Case No. S241471

In the Supreme Court of the State of California

MICHAEL MCCLAIN, ET AL.,
Plaintiffs and Appellants,

vs.

SAV-ON DRUGS, ET AL.
Defendants and Respondents.

THE RETAILER DEFENDANTS' JOINT ANSWER BRIEF ON THE MERITS

After a Decision by the Court of Appeal, Second Appellate District, Division Three, Case Nos. B265011 & B265029

Appeal from a Judgment of Dismissal
Los Angeles Superior Court, Case Nos. BC325272 & BC327216
Honorable John Shepard Wiley

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I.

INTRODUCTION

Plaintiffs—who are consumers, not taxpayers—maintain they have the right to drag the Retailers who sold them certain products into their taxability dispute with the State Board of Equalization (the Board).[1] Relying on *Javor v. State Board of Equalization* (1974) 12 Cal.3d 790 (*Javor*) and Civil Code section 1656.1 Plaintiffs asserted both an equitable cause of action that sought to compel the Retailers to pursue sale tax refund actions on their behalf and order the Board to make the refunds Plaintiffs contend are owed and a contract cause of action that sought to hold the Retailers liable for collecting sales tax reimbursements on transactions Plaintiffs believe are exempt. The causes of action Plaintiffs pled, however, impermissibly demand that a court make the taxability determination with regard to disputed exemption in the first instance.

Although Plaintiffs' causes of action as pled clearly fail under controlling law, this Court granted review to consider a more

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[1] On July 1, 2017, responsibility for the administration of the sales tax was transferred to the Department of Tax and Fee Administration. (Gov. Code, §§ 15570, 15570.22.) On January 1, 2018, responsibility for adjudicating tax matters and making of taxability rulings in the first instance will transfer to the Office of Tax Appeals. (Gov. Code, § 15674.) For ease of reference, this brief refers to these functions as being performed by the Board.

nuanced question: "Can a purchaser of products allegedly exempt from sales tax but for which the retailer collected sales tax reimbursement bring an action to compel the retailer to seek a sales tax refund from the State Board of Equalization and remit the proceeds to the purchasers?" As we will explain, the answer to that question also should be a resounding "no."

There is no dispute that the courts have a very limited role in resolving disputes implicating the tax code and the Board's decision-making. This is especially true where, as here, a non-taxpayer consumer is the one seeking relief. It is only in those rare circumstances—where no conflict with the tax code exists, taxability is undisputed, and the amount of the refund is so clear that an analogy to a constructive trust remedy can be drawn—that equitable relief benefiting a non-taxpayer can even be contemplated. That is not this case. Here, the Retailers have elected to remit the sales tax reimbursements to the State, the applicability of a tax exemption is at issue, and taxability itself remains in dispute. In these circumstances, where there is no ready analogy to constructive trust, Plaintiffs cannot compel the Retailers to pursue a refund claim on their behalf.

First, although the relief allowed in *Javor* did not conflict with the tax code, the equitable relief contemplated here clearly does so. The code, among other things, provides a statutory safe harbor for taxpayers who remit reimbursements to the State and gives taxpayers the right to decide when to rely on the statutory

presumption of taxability or, alternatively, pursue an exemption. In this case, the Retailers have sought the safe harbor and decided not to pursue an exemption. It is the consumers who are interested in exemptions and dispute the meaning of the Board's regulations. But the Retailers have no dog in that fight; they have paid every penny of the disputed reimbursements to the State. The law therefore does and should leave the Retailers out of Plaintiffs' taxability dispute with the Board. To allow consumers to force the Retailers to pursue refund actions when they occupy a safe harbor and elect not to pursue an exemption conflicts with the code and will do nothing but drive up the cost that retailers charge for the products at issue.

Second, although this Court in *Javor* fashioned a remedy based on constructive trust principles, none of the considerations that drove the constructive trust analysis in *Javor* are present with respect to the taxpayers in this case. To start with, the Retailers are not holding any disputed funds. Thus, unlike in *Javor*, with respect to the taxpayers, there is no identifiable "res." Nor, as in *Javor*, is there an identifiable class of beneficiaries indisputably entitled to the non-existent "res." Here, the amount of the purported refund is in dispute and there is no ready means to identify to whom a refund might be owed. Simply put, the constructive trust analogy as to the Retailers fails in all its particulars.

Third, although the remedy crafted in *Javor* did not raise constitutional concerns, enfranchising non-taxpayer consumers

to force the Retailers to pursue an exemption to benefit those consumers would raise serious constitutional issues. The California Constitution authorizes the Legislature—and only the Legislature—to decide how refund claims are pursued. And the Legislature did not give non-taxpayer consumers the right to pursue refund claims themselves or the ability to compel taxpayer-retailers to file refund lawsuits. To the contrary, the Legislature gave the Retailers a safe harbor and the right to elect whether to pursue an exemption. These constitutional concerns should be avoided, not invited, and no *Javor*-type remedy should be considered for that reason as well.

Fourth, in *Javor*, this Court felt compelled to craft a remedy because the consumers had no other avenue to obtain relief. That compulsion is not present in this case either. Here, the statutory scheme already provides for the resolution of taxability questions without forcing the Retailers into the middle of Plaintiffs' dispute with the Board. A consumer can petition the Board under Government Code section 11340.6 to repeal, amend, or enact a regulation, thereby empowering the Board to address a taxability dispute created by a particular regulation. Similarly, Government Code section 11350 permits a consumer to file a declaratory relief action to determine whether a regulation conflicts with a statute or the constitution. And the statutory refund procedures apply equally to use tax. For purchases subject to use tax, the consumer is the

taxpayer and thus is free to litigate a taxability dispute with the Board under established administrative procedures.[2]

Finally, Plaintiffs' breach of contract claim (framed under section 1656.1) triggers precisely the same conflicts with the tax code and the California Constitution as Plaintiffs' flawed effort to obtain equitable relief against the Retailers. Plaintiffs cannot use that section to circumvent the fundamental statutory and administrative obstacles that foreclose the relief they seek on the allegations they advance. There likewise is no need, for the reasons noted, to disrupt established law by dramatically expanding section 1656.1 to provide the relief Plaintiffs seek.

In sum, the Retailers do not belong in this lawsuit and there is no basis on which *Javor* can or should be expanded and extended to force them to file a refund action. Nor should section 1656.1 be judicially redrafted in an effort to accomplish that result. The existing law preserves the proper roles for the Legislature and the courts and avoids conflicts with the provisions of the tax code and the California Constitution. This Court should maintain that balance and affirm the result reached by the Court of Appeal.

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2 The existence of such established avenues for resolving their alleged wrongs eliminates Plaintiffs' assertions that the tax code is unconstitutional and the remittance of sales tax an escheat to the State by virtue of the safe harbor provision of Revenue and Tax Code section 6901.5.

II.

RELEVANT BACKGROUND

As the Court of Appeal recognized here, and as this Court has recognized before, any relief provided to a non-taxpayer in a case like this must be consistent with the tax code. Here, this Court's inquiry must take account of the provisions of the Sales and Use Tax Law, applicable regulations, and the conduct of the Board and the retailer-taxpayers in relation to both.

A. California's Sales And Use Tax Law

California's Sales and Use Tax Law is set forth in division two, part one, of the Revenue and Taxation Code (beginning with Revenue and Taxation Code section 6001, et seq.).[3] Although division two covers two distinct taxes—sales tax and use tax—which are imposed on different categories of persons for different reasons, many of the relevant provisions—including those concerning exemptions and how refunds are to be obtained—apply to both taxes.

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[3] Unless otherwise stated, all subsequent statutory citations are to the Revenue and Taxation Code.

1. Sales Tax

"Sales tax" is imposed on the "gross receipts" of all retailers doing business within the state "[f]or the privilege of selling tangible personal property at retail . . . ." (§ 6051.) It is "presumed that all gross receipts are subject to the tax until the contrary is established" and it is the retailer's burden to prove otherwise. (§ 6091.) Although the retailer is the taxpayer, retailers are permitted, but not required, to collect "reimbursements" from their customers. (Civ. Code, § 1656.1.) Retailers who elect to collect reimbursements from customers are afforded a statutory safe harbor that relieves them of any obligation vis-à-vis the reimbursements as long as they remit the reimbursements to the Board. (§ 6901.5.)

2. Use Tax

"Use tax" in contrast, is not imposed on retailers but on "[e]very person storing, using, or otherwise consuming in [California] tangible personal property" that is purchased from any retailer. (§ 6202.) While the use tax is imposed on all tangible personal property stored or used within the state, a person's liability for use tax is extinguished by a receipt demonstrating that the item was purchased from a retailer engaged in business in California or one who is authorized by the Board to collect use tax. (*Ibid.*) Thus, for purposes of use tax, the consumer is deemed the taxpayer. (*Ibid.*)

3. Exemptions From Sales And Use Tax

An entire chapter of the Sales and Use Tax Law is devoted to various exemptions taxpayers are permitted to claim. (§§ 6351-6423.) As this Court noted in *Loeffler v. Target* (2014) 58 Cal.4th 1081 (*Loeffler*), the "law of exemptions is comprehensive, governing every imaginable type of sales transactions."[4] (*Id.* at p. 1105.) All sales and uses are presumed taxable unless the retailer proves otherwise. (§ 6091 ["it shall be presumed that all gross receipts are subject to the tax until the contrary is established. The burden of proving that a sale of tangible personal property is not a sale at retail is upon the person who makes the sale unless he takes from the purchaser a certificate to the effect that the property is purchased for resale"]; § 6202 [similar provision for use tax].) If a taxpayer wants to claim an exemption for a particular sale or use, then it is the taxpayer's burden to establish that an exemption applies. This construct is intended to help "the proper administration" of the Sales and Use Tax Law and to prevent tax evasion. (*Loeffler*, *supra*, 58 Cal.4th at p. 1107.)

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[4] "One article in the exemption chapter includes 79 provisions exempting particular types of transactions from sales and use taxation—including, for example, relatively straightforward exemptions for poultry litter (§ 6358.2), to much more complicated and fact-specific exemptions for some sales of food or medicine (§§ 6359, 6369) or for gross receipts from food stamp sales (§ 6373), to some quite arcane exemptions. (See § 6366.5 [sales of endangered species].)" (*Loeffler*, *supra*, 58 Cal.4th at p. 1105.)

4. Deficiency Determinations And Taxpayer Refund Claims

Persons subject to either sales or use tax are required to file returns and make payments on a quarterly basis. (§§ 6451-6459.) The tax code provides, however, that persons who purchase items subject to "qualified use tax" (which is defined to mean use tax due on purchases of certain individual items with a sales price of less than one thousand dollars), may elect to pay the qualified use tax they owe on an annual basis as part of their annual income tax return. (§ 6452.1, subd. (d); § 6452.2.)

To the extent the Board is not satisfied with a return or the amount of tax paid on its own initiative, the Board may audit the taxpayer, make deficiency determinations, and impose penalties on the taxpayer for underpayment of tax. (§ 7054 [audits]; § 6481 [deficiency determinations]; §§ 6484-6485 [penalties].) If a deficiency determination is made, the taxpayer is permitted to challenge the determination by filing an administrative petition with the Board. (§§ 6561-6564 [petitions for redetermination of deficiency and process for having a hearing on the same].)

On the flip side, to the extent the taxpayer believes the taxpayer has overpaid the amount of tax due, the taxpayer is permitted, but not required, to file refund claims with the Board. (§ 6901.) The filing of an administrative refund claim is a necessary prerequisite to maintaining a refund lawsuit [§ 6932], and the failure

to file a timely refund claim waives the right to recover any overpaid amounts [§ 6905]. The tax code makes clear, however, that *only* the taxpayer is permitted to file a refund claim or sue in court to seek a refund. (§ 6937.)

Irrespective of how a taxability dispute arises, be it through a deficiency determination or a refund claim, under the administrative procedures established by the tax code "it is for the Board in the first instance to interpret and administer an intensely detailed and fact-specific sales tax system governing an enormous universe of transactions." (*Loeffler*, *supra*, 58 Cal.4th at p. 1103.) In that regard, court involvement is limited to review of the Board's administrative determinations. (*Ibid.* ["Administrative procedures must be exhausted before the taxpayer may resort to court."].)

5. Non-Taxpayer Lawsuits To Recoup Reimbursements

By legislative design, the tax code does not provide a mechanism for non-taxpayer consumers to pursue refund actions or file suit against the retailers who collected reimbursements. Given this statutory limitation, courts should tread cautiously before providing non-taxpayers with relief. In both *Javor* and *Loeffler*, this Court exercised that caution in determining whether a non-taxpayer lawsuit could proceed.

Javor involved a consumer's attempt to obtain a refund from the Board of sales tax reimbursements to which the Board was indisputably not entitled. (*Javor*, *supra*, 12 Cal.3d at pp. 792-793.) In that case, Congress's retroactive repeal of an excise tax imposed on the sale of new cars and accessories reduced the total vehicle price on which sales tax had previously been imposed. (*Ibid.*) The retroactive reduction meant the Board had collected excess sales tax. (*Ibid.*) Recognizing this, the Board adopted procedures by which retailers could secure refunds on condition that the retailers passed on the refund to their customers who had paid sales tax reimbursements. (*Id.* at p. 794.) Tellingly, the Board admitted it would order the refunds if the retailers applied for them. (*Ibid.*)

Many retailers did not, however, pursue refund claims, because they had no incentive to do so. As a result, the *Javor* plaintiff brought a putative class action on behalf of all purchasers of new motor vehicles and accessories in California to compel the retailers to seek, and the Board to issue, refunds. (*Javor*, *supra*, 12 Cal.3d at p. 793.) Although the retailers who sold the vehicles and accessories were named as defendants, they were never served and were not involved in the case. (*Id.* at p. 793, fn.2 ["The record discloses that the Board is the only defendant either served with summons or appearing in the action"].) This Court fashioned a remedy nonetheless. (*Id.* at pp. 801-802.)

It began by recognizing "that the Board's liability to refund taxes erroneously collected . . . is governed by statute . . .

and the orderly administration of the tax laws requires adherence to the statutory procedures and precludes imposing on [the Board] the burden of making refunds to the taxpayers' customers." (*Javor*, *supra*, 12 Cal.3d at p. 798.) Because of the unique factual circumstances, this Court allowed the suit to proceed—as it was unwilling to leave the Board with the excess revenue that rightfully belonged to the purchasers. (*Id.* at pp. 800-802.) Relying on the equitable principles of restitution and unjust enrichment, this Court decided it was appropriate to permit the named plaintiff to pursue a class action which nominally would "compel" the retailers (who had not been served and did not participate in the case) to file refund claims to avoid the unjust enrichment that would otherwise result. (*Ibid.*)

In crafting this remedy, this Court drew heavily on both its earlier decision in *Decorative Carpets, Inc. v. State Board of Equalization* (1962) 58 Cal.2d 252 (*Decorative Carpets*) and Civil Code section 2224 (upon which *Decorative Carpets* relied). As this Court explained, section 2224 codifies the constructive trust principle that "'[o]ne who gains a thing by fraud, accident, mistake [is] an involuntary trustee of the thing gained, for the benefit of the person who would otherwise have had it.'" (*Javor*, *supra*, 12 Cal.3d at p. 798, quoting Civ. Code, § 2224.) Relying on constructive trust principles, *Decorative Carpets* upheld the Board's refusal to refund sales tax overpayment to a retailer unless the retailer demonstrated that it would return the money to the consumers who paid reimbursements. (*Ibid.*) To support that

holding, the *Decorative Carpets* Court explained that the Board "had a vital interest in the integrity of the sales tax and might therefore 'insist as a condition of refunding overpayments to [the retailer] that it discharge its trust obligations to its customers.'" (*Ibid.*, quoting *Decorative Carpets*, *supra*, 58 Cal.2d at p. 255.) In *Javor*, this Court went further, noting that "[t]he 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" and thus allowed the plaintiff's lawsuit to proceed. (*Javor*, *supra*, 12 Cal.3d at p. 802, internal citation omitted.)

For its part, *Loeffler* stood on a very different footing and generated a different result. The plaintiffs there wanted to hold Target, a retailer who had remitted the disputed sales tax collections to the Board, liable for allegedly charging sales tax reimbursements on transactions the plaintiffs argued were not taxable. (*Loeffler*, *supra*, 58 Cal.4th at pp. 1092-1093.) They asserted Target's conduct violated the Unfair Competition Law (UCL), Consumer Legal Remedies Act (CLRA), and the common law because Target misrepresented to the general public that Target had a legal right to collect tax reimbursement on sales of hot coffee "to go." (*Ibid.*)

This Court again noted the difficulties with allowing non-taxpayers to insert themselves into California's carefully-crafted taxation and tax refund statutory schemes. (*Loeffler*, *supra*, 58 Cal.4th at pp. 1100-1101.) Those schemes provide no direct right of action for consumers to obtain tax refunds and the California

Constitution, in article XIII, section 32, prohibits courts from expanding the methods for obtaining tax refunds beyond those provided by the Legislature. (*Woosley v. State of California* (1992) 3 Cal.4th 758, 789 (*Woosley*) ["The California Constitution expressly provides that actions for tax refunds must be brought in the manner prescribed by the Legislature"].) With that backdrop, this Court held that the plaintiffs' UCL and CLRA claims were barred because they conflicted with the tax code and the comprehensive taxation and refund scheme the Legislature had crafted. (*Loeffler*, *supra*, 58 Cal.4th at p. 1100.)

As a threshold matter, this Court found that the consumers' claims improperly invaded the Board's core function. That is, taxability determinations are "committed in the first instance to the Board, subject to judicial review under the restrictions and pursuant to the procedures provided by the tax code." (*Loeffler*, *supra*, 58 Cal.4th at p. 1100.) Applying that principle to the UCL and CLRA claims, this Court concluded that because the plaintiffs' lawsuit would have conflicted with the Board's exclusive jurisdiction to make taxability determinations, it was subject to dismissal:

> The clear basis of plaintiffs' action – that Target represented that it properly was charging and in fact charged sales tax reimbursement on a sale that plaintiffs believe the tax code exempted from taxation – requires resolution of a sales tax law question, that is, whether Target's sales of hot coffee to go to plaintiffs were subject to sales tax or fell

> within an exemption. That question, which we may characterize as the "taxability" question, is committed in the first instance to the Board, subject to judicial review under the restrictions and pursuant to the procedures provided by the tax code. A UCL or CLRA cause of action such as plaintiffs' cannot be reconciled with the primary decision making role that the tax code vests in the Board with respect to tax issues. . . . *For these reasons, the tax code precludes claims such as plaintiffs'.*

(*Loeffler*, *supra*, 58 Cal.4th at p. 1100, italics added.)

This Court was careful to distinguish the consumer claims brought against Target (which conflicted the procedures set forth in tax code), from the equitable relief sought in *Javor* (which did not). The equitable relief sought in *Javor*, which would have allowed the non-taxpayer consumer "to compel the retailer/taxpayer to seek a refund from the Board," was permissible because it "invoke[d], rather than avoid[ed], tax code procedures." (*Loeffler*, *supra*, 58 Cal.4th at p. 1101.) In keeping with *Javor*, this Court observed that "any remedy must be constrained by and not *inconsistent* with the tax code" and "carefully identif[y] an appropriate means to vindicate a consumer interest in a refund of a reimbursement charge *without* embracing procedures that were inconsistent with the tax code or disregarded the central function of the Board." (*Id.* at p. 1133, original italics.) The *Loeffler* plaintiffs' claims, in contrast, did no such thing. (*Ibid.*)

B. Plaintiffs Press Their Dispute Over The Taxability Of Glucose Test Strips And Skin Puncture Lancets By Suing The Retailers, Who Join The Board Of Equalization

This lawsuit, like *Javor* and *Loeffler,* was brought by non-taxpayer consumers attempting to obtain a sales tax refund. It concerns a dispute between Plaintiffs and the Board over the taxability of glucose test strips and skin puncture lancets. There is no provision in the tax code that expressly exempts glucose test strips and skin puncture lancets from sales and use tax. Rather, the dispute between Plaintiffs and the Board concerns the correct interpretation of section 6369 and Sales and Use Tax Regulation 1591.1 (a sales and use tax regulation adopted by the Board that interprets the scope of section 6369).

Section 6369, entitled "Medicines," provides for an exemption "from the taxes imposed by the [Sales and Use Tax Law] for the gross receipts from the sale . . . and the storage, use, or other consumption" of medicines prescribed or furnished for certain uses. (§ 6369.) As relevant to this case, section 6369, subdivision (a)(1), exempts from sales and use tax medicine "[p]rescribed for the treatment of a human being by a person authorized to prescribe the medicines, and dispensed on prescription filled by a registered pharmacist in accordance with law." (§ 6369, subd. (a)(1).)

Regulation 1591.1 is entitled "Specific Medical Devices, Appliances, and Related Supplies" extends section 6369 to

various medical products—including glucose test strips and skin puncture lancets when purchased from a pharmacist for treatment of diabetes in accordance with a physician's instructions. With regard to the two products in this dispute in this case, regulation 1591.1 states:

> 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. These medical supplies are not medicines and their sale or use does not qualify for tax exemption under subsections (a) or (b) of Revenue and Taxation Code section 6369.

(Cal. Code Regs., tit. 18, § 1591.1, subd. (b)(5).)[5]

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5 Formal regulations, such as regulation 1591.1, "do not present a matter for the independent judgment of [the courts] . . . ." (*Wallace Berrie & Co. v. State Bd. of Equalization* (1985) 40 Cal.3d 60, 65.) Instead, they are presumed valid unless it is determined that they were adopted outside the authority conferred on the administrative agency by the legislature or not reasonably necessary to effectuate the purpose of the underlying statute. (*Ibid.*)

As the text of regulation 1591.1 reveals, the exemption for glucose test strips and skin puncture lancets is not categorical. It applies only to glucose test strips and skin puncture lancets furnished by a registered pharmacist in accordance with a physician's instructions for use by a diabetic to treat his or her disease. Thus, three years after its effective date, the Board sent a letter to retailers selling diabetic testing products which reiterated that regulation 1591.1 means what it says. (1AA:210.) There, the Board explained that sales of glucose test strips and skin puncture lancets are exempt from sales tax only if they are made by a registered pharmacist to a person who uses them in accordance with a physician's instructions. (*Ibid.*)

The Board's letter went on to point out that, consistent with other regulations, the retailer "must maintain a copy of the instructions in its records . . . as support for the exemption." (1AA:210.) It further explained that if "customers are able to remove the items directly off the shelf and pay for them at [the] store's registers, without a pharmacist's intervention," those sales would not be considered tax exempt because they were not being made by a registered pharmacist. (*Ibid.*)

In December 2004, Plaintiffs filed two lawsuits against the Retailers—one related to the Retailers' practice of collecting sales tax reimbursements on sales of glucose test strips, and the other related to tax reimbursements on sales of skin puncture lancets. (RA:5-38.) Although the reimbursements at issue had been

remitted to the State, Plaintiffs sought compensatory and exemplary damages, as well as restitution from the Retailers. (RA:19, 36-37.)

The Retailers' demurrers were overruled and they answered. (3AA:653-656.) Thereafter, the trial court ordered the Retailers to file cross-complaints against the Board which sought equitable indemnity and other relief. (1AA:1-61.) This action was stayed when this Court granted review in *Loeffler*. (RA:40, 46-48.)

C. The Trial Court Finds Plaintiffs' Taxability Challenge Is Not Justiciable And Dismisses The Action

Following this Court's decision in *Loeffler*, Plaintiffs filed their Fourth Amended Complaint (Complaint)—the operative pleading for this appeal—asserting seven causes of action: (1) two for breach of contract; (2) two for violations of the UCL; (3) one for negligence; (4) one for violations of the CLRA; and (5) one for injunctive/equitable relief which sought to pursue a *Javor*-type remedy. (1AA:77-89.) As before, all of these claims were aimed at the Retailers' practice of collecting sales tax reimbursements on certain sales of glucose test strips and skin puncture lancets. (*Ibid.*) Plaintiffs tried to avoid *Loeffler*'s preclusive effect by claiming the joinder of the Board aligned their lawsuit with *Javor* because the sales tax exemption for retail sales involving test strips and lancets allegedly was clear. (1AA:83-85.)

The Retailers responded with a joint demurrer, contending Plaintiffs' claims were foreclosed by *Loeffler* and *Javor* because Plaintiffs' lawsuit improperly sought to have a court make a taxability determination and order a refund in the first instance, without the benefit of any administrative proceedings before the Board. (1AA:104-107.) The Retailers also argued they were entitled to avail themselves of the safe harbor, as they have remitted the reimbursements to the Board. (*Ibid.*)

After a lengthy hearing, the trial court agreed that *Loeffler* controlled, found the "unique circumstances" of *Javor* were not satisfied, and sustained the Retailers' joint demurrer without leave to amend. (3AA:613-614.)

D. The Court Of Appeal Unanimously Affirms The Trial Court's Lack Of Justiciability Decision

The Court of Appeal's opinion focused on Plaintiffs' contention that they should be permitted to pursue a *Javor*-type equitable cause of action that would compel the Retailers to file a refund claim with the Board, but also addressed Plaintiffs' contract-based cause of action under section 1656.1 based upon the existence of an alleged "agreement" that sales tax would not be charged on exempt transactions. The Court of Appeal rejected both avenues of relief.

It began its analysis with the California Constitution, which states that "[a]fter payment of a tax claimed to be illegal, an

action may be maintained to recover the tax paid, with interest, in such manner as may be provided by the legislature." (Cal. Const., art. XIII, § 32.) It then acknowledged that courts on occasions have recognized "equitable exceptions" to this rule, but that such exceptions only arose under "unique circumstances." (Op:13-14.)

Looking particularly at this Court's decision in *Javor*, the Court of Appeal identified the "unique" circumstances where *Javor* applies to provide judicial relief in light of recognized constitutional limitations. It determined that those unique circumstances only arise when: "(1) the person seeking the new tax refund remedy has no statutory tax refund remedy available to it; (2) the tax refund remedy sought is not inconsistent with existing tax refund remedies; and (3) the Board has already determined that the person seeking the new tax refund remedy is entitled to a refund, such that the refusal to create that remedy will unjustly enrich either the taxpayer/retailer or the Board." (Op:3-4).

The Court of Appeal then found *Javor*'s unique circumstances absent in this case. Instead of compatibility with the code, judicial recognition of a right to sue the Retailers and the Board would conflict with section 6905 (which permits retailers to waive their right to seek a refund) and section 6901.5 (which provides a safe harbor from suit). (Op:21-23.) Moreover, the Board had yet to decide whether the Retailers (and by extension the customers) were entitled to a refund. (Op:23.) Plaintiffs' demand for a "*Javor*-type" remedy did not resemble *Javor* remedy at all.

The Court of Appeal also held that Plaintiffs' breach of contract cause of action under section 1656.1 took them no further because it was based on the same flawed premise. (Op:27.) It found Plaintiffs had not alleged a viable basis to rebut section 1656.1's presumption that the parties had agreed to contract to pay reimbursements because "the retailer's unexpressed intention not to charge sales tax in some transaction cannot alter the express terms of the parties' contract or otherwise rebut the statutory presumption." (Op:27, citing *Patel v. Liebermensch* (2008) 45 Cal.4th 344, 352 (*Patel*)). Under any circumstances, therefore, Plaintiffs' pleading did not meet the prerequisites for a cause of action under section 1656.1. (Op:28-29.)

III.
ARGUMENT

A. A *Javor*-Type Remedy Should Not Be Extended To Force Retailers To Pursue A Refund Action Where They Have Remitted Sales Tax Reimbursements To The State, Not Sought An Exemption, And Taxability Is In Dispute

At bottom, *Loeffler* and *Javor* both hold that any remedy courts permit non-taxpayer consumers to pursue is constrained by, and must be consistent with, the administrative procedures set forth in the tax code. Consistent with *Loeffler*, where, as here, a proposed a remedy or cause of action: (i) fundamentally conflicts with the tax code by infringing on the Board's essential role as the initial arbiter of taxability issues,

(ii) violates the safe harbor retailers enjoy under section 6901.5, and (iii) would force retailers to claim exemptions they are not required to take—the remedy or claim is legally barred. (See *Loeffler*, *supra*, 58 Cal.4th at p. 1100.) In contrast, where, as in *Javor*, the remedy or cause of action does not fundamentally conflict with the tax code and preserves the Board's essential function, then it is not necessarily barred and countervailing concerns, such as unjust enrichment, may permit a court to craft appropriate relief. (See *Javor*, *supra*, 12 Cal.3d at p. 802.)

Plaintiffs' causes of action, as pled, are incompatible with the tax code and deserve the same fate as *Loeffler*. Just as in *Loeffler*, Plaintiffs' causes of action demand that the court make the taxability determination with regard to disputed exemption in the first instance. (1AA:83-85, 90.) While that should end the matter, this Court granted review to address a different issue: Whether a purchaser of products allegedly exempt from sales tax, but for which the retailer has collected sales tax reimbursements, may bring an action to compel the retailer to seek a sales tax refund from the Board and remit the proceeds to the purchaser? There are a number of sound reasons this Court should answer that broader question in the negative as well.

1. Requiring Retailers To Pursue Refund Claims Where They Have Remitted Sales Tax Reimbursements Conflicts With The Tax Code By Violating The Safe Harbor

No provision of the tax code permits a non-taxpayer consumer to compel a retailer to pursue a refund action on behalf of the consumer. Rather, the Legislature addressed the issue of a retailer's obligations vis-à-vis a consumer by creating the "safe harbor" retailers enjoy under section 6901.5. (See *Loeffler*, *supra*, 58 Cal.4th at p. 1118.)

In relevant part, section 6901.5 states that when a retailer charges a customer a reimbursement on an amount that is not taxable or is in excess of the taxable amount, "the amount so paid shall be returned by the [retailer] to the customer upon notification by the Board . . . or by the customer that such excess has been ascertained," but a retailer may "fail[] or refus[e] to do so" provided that the "amount that is not taxable or is in excess of the taxable amount, shall be remitted by [the retailer] to this state." (§ 6901.5.)

When a consumer contends excess reimbursement has been charged, section 6901.5 gives the retailer the option of either: (i) returning the excess payment to the consumer; or (ii) refusing to do so and instead remit the money to the Board. (§ 6901.5; *Loeffler*, *supra*, 58 Cal.4th at p. 1120 ["Based upon the statutory language [of section 6901.5], it appears that a retailer may *refuse* a

consumer's request that excess reimbursement be refunded, so long as the retailer remits the amount to the Board"].) Thus, through section 6901.5, "the Legislature intended to allow a taxpayer to satisfy his or her tax liability on a transaction by paying to the State an equivalent amount of tax reimbursement collected from a customer on the same transaction." (*Loeffler*, *supra*, 58 Cal.4th at p. 1119.)

Allowing a consumer to force a retailer to litigate taxability by pursuing a refund claim plainly is inconsistent with the safe harbor. Instead of allowing a retailer to discharge its obligation by remitting excess reimbursements to the Board, such a lawsuit would compel the retailer to pursue refund claims at a consumer's behest. The retailer's obligation would not be, as *Loeffler* provides, "at an end." (*Loeffler*, *supra*, 58 Cal.4th at p. 1120.) Consumers instead would be able to commandeer businesses in which they have no ownership interest to pursue tax refunds for their own reasons. Taken to its natural extension, this theory would authorize any consumer to take control of any business for purposes of tax litigation arising from any transaction that included sales tax reimbursement and the safe harbor would cease to exist.[6]

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[6] In their brief, Plaintiffs contend the burden on the Retailers is minimal, as it boils down to "the price of a postage stamp," and thus would not run afoul of the safe harbor. (OBOM:22.) That is not true. The refund process itself contains a number of time-consuming steps, including the submission of documentation and (continued on next page)

Yet as this Court consistently has made clear, any legal remedies authorized for a non-taxpayer consumer must align with the statutory provisions, not undermine them. A conflicting remedy cannot be permitted. (See *Loeffler*, *supra*, 58 Cal.4th at p. 1133 ["Neither *Javor* [], nor *Decorative Carpets* [], contains language implying that current law—with its firmer identification of the retailer as the taxpayer, its safe harbor for retailers who have paid the State amounts they collected as reimbursement, and its penalty system—would require that a court approve a consumer action that would in various ways be inconsistent with the tax code. Rather, in those cases we warned that any remedy must be constrained by and not *inconsistent* with the tax code . . ."]; see also Part III.A.3, *post* [discussing constitutional concerns presented by failing to adhere to the Legislature's remedial scheme].) Any effort to engraft a *Javor*-type remedy onto Plaintiffs' lawsuit should be rejected for this reason alone.

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possible appeals. (See, e.g., Cal. Code Regs., tit. 18, §§ 5230, subd. (a), 5235, subd. (c), 5261, subd. (c).) What is more, litigating tax issues in court can itself be a costly endeavor. (See, e.g., *Northwest Energetic Services, LLC v. California Franchise Tax Bd.* (2008) 159 Cal.App.4th 841, 850 [taxpayer incurred over $200,000 in attorney's fees litigating constitutionality of tax with government]; *Apple, Inc. v. Franchise Tax Bd.* (2011) 199 Cal.App.4th 1, 26 [taxpayer incurred over $650,000 in attorney's fees litigating deductibility issue with government].)

2. Requiring Retailers To Pursue Refund Claims Where They Have Elected To Remit Sales Tax Reimbursements Conflicts With The Tax Code By Forcing Retailers To Take An Exemption

Compelling retailers to pursue a refund action in this case also would directly conflict with the code provision allowing them to elect not to do so. This case involves a purported refund claim regarding the applicability of a sales tax exemption, which under section 6905, retailers have no obligation to pursue. (§ 6905.) This is significant because it is a retailer's burden to establish that an exemption applies in the face of the presumption that all sales are taxable. (§ 6091 ["it shall be presumed that all gross receipts are subject to the tax until the contrary is established. The burden of proving that a sale of tangible personal property is not a sale at retail is upon the person who makes the sale unless he takes from the purchaser a certificate to the effect that the property is purchased for resale"].)

There are, as *Loeffler* notes, multiple reasons why a retailer may elect not to seek an exemption or pursue a refund claim. For example, a retailer may not have adequate records to support the exemption or the costs of pursuing an exemption may be prohibitive compared to paying the tax. Simply stated, "it would not be unreasonable if the retailer's tax payment to some extent erred on the side of considering sales taxable. Indeed, the taxpayer may recognize that it has failed to retain records adequate to carry

its burden of establishing it is entitled to an exemption or has overpaid." (*Loeffler*, *supra*, 58 Cal.4th at p. 1129.)

A *Javor*-type remedy compelling retailers to file refund claims and litigate taxability issues with the Board conflicts with these provisions as well. Rather than giving retailers the option of deciding whether to take an exemption, a *Javor*-type lawsuit would effectively require retailers to take exemptions they have no legal obligation to claim and to pursue a refund action for the benefit of non-taxpayer consumers. That result would, in turn, force retailers to incur the costs and expense of establishing the exemption and distributing the refunds—exactly what the tax code allows them to avoid. This would serve no purpose and do little but to increase the costs retailers would have to charge for their products.

Here again, imposing a *Javor*-type remedy would rewrite the tax code in a manner that makes exemptions mandatory when they are not. This conflict, too, forecloses a *Javor*-type remedy in these circumstances.

3. Requiring Retailers To Pursue Refund Claims On The Demand Of Consumers Where They Have Remitted Sales Tax Reimbursements Presents Serious Constitutional Concerns That Should Be Avoided

Forcing retailers to pursue refund actions where the code relieves them of any obligation to do so puts this Court in a

position of crafting a new tax refund remedial scheme for non-taxpayers. Constitutional concerns strongly counsel against interpreting the law in such a manner and crafting relief the Legislature did not see fit to grant non-taxpayers. Those concerns should be avoided where, as here, there are other ways the dispute can be resolved. (See Part III.B, *post* [discussing other ways the taxability issue could be resolved consistent with the statutory scheme].)

California Constitution, article XIII, section 32, "expressly provides that actions for tax refunds must be brought in the manner prescribed by the Legislature." (*Woosley*, *supra*, 3 Cal.4th at p. 789, citing Cal. Const., art. XIII, § 32.) As a result, courts are precluded "from expanding the methods for seeking tax refunds expressly provided by the Legislature." (*Id.* at p. 792; see also *ibid.* [disapproving *Javor* to the extent it suggests a court is permitted to expand on the methods for seeking tax refunds the Legislature has enacted].[7])

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[7] It is unclear the extent to which the equitable remedy crafted in *Javor* would still be permissible in light of *Woosley*'s disapproval of *Javor*. (*Woosley*, *supra*, 3 Cal.4th at p. 792 [disapproving *Javor*].) The Court need not, however, reach that issue as the equitable remedy Plaintiffs contend they should be permitted to pursue in this case would go far beyond what was contemplated in *Javor* and thus is unwarranted for other reasons discussed. (*Loeffler*, *supra*, 58 Cal.4th at pp. 1102-1103 [declining to reach constitutional question because case could be resolved on narrower grounds].)

The outcome required by this prohibition is settled as well: Where a plaintiff attempts to pursue a refund action in a manner that has not been expressly authorized by the Legislature, the action is constitutionally barred. (*Woosley*, *supra*, 3 Cal.4th at pp. 790-792 [plaintiff's attempt to pursue a class action seeking a refund of use taxes paid by the class was barred because the Legislature did not authorize use of class actions to pursue refund claims]; see also *Farrar v. Franchise Tax Bd.* (1993) 15 Cal.App.4th 10, 20-22 [applying *Woosley* and concluding section 32 precluded class refund action in form not expressly authorized by the Legislature]; *Kuykendall v. State Bd. of Equalization* (1994) 22 Cal.App.4th 1194, 1203-1204 [discussing this issue].)

Even without reference to section 32, it is a bedrock principle of constitutional jurisprudence that it is the Legislature's role to write the laws and the courts' role to "accept and apply the law as the legislature has written it." (*Helbach v. City of Long Beach* (1942) 50 Cal.App.2d 242, 245; accord *McCann v. Lucky Money, Inc.* (2005) 129 Cal.App.4th 1382, 1387 ["If the Legislature has permitted certain conduct . . . courts may not override that determination"].) "Courts have nothing to do with the wisdom of laws or regulations, and the legislative power must be upheld unless manifestly abused so as to infringe on constitutional guaranties." (*Eye Dog Foundation v. State Bd. of Guide Dogs for Blind* (1967) 67 Cal.2d 536, 544.) These principles should foreclose explanation of *Javor* to reach this case. Courts should act in harmony with

administrative and statutory objectives to preserve the balance our legislatively-established system of taxation intends. (*Id.* at p. 544.)

Further, as a matter of course, the law should be interpreted, and applied, in such a manner as to eliminate potential constitutional concerns. (*Harrott v. County of Kings* (2001) 25 Cal.4th 1138, 1151 [discussing constitutional avoidance]; *Santa Clara County Local Transportation Authority v. Guardino* (1995) 11 Cal.4th 220, 230-231 [same].) Here, the California Constitution "expressly provides that actions for tax refunds must be brought in the manner prescribed by the Legislature." (*Woosley*, *supra*, 3 Cal.4th at p. 789, citing Cal. Const., art. XIII, § 32.) Yet, in adopting the tax code, the Legislature saw fit not to give consumers the right to pursue refund actions. Rather than giving non-taxpayers that right, the Legislature instead enacted section 6937 which specifies that only the *taxpayer* is permitted to file a refund claim or sue in court to seek a refund. (§ 6937 ["A judgment shall not be rendered in favor of the plaintiff in any action brought against the board to recover any amount paid when the action is brought by or in the name of an assignee of the person paying the amount or by any person other than the person who paid the amount"].)

Although the Legislature could have enacted a provision that would have permitted non-taxpayers consumers who have contracted to pay sales tax reimbursements to pursue refund claims, it did not to do so. It decided instead that the most appropriate taxation system was one that permitted the taxpayer and only the

taxpayer to pursue refund claims. That legislatively-crafted balance should be honored. (*Woosley*, *supra*, 3 Cal.4th at pp. 789-792.)

4. Drawing Retailers Into Taxability Disputes Is Not Required To Avoid Unjust Enrichment

Forcing retailers to pursue a refund action in a case like this one where taxability remains in dispute makes no sense because the primary driver that persuaded this Court to allow a *Javor*-type lawsuit to go forward is lacking—the ability to use constructive trust principles to craft a remedy to avoid unjust enrichment.

In *Javor*, absent this Court's creation of a remedy, the Board would have been permitted to keep money to which it indisputably was not entitled. (*Javor*, *supra*, 12 Cal.3d at p. 802.) In that unique circumstance, this Court concluded that "[t]he 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." (*Ibid.*, internal citation omitted.) Thus, to avoid the unjust enrichment that would otherwise result by permitting the Board to keep funds to which it had no legal right, this Court fashioned a remedy to compel the Board to act. (*Ibid.*) That remedy could involve the retailers because the safe harbor provisions in section 6901.5 did not exist at the time *Javor* was decided. (*Loeffler*, *supra*, 58 Cal.4th at pp. 1117-1118 [noting section 6901.5 was enacted in 1982, well after *Javor* was decided].)

In a case like this, where the reimbursements have been remitted to the State and taxability remains in dispute, there is no ready analogy to *Javor* as far as the Retailers are concerned. Because there is a live dispute about whether the Board is entitled to the funds in question and it has not been established to whom those funds would be owed (in the event it were determined refunds were owed), there is no "res" for purposes of the constructive trust remedy. Nor, unlike *Javor*, is there a ready means to identify those who are entitled to the benefits of the "trust." Taxability is in dispute and it is unknown who is entitled to relief or how much relief would be owed. The class here thus does not bear even rough analogy to the documented car purchasers who paid the reimbursements at issue in *Javor*.

Rather than implicating the "unique circumstance" that led this Court to craft an equitable remedy *Javor*, this case involves the type of run-of-the-mill taxability dispute that could be presented by any case, involving any product. Allowing a non-taxpayer consumer to compel a retailer to seek a refund, based solely on the fact that the consumer disagrees with the taxability of the transaction (or the retailer's decision not to pursue an exemption), would open the floodgates of litigation by allowing any consumer to challenge the taxability of any transaction.

B. Plaintiffs' Call To Unsettle Established Law Is Unnecessary; Consumers Have Viable Avenues To Raise Taxability Disputes

There is no reason to compel the Retailers to file a refund action to settle Plaintiffs' taxability dispute with the Board. There are multiple ways to resolve that dispute in a manner consistent with the tax code without dragging the Retailers into the proceeding.

For example, to the extent that Plaintiffs believe the Board's interpretation of regulation 1591.1 is incorrect, they have the ability under Government Code section 11340.6 to petition the Board to amend the regulation to make clear that all testing supplies, regardless of the manner or purpose for which they are sold, be declared exempt.

In addition, to the extent Plaintiffs contend regulation 1591.1 itself conflicts with section 6369 or some other provision of the tax code, Plaintiffs could file a declaratory relief action under Government Code section 11350 to have the regulation declared invalid. That action would likewise provide an avenue, consistent with existing procedures, for Plaintiffs to take up this issue and obtain the relief they desire.

And, finally, to the extent these other avenues are unsatisfactory, Plaintiffs could raise their taxability challenge in the

context of litigation with the Board over transactions subject to use tax. For purposes of use tax, the Plaintiffs are themselves deemed to be the taxpayer. (§ 6202.) As such, they have the right to file refund claims and litigate with the Board. (§§ 6932-6937.)

By their plain terms, both section 6369 and regulation 1591.1 exempt certain products from both sales tax and *use tax*. (§ 6369; Cal. Code Regs., tit. 18, § 1591.1, subd. (b)(5).) What is more, in transactions subject to use tax, a consumer's liability for the tax is extinguished only by a receipt demonstrating the item was purchased from a retailer engaged in business in California or one who is authorized by the Board to collect use tax. (§ 6202.) Thus, if a consumer purchased products online, purchased products out-of-state, or simply lost his or her receipt, use tax would be due and the consumer would be free to litigate the exemption issue with the Board by invoking the procedures of the tax code without need to implicate the Retailers.

Given the statutory conflicts, and constitutional concerns raised in this case, these other avenues of resolution should be preferred. There is no need to scrap the boundaries of existing law to resolve the taxability dispute in this case.

C. Plaintiffs' Breach Of Contract Cause Of Action Under Civil Code Section 1656.1 Fails As A Matter Of Settled Law

Plaintiffs' breach of contract cause of action is premised on the claimed existence of an unwaivable exemption. Thus, the crux of this claim is to have a court make taxability determinations in the first instance. But, as the Court of Appeal recognized, Plaintiffs cannot use section 1656.1 to avoid *Loeffler's* limitations, and they cannot establish a breach of contract claim based upon unstated intent.

Section 1656.1 states that 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." (Civ. Code, § 1656.1, subd. (a).) The statute creates a rebuttable presumption that the parties agreed to the addition of the reimbursement provided: (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." (§ 1656.1, subds. (a)(1)-(3).)

Plaintiffs contend they are permitted to pursue a breach of contract claim under section 1656.1 because the sales at issue were not actually taxable. (OBOM:35-38.) According to Plaintiffs, while they do not dispute they entered into point-of-sale contracts to reimburse the Retailers for whatever sales tax was owed, they "never agreed to reimburse retailers for making voluntary payments—essentially gifts—to the [the Board] on sales that were exempt from sales tax." (*Id.* at 36.) Plaintiffs thus alleged that the Retailers violated section 1656.1 by improperly charging them sales tax reimbursement on non-taxable purchases. (1AA:85-87.)

Plaintiffs' breach of contact claim has nothing to do with whether a contract was entered to pay sales tax reimbursement as provided in section 1656.1. On the contrary, Plaintiffs' purported right to relief, as they describe it, is based on implied contract terms preventing the retailer from collecting sales tax reimbursements on taxable, but allegedly tax-exempt sales. Any such analysis directly hinges on findings that an exemption exists and a refund is owed. Their contract cause of action therefore faces precisely the same obstacles identified by this Court in rejecting the claims advanced in *Loeffler*. (E.g., *Brennan v. Southwest Airlines Co.* (9th Cir. 1998) 134 F.3d 1405, 1410 [dismissing breach of contract claim as an improper tax refund claim].) To hold otherwise and accept Plaintiffs' argument would allow any plaintiff to end-run *Loeffler* simply by asserting breach of contract claims under section 1656.1 predicated upon the assertion such taxes were not owed, and

then invite courts to make taxability determinations and order refunds to consumers.

In light of Plaintiffs' allegations, the Court of Appeal correctly refused to rewrite section 1656.1 to accomplish their aim. Instead, as set forth above, it correctly determined that "the premise of [Plaintiffs'] breach of contract claims is that the retail pharmacies wrongly collected sales tax reimbursement *that was not due*, yet they have no means in this lawsuit of establishing whether it was due." (Op:27, original italics.) This holding is entirely consistent with this Court's decisions in both *Javor* and *Loeffler*.

Nor did the Court of Appeal create an "irrebuttable" presumption under section 1656.1. Again, the Court of Appeal correctly rejected Plaintiffs' breach of contract claim because Plaintiffs cannot state any such claim based upon an alleged undisclosed intent. (Op:27-28.) Under Plaintiffs' asserted position, although the receipt admittedly showed a charge for sales tax reimbursement, which gives rise to a presumption of an agreement that the customer will pay the sales tax reimbursement, a customer can later claim, after the sale, that no such agreement was reached. But not only do such contracts arise at the time of sale as a matter of law [Com. Code, § 2401, subd. (2)], and occur at the place of sale [Rev. & Tax. Code, § 6010.5], California law clearly holds that contract terms are determined by external standards. (*Patel, supra,* 45 Cal.4th at p. 352 ["The terms of the contract are determinable by an external, not by an internal standard."].) Additionally,

uncommunicated subjective intent is irrelevant. (*Reigelsperger v. Siller* (2007) 40 Cal.4th 574, 579-580, citing 1 Witkin, *Summary of Cal. Law* (10th ed. 2005) Contracts, § 116 ["mutual consent is gathered from the reasonable meaning of the words and acts of the parties, and not from their unexpressed intentions or understanding"].)[8] Therefore, beyond the prohibitions in *Loeffler*, Plaintiffs failed to state a claim.

Finally, with respect to the relevant constitutional considerations, Plaintiffs assert that dismissing their claim under section 1656.1 would render the entire tax system unconstitutional. (OBOM:43.) In fact, upholding Plaintiffs' contract claim would do so. This Court already has recognized that:

> As a practical matter, if we did not view the tax code as providing the exclusive procedure under which a claim such as plaintiffs' may be resolved, independent consumer claims against

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8 In an attempt to obtain the same legally impermissible result, Plaintiffs also argue that the assessment of sales tax reimbursements on transactions they believe to be non-taxable amounts to a breach of the implied covenant of good faith and fair dealing. (OBOM:37.) The implied covenant, however, is relied on, at best, to enforce obligations created by a contract. It cannot be used to create independent rights or implement private causes of action in conflict with controlling law. (See *Carma Developers (Cal.), Inc. v. Marathon Development California, Inc.* (1992) 2 Cal.4th 342, 373-376 [covenant of good faith and fair dealing is circumscribed by the express terms of the contract]; *Storek & Storek, Inc. v. Citicorp Real Estate, Inc.* (2002) 100 Cal.App.4th 44, 55 [alleged breach of implied covenant cannot contradict the express terms of a contract].)

> retailers for restitution of reimbursement charges on nontaxable sales could form a huge volume of litigation over all the fine points of tax law as applied to millions of daily commercial transactions in this state. Such litigation would occur outside the system set up by the Legislature to develop that law, and without the benefit of the Board's expertise or its ability to conserve judicial resources by correcting error by means of administrative proceedings. Actions of this sort could displace the Board and the procedures currently established by the Legislature, thereby undermining the "orderly administration of the tax laws."

(*Loeffler*, *supra,* 58 Cal.4th at p. 1130, quoting *Decorative Carpets, supra,* 58 Cal.2d at p. 255.)

Plaintiffs' contract claim under section 1656.1 would disrupt, not promote, the orderly tax collection process in California, thereby giving rise to an unconstitutional attempt to enjoin or interfere with the lawful collection of a tax. Because Plaintiff's contract claim under section 1656.1 runs directly afoul of the limitations set forth in *Loeffler* and basic California contract principles, it fails.

D. Applying The Tax Code As Written Here Is Not Unconstitutional

Plaintiffs raise several indiscriminate arguments asserting that if their equitable or contractual causes of action are not

allowed, California's sales tax system would not pass constitutional muster. Controlling law once again cuts these arguments off at inception.

1. The Incidence Of The Tax Is Not On The Consumer

To begin with, this Court consistently has recognized that in this context the incidence of the tax is not on the consumer. As *Loeffler* recognized, "[t]he *retailer* is the taxpayer, *not* the consumer." (*Loeffler*, *supra*, 58 Cal.4th at p. 1104; *City of Pomona v. State Board of Equalization* (1959) 53 Cal.2d 305, 309; § 6051 [the "sales tax" is imposed on the "gross receipts" of all retailers doing business within the state "[f]or the privilege of selling tangible personal property at retail"].)

Plaintiffs cannot alter this conclusion by claiming that the economic cost of the sales tax is passed onto the consumers. Such effect does not determine where the incidence of the tax lays. In fact, even if retailers opted not to collect sales tax reimbursement, but merely chose to increase the cost of the products to account for the sales tax paid, the economic effect would be the same on the consumer. And there still would be no question that the sales tax remains imposed on the retailers.

Similarly, section 1656.1 does not change the incidence of the tax and the failure of Plaintiffs' contract claim does not create any due process issues. Instead, section 1656.1 only reinforces that

the sales tax is imposed upon the Retailers, who may then seek sales tax reimbursement through a private, implied contract. "It is well established . . . that state legislative bodies retain the authority to determine what is and what is not an actionable [contract], and to decide the conditions under which suits for these alleged wrongs will be entertained—so long as the statutes they enact are rationally based and do not draw constitutionally prohibited distinctions." (*Jenkins v. Cnty. of Los Angeles* (1999) 74 Cal.App.4th 524, 536, citation and internal quotation marks omitted.) This Court has already determined that the limitations imposed by the Legislature when seeking sales tax refunds are rationally related to "serve[] the state's interest in being able to plan for needed public expenditures" and are " 'necessary so that governmental entities may engage in fiscal planning based on expected tax revenues." (*Loeffler*, *supra*, 58 Cal.4th at p. 1102; see also Cal. Const., art. XIII, § 32.) Plaintiffs' "due process" refrain stops there.

Lastly, there is no dispute that the Retailers, as the taxpayers, are afforded the opportunity to file refund claims with the Board and, thus, are clearly afforded the constitutionally-mandated procedural due process. (*Loeffler*, *supra*, 58 Cal.4th at pp. 1107-1108 [retailers are permitted to file refund claims with the Board].) Therefore, Plaintiffs do not derive any right to be heard from a statutory scheme that does not directly affect them. (*Doyle v. Oklahoma Bar Ass'n* (10th Cir. 1993) 998 F.2d 1559, 1567 [parties do not have due process interest merely because government's

taking of another's substantive right may have a derivative impact on them].)

2. The Due Process Clause Is Not Implicated

Plaintiffs also contend that a due process violation and an escheat arises because Plaintiffs lack the ability to challenge taxability in this action. (OBOM:28-35.) There is, however, no due process concern implicated here.

First, Plaintiffs' payment of sales tax reimbursement to a Retailer is not an escheat of unclaimed property nor did Plaintiffs interplead the money into a court. Rather, Plaintiffs voluntarily paid sales tax reimbursement to the Retailers as a matter of implied contract, which does not implicate due process. (Civ. Code, § 1656.1; *Garfinkel v. Superior Court* (1978) 21 Cal.3d 268, 281-282 [non-judicial foreclosure of a deed is a private contractual agreement not subject to due process protections].)

Second, Plaintiffs are not without procedures they can use if they believe they have been charged excess sales tax reimbursement. As set forth above and by this Court in *Loeffler*, there are various procedures consumers can use in such situations. (Part II.A.5, *ante*; *Loeffler*, *supra*, 58 Cal.4th at pp. 1103-1104.) Consumers can, and often do, lodge complaints with the Board, which can lead to audits of the retailer. (*Id.* at p. 1123.) Consumers can "petition the Board to adopt, amend, or repeal a

regulation," or file a declaratory relief action "that does not seek an adjudication of tax liability . . . ." (*Ibid.*)

Third, Plaintiffs' due process argument cannot be divorced from the allegations in their Complaint. The causes of action remaining at issue here still depend on a court declaring that glucose test strips and skin puncture lancets are exempt from sales tax and then ordering a refund based on that judicially-declared exemption in the first instance. Plaintiffs' unsubstantiated due process argument would produce a result that the law expressly disallows. Indeed, Plaintiffs' due process argument, if embraced, would result in a ubiquitous and unlawful interference with a lawful tax collection process, a result that is itself unconstitutional. (*Woosley, supra,* 3 Cal.4th at p. 789 ["The California Constitution expressly provides that actions for tax refunds must be brought in the manner prescribed by the Legislature"].) The due process clause does not operate to bring about results that contravene what controlling law allows or that would give rise to a result the law prohibits. Plaintiffs' due process argument accordingly cannot be adopted here.

Fourth, Plaintiffs' reliance on *State v. Savings Union Bank & Trust Co.* (1921) 186 Cal. 294 (*Savings Union Bank*) and *Webb's Fabulous Pharmacies, Inc. v. Beckwith* (1980) 449 U.S. 155 (*Webb's Fabulous Pharmacies*) is misplaced. In *Savings Union Bank*, the state claimed certain monies were automatically escheated to the state after twenty years pursuant to a banking statute and a

dispute arose with the depositor's estate. In *Webb's Fabulous Pharmacies*, parties deposited money into the court for interpleader purposes. The United States Supreme Court made a narrow ruling based on the facts of that case, finding that interest on the interpleaded funds did not belong to the court. (*Webb's Fabulous Pharmacies*, *supra*, 449 U.S. at pp. 162-63.) Here, Plaintiffs' money was not "escheated" to the state or interpleaded to a court. Plaintiffs entered a contractual agreement to pay such monies for purposes of sales tax reimbursement. (OBOM:35-37; *Loeffler*, *supra*, 58 Cal.4th at p. 1108 ["Whether a reimbursement amount will be added is purely a matter of contract between the retailer and consumer"].) And consistent with expectations, the Retailers eventually paid those sums as presumptively owed sales tax to the Board. Thus, in light of the private contractual agreement with Retailers and the procedures Plaintiffs can utilize, these cases are inapposite.

3. There Can Be No Takings Claim Because There Is No State Action And The Retailers Are Not Taking Anything

The Court of Appeal correctly held Plaintiffs could not cure the defect in their pleading by amending to add a takings clause claim, and certainly could not do so against the Retailers, who are not state actors. Plaintiffs nevertheless contend that leave should have been granted because they could plead a constitutional claim for a taking without just compensation under the Fifth Amendment.

(OBOM:43-44.) Without support, they say unjust enrichment "is just the flip side of a [constitutional] 'taking' . . . ." (OBOM:43.) Plaintiffs' theory is that the Board's "taking" of excess sales-tax reimbursement from retailers constitutes a taking of Plaintiffs' property so that they are entitled to just compensation from the government. (OBOM:44-46.) This contention is wrong as a matter of law.

First, Plaintiffs' constitutional assertions fly in the face of this Court's holdings in *Loeffler*, and do not come close to rebutting the "strong presumption that legislative enactments must be upheld unless their unconstitutionality clearly, positively, and unmistakably appears." (*Williams v. Garcetti* (1993) 5 Cal.4th 561, 568, internal quotation marks omitted.)

Second, a Fifth Amendment takings claim requires that the government do the taking—or, put the other way, there can be no takings claim where there is no government action. (*City of Perris v. Stamper* (2016) 1 Cal.5th 576, 591; *Barrett v. Dawson* (1998) 61 Cal.App.4th 1048, 1054 ["The simple answer here is that taking claims require state action."]; *Lyons v. Santa Barbara County Sheriff's Office* (2014) 231 Cal.App.4th 1499, 1501-1504 [finding appeal of takings claim against county officials, claiming a regulation authorizing non-judicial foreclosures violated the federal Takings Clause was frivolous, in part, because a non-judicial foreclosure "is not state action"].)

Plaintiffs concede that sales-tax reimbursement is a matter of private contract between the consumer and the retailer. (OBOM:35-37; *Loeffler*, *supra*, 58 Cal.4th at p. 1108 ["Whether a reimbursement amount will be added is purely a matter of contract between the retailer and consumer"].) Their effort to transform private contracts into state action entitled to constitutional scrutiny accordingly goes too far. (*King v. Meese* (1987) 43 Cal.3d 1217, 1229 ["We have never held that a private company in a competitive industry is a state agent, or that its decisions on how to price and market its product constituted state action"].) Because there is no state action, there is no takings claim.

IV.
CONCLUSION

For the foregoing reasons, this Court should affirm the decision of the Court of Appeal.

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Certification of Word Count Pursuant To California Rules Of Court, Rule 8.204(c)(1)

I, Douglas Rawles, declare and state as follows:

1. The facts set forth herein below are personally known to me, and I have first-hand knowledge thereof. If called upon to do so, I could and would testify competently thereto under oath.

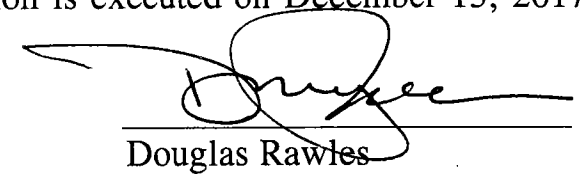
2. I am one of the appellate attorneys principally responsible for the preparation of the Retailer Defendants' Joint Answer Brief on the Merits in this case.

3. The Retailer Defendants' Joint Answer Brief on the Merit was produced on a computer, using the word processing program Microsoft Word 2010.

4. According to the word count feature of Microsoft Word 2010, the Retailer Defendants' Joint Answer Brief on the Merits contains 10,976 words, including footnotes, but not including the table of contents, table of authorities, and this Certification.

5. Accordingly, the Retailer Defendants' Joint Answer Brief on the Merits complies with the requirement set forth in Rule 8.204(c)(1), that a brief produced on a computer must not exceed 14,000 words, including footnotes.

I declare under penalty of perjury that the forgoing is true and correct and that this declaration is executed on December 13, 2017, at Los Angeles, California.



Douglas Rawles

McClain v. Sav-On Drugs, et al.
California Supreme Court No. S241471
Second Appellate District, Div. 2, Case Nos. B265011 & B265029
Los Angeles County Superior Court, Case Nos. BC325272 and BC327216

PROOF OF SERVICE

I am a resident of the State of California, over the age of eighteen years, and not a party to the within action. My business address is REED SMITH LLP, 101 Second Street, Suite 1800, San Francisco, CA 94105. On December 13, 2017, I served the following document(s) by the method indicated below:

THE RETAILER DEFENDANTS' JOINT ANSWER BRIEF ON THE MERITS

☒	by placing the document(s) 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. I am readily familiar with the firm's practice of collection and processing of correspondence for mailing. Under that practice, it would be deposited with the U.S. Postal Service on that same day with postage thereon fully prepaid in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if the postal cancellation date or postage meter date is more than one day after the date of deposit for mailing in this Declaration.

PLEASE SEE SERVICE LIST

I declare under penalty of perjury under the State of California that the above is true and correct. Executed on December 13, 2017, at San Francisco, California.

Eileen Kroll

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