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 TO PETITION FOR REVIEW

After an Opinion By The Court of Appeal
Second Appellate District, Division Two B265011 & B265029

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Required by Bus. & Prof. Code § 17209 and
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I.
INTRODUCTION

Plaintiffs Michael McClain, Avi Feigenblatt, and Gregory Fisher identify two issues for review, neither of which has anything to do with the decision in this case. The Court of Appeal could not and did not overrule *Javor v. State Board of Equalization* (1974) 12 Cal.3d 790, or rewrite Civil Code section 1651.1 to create an "irrebuttable" presumption. All the Court of Appeal did was apply this Court's decisions in *Loeffler v. Target Corp.* (2014) 58 Cal.4th 1081, *Javor, supra*, 12 Cal.3d 790, and *Decorative Carpets, Inc. v. State Board of Equalization* (1962) 58 Cal.2d 252 to settled facts. No conflicts with existing precedent were created. Settled law remains. There is no review-worthy issue.

Plaintiffs wanted the trial court to determine in the first instance that retail transactions involving glucose test strips and skin puncture lancets are exempt from sales tax *and* order the retailers to refund the sales tax reimbursements paid by Plaintiffs at the time of their purchase. *Loeffler* bars that relief — which explains Plaintiffs' effort to massage *Javor* to fit this case. According to Plaintiffs, *Javor* authorizes courts to make initial taxability or refund determinations when the Board of Equalization is joined as a party. It follows, they say, that the Court of Appeal erred when it held that *Javor* says no such thing. Plaintiffs are mistaken.

The Court of Appeal held, correctly, that Plaintiffs' case is nothing more than an improper policy objection to California's sales

and use tax system — a complaint that should be made to the Legislature, not the courts. The petition for review should be denied.

II.

STATEMENT OF CASE

A. BACKGROUND.

There are two separate lawsuits against the Retailers — one challenging the Retailers' practice of collecting sales tax reimbursements on sales of glucose test strips, the other challenging sales tax reimbursements on sales of skin puncture lancets. (Slip Op. at 4.) Although the reimbursements at issue had been remitted to the State, Plaintiffs wanted refunds from the Retailers. (Slip Op. at 5.) At the trial court's behest, the Retailers cross-complained against the Board to bring it into this action. (AA Vol. I, tab 2, p. 37.)

Following several demurrers, this case was stayed pending this Court's resolution of *Loeffler*. (RA Vol. I, tab 3, p. 40.) Thereafter, Plaintiffs filed their fourth amended complaint, the operative pleading (Slip Op. at 5), alleging seven causes of action — two for breach of contract, two for violations of Business & Professions Code section 17200 et seq. (the "UCL"), one for negligence, one for violations of Civil Code section 1770 et seq. (the "CLRA"), and one for injunctive and equitable relief consistent with *Javor*. (Slip Op. at 6.) 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.*)

Relying on *Loeffler*, the Retailers demurred. (Slip Op. at 6.) Plaintiffs responded with *Javor*. The trial court got it right and sustained the demurrers without leave to amend. (Slip. Op. at 6.) Plaintiffs appealed. (*Ibid.*)

B. THE COURT OF APPEAL'S OPINION.

The Court of Appeal rejected Plaintiffs' interpretation of *Javor* and *Decorative Carpets* (Slip Op. at pp. 13-15), identifying the "unique" circumstances where *Javor* permits judicial relief — when "(1) the person seeking the new tax refund 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." (Slip Op. at p. 20.)

The Court of Appeal applied these factors here, concluding Plaintiffs do not have a statutory remedy because they are not the taxpayers, but are nevertheless not completely without a remedy. (Slip Op. at pp. 20-21.) Additionally, as the Court of Appeal explained, judicial recognition of a right to sue the Retailers and the Board would conflict with both Revenue and Taxation Code section 6905 (permitting a retailer to waive its right to seek a refund) and section 6901.5 (proving a safe harbor from suit). (Slip Op. at pp. 21-22.) Finally, the Court of Appeal recognized that the Board has yet to decide whether the retailers (and by extension the customers) are

entitled to a refund. (Slip Op. at p. 23.) The Court of Appeal rejected Plaintiffs' breach of contract claim based on a claim that no sales tax was due (Slip Op. at p. 27), and also found no factual basis to rebut the presumption of taxability. (Slip Op. at p. 27).

Plaintiffs' petition for review abandons all causes of action except their *Javor* claim and their first claim for breach of the implied contract.

III.

ARGUMENT

A. The Court of Appeal's Straight-Forward Application Of *Loeffler* And *Javor* Does Not Present Grounds For Review.

Review should be denied because there is no ground for review — the Court of Appeal's opinion does not create any conflict among appellate court decisions and does not raise unsettled or important issues of law requiring this Court's review. (Cal. Rules of Court, rule 8.500(b)(1).) The Court of Appeal followed *Javor* and *Loeffler*. This Court has already spoken and does not need to revisit these issues.

1. The Court Of Appeal Properly Limited *Javor* To Its "Unusual" Circumstances.

Plaintiffs' appeal claimed *Javor* trumped *Loeffler* in this case because the Board was a party. The Court of Appeal examined this claim and then correctly rejected it based on the constitutional constraints limiting judicial interference with California's tax scheme.

As this Court explained in *Loeffler*, 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.) And of course, *Javor* only applies where there is no dispute about taxability. (*Javor*, *supra*, 12 Cal.3d at pp. 792-793.)

Here, the Court of Appeal construed *Javor* in light of *Loeffler* and identified three circumstances that must be present to justify *Javor*-type relief — "(1) the person seeking the new tax refund 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." (Slip Op. at p. 20).

Plaintiffs' petition says the Court of Appeal simply made up these prerequisites. (Pet at 4.) Not so. All of these prerequisites are compelled by this Court's precedents and the California Constitution. (Slip Op. pp. 12-16.) First, the petition claims that the Court of Appeal denied a *Javor*-type remedy because it stated that the consumers "have several other remedies available to them." (Pet. at 17 citing Slip Op. at 20-21). However, the petition takes this discussion out of context. The Opinion actually identified the first circumstance as requiring no *statutory* remedy. This is consistent with Article XIII, section 32 of the California Constitution, which provides that any action maintained to recover a tax claimed to be illegal must be brought "in such manner as

may be provided by the Legislature." (Slip Op. at 12.) Here, however, the Court of Appeal found that the customers did not have any such statutory remedy because the customers were not the taxpayers. (Slip Op. at 20). However, the Court of Appeal did go on to recognize that there were other remedies available, (Slip Op. at 20-21), much like this Court did in *Loeffler*. (See *Loeffler*, *supra*, 58 Cal.4th at pp. 1103-1104, 1123.)

Second, the petition takes issue with the fact that any judicial recognition of a right of a consumer to sue when the Board has yet to determine taxability may not be inconsistent with existing tax refund remedies. Again, the Court of Appeal did not create any new requirement. It merely applied *Javor* and did so consistently with *Loeffler*, which explained that "[n]either *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." (*Loeffler*, *supra*, 58 Cal.4th at p. 1133.)

Finally, the Court of Appeal correctly observed that the Board has not yet made a determination as to whether the products are exempt and whether a refund is therefore due. Plaintiffs' position that this case may proceed even when taxability is still in dispute would effectively divest the Board of its role as the initial arbitrator of

taxability issues. As this Court has explained: "[T]he sales tax scheme depicts a system that comprehensively regulates taxation on myriad types of transactions, and confirms that the Board is the entity responsible for determining in the first instance whether transactions, in their nearly infinite variety, are taxable and how much tax is due." (*Loeffler*, *supra*, 58 Cal.4th at p. 1123.)

When the case law is properly analyzed in light of all relief sought, it is apparent what Plaintiffs are up to. They do not seek to enforce the tax code or this Court's precedent, but seek an end-run around them. As Plaintiffs would have it, as long as a consumer joins the Board as a party, the claim could proceed under *Javor*. Plaintiffs' construct accordingly abandons the judicial restraint reflected in this Court's decisions and proposes the adoption of a limitless exception to Article XIII, section 32 of the California Constitution. There is no basis in *Javor* for such an expansive remedy and *Loeffler* makes clear that such a remedy would conflict with our statutory scheme. Plaintiffs' attempt to expand *Javor* provides no reason for review.

2. The Court of Appeal Did Not Rewrite Section 1656.1

The petition also maintains that by applying this Court's precedent and basic contract law, the Court of Appeal somehow rewrote section 1656.1. Civil Code section 1656.1 states that whether "a retailer may add sales tax reimbursement to 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 then 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." (Civ. Code § 1656.1, subds. (a)(1)-(3).)

Plaintiffs claim that the Court of Appeal created a constitutional issue by turning the rebuttable presumption in section 1656.1 into an "irrebuttable" one because the Court of Appeal denied its claim. Again, however, the Court of Appeal's decision reflects settled law.

To begin with, the Court of Appeal correctly found that Plaintiffs' purported right to relief under section 1656.1 hinged on findings that an exemption exists and a refund is owed. (Slip Op. at 27.) Therefore, their contract cause of action faces precisely the same obstacles identified by the Court in rejecting its claim under *Javor*, (Slip Op. at 23-24), and the prohibitions of *Loeffler*. Additionally, the Court of Appeal found that factually the presumption arose, but the Plaintiffs alleged nothing to rebut the presumption.[1] (Slip Op. at 27 citing *Patel*

[1] Apart from running aground on the controlling precedent, Plaintiffs' petition also is based on an erroneous premise.

v Liebermensch (2008) 45 Cal.4th 344, 352). That conclusion follows from the face of Plaintiffs' complaint. Here, because the Court of

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Plaintiffs' lawsuit seeks to challenge the Retailers' practice of paying sales tax and collecting sales tax reimbursement consistent with Regulation 1591.1. Sales and Use Tax Regulation 1591.1, titled "Specific Medical Devices, Appliances, and Related Supplies" governs whether various medical products—including insulin syringes, glucose test strips, and skin puncture lancets—are subject to sales and use tax. (Sales & Use Tax Reg. 1591.1.) Regulation 1591.1 went into effect on March 10, 2000. With respect to the product sales in this dispute, Regulation 1591.1 provides in relevant part:

> 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.

(Sales & Use Tax Reg. 1591.1, subd. (b)(5).)

As this language reveals, unlike Plaintiffs' contention, this sales tax exemption is not categorical. Rather, 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, even if there were some hypothetical disputes about the precise contours of applying *Javor*, this case does not test those contours.

Appeal adhered to section 1656.1, no constitutional implications arise from its Opinion.[2]

Just as with *Javor*, there is no call for review here either. The Court of Appeal stuck to the plain meaning of section 1656.1; it is Plaintiffs' claims that come up short. Thus, the petition should be denied.

B. Plaintiffs' Arguments Concerning the Propriety of California's Sales Tax System Were Not Presented In The Underlying Proceedings And Are For the Legislature, Not The Courts To Address.

Plaintiffs' petition also argues that the Court of Appeal's interpretation of *Javor* and application of Civil Code section 1656.a where the contention is the sales tax was not owed, unconstitutionally placed the incidence of the tax on the consumers, making them a taxpayer. This issue of escheat, however, was not properly presented below. "As a policy matter," this court "normally will not consider an issue that the petitioner failed to timely raise in the Court of Appeal." (Cal. Rules of Court 8.500(c)(1); *Jimenez v. Superior Court* (2002) 29 Cal.4th 473, 481.) As the Court of Appeal's Opinion notes, Plaintiffs'

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[2] Plaintiffs' contract claim under Civil Code section 1656.1 would disrupt this orderly tax collection process, thereby giving rise to an unconstitutional attempt to enjoin or interfere with the lawful collection of a tax. As this Court noted, by not following the legislature's exclusive procedures, a huge volume of litigation over the various fine points of the tax law would arise without the Board's expertise. (*Loeffler, supra,* 58 Cal.4th at p. 1130, quoting *Decorative Carpets, Inc. v. State Board of Equalization* (1962) 58 Cal.2d 252, 255.) Thus, it is Plaintiffs' claims that would imperil the tax system and create constitutional issues.

escheat argument, among others, was not raised until the Petition for Rehearing was filed. (Slip Op. at 28, n.9.) Thus, review should be denied on this basis alone.

Moreover, Plaintiffs do not present a significant issue for this Court to review. Rather, Plaintiffs' escheat arguments are really a challenge to how the entirety of California's taxation system operates. The Court of Appeal recognized as much, explaining: "[t]his is the result we must reach because our Constitution chiefly assigns the task of creating tax refund remedies to our Legislature * * * Because the prerequisites for making it a topic of judicial consideration are not present, we adhere to the statutes as they are written." (Slip Op. at 28-29.) That holding aligns with *Loeffler* where this Court also rejected the attempt to utilize judicial procedures to litigate taxability issues. Plaintiffs strain credibility when they offer to convert their statutory end-run into a takings issue. There is no reason here for a takings claim against the Retailers where there is no government action. (Slip Op. at 25.) Plaintiffs' effort to transform private contracts into state action is unsupported and unsupportable. (*See Lyons v. Santa Barbara County Sheriff's Office* (2014) 231 Cal.App.4th 1499.) Thus, to the extent Plaintiffs believe that a change to the tax system is necessary, the proper remedy is to seek change from the legislature, not through a petition to this Court.

IV.

CONCLUSION

The Retailers respectfully request that this Court summarily deny the petition.

DATED: May 12, 2017

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IV.

CONCLUSION

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Certification of Word Count Pursuant To California Rules Of Court, Rule 8.504(d)(1)

I, Robert P. Berry, 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.

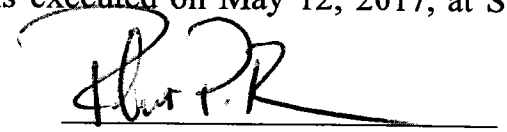
2. I am one of the appellate attorneys principally responsible for the preparation of the Answer to Petition for Review in this case.

3. The Respondents' Answer to Petition for Review 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 Respondents' Answer to Petition for Review contains 2,844 words, including footnotes, but not including the table of contents, table of authorities, and this Certification.

5. Accordingly, the Respondents' Answer to Petition for Review complies with the requirement set forth in Rule 8.204(c)(1), that a brief produced on a computer must not exceed 8,400 words, including footnotes.

I declare under penalty of perjury that the forgoing is true and correct and that this declaration is executed on May 12, 2017, at St. Louis, Missouri.



Robert P. Berry

Michael McClain, et al. v.Sav-On Drugs, et al.
California Supreme Court No. S241471;
California Court of Appeal, Second Appellate District, Division 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 May 15, 2017, I served the following document(s) by the method indicated below:

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THE RETAILER DEFENDANTS' JOINT ANSWER TO PETITION FOR REVIEW

☒	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.

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I declare under penalty of perjury under the State of California that the above is true and correct. Executed on May 15, 2017, at San Francisco, California.

Eileen Kroll

Michael McClain, et al. v.Sav-On Drugs, et al.
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