoid unjust enrichment of the State, what sense would it have made for this Court, in either *Javor* or *Loeffler*, to condition the *Javor* remedy on the Board having already determined that "the person seeking the new tax refund remedy is entitled to a refund"? Obviously, that would make no sense, because it would provide the SBE with a made-to-order method of evading the *Javor* remedy, thereby evading judicial review under Tax Code §6933, and perpetuating the State's unjust enrichment, by the Board simply failing to consider the customers' entitlement to a refund (as the SBE admits the Board has done here). (*See* pp. 18-19; 23-24.)

Finally, it should be noted that under *McClain*, failing to satisfy any one of the opinion's supposed "prerequisites" would disqualify a case from a *Javor* remedy. But as shown above, no case could ever meet *any* of *McClain*'s "prerequisites," much less all of them. *McClain* therefore effectively abolishes the *Javor* remedy.

2. By Denying Customers Any Recourse To Recover Excess Sales Tax Reimbursement From The SBE, *McClain* Makes Tax Code §6901.5 Unconstitutional.

By effectively abolishing the *Javor* remedy, *McClain* would convert Tax Code §6901.5 into a permanent State escheat of excess sales tax reimbursement with no recourse for customers from whom the excess reimbursement was collected. This would make Tax Code §6901.5 unconstitutional under the Due Process Clause of the U.S. and California Constitutions. Moreover, even if excess sales tax reimbursement were a "tax" rather than an escheat, Tax Code §6901.5 would still be unconstitutional under the Due Process Clause because the State does not afford "meaningful backward-looking relief to rectify any unconstitutional

deprivation."

a. Tax Code §6901.5 Is An Escheat Statute, Not A Taxation Statute.

As the SBE admits, Tax Code §6901.5 "ensures that retailers do not wrongfully retain excess sales tax reimbursement paid by customers." (SBE's Answer to Petition for Review at 14.) In other words, the purpose of Tax Code §6901.5 is to escheat excess sales tax reimbursement from retailers so as to avoid their being unjustly enriched, *not* to raise tax revenue.

The fact that Tax Code §6901.5 was not designed to be a taxation statute is proven by the underscored language of the statute itself:

> When an amount represented by a person to a customer as constituting reimbursement for taxes due under this part is computed upon an amount that is not taxable or is in excess of the taxable amount and is actually paid by the customer to the person, the amount so paid shall be returned by the person to the customer . . . [or] shall be remitted by that person to this state. . . . those amounts remitted to the state shall be credited by the board on any amounts due and payable under this part on the same transaction . . . and the balance, if any, shall constitute an obligation due from the person to this state.

(Emphasis added.)

Thus, the excess sales tax reimbursement funds governed by §6901.5 are, by definition, not owed as taxes because they are "computed upon an amount that is not taxable or is in excess of the taxable amount." Additionally, under §6901.5 the excess sales tax reimbursement must be either "returned by the person [i.e. the retailer] to the customer" or "remitted by that person to this state." If Tax Code §6901.5 were designed to raise tax revenue, there would be no reason to provide retailers with the option of returning the excess sales tax reimbursement to customers, since that would defeat the goal of raising tax revenue. Moreover, the retailers'

option of returning excess sales tax reimbursement to customers is a statutory recognition that customers are the rightful owners of excess sales tax reimbursement. (*See also Loeffler/Javor* quote at pp. 34-35, *infra.*) It is therefore clear that Tax Code §6901.5 is an escheat statute, not a taxation statute.

b. Absent A *Javor* Remedy, Tax Code §6901.5 Is Unconstitutional Under The Due Process Clause Because It Would Authorize A Permanent Escheat Of Property Without Adequate Notice To Potential Claimants And A Judicial Proceeding To Terminate Their Rights.

This Court has long held that a permanent escheat of money by the State is an unconstitutional deprivation of property without due process of law if done without adequate notice to potential claimants and a judicial proceeding to terminate their rights. In the landmark case of *State v. Savings Union Bank & Trust Co.* (1921) 186 Cal. 294, the State contended that under former Civil Code §1273, when money on deposit in a bank remained unclaimed for 20 or more years after the last deposit or withdrawal, it automatically, immediately and irrevocably escheated to the State without any notice or judicial proceeding. This Court emphatically rejected that interpretation, stating that it would be an unconstitutional "taking of property without due process of law":

> [T]he effect of the statute as it is claimed to be by the state would be to divest a person of his title without any proceeding against him for that purpose and would manifestly be a taking of property without due process of law.
>
> * * * *
>
> In view of . . . the fact that the statute would be utterly void if given the meaning attributed to it by the attorney-general, . . . the provision . . . must not be taken as intending to provide for an immediate escheat, but as providing that the same shall

> be taken over by the state as an escheat when so adjudged in the action so provided for."

(*State v. Savings Union Bank* at 300. *See also Cerajeski v. Zoeller* (2013) 735 F.3d 577, 582 (7th Cir., Posner J.) ["[A] state may not escheat property without a judicial or administrative determination that the property has been abandoned or is otherwise subject to escheat."].)

Because of the constitutional restrictions on permanent escheat, most modern escheat statutes only provide for provisional, nonpermanent escheats which are "subject to the right of claimants to appear and claim the escheated property." (C.C.P. §1300(c), emphasis added); *Morris v. Chiang* (2008) 163 Cal. App. 4th 753, 756 ("*Morris*"). There are generally no constitutional concerns with nonpermanent escheats. (*See Harris v. Westly* (2004) 116 Cal. App. 4th 214 ["This case, however, does not involve permanent escheat to the state . . . We perceive no constitutional dimension to that deprivation under the circumstances."].)

Here, the *Javor* remedy provided such a "right of claimants [i.e. customers] to "appear and claim the escheated property" [i.e. excess sales tax reimbursement]." (*See Javor* at 802 ["[A] customer, who has erroneously paid an excessive sales tax reimbursement to his retailer who has in turn paid this money to the Board, may join the Board as a party to his suit for recovery against the retailer in order to require the Board in response to the refund application from the retailers to pay the refund owed the retailers into court."].) Tax Code §6901.5 was therefore a "nonpermanent escheat" prior to the Court of Appeal's *McClain* opinion.

But *McClain* effectively abolishes the *Javor* remedy by imposing supposed "prerequisites" that no case, not even *Javor* itself, could possibly satisfy. (*See* pp. 24-28, *supra.*) Tax Code §6901.5 is thereby transformed into a "permanent escheat" (*See* C.C.P. §1300(d) ["'Permanent escheat means the absolute vesting in the state of title to property...."].) To satisfy

due process, a permanent escheat "generally requires a judicial proceeding" to cut off the ownership rights of claimants to the property (*Morris* at 756; *State v. Savings Union Bank* at 300; *Cerajeski* at 582). But under *McClain*, customers have no rights to a judicial proceeding to recover excess sales tax reimbursement. Therefore, under *McClain*, Tax Code §6901.5 become an unconstitutional deprivation of property without due process of law.

c. The Fact That Tax Code §6901.5 Is An Escheat Statute Further Undermines The *McClain* Court's Stated Reasons For Its Opinion, But The *McClain* Court Refused To Consider Petitioners' Escheat Argument.

At every stage of the demurrer and appellate proceedings, Petitioners have argued that Tax Code §6901.5 works an escheat of excess sales tax reimbursement. Petitioners' did so in their (1) Opposition to Retailer Defendants' Demurrer (AA 517-518), (2) oral argument to the trial court (RT 633:6-10); (3) Appellants' Opening Brief (AOB 73-76), (4) Appellants' Reply Brief (ARB 35-39), (5) Petition for Rehearing (RP 20-21; 24; 26-36; and 40-43), (6) Petition for Review (PR 1, 8, 10-11, 13-14, 16-17, 28-33), and (7) Reply to Answer to Petition for Review (RTA 9-14).

Yet the trial court never mentioned "escheat" during the hearing on demurrer, nor did the *McClain* Court's 3/13/2017 opinion. When Petitioners called that omission to the *McClain* Court's attention in their Petition for Rehearing (RP 29), the *McClain* Court incorrectly responded that "because the initial round of briefing on appeal is not a dry run for a whole new round of post-opinion briefing on rehearing, we respectively decline to consider these arguments for the first time on rehearing." (4/10/2017 Slip Op. at 28, n.9, emphasis added.)

If the *McClain* Court had considered Petitioners' escheat argument, it would have realized that the escheat nature of Tax Code §6901.5 further

undermines the *McClain* opinion. For example, *McClain* relies upon Article XIII §32 of California's Constitution (*McClain* at 689, 695, 698, 699), but that section only applies to the "collection of any tax," not to the State's escheat of excess sales tax reimbursement under Tax Code §6901.5. (Moreover, even if excess sales tax reimbursement were a "tax," Tax Code §6901.5 would still be unconstitutional under the due process clause because the State does not afford meaningful backward-looking relief to rectify the State's unjust enrichment. (*See* pp. 33-35, *infra.*)

McClain holds that "our refusal to craft a judicial tax refund remedy for consumers does not risk a due process violation" because "[t]he payment of sales tax alleged. . . entails two sequential transactions: Consumers pay sales tax reimbursement to retailers, and retailers pay sales tax to the state." (*McClain* at 704.)

In fact, it is common for escheats to involve two sequential steps. For example, *State v. Savings Union Bank* and *Cerajeski* both involved a two-step process. First, the customer deposited funds with the bank. Second, when the account became dormant, the funds escheated from the bank to the State. The fact that two sequential steps were involved, or that the customers did not directly pay the funds to the State, did not prevent the escheats from being violative of due process. Moreover, as shown below, even if the second step were regarded as a "tax," that would not save §6901.5 from unconstitutionality.

d. Even If Excess Sales Tax Reimbursement Were A "Tax," Tax Code §6901.5 Would Be Unconstitutional Under The Due Process Clause Because The State Does Not Afford "Meaningful Backward-Looking Relief To Rectify Any Unconstitutional Deprivation."

McClain summarizes the constitutional due process that is required

for challenges to state taxation:

> The federal and California Constitutions also provide that the state shall not deprive persons of their property "without due process of law." (U.S. Const., 14th Amend., § 1; Cal. Const., art. I, § 7, subd. (a).) This guarantee applies to the payment of taxes (*T. M. Cobb Co. v. County of Los Angeles* (1976) 16 Cal.3d 606, 617, fn. 6), but authorizes a state to relegate taxpayers to a "'postpayment refund action'" as long as they are afforded "'meaningful backward-looking relief to rectify any unconstitutional deprivation'" (*River Garden Retirement Home v. Franchise Tax Bd.* (2010) 186 Cal.App.4th 922, 937–938 (*River Garden*), quoting *McKesson Corp. v. Florida Alcohol & Tobacco Div.* (1990) 496 U.S. 18, 31 (*McKesson*); *see City of Anaheim, supra*, 179 Cal.App.4th at p. 831). A state provides "'meaningful backward-looking' relief" if it gives taxpayers (1) "a 'fair opportunity to challenge the accuracy and legal validity of their tax obligation,'" and (2) "a '"clear and certain remedy"' for the erroneous or unlawful tax collection." (*River Garden*, at p. 938, quoting *McKesson*, at p. 39.)

(*McClain* at 703-704, parallel citations omitted, emphasis added,)

Here, diabetic customers have unquestionably been denied "meaningful backward-looking relief," whether in the form of a "fair opportunity to challenge the… legal validity of their [supposed] tax obligation," or in the form of a "clear and certain remedy."

Respondents and *McClain* contend, however, that purchasers are not "taxpayers" with respect to the sales tax. But as even the *McClain* Court acknowledges, the Fifth Amendment's constitutional guarantee of due process ("No person shall… be deprived of life, liberty, or property, without due process of law") is not limited to "taxpayers" but runs to "persons" with respect to "their property:" Here, no one contends that customers are not "persons" or that excess sales tax reimbursement does not belong to them. (*See Loeffler* at 1115 quoting *Javor* at 802 ["We observed that the Board 'is very likely to become enriched at the expense of

the customer to whom the amount of the excessive tax actually belongs.'"] (Emphasis added).)

Moreover, when it comes to federal constitutional rights, the courts are not bound by the California Legislature's self-motivated characterization of retailers as the "taxpayers" of the sales tax. In *Diamond* the U.S. Supreme Court stated:

> We are not bound by the California court's contrary conclusion and hold that the incidence of the state and local sales taxes falls upon the national bank as purchaser and not upon the vendors.

(*Diamond* at 268.)

Accordingly, even if excess sales tax reimbursement remitted by retailers were a "tax" rather than an escheat, Tax Code §6901.5 would still be in violation of the due process clause because, absent a *Javor* remedy meeting due process standards, §6901.5 does not provide "meaningful backward -looking relief" in the form of a "fair opportunity to challenge the... legal validity of their [supposed] tax obligation," and a "clear and certain remedy."

B. Petitioners' First Cause of Action Alleges An Actionable Claim Against Respondent Retailers For Breach Of The Agreement Specified In Civil Code §1656.1.

1. The Legal Basis For Petitioners' First Cause Of Action Against Respondent Retailers.

Petitioners' First Cause of Action alleges an implied-in-fact contract that the retailers would not seek tax reimbursement if a transaction was not subject to, or was exempt from, sales tax. (AA 077-078 ¶¶46-48.) It also alleges breach of the implied covenant of good faith and fair dealing that is inherent in that contract[8]:

---

[8] *See* California Civil Jury Instruction (CACI) 325 ("In every contract or agreement there is an implied promise of good faith and fair dealing.")

> Defendants breached the contract and the implied covenant of good faith and fair dealing by, *inter alia*, charging Plaintiffs and the Class members sales tax reimbursement on the glucose test strips and skin puncture lancets when no sales tax was payable.

(AA 079 ¶50.)

Although "[i]t shall be presumed that the parties agreed to the addition of sales tax reimbursement to the sales price [if] sales tax reimbursement is shown on the sales check" (*Loeffler* at 1109), Civil Code §1656.1's presumption is rebuttable, and there is no presumption that a consumer agreed to reimburse a tax that was never owed. For example, this Court in *National Ice* suggested it would be constitutional for a retailer to "'pass on' the tax to a purchaser with the latter's consent thereto, either expressly or impliedly given." (*National Ice* at 292, emphasis added.) The *National Life* Court did not, however, envision the "pass-on" of amounts *in excess of the tax actually owed.* Neither did diabetics. So while Petitioners do not dispute that they entered into point-of-sale contracts to reimburse retailers for whatever sales taxes were owed on their purchases, Petitioners never agreed to reimburse retailers for making voluntary payments — essentially gifts —to the State on sales that were entirely exempt from sales tax.

Moreover, under both Civil Code §1656.1 and Evidence Code §604, any presumptions disappear as soon as contrary evidence is introduced. (*See* Section 22 of Stats 1978 ch 1211, Attachment A hereto ["[T]he purpose of the Legislature in adding Section 1656.1 to the Civil Code is to create a rebuttable presumption as to the intention of the parties for use in the absence of evidence of other intention . . ."]; Evidence Code §604 ["the trier of fact [is required] to assume the existence of the presumed fact unless and until evidence is introduced which would support a finding of its nonexistence"]; *Rancho Santa Fe Pharmacy, Inc. v. Seyfert* (1990) 219

Cal.App.3d 875, 882 ["when the party against whom such a presumption operates produces some quantum of evidence casting doubt on the truth of the presumed fact, the other party is no longer aided by the presumption. The presumption disappears, leaving it to the party in whose favor it initially worked to prove the fact in question."].)

Thereafter, "the trier of fact shall determine the existence or nonexistence of the presumed fact from the evidence without regard to the presumption" (Evidence Code §604, emphasis added.)

The covenant of good faith and fair dealing finds particular application in situations where one party is invested with a discretionary power affecting the rights of another. Such power must be exercised in good faith." (*Carma Developers (Cal.), Inc. v. Marathon Development California, Inc.* (1992) 2 Cal.4th 342, 372 ("*Carma Developers*"). Respondent retailers are "invested with a discretionary power affecting the rights" of diabetics because the retailers have the sole power to seek refunds of excess tax reimbursement that was improperly collected and remitted by them to the SBE.

The duty of good faith and fair dealing therefore applies to the retailers' contracts with Petitioners and members of the class, especially with regard to the retailers disregarding sales tax exemptions enacted for the benefit of diabetics and refusing to pursue appropriate refunds. Whether the retailers breached the implied covenant will likely turn upon whether they lacked belief in the validity of their acts or if their conduct was "objectively unreasonable." (*Carma Developers* at 372-73 ["A party violates the covenant if it subjectively lacks belief in the validity of its act or if its conduct is objectively unreasonable."].) Whether conduct is "objectively unreasonable" is most usually an issue of fact for a jury. (*See, e.g., Acree v. General Motors Acceptance Corp.* (2001) 92 Cal.App.4th 385, 393, 395.)

Here, the Respondent retailers have disregarded the sales tax exemption on test strips and lancets for over a decade on the basis of an unauthorized and void letter from a SBE staffer which was inconsistent with Tax Code §6369(e), the Pharmacy Law (B&PC §§4007(b) and 4026), SBE Reg. 1591.1(b)(5), SBE Annotations 425.0135 and 425.0460, and the tax exemption's legislative and administrative history. (*See* pp. 19-21, *supra.*) Petitioners have the right to discovery and to present evidence and argument to a trier of fact on whether Respondent retailers' lacked belief in the validity of their acts and/or their conduct was objectively unreasonable, but Petitioners were denied that right by the rulings of the courts below.

2. *McClain* Re-Writes Civil Code §1656.1's Rebuttable Presumption Of Consumer Agreement To Sales Tax Reimbursement Into Its Opposite – An Irrebuttable Presumption.

McClain cites two statutory basis for rejecting Petitioners' First Cause of Action against Respondent retailers for breach of contract. The first basis is the existence of Tax Code §6905:

> [Tax Code §6905] allows retailers to waive their right to seek a tax refund; if consumers can compel a retailer to seek a refund when it would rather waive it, the retailer's right to waiver would be negated. (*Loeffler, supra*, 58 Cal.4th at p. 1129 [so noting].) . . . [T]he contractual nature of the right to collect sales tax reimbursement in no way affects the fact that a judicial remedy compelling a retailer to seek a refund overrides a retailer's election not to seek one.

(*McClain* at 701, emphasis added.)

The second basis is the existence of Tax Code §6901.5:

> Judicial recognition of a right of customers to sue retailers . . . is also inconsistent with section 6901.5. . . . . In *Loeffler*, our Supreme Court read this section as providing a "safe harbor" or "safe haven" for any retailer/taxpayer "vis-à-vis the consumer" if the retailer/taxpayer "remits reimbursement

> charges [it collects] to the Board." (*Loeffler, supra*, 58 Cal.4th at pp. 1100, 1103–1104, 1119.)

(*McClain* at 701, emphasis added.)

Tax Code §6905 and §6901.5 are present in every case involving sales tax reimbursement, so under *McClain*, a customer could never sue for breach of the express or implied agreement required by Civil Code §1656.1 regardless of how clearly the sale was legally tax exempt. *McClain* therefore effectively re-writes Civil Code §1656.1's rebuttable presumption of customer agreement into its opposite – an *ir*rebuttable presumption.

3. By Interpreting Tax Code §6905 So As To Re-Write Civil Code §1656.1's Rebuttable Presumption Into An Irrebuttable Presumption, *McClain* Is Directly Contrary To *Javor*.

McClain holds that the retailer's power to let the tax refund claim period against the SBE lapse under Tax Code §6905 is "inconsistent" with a cause of action for breach of the contract specified in Civil Code §1656.1. From that, *McClain* concludes that all customer breach of contract claims against a retailer to recover excess sales tax reimbursement must be barred (even those where the claim period against the SBE has not lapsed). In fact, the opposite is true. Any power of the retailer to prejudice its customers by allowing the tax refund claim period to lapse under Tax Code §6905 is a strong reason for recognizing the customers' right to sue the retailer for breach of the contract required by Civil Code §1656.1, including breach of the duty of good faith and fair dealing.

Javor is best known for devising an equitable remedy that customers can initiate in order to recover excess sales tax reimbursement from the SBE, but *Javor* also had something to say about customers' ability to sue retailers for excess sales tax reimbursement:

> . . . a customer, who has erroneously paid an excessive sales tax reimbursement to his retailer who has in turn paid this money to the Board, may join the Board as a party to his suit for recovery against the retailer . . . .

(*Javor* at 802, emphasis added.)

Thus, *Javor* expressly endorses a customer "suit for recovery against the retailer" even where the retailer has remitted the excess sales tax reimbursement to the SBE. The *McClain* Court's ruling that Tax Code §6905 is "inconsistent" with a cause of action for breach of the contract specified in Civil Code §1656.1 is therefore not only contrary to the plain language of §1656.1's rebuttable presumption, but also directly contrary to this Court's decision in *Javor*.

Indeed, the *Javor* court understood that a retailer who refuses or fails to voluntarily file a refund claim for the benefit of its customers (thereby creating the need for a *Javor* remedy) might also have an incentive to compromise or forfeit a *Javor* claim, such as by letting the claim period lapse under §6905. The *Javor* Court therefore held that the customer can join the *Javor* claim (seeking recovery from the SBE) with "his suit for recovery against the retailer." To be sure, the retailer will normally be entitled to implied indemnity from the SBE, since it is the SBE that is unjustly enriched. But if the retailer compromises or forfeits the *Javor* claim against the SBE — such as by allowing the tax refund claim period to lapse under §6905 — then the retailer can be liable to the customer for the consequences of breaching the agreement specified in Civil Code §1656.1, including for breaching the covenant of good faith and fair dealing. (*See* pp. 37-38, *supra.*) That potential liability exposure, in turn, provides an incentive for the retailer not to intentionally jeopardize the *Javor* claim against the SBE, thereby eliminating the supposed "inconsistency" between Civil Code §1656.1 and Tax Code §6905 that bothered the *McClain* Court.

4. By Interpreting Tax Code §6901.5 So As To Re-Write Civil Code §1656.1's Rebuttable Presumption Into An Irrebuttable Presumption, *McClain* Is Directly Contrary To *Cel-Tech* and *Loeffler*.

The majority opinion in *Loeffler* held that Tax Code §6901.5 impliedly "affords a safe harbor for retailers who remit the amounts [collected] to the Board." (*Loeffler* at 1118.) But the majority's discussion of the "safe harbor" was confined to just two causes of action brought under the general consumer protection statutes, the UCL and the CLRA. Those statutes share two common characteristics: (1) both statutes broadly cover "unfair" business acts or practices (B&PC §17200, Civil Code §1770), and (2) under both statutes the "remedies are not exclusive but are 'in addition to any other procedures or remedies . . . provided for in any other law.'" (*Loeffler* at 1125.)

Nineteen years ago in *Cel-Tech* this Court became concerned that unless cabined by the courts, litigation under the UCL and CLRA could create a law of "unfairness" parallel to, but potentially inconsistent with, statutes enacted by the Legislature. To avoid such a result, this Court first coined the phrase "safe harbor" in connection with a UCL case:

> Although the unfair competition law's scope is sweeping, it is not unlimited. Courts may not simply impose their own notions of the day as to what is fair or unfair. Specific legislation may limit the judiciary's power to declare conduct unfair. If the Legislature has permitted certain conduct or considered a situation and concluded no action should lie, courts may not override that determination. When specific legislation provides a "safe harbor," plaintiffs may not use the general unfair competition law to assault that harbor.

(*Cel-Tech* at 182, emphasis added.)

Following *Cel-Tech*, many decisions of this and other California appellate courts have applied a "safe harbor" to limit or dismiss UCL or

CLRA claims at variance with laws enacted by the Legislature. But Petitioners are unaware of any case where a "safe harbor" has been held to bar a breach of contract cause of action.

A cause of action for breach of contract is very different than one for violation of the UCL or CLRA. Breach of contract causes of action are decided based upon the parties' agreement, express or implied, and upon time-honored principles of contract law, rather than upon an overlay of generalized notions about what is "fair" or "unfair.

The inappropriateness of applying a "safe harbor" to a breach of contract cause of action is especially pronounced with respect Petitioners' First Cause of Action. This Court's concern in *Cel-Tech* was to protect statutes enacted by the Legislature from being undermined by inconsistent court decisions under the UCL or CLRA. But Petitioners' First Cause of Action is for breach of a contract *mandated by Civil Code §1656.1*. Thus, the *McClain* Court's misapplication of a "safe harbor" operates *not* to protect a statute enacted by the Legislature, but to nullify it. That is a misuse of the "safe harbor" and directly contrary to this Court's decision in *Cel-Tech.*

Moreover, *Loeffler* held that "orderly administration of the tax laws requires adherence to the statutory procedures" (*Loeffler* at 1111, emphasis added.) The rebuttable presumption of Civil Code §1656.1 is one such "statutory procedure." Indeed, §1656.1 was the critical provision of 1978 Senate Bill 472 that overhauled the sales tax law in response to the U.S. Supreme Court's decision in *Diamond.* (*See* pp.12-13, *supra.*) Therefore, by effectively nullifying a customer's right under §1656.1 to rebut the presumption of agreement to the addition of sales tax reimbursement to the sales price, *McClain* is also directly contrary to this Court's decisions in *Loeffler*.

5. By Re-Writing Civil Code §1656.1's Rebuttable Presumption Into An Irrebuttable Presumption, *McClain* Makes The Collection Of *All* Sales Tax Reimbursement Unconstitutional.

Under *McClain*, if sales tax reimbursement is shown on the sales check or other proof of sale, customers have no legal power to dispute the charge, no matter how clearly the sale is legally tax exempt. With customers having no power to *dispute* the charge, there is also no basis for presuming that customers *agree* with the charge. The consensual basis for the constitutionality of sales tax reimbursement that this court first suggested in *National Ice* (*see* pp.10-11, *supra*) is therefore destroyed. And, as this court held in *National Ice*, there is no other constitutional basis for customers being obligated to reimburse retailers for a tax obligation that is statutorily imposed exclusively upon retailers.

The *McClain* Court's opinion therefore makes collection *of all* sales tax reimbursement from customers (not just *excess* sales tax reimbursement under Tax Code §6901.5) unconstitutional as a deprivation of property without due process of law.

C. The Courts Below Erred By Denying Leave To Amend For Petitioners To State A Claim For "Just Compensation" Under the Takings Clause.

In response to the trial court's tentative ruling, Petitioners' counsel asked for leave to amend to add a claim for "just compensation" under the Takings Clause, noting that such claim had not been ripe "as long as *Javor* was still in play" (RT, 643:19-644:3) and that lack of leave to amend could adversely affect the claims period. (RT 645:20-24.) The trial court, however, denied leave to amend. (RT 646:7-10.)

Unjust enrichment from the perspective of the State is just the flip side of a "taking" from the perspective of the rightful owner of property taken by the State. It therefore follows that Petitioners could have stated a

claim for "just compensation" under the Takings Clause of the Fifth Amendment which is made applicable to the states through the Fourteenth Amendment (*Chicago, B. & Q. R. Co. v. Chicago* (1897) 166 U.S. 226, 241).

The Takings Clause states: "nor shall private property be taken for public use, without just compensation." By making the collection of sales tax reimbursement "depend solely upon the terms of the agreement of sale" (Civil Code §1656.1), and by giving the retailer the option of refunding excess sales tax reimbursement directly to the customer (Tax Code §6901.5), the Legislature has clearly established that excess sales tax reimbursement is "private property" owned by the customer. (*See also Loeffler* at 1115 quoting *Javor* at 802 ["We observed that the Board 'is very likely to become enriched at the expense of the customer to whom the amount of the excessive tax actually belongs.'" (Emphasis added)].)

Absent the *Javor* remedy, the effect of the retailer remitting excess sales tax reimbursement to the SBE is to reclassify that private property into public property belonging to the State. (*See* Tax Code §6901.5 ["the balance, if any, shall constitute an obligation due from the person to this state."].) But this is precisely what the Takings Clause forbids unless accompanied by payment of "just compensation." As stated by the U.S. Supreme Court:

> [A] State, by *ipse dixit*, may not transform private property into public property without compensation, even for the limited duration of the deposit in court. This is the very kind of thing that the Taking Clause of the Fifth Amendment was meant to prevent. That Clause stands as a shield against the arbitrary use of governmental power.

Webb's Fabulous Pharmacies v. Beckwith (1980) 449 U.S. 155, 164. *See also Cerajeski* (holding that Indiana's escheat of interest on a small bank savings account was a "taking without just compensation.")

The SBE's "taking" of excess sales tax reimbursement under Tax Code §6901.5 operates as a "physical taking" (rather than a "regulatory taking" such as a land use regulation). Physical takings amount to a *per se* taking for which victims are entitled to just compensation without "complex factual assessments of the purposes and economic effects of government actions." (*Brown v. Legal Foundation* (2003) 538 U.S. 216, 233-234. *See also* (*Koontz v. St. Johns River Water Mgmt. Dist.* (2013) __ U.S. __, [133 S.Ct. 2586, 2600] ["[W]hen the government commands the relinquishment of funds linked to a specific, identifiable property interest such as a bank account or parcel of real property, a "per se takings approach" is the proper mode of analysis under the Court's precedent" citing *Brown*].)

The *McClain* Court's only answer to the obvious unconstitutionality of its ruling is that "the Board's subsequent receipt of that money as part of the retailers' sales tax . . . is not a 'taking' because 'taxes' and users fees are not 'takings.'" (*McClain* at 703.) But that response simply begs the questions of whether a retailer's remission of excess sales tax reimbursement is a "tax" (it obviously is not a "users fee.")

The State cannot have it both ways, defining sales tax reimbursement as a matter of private contract under Civil Code §1656.1 (when it suits the State's tax maximization goal of placing the tax incidence on retailers [*see* pp. 7-8]), and alternatively treating excess sales tax reimbursement as a "tax" (when it suits the State's purpose of avoiding paying just compensation under the Takings Clause). Rather, excess sales tax reimbursement is not a "tax" (*see* p. 9, *supra*) because Tax Code §6901.5 works an escheat (*see* pp. 29-30, *supra*,).

Moreover, the fact that California has the taxing power (but does not use it) to make all sales of test strips and lancets taxable does not save it from committing a "taking." (*See Koontz* at 2601 ["[W]e have repeatedly

found takings where the government, by confiscating financial obligations, achieved a result that could have been obtained by imposing a tax."].)

This Court set forth the standard of review when a demurrer has been sustained without leave to amend as follows:

> On appeal, "[w]hen a demurrer ... is sustained without leave to amend, we decide whether there is a reasonable possibility that the defect can be cured by amendment: if it can be, the trial court has abused its discretion and we reverse."

(*Loeffler* at 1100.)

Because Petitioners could have stated a claim under the Takings Clause of the U.S. Constitution, the trial court abused its discretion by denying leave to amend.

VI. CONCLUSION.

For the foregoing reasons this Court should reverse the Court of Appeal's decision and remand to the Superior Court with instructions (1) to reinstate Petitioners' First and Fifth Causes of Action, and (2) to grant leave to amend for Petitioners to state a cause of action for "just compensation" under the Takings Clause of the U.S. Constitution.

Finally, because the *Javor* remedy is necessary in order for Tax Code §6901.5 to satisfy due process, the *Javor* remedy must itself be administered in a manner that comports with due process. This Court should therefore provide guidance that prosecution of the *Javor*-compelled refund claims (before the new Department of Fee and Tax Administration Board and, if disallowed, before the Superior Court under Tax Code §6933) should vest in Petitioners. This is consistent with California common law that when a party with legal title to a claim has no interest in pursuing it, the real-party-in-interest may bring a derivative claim in the right of the title owner, who becomes a nominal party as to that claim. (*See e.g. Wallner v. Parry Professional Bldg., Ltd.* (1994) 22 Cal.App.4th 1446

[recognition of limited partner's common law and equitable standing to sue derivatively on partnership's claim.].)

DATED: August 14, 2017

Respectfully submitted,

McKool Smith Hennigan, P.C.
The Kick Law Firm, APC

By: /s/Bruce R. MacLeod

Attorneys for Petitioners/Appellants

Certificate Of Word Count

The undersigned certifies, pursuant to California Rules of Court, Rule 14(c)(1), that this brief contains 13,984 words, including footnotes, as counted by Microsoft Word 2010, the word processing program used to prepare the brief.

DATED: August 14, 2017

By: /s/Bruce R. MacLeod

Attorneys for Petitioners/Appellants

PROOF OF SERVICE

I declare as follows:

I am a citizen of the United States and employed in San Mateo County, California. I am over the age of eighteen years and not a party to the within action. My business address is 255 Shoreline Drive, Suite 510 Redwood Shores, CA 94065. On **August 14, 2017**, I served the foregoing document(s) described as **PETITIONER'S OPENING BRIEF ON THE MERITS** on the interested parties in this action follows:

☒by placing the document listed above in a sealed envelope with postage thereon fully prepaid, in the United States mail at Los Angeles, California addressed as set forth below.

☐by transmitting via e-mail or other electronic transmission the document(s) listed above to the person(s) at the e-mail address(es) set forth below.

Joseph Duffy (SBN 241854) Joseph Bias (SBN 257127) MORGAN LEWIS & BOCKIUS, LLP 300 South Grand Ave., 22nd Floor Los Angeles, CA 90071-3132 Tel: (213) 612 2500 Fax: (213) 612 2501 Email: jduffy@morganlewis.com Attorneys for Defendants and Respondents *Walgreen Co. and Rite Aid Corporation*	Robert P. Berry (SBN 220271) Carol M. Silberberg (SBN217658) BERRY & SILBERBERG, LLC 16150 Main Circle Dr., Suite 120 St. Louis, Missouri 63017 Tel: (314) 480 5882 Fax: (314) 480 5884 Email: rberry@berrysilberberg.com Email: csilberberg@berrysilberberg.com Attorneys for Defendant and Respondent *Wal-Mart Stores, Inc.*
Phillip J. Eskenazi (SBN 158976) Kirk A. Hornbeck (SBN 241708) HUNTON & WILLIAMS LLP 550 South Hope Street, Ste. 2000 Los Angeles CA 90071 Telephone: (213) 532-2000 Facsimile: (213) 312-4769 Email: peskenazi@hunton.com Email: khornbeck@hunton.com Attorneys for Defendants and Respondents *Albertson's Inc. and Sav-On Drugs*	David F. McDowell (SBN 125806) Miriam A. Vogel (SBN 67822) MORRISON & FOERSTER, LLP 707 Wilshire Blvd., Suite 6000 Los Angeles, CA 90017-3543 Tel: (213) 892 5200 Fax: (213) 892 5454 Email: dmcdowell@mofo.com Email: mvogel@mofo.com Attorneys for Defendant and Respondent *Target Corporation*

Richard T. Williams (SBN 52896) Shelley Hurwitz (SBN 217566) HOLLAND & KNIGHT LLP 400 S. Hope St., 8th Floor Los Angeles, CA 90071 Tel: (213) 896 2400 Fax: (213) 896 2450 Email: shelly.hurwitz @hklaw.com Attorneys for Defendants and Respondents *CVS Caremark Corporation, Longs Drug Stores Corporation and Longs Drug Stores California, Inc.*	Theodore Keith Bell (SBN 184289) Senior Corporate Counsel SAFEWAY, INC. Legal Division, Trial Group 5918 Stoneridge Mall Road Pleasanton, CA 94588 Tel: (925) 467 2422 Fax: (925) 467 3214 Email: tad.bell@safeway.com Attorneys for Defendants and Respondents *The Vons Companies and Vons Food Services, Inc.*
Douglas C. Rawles (SBN 154791) James C. Martin (SBN 083719) Kasey J. Curtis (SBN 268173) REED SMITH LLP 355 South Grand Ave., Suite 2900 Los Angeles, CA 90071-1514 Telephone: (213) 457 8000 Facsimile: (213) 457 8080 Email: DRawles@ReedSmith.com Attorneys for Defendants and Respondents *Walgreen Co. and Rite Aid Corporation*	Kamala D. Harris (SBN 146672) ATTORNEY GENERAL OF CALIFORNIA Lisa W. Chao (SBN 198536) Supervising Deputy Attorney General Nhan T. Vu (SBN 189508) Deputy Attorney General 300 South Spring Street, Suite 1702 Los. Angeles, CA 90013-1230 Tel: (213) 897 2484 Fax: (213) 897 5775 Email: nhan.vu@doj.ca.gov Attorneys for Defendant, Cross-Defendant and Respondent *California State Board of Equalization*
Taras P. Kick, Esq. (SBN 143379) James Strenio, Esq. (SBN 177624) THE KICK LAW FIRM, APC 201 Wilshire Blvd., Ste. 350 Santa Monica, CA 90401 Telephone: (310) 395-2988 Facsimile: (310) 395-2088 E-mail: taras@kicklawfirm.com Attorneys for Plaintiffs and Appellants *Michael McClain, Avi Feigenblatt and Gregory Fisher*	Court of Appeals, 2nd District Ronald Reagan State Building 300 S. Spring Street 2nd Floor, North Tower Los Angeles, CA 90013 Tel: (213) 830-7000
Office of the District Attorney Consumer Law Section Appellate Division 320 W. Temple St., #540 Los Angeles, CA 90012	Clerk, Honorable John Shepard Wiley Los Angeles County Superior Court CCW- Dept. 311 600 S. Commonwealth A venue Los Angeles, CA 90005

Office of the Attorney General Appellate Coordinator Consumer Law Section 300 South Spring Street Nmth Tower, 5th Floor Los Angeles, CA 900 13	

I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Executed on **August 14, 2017**, at Redwood Shores, CA.

Adrian Corona

*** This document is current for urgency legislation through Chapter 1 of the 2016 Session. ***

CIVIL CODE
Division 3. Obligations
Part 2. Contracts
Title 3. Interpretation of Contracts

GO TO CALIFORNIA CODES ARCHIVE DIRECTORY

Cal Civ Code § 1656.1 (2016)

§ 1656.1. Sales tax reimbursement included in retail sale price; Rebuttable presumption

(a) Whether a retailer may add sales tax reimbursement to the sales price of the tangible personal property sold at retail to a purchaser depends solely upon the terms of the agreement of sale. It shall be presumed that the parties agreed to the addition of sales tax reimbursement to the sales price of tangible personal property sold at retail to a purchaser if:

(1) The agreement of sale expressly provides for such addition of sales tax reimbursement;

(2) Sales tax reimbursement is shown on the sales check or other proof of sale; or

(3) The retailer posts in his or her premises in a location visible to purchasers, or includes on a price tag or in an advertisement or other printed material directed to purchasers, a notice to the effect that reimbursement for sales tax will be added to the sales price of all items or certain items, whichever is applicable.

(b) It shall be presumed that the property, the gross receipts from the sale of which is subject to the sales tax, is sold at a price which includes tax reimbursement if the retailer posts in his or her premises, or includes on a price tag or in an advertisement (whichever is applicable) one of the following notices:

(1) "All prices of taxable items include sales tax reimbursement computed to the nearest mill."

(2) "The price of this item includes sales tax reimbursement computed to the nearest mill."

(c)

(1) The State Board of Equalization shall prepare and make available for inspection and duplication or reproduction a sales tax reimbursement schedule which shall be identical with the following tables up to the amounts specified therein: Click here to view image. Click here to view image. Click here to view image. Click here to view image. Click here to view image. Click here to view image. Click here to view image. Click here to view image. Click here to view image. Click here to view image. Click here to view image. Click here to view image.

(2) Reimbursement on sales prices in excess of those shown in the schedules may be computed by applying the applicable tax rate to the sales price, rounded off to the nearest cent by eliminating any fraction less than one-half cent and increasing any fraction of one-half cent or over to the next higher cent.

(3) If sales tax reimbursement is added to the sales price of tangible personal property sold at retail, the retailer shall use a schedule provided by the board, or a schedule approved by the board.

(d) The presumptions created by this section are rebuttable presumptions.

HISTORY:

Added Stats 1978 ch 1211 § 1. Amended Stats 1985 ch 20 § 1, effective March 29, 1985, operative April 1, 1985; Stats 1990 ch 1528 § 1 (SB 2196).

NOTES:

Amendments:

1985 Amendment:

Added to the sales tax reimbursement schedule a table for a sales tax rate of 7% in subd (c)(1).

1990 Amendment:

(1) Added "or her" after "posts in his" in subds (a)(3) and (b); and (2) made changes in the sales tax reimbursement schedule.

Historical Derivation:

(a) Former CC § 6052.5, as added Stats 1973 ch 296 § 4.

(b) Former CC § 6052.5, as added Stats 1972 ch 1406 § 18, amended Stats 1973 ch 67 § 2.5.

(c) Former CC § 6052.5, as added Stats 1961 ch 869 § 1, amended Stats 1967 ch 963 § 3, Stats 1968 ch 940 § 4, Stats 1969 ch 24 § 4, ch 180 § 2, Stats 1971 ch 1400 § 7, Stats 1972 ch 1408 § 61.

Note

Stats 1978 ch 1211 provides:

SEC. 19. The Legislature in adopting the Sales Tax Act in 1933 intended that the incidence of the sales tax be on the retailer. In Section 8 of Chapter 681 of the Statutes of 1941, the following statement appears: "... the Legislature hereby declares and reaffirms that the sales tax is not imposed on any purchaser of tangible personal property in this state, but is for the privilege of engaging in the business of selling such property." Notwithstanding such legislative intent and decisions of California courts holding that the incidence of the California sales tax is upon the retailer and not upon the purchaser, the United States Supreme Court in *Diamond National Corp. v. State Board of Equalization, 47 L. Ed. 2d 780,* and the Court of Appeals for the Ninth Circuit in *United States of America v. State Board of Equalization, 536 F.2d 294,* held that for federal purposes the incidence of the California sales tax is on the purchaser. This act provides for changes in the California Sales and Use Tax Law to make it clear that for both federal and state tax purposes the incidence of the California sales tax is upon the retailer for the privilege of selling tangible personal property at retail and is not upon the purchaser. This act is not intended to affect any litigation or claims for refund relating to taxable periods prior to the effective date hereof.

SEC. 22. Although the California sales tax law has uniformly been construed by the California Legislature, courts, and administrative agencies as imposing an excise tax upon the retailer and as imposing no legal obligation upon a purchaser, the law does not prevent the parties from contracting between themselves for collection by the retailer of reimbursement for the sales tax from his customer in order to obtain the benefit of a lower sales tax measure or income tax deduction of the sales tax reimbursement by the purchaser or for any other purpose. Most sales transactions involve small amounts of money, are oral, and do not disclose the parties' intention with respect to reimbursement for sales tax. Ascertainment of this intention is necessary to a determination of a proper measure of sales tax and for other purposes. Accordingly, the purpose of the Legislature in adding *Section 1656.1 to the Civil Code* is to create a rebuttable presumption as to the intention of the parties for use in the absence of evidence of other intention by those who have occasion to use this information.