BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	
STERILMED, INC.,	OTA NO. 18011881
Appellant.	

TRANSCRIPT OF PROCEEDINGS

Los Angeles, California

Thursday, February 21, 2019

Reported by:

SHELBY K. MAASKE
Hearing Reporter

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TRANSCRIPT OF PROCEEDINGS, taken at 355 South Grand Avenue, South Tower, 23rd Floor, Los Angeles, California, commencing at 11:05 a.m. and concluding at 12:30 p.m. on Thursday, February 21, 2019, reported by Shelby K. Maaske, Hearing Reporter.

APPEARANCES:

Panel Lead:	HON. MICHAEL GEARY
Panel Members:	HON. LINDA CHENG HON. DANIEL CHO
For the Appellant:	JOHN BHOLAT, Representative
For the Respondent:	MENGJUN HE, Tax Counsel
	SCOTT CLAREMON, Tax Counsel
	LISA RENATI, Hearing Representative

I N D E X

E X H I B I T S

Los Angeles, California; Thursday, February 21, 2019

11:05 a.m.

ADMINISTRATIVE LAW JUDGE GEARY: On the record.

Good morning, everybody. Thank you for your patience this morning as we waited for that first hearing to conclude. My name is Michael Geary, I will be lead judge this morning. I'm joined up here by my co-judges, my co-panelists, Judges Cho and Cheng; and we, together, will decide the issues. The other judges may have questions for the parties as this matter proceeds, and I may have questions for the parties, but when it comes to deciding the issue, we will deliberate together and decide the issues together.

We are here today to take evidence and hear the argument in the appeal of Sterilmed, Inc, OTA Case No. 18011881. We have a court reporter who is reporting this hearing; she's using a stenotype machine to do that. To help us make a clear and easily read and understood record, I am going to ask everyone to, please, speak one at time and speak clearly and slowly; if you do that, it will help us make a record that's easy to understand.

Let's state the appearances starting with the Appellant, please.

MR. BHOLAT: My name is Jacob Bholat with Equity Recovery

Solutions, representing the Appellant.

ADMINISTRATIVE LAW JUDGE GEARY: Thank you. Could you spell your last name for the record.

MR. BHOLAT: Sure. B-H-O-L-A-T.

ADMINISTRATIVE LAW JUDGE GEARY: Thank you.

And for the Department.

MS. HE: Mengjun He.

MR. CLAREMON: Scott Claremon.

MS. RENATI: Lisa Renati.

ADMINISTRATIVE LAW JUDGE GEARY: Thank you.

I should mention that the Office of Tax Appeals is an independent agency; we are not the same agency as the taxing agencies that appear before us, so when a case comes to us, usually from an appellate-type procedure within those agencies, the judges on the panel take a completely new look at the evidence to determine what the correct legal result is.

This is an appeal from the denial of a claim for refund filed in the name Sterilmed, Inc, and the claimed amount is $62,951.00 -- I have rounded that -- for used tax plus interest paid in connection with the transfer of what is referred to as single-use medical devices, during the period July 1, 2010, through December 31, 2012. I think the original claim was in the amount of $64,115.79, but Appellant has indicated it does not dispute $1,164.70 in new tax paid for first quarter of 2011.

A single-use medical device, the type at issue here, are

not medical devices that are attached to or implanted into the human body, rather, they are generally treatment tools used by hospitals and medical professionals. The United States Food and Drug Administration approves these devices for single uses only, and they usually do not allow the users to sterilize and reuse those; however, there has been procedures approved for what's call "Reprocessing" these devices that allow, sometimes hospitals and sometimes companies like Sterilmed, to perform a reprocessing, some type of a sterilization so that the product can be reused. Those are the types of products that we are here to talk about today.

Appellant collected these medical devices after the first use from its customer, it then processed the devices in a way that allowed them to be reused. In some cases, the devices can be reprocessed more than once and reused more than twice. Appellant collected tax from its customers and remitted those funds to the state, and thereafter, one or more of the Appellant's customers decided to seek a refund of used tax paid. And because it was Appellant that paid that used tax, Appellant is the named claimant in this case.

The California Department of Tax and Fee Administration, I'll refer to them as the "Department" or its predecessor, the "Board of Equalization," determined that when Appellant transferred possession of the processed devices or reprocessed devices to its customers for a consideration, a sale of tangible

personal property occurred, and in that case, the Department denied the claim for refund.

The Appellant contends that no tax was due in connection of the transfer of this tangible property, and that any consideration paid by the customers was services, not for the sale of tangible personal property. The sole issue that we are addressing at this hearing is whether or not the Appellant is entitled to a refund.

The Department has submitted exhibits that have been marked A through G for identification, and I will just briefly run through those. Exhibit A is the Decision and Recommendation Issued by the Department's Appellate Bureau. Exhibit B is a Supplemental Decision and Recommendation Issued by the Department's Appellate Bureau. Exhibit C is a Summary Analysis, a document that's prepared by the Department's Tax and Fee Division. I'm not sure what it's called, but it's issued by the Department.

Exhibit D is Group Purchasing Agreement with Exhibits. Exhibit E are Selected E-mails Between Appellant's Representative and the Department. Exhibit F, as in "Frank" are Frequently Asked Questions Printout from Appellant's Web Page. And Exhibit G is a FDA Document on Single-use Device Reprocessor Regulations.

I believe Mr. Bholat, you have received a copy of the Department exhibits?

MR. BHOLAT: Yes.

ADMINISTRATIVE LAW JUDGE GEARY: Any objections to then admission of those exhibits?

MR. BHOLAT: No.

ADMINISTRATIVE LAW JUDGE GEARY: Those exhibits are all admitted.

(Department's Exhibits A through G were received in evidence by the Administrative Law Judge.)

ADMINISTRATIVE LAW JUDGE GEARY: Mr. Bholat also submitted a series of documents. They were actually entitled -- or they have been marked as Exhibit 1 collectively, but in looking through those exhibits, it looks like there's several documents, the first being the Purchasing Agreement, the HIPAA addendum is attached to that agreement. There's an Exhibit K entitled Ordering Instructions that is part of that exhibit. And there are FAQs from the Appellant's website. I did not determine whether they were the same ones that were attached by the Department as their exhibit. There are archived pages from the Appellant's web page -- "Archived," meaning, somebody uses the way back function and produced pages that are typically no longer displayed. And then there is a different FDA publication, I believe it's entitled Reprocessing Medical Devices.

Department, did you receive copies of the Appellant's exhibits?

MS. HE: Yes.

ADMINISTRATIVE LAW JUDGE GEARY: Any objection?

MS. HE: We have no objections.

ADMINISTRATIVE LAW JUDGE GEARY: That Exhibit 1, which consists of the documents I indicated, are admitted.

(Appellant's Exhibit 1 was received in evidence by the Administrative Law Judge.)

ADMINISTRATIVE LAW JUDGE GEARY: Department, do you have a live witnesses today?

MS. HE: No.

ADMINISTRATIVE LAW JUDGE GEARY: And Mr. Bholat, live witnesses today?

MR. BHOLAT: No.

ADMINISTRATIVE LAW JUDGE GEARY: We discussed, in a prehearing conference -- before I go there, I should mention, when Mr. Bholat arrived today, he submitted another document to staff and staff provided it to me, and I had provided a copy to the Department and to my co-panelists.

And just glancing at this document, Mr. Bholat, it appears to be like a written closing argument where you hope to guide the panel of judges through what your arguments will be; is that correct?

MR. BHOLAT: Correct. Basically, an overview of our presentation/argument, our opening argument, as well as what we expect to be our ending argument.

ADMINISTRATIVE LAW JUDGE GEARY: Department, any objection to the admission of this?

MS. HE: No objections.

ADMINISTRATIVE LAW JUDGE GEARY: All right. I will admit this your Exhibit 2.

(Appellant's Exhibit 2 was received in evidence by the Administrative Law Judge.)

MR. BHOLAT: Thank you.

ADMINISTRATIVE LAW JUDGE GEARY: All right. So during the prehearing conference we talked about argument, I believe I indicated to the Appellant that we typically allow 15 minutes for initial argument, and you felt that would be sufficient. The Department will have 15 minutes for its response, and Mr. Bholat, when that's concluded, we will turn to you and allow you, if you wish to have it, an additional five minutes for rebuttal; okay?

MR. BHOLAT: Okay.

ADMINISTRATION LAW JUDGE GEARY: Madam Court Reporter, are you ready to proceed?

THE COURT REPORTER: Yes. Thank you.

ADMINISTRATIVE LAW JUDGE GEARY: All right.

Mr. Bholat, you may proceed.

MR. BHOLAT: Thank you for the time to present before this panel. As you stated earlier, the single disagreed issue in this case relates to reprocessing service charges, which

includes repair, inspecting, cleaning, testing, sterilizing services performed on instruments not originally purchased, nor owned by the service provider, Sterilmed, who performed the services.

The hospital customer purchased various items from original manufacturer for use on patients and paid sales tax when due on the original purchase. On the initial use, the hospital has three options, they can discard the item; they can clean it, resterilize it, and reprocess it in-house; or they can hire a third party, as in this case, is what has happened, and that third party will then do the reprocessing for them.

In our argument, what we would like to provide is support that the supplier restores the equipment to the original condition and then returns the exact same item back to the customer for reuse. So first, I want to the go over what does "Sterile processing" mean, using the dictionary definition.

Merriam Webster defines "Sterile" free from living organisms, especially pathogenic microorganisms. "Reprocess" or "Reprocessing," is defined subject to a special process or treatment in preparation for use. When you combine the two words together, you get a clean instrument ready for reuse.

Sterile reprocessing is the description used to title this agreement and is used in various places throughout the agreement. The description is the key to the true intent to the object of the agreement and that is the service. Now, I'd like

to go through some of the key language in the agreement. In the exhibit that we have, I believe I have marked them 1 through 80 or so, page 2, there are three parties involved in the agreement; however, the agreement is only signed by two of the parties. The third party is the hospital, which purchases the item based on the relevant terms of the agreement; however, they never actually signed the agreement.

Premier is the group purchasing organization which secures the agreement with many different types of retailers, including those of the sellers of tangible personal property, as well as sellers of services.

ADMINISTRATIVE LAW JUDGE GEARY: Slow down just a little bit, Mr. Bholat.

MR. BHOLAT: Sorry.

The seller, Sterilmed, reprocesses the medical instrument. Page 4 of the exhibit states in the beginning, "Alliance of hospitals. Hospitals that are a part of the GPO that can chose to purchase using these types of agreement if they desire." So those are the three parts. This overall agreement that we are all relying on is a broad general agreement that can cover many types of transactions, commodities, and services.

On the bottom of page 4, Section 2.0 states: "Seller hereby agrees to provide products and services described in Exhibit A 3, referred to collectively as products." This is a very important statement. "Referred to collectively as

products" clearly indicates that the agreement covers both services and sales of tangible person property, and that the term "Product" does not represent a tangible personal property in the normal way that the Revenue Taxation Code does.

The term "Service," or more accurately "Reprocessing Service" is interchangeable with "Product" throughout the entire agreement, which is ignored in the Department's analysis. We have provided the Department staff with invoices that support sales of parts, which are clearly tangible personal property and not in contention here, so we can confirm that both products and reprocessing services were covered in this agreement.

The invoices in contention relate to the charges for reprocessing only. Now, I would like to turn to page 9, which is Section 12.2, which is the section that Department relies on heavily on their determination that the sterile reprocessing is a sale, not a service. The section is titled "Warrantees and Published Specifications," which is interesting, this section is not defined as a title, yet that is how it is being misapplied.

"The section seller has good and merchantable title," when read alone, can easily be taken out of context. First, as discussed, the agreement covers both services and products when there is a sale of property, the traditional term of "Product" would apply for title passage. In the case of the reprocessing service, the clause is still relevant and necessary, however, should be interpreted differently.

Further down in the section, "Seller." It states: "Seller further represents and warrants that none of the, A, products; B, packaging instructions and other materials supplied therewith; C, their contemplated use will directly or contributory infringe on intellectual property right, including any patent, copyright, trade mark or other trade secrets." So it goes further to define the section.

Here, the clause is important in providing service because it ensures that the vendor repackages and reprocesses the equipment with incidental materials that it has a legal right to use. If, for example, the vendor uses the original manufacturer's copyright information without approval, they would be in violation of the agreement. These small ancillary items are a necessary part of the service, but they are not the true object as defined in Regulation 1501. The true object is the reprocessing service and not the packaging material.

Next, I would like the panel to further analyze the title question. The agreement has no explicit discussion of title passage as previously confirmed in the DNR. In a repair service agreement, a title clause is not necessary because neither party is exchanging title, the vendor is taking position of customer's property, preparing it to the original condition, and returning the possession of the original item back to its customer.

The Department never addressed the issue that the agreement never transfers title to the service provider, which is

Sterilmed, nor is there any consideration given or exchanged between the parties for such claim transfer. This is an assumption that the entire agreement is for product and the service portion is ignored. The Department's assumption that a title transfer occurred is inaccurate.

This position that the ownership of the item remains with the hospital can clearly be supported with the vendor's historical public website and published information, which we provided. The historical website pages are found on pages 19 through 36 of the exhibit. During this period of time, the vendor clearly published the instruments were owned by the hospital and then 100 percent of the exact same instruments were returned back to the original hospital. There was no commingling, there was no exchanging, no shifting of one customer to another.

Page 20 of the exhibit says: "What happens after we ship our device for reprocessing?" Step 9 says: "The product is inspected for a final time, packed out specifically to match customers and departments, and shipped back to the facility." "Does my hospital get its own devices back after reprocessing?" "Only Sterilmed guarantees the same device collected at your facility are returned to you."

Page 22 -- this is all from the website -- "every hospital order is logged into our tracking system by barcoding and labeling each catheter. This identifies the catheters health

facility, departmental ownership, job number, reprocessing history."

Page 24, "Every device is entered into Sterilmed's database and labeled with barcodes identifying the device with internal tracking of the healthcare facility, order device and ownership." Page 28, "When will I get it back?" "Through the Sterilmed Internet Reporting System, you will get up-to-the-minute receiving packaging shipping dates for all your Sterilmed reprocessing orders.

Page 28, again, "Job status." "The Sterilmed Internet Reporting System tells you the status of every reprocessing job broken down by department. You can instantly review the devices included in your order. You will know exactly when the job arrives at Sterilmed and when it is shipped back to you." Page 29, "On-Time Shipping." "You get a sealed, sterile device returned to inventory when you need them. Each device is returned to its owner."

These pages included in the exhibit come directly from their historical website. You can easily search the noted website to retrieve information directly to confirm accuracy. Page after page supports that the title transfer never occurred to Sterilmed, inventory was never co-mingled. The hospital received its own instruments back 100 percent of the time. The hospital was able to track their inventory of instruments through the entire reprocessing service. Ultimately, the

hospital retained ownership of the instrument.

Finally, I would like to address the Department's reliance on the FDA guidelines. Clearly, the FDA plays a vital role in providing as much information as possible to assist all parties involved; their role remains to protect the public health, ensure knowledge is provided to all parties, and provide scientific-based guidance.

Page 37 through 80 of our exhibit provide you with their publication related to the reprocessing of instruments. Now I'd like you to turn to page 41 and 42 of the exhibit where it states" "FDA guidance documents, including this guidance, do not establish legal enforceable responsibilities." Page 42, "Guidance means something that is suggested or recommended, but not required."

"The structure of the FDA's guideline can be helpful in interpreting and applying the Revenue and Taxation Code, however, they should not be a crutch used to support an argument that is contradicted by the actual facts and circumstance of the transaction between the parties."

Thank you. That ends my opening statement.

ADMINISTRATIVE LAW JUDGE GEARY: Thank you.

Is the Department ready to proceed with this argument?

MS. HE: Yes, we are.

ADMINISTRATIVE LAW JUDGE GEARY: Proceed when you're ready.

MS. HE: Thank you.

This refund issue of whether or not Appellant, Sterilmed, made sales used these single-use devices, we'll call them SUDs, or just provided the reprocesses of this, on the SUDs collected from its customer, DCHS here. The evidence establishes that the Appellant made sales of reprocessed SUDs, and therefore, the transactions were properly subject to tax as Appellant original reported, and as Appellant believed it should be, with no refund due.

As you know, Revenue Taxation Code Section 606 provides sale means and includes, among other things, A, any transfer of title or possession, exchange, or bought or condition or otherwise, in any manner, over any means whatsoever, for tangible personal property for conversation; B, the producing, fabricating, processing, printing, or imprinting of tangible personal property for consideration for consumers for furnishing directly and indirectly materials use in the producing, fabricating, process, printing, or imprinting."

A person claiming a refund bears the burden of proof of the entitlement to a refund. First, a little bit of background on the SUD reprocessing. An SUD, also commonly referred to as a disposable medical device, is a device intended to be used only once on one patient only during one single procedure. The decision to label a device a single use or reusable rests with the manufacturer with the caveat that it depends also on whether the manufacturer wants to or can demonstrate to the FDA's

satisfaction that the device can be cleaned and sterilized without impairing its function for medical uses.

Even though labeled for single use, some SUDs reprocess for reuse with FDA clearance. The Department Exhibit G, that's pages 120 to 126, contains FDA's summary of the legal requirements of the third party and hospital reprocess of SUDs with the corresponding code and regulations sections.

The Appellant brought up the fact that FDA guidance is only for guidance and recommendation only, but what the Appellant fails to read to the record is that that section also actually said on this, specific regulatory and statutory requirement are cited, so the only use the Department is making of FDA document is to reference this specific legal sections regulatory and statutory sections as cited in the FDA document, so there can be no objection to those.

So those legal requirements include registering the establishment engaged in reprocessing, submitting a list of the devices to be reprocessed, and labeling and the premarketing requirements for the reprocessed devices, et cetera. Appellant has confirmed that as the reprocess of SUDs, all the legal requirements as listed in the FDA document that I just referenced about, apply to Appellant as reflected in the Department's Exhibits E, that's pages 95 and 97; and the Department's Exhibit F, pages 101 to 102.

In fact, Appellant itself has listed the following position

regarding the taxability of the reprocessed SUDs here at issue. As shown in the Exhibit E, page 97, Appellant states, I quote, "Sterilmed is registered with the FDA as a manufacturer and it's considered the manufacturer of record for the reprocessed device, therefore, sales tax is charged."

In addition to Appellant's position on this issue that's a seller, when you are dealing with the customer, DCHS, in addition to seller's position, the transactions at issue are governed by the group purchasing agreement, which also supports the sale and purchase of reprocessed SUDs. The group purchasing agreement is in Department's Exhibit D pages 56 to 93, that agreement makes it very clear that the Appellant's customer, as found here, DCHS, relinquished title of the used SUDs to Appellant by placing them in Appellant's designated bins, and then after reprocessing, Appellant's passed title to the reprocessed SUDs back to the customer, DCHS.

These transactions are, therefore, sales, and Section 606, and also supported by the follows contract provisions: First, the agreement between Appellant and it's customer issued here is titled "Group Purchasing Agreement," that's page 57 in our Exhibit package. The Appellant identifies itself as a seller throughout the contract in the group purchasing agreement starting with page 57 and describes itself as, I quote, "Manufacturer and Supplier of House Products." And it further states, I quote, "Has offered to provide products," end quote.

That's page 59 of our exhibit package.

On the same page, 59, Sections 3.0 provides the part that participating members, for example, DCHS, shall have the right to purchase products in accordance with this agreement. Similarly, Section 6.3 of the agreement, that's page 60 of our exhibit package provides that, I quote, "All shipments of products from seller to participating members shall be FOB destination. Title and rest of loss shall transfer to participating members upon delivery." Likewise, Section 12.2, page 64 of our exhibit package provides that, I quote, "Seller hereby warrants that all products supplied hereunder shall be free and clear of liens and encumbrances, that the seller has good and merchantable title, and that each of the products shall be free from defects in material and workmanship and shall confirm to the published specification for such product and the seller's representation regarding the functions and uses for which the products is marketed," end quote.

Appellant just brought up a new argument basically saying the warranty of merchantable title applies to only the incidental the reprocessor happened to incorporate into the final reprocessed SUDs. When you read the title language here, no where it says the seller only warrantees title, good title, free and clear of liens and encumbrances only to the incidentals. It's the whole product; there's no breaking down by parts or materials.

The language used in the other sections also indicates the sale and purchase situation. For example, Section 8.0 talks about sales support, Section 9.2 mentions sales catalogues, Section 9.3, sales documentation, Section 9.5 discusses documents used in the sales and use transactions of the preprocessed SUDs and it states -- the documentation includes transactions sets 810, those are invoices; 820, those are payment order and remittance advice; 832 price and sales catalogue; 850 purchase order; 855, purchase order acknowledgment; 856, ship notice and manifests; 844 product transfer and account adjustment; and 849, response to product transfer account adjustment or charge back or rebate.

Section 9.7 talks about sales for customer reports; Section 7.2 talks about orders; Section 14.5 discussed the right to use any confidential information relating to the sale of goods to lodge members of the healthcare facilities. We have Section 15.18 that makes reference to constantly developing electronic process which may enable the members and the Appellant to more efficiently purchase and sell products.

Also, the exhibits support the same conclusion of the sales and purchase transaction. Exhibit G, seller's information discloses the seller maintains destination of ISO 13485, medical device manufacturer. Exhibit J, this is also very important, that's page 88 of our exhibit package, it's titled "Seller's returned goods policy." A customer can, like the hospital, can

return reprocessed goods to seller, and it also specifies that the product return will be handled in accordance with establishes protocols and documentation obtained in the returned goods authorization case.

We have the Exhibit K with other instructions. All these terms are consistent with the Appellant acting as seller of property and that the transactions were conducted as mentioned, with purchase orders, invoices, and all the other typical sales and purchase documents, plus any other TDB sales. And it's also important structuring the transactions as sales were what Appellant intended to reflect in Exhibit E, page 97, which I read out earlier, the manufacturer of the record, therefore, we are charging sales tax. Actually, they didn't charge sales tax, there was no evidence that when engaging in business in California so they charged, really, used tax, but it doesn't matter. The fact is their position is it was a taxable transaction.

Regarding DCHS's assertion that ownership terms in the agreement pertained only to the Appellant's sale of repaired parts, the Department notes that the group purchasing agreement contains only one product, look at page 57, "Product Category, sterile reprocessing." And then when you look at each and every schedule in the contract, they all referenced the same one and only product category. So it's implausible that the group purchasing agreement is even applicable to anything other than

the Appellant's reprocessing.

The Appellant's reference about product and services as listed in Exhibit A3 is misplaced because when you look at Exhibit A3, there are 300-some pages of documents, they are all -- I cannot make what those products are, I can tell they're not services, they're are medical products. So A3 contains no listing of services, so Appellant's document doesn't get us anywhere.

Consistent with the groups purchasing agreement and with the seller's own intent, it appears that Appellant had full control over the used SUDs once they were placed in Appellant's designated containers. Appellant had no obligation to return non-reprocessed SUDs to its customers or need for consent from its customers, DCHS, to dispose of any of the SUDs collected.

Similarly, for the used SUDs which Appellant deemed suitable for reprocessing for which DCHS initiated the purchase order, Appellant, again, alone decide what to do with them. This is established by Appellant's Exhibit E at page 100. When starting with page 99, really, there was an e-mail from the Appellant's representative saying there was a change of business model and then as attachment, so page 100 is that attachment that's referenced in the earlier e-mail.

In that attached document, Appellant informed its customers that beginning March 4, 2013, Appellant will transition to inventory now system where they began to commingle SUDs of

different customers to allow one customer to all the devices not being collected at the customer's facility. In other words, one customer can order another customer's discarded SUDs once reprocessed by Sterilmed.

Notably, the group purchasing agreement was in effect until January 31st of 2014, and the business model change document was dated March 4th, 2013, so that business model happened in the middle of the contract term. Apparently, we agreed to notice there was no contract modification or other forms of customer's consent. This suggests that Appellant had always had full control of the SUDs once they were placed in the Appellant's designated containers.

This is even more obvious when you read that business model update, together with our purchase agreement on file, Section 12.2, Seller has good and merchantable title so for the seller to sell one customer's discarded products to a different customer, he had to have good merchantable title as warranted in the contact. So that shows, again, Appellant has had ownership of the discarded SUDs once they picked it up from the site in the containers.

This structure to the transaction is also consistent with the Appellant's legal status as a legal manufacturer of the processed SUD with all the associated legal duties and obligation. It's further consistent with what reprocessing really entails, that is, Appellant as a SUD is only good for

one-time use, by reprocessing SUDs, Appellant essentially fabricates a new SUD by according as Appellant already brought up himself, other incidental materials into the discarded SUDs. So they discarded the SUDs only acting as starting material, and then Appellant introduced other characteristics to the product and other incidental materials and made it into a different product, otherwise it could not be because it's a single use, once it's used, it's junk, it's a biohazard, there's no other use it can be restored to.

So this, again, Appellant's argument about selling other materials into the final reprocessed SUDs supports the Department's conclusion or position, all alone, that there was a sale and purchase of the reprocessed SUDs. We realize that this unique characteristics of the SUD reprocessing are the lacking basis for the party's restructure of the contact as a sales contract instead a service contract, but regardless of the reason, based on what we discussed, the Department finds that Appellant, who acquired the title to the used medical device once they were placed by DCHS in the Appellant's collection bins, and the Appellant then sold the reprocessed devices back to DCHS for use in California, therefore, the transaction at issue constituted retail sales of tangible personal property by Appellant, and thus are subject to tax without any refund due.

As to DCHS relies on the ownership records on the archived web pages, they're just that, they're web page information.

It's not the legal document. The only legal document that governs the transactions at issue is the group purchasing agreement. And the group purchasing agreement made it very clear, it says sales and purchase transaction. They are sellers, they are buyers, they are warranties of title, they are title transfer, everything and anything you can see in a sales and purchase transaction.

Back to web page references. Anyway, those references appear for only marketing purposes. And it's kind of catchy for, as Sterilmed said on the web page. "Only Sterilmed guarantees that the same device collected at your facility are returned to you." It's catchy. It makes it stand out and makes it easier to get business. They are no way controlling as to the transactions. Particularly if it contradicts the terms and conditions of the group purchasing agreement.

In fact, when you look at Section 15.5, the group purchasing agreement, it specifically provides that in the event of any conflict between this agreement -- meaning the group purchasing agreement -- and any document, instrument, or agreement provided by the seller, including without limitation, seller's purchase orders and invoices, the terms of this agreement shall control.

As previously discussed, the terms of the agreement to the group purchase agreement reflected Appellant held the title to the reprocessed SUDs that it acquired from DCHS and was the

seller of the reprocessed devices.

In sum, based on the evidence presented, the Department properly denied the claim for refund and the appeal should be denied. Thank you.

ADMINISTRATIVE LAW JUDGE GEARY: Thank you. I'm going to have some questions, and my fellow judges may have some questions, however, we are going to hold those until you give your final closing, and there will likely be questions when you're done, so if you are ready to proceed, you may.

MR. BHOLAT: Thank you. First of all, I would like to say that in the agreement, it specifically says product and services, so clearly the agreement covering both types of purchases. With respect to the overall process. Let's walk through the logic of what happens. The instrument is originally purchased, used, becomes unsterile, it can't be used for another patient, it gets placed in the bin for collection. That is what the Department is saying, okay, we are now transferring title to you. It sounds illogical.

Let's walk through the process. They place it into the bin, the bin is collected, there's a bunch of different instruments, they do things to prepare the process. They put them in certain solutions to start cleaning them -- this is the hospital that's actually doing this process -- and they then place them in the bin, then once the bin is full, ready to ship out, the hospital staff puts it together, packages it, and sends

it off to Sterilmed, and Sterilmed then receives the property. They will go through the process, a very specific process they have to go through in order to return the product to its original condition. That's what the FDA guidelines establish.

They have to go through and reclean it, they have to resharpen it. For different types of product, they have to go through various steps, and those steps are established by the FDA, and the requirement of the FDA jumping into that process was to ensure, again, that all parties are aware of what the requirements. There is no issues if there are any legal issues that come on later on for a processor who fails their responsibility.

Then there's an established process. Once the item is finished and reprocessed, there is -- actually, let me take a step back. When the product is received by Sterilmed, they have a number of times that each device has useful life, so a particular item may be used twice, three times, four times, five times. Every time they receive a product, they actually bar code everything so they know how many times it has been reused. They have to monitor that. That is all part of the process of their service.

Once the item hits a useful life, the hospital may not know the useful life of that particular product when they place it into the bin, mistakenly, but once Sterilmed receives it and it's beyond its useful device, they disregard that product. So,

there's no, Hey, we are taking this product and doing whatever we want with it. Clearly, the evidence shows in their historical printout pages of web sites of what they published of what they do, they're returning those items back to the original hospital. There was a change, agreed, in March of 2014 in that approach.

ADMINISTRATIVE LAW JUDGE GEARY: 2013. I think, wasn't it?

MR. BHOLAT: It was all after the refund period.

ADMINISTRATIVE LAW JUDGE GEARY: Okay.

MR. BHOLAT: Regarding the FDA regulations and their requirement. Their requirements are that the instrument is processed in a certain manner, depending on the instrument. Their requirements are that a new label is put on to the product to provide information on what the product is, item number, all of those things, because they have to be able to track that through the process.

They require information for use. Those are, again, requirements as part -- again, all medical products, every item out there, has to have instructions for use because it has to be provided to the person using it on the other end has some idea how to use it. They take that information, they actually take that original manufacturer's information for use and replace it and put it back in there.

There is no title transfer from the hospital back to the Sterilmed. The Department says, well, they transferred it when

they placed it into the bin. The contract is exactly silent about that whole process. Placing it in the bin and returning it is just the process that they have to deliver the product back to the Sterilmed in order to get it reprocessed. They are not doing to reprocessing in house. There has to be a mechanism in place for them to deliver it back to Sterilmed.

When the Department says that there's no specific items listed, actually, Section 12.2 specifically lists packaging material as part of the discussion. So there's clearly an intent, the list of items that she mentioned, are all of the devices that were. So the original instrument is Product 123, that Product 123 is then listed as the items and then what the charge is for a reprocessing service. So that's how that contract is structured.

Relating to the Department's position on the -- Sterilmed's position to the items taxable. They're only stating that we have been told by the Board of Equalization that these charges are taxable, we have been given that instruction, that's what we've been told, that's the way we treat the process we continue to collect tax, otherwise, they put themselves in a position where they under collected tax, and they put themselves at risk, which they weren't willing to do.

Return goods is the other thing that she mentioned. If the processor receives a property, they reprocess the item and the reprocessing service doesn't meet the needs of requirements of

where it should have been, that's a bad item, then the hospital has a right to send that product back or destroy it or not pay them and say we are not using this product, it came back dirty, it wasn't clean, the knife wasn't sharpened, whatever the flaw in the reprocessing service was.

The annotation that we actually started within this whole process in doing this analysis is 3.15.0360. And it is not related, it is talking about bumpers, so it's a different product, however, the facts and circumstances is almost exactly on point. And it's basically auto bumpers which are sent out for re-chroming are taxable if the general practice of the chroming industry is to commingle bumpers received so the customer received an equivalent bumper, though not necessarily the same one.

However, if the re-chromer keeps adequate records to prove the bumper returned is the identical bumper sent, then charge is a nontaxable as a repair. That is exactly what we have in this situation. It's 100 percent on point. I agree, after March 2014, after the refund period, circumstances charged. This is definitely a unique situation. Sales tax rules for this type of transaction should be evaluated based on four questions.

Question one, what is being sold? Clearly, we have a service that's taking worn equipment back to its original condition. No question about that. Second, does the service provider send back the original equipment? The answer to that

question is yes. Third question, does the service maintain documented evidence so co-mingled property is not to be returned to a different entity? Clearly, the answer is yes. The final question, can we determine title retains with the original customer? Again, the answer is a yes, based on the voluminous public information they have. This is what they're telling their customers. This is out in the public. This what the hospital sees.

This agreement right here is between the GPO and Sterilmed. The information that is being presented to the customer, which is the hospital, who's the ultimate payer of use, they are going to rely on as well, that's published by the seller or the processor. All the other terms and conditions of use are being used to evaluate this contract. We have to remember that this contract covers both product and services. This is a very generic, it's a very broad agreement, to cover a lot of different scenarios. Clearly, they intended to include services in there because it specifically says services. And then we have to go back and look at what happened in the transaction, what was exchanged? There was an instrument sent in, it was resterilized and reprocessed and cleaned back to its original condition, adding packaging material for shipping, and for cleanliness and sterilization and sanitary purposes and then it was sent back to its original customer, and that's the transaction. That's it. Thank you.

ADMINISTRATIVE LAW JUDGE GEARY: Thank you. I'm going to start off with some questions for you, the Appellant. I think in your introductory comments you might have referred to there being three parties to the contract. I'm assuming you mean that the customer who initiated this process of requesting a refund is a party to the contract in that they were members of the purchasing group that entered into the contract with Sterilmed.

MS. BHOLAT: Correct.

ADMINISTRATIVE LAW JUDGE GEARY: Do you have any information about who drafted this?

MR. BHOLAT: It was drafted by the Group Purchasing Organization.

ADMINISTRATIVE LAW JUDGE GEARY: It was not drafted by Sterilmed?

MR. BHOLAT: No. This is a standard agreement that they use for products and services. If you go to the website, they organize the purchasing of construction contracts, sales of services, equipment, all kinds of services and all kinds of different things.

ADMINISTRATIVE LAW JUDGE GEARY: Can you point to any specific provision in the contract that states that the hospitals retain.

MR. BHOLAT: The title transfer is silent.

ADMINISTRATIVE LAW JUDGE GEARY: So there's nothing?

MR. BHOLAT: There's nothing in the agreement.

ADMINISTRATIVE LAW JUDGE GEARY: Am I correct that if a hospital does not request that a processed product be returned to it, ultimately, that product is destroyed?

MR. BHOLAT: Yes.

ADMINISTRATIVE LAW JUDGE GEARY: Who destroys it or disposes of that product?

MR. BHOLAT: The product physically is send back to the Sterilmed, so Sterilmed has possession of the product. There's two ways it's going to get destroyed, the most likely way is it's beyond it's useful life or it's unrepairable. They are going to make that determination, whether they can get it back to its original condition or not. If they decide that it can't be returned to its original condition, then it is destroyed at that point.

The other scenario is that the hospital could have an issue and tell them we don't want it back. Not likely to happen because it's their inventory, their instrument that they're going through the effort of collecting and spending the resources and time to collect it. They have made a conscious decision to recapture as many products as they can.

ADMINISTRATIVE LAW JUDGE GEARY: But it did happen.

MR. BHOLAT: But it's possible.

ADMINISTRATIVE LAW JUDGE GEARY: Isn't that why Sterilmed changed its policy to include the option of purchasing or acquiring reprocessed products that were not actually submitted

by the hospital?

MR. BHOLAT: Initially, so what happened was that whole approach of guaranteeing the customer back their property or their instruments was a way that they separated themselves from the marketplace. And they, themselves, came up -- and many of my hospital clients actually preferred that because they know when they're using an instrument, they know what process they are going to use. They have procedures in place to retain it.

So initially, when this reprocessing service was established, it's fairly new, you know, it's a newer issue, they wanted to get their own property back because that was a significant advantage for Sterilmed because then the customer could rely on we know it's our product, we know that the quality level is, we know somebody didn't bang it on the floor or drop it or whatever. They can control what happened.

Ultimately, Sterilmed backed out of that process because as the market grew, the logistics became very difficult. So you have a lot of products coming in and all their competitors were not doing that. So they then ultimately conformed to the marketplace.

ADMINISTRATIVE LAW JUDGE GEARY: No specific contractual modification was required for that?

MR. BHOLAT: There was a notification given.

ADMINISTRATIVE LAW JUDGE GEARY: We saw that.

MR. BHOLAT: There was a notification given to the

customers. This contract is not, Hey, we are going to buy and process X number of units, we have the option of using you. So if they don't like that, they can decide to go with somebody else.

ADMINISTRATIVE LAW JUDGE GEARY: Were products or devices immediately reprocessed and then held in a reprocessed inventory for purchase orders from the original user, is that how the process worked?

MR. BHOLAT: So the inventory products logs -- the product was placed into the bin, send to Sterilmed. Once the determination is made that the product is reusable in their Internet reporting system, they know these are the devices that are reusable and these are the devices that failed. During the resterilization process that reusable so those items will drop off then they are processing.

ADMINISTRATIVE LAW JUDGE GEARY: Let me just stop you right there because I think you answered my question.

MR. BHOLAT: There's an important fact in the process is that during the resterilization process, the product could also fail. So it's premature for them to purchase an order for a product that may fail in a curtain point that may fail if Sterilmed has taken the position we will do everything we can to get as much reprocessing as possible for as much profit as possible.

ADMINISTRATIVE LAW JUDGE GEARY: So I think the answer to

my question is, yes, Sterilmed reprocessed the devices before receiving any purchase order for those devices from the customer. In other words, they have a reprocessed inventory for hospital ABC that is available for delivery to the customer?

MR. BHOLAT: Yes. But you have to remember that the hospital management staff determined that they're going to do the reprocessing. They made conscious effort and spent recourses to taking those products and placing them into the reprocessing system. It's not just, Hey, we are not going to throw it in the bin and let them figure it out, it's, This item is reprocessable and this one is too risky for us to reprocess, we are not going to reprocess this item.

ADMINISTRATIVE LAW JUDGE GEARY: I think you answered my question. I think you're assuming I had a point in the question that I don't have. I simply wanted to confirm that the order of events is not the hospital sending a purchase order and then Sterilmed reprocessing that number of devices that it had already determined were appropriate for reprocessing. That's not the way it went.

MR. BHOLAT: Correct. The purchase order was issued once the process was completed. The reason why I answered the question the way I did is because the Department is a taking that position they can't issue a purchase order right away, it doesn't make sense to issue a purchase order and then have to cancel.

ADMINISTRATIVE LAW JUDGE GEARY: Understood.

MR. BHOLAT: So administratively and logistically, it doesn't work.

ADMINISTRATIVE LAW JUDGE GEARY: Are devices reprocessed individually or in groups?

MR. BHOLAT: Individually, every single product reprocessed. You can watch the video if you are ever interested.

ADMINISTRATIVE LAW JUDGE GEARY: I don't want to hear what the video says. I can't watch it.

MR. BHOLAT: True.

ADMINISTRATIVE LAW JUDGE GEARY: So the decision to dispose -- I think you have already indicated -- the hospital doesn't have to consent to the disposal of the product, that's the decision that Sterilmed made.

MR. BHOLAT: The hospital is to consent to the disposal of the product is made at two different places, the first is do we want to reprocess it or not, that's a decision we have to make; the second place is do we want to continue to use that product because they know it's been used a certain number of times. They may have a separate protocol. Sterilmed may say we can reprocess it five times and the hospital may say we only want it three times, so there is that ability for them to have that flexibility.

ADMINISTRATIVE LAW JUDGE GEARY: The devices are repackaged

by Sterilmed?

MR. BHOLAT: Yes. The packages have been broken, they come in and are reprocessed. They have to resterilize them, reseal them, and put a label on what it is so everybody knows what it is.

ADMINISTRATIVE LAW JUDGE GEARY: You said something about instructions.

MR. BHOLAT: Correct.

ADMINISTRATIVE LAW JUDGE GEARY: And those are certain types of instructions required for certain devices?

MR. BHOLAT: Every medical product has to have instructions for use, an IFU, what that basically says is this is what the product is and this is how it's intended to be used.

ADMINISTRATIVE LAW JUDGE GEARY: And Sterilmed would create the instructions included in the packaging before it was shipped back to the customer?

MR. BHOLAT: Yes.

ADMINISTRATIVE LAW JUDGE GEARY: The regulations talk about premarket approval, are you familiar with that term?

MR. BHOLAT: Correct.

ADMINISTRATIVE LAW JUDGE GEARY: Tell me what that means.

MR. BHOLAT: Premarket approval is a process that the FDA requires to have approval before they go to premarket. I'm not an expert at it, but I understand the basics of it. It is a process that they require so that they know that products are

tested, evaluated, and used in very specific circumstances before they're ultimately approved for use. The reprocessing service -- if you look at the historical process of the developing of the processing services it was the single manufacturer -- single-unit device manufactures started labeling their products as SUDs because the more products they sell, the more money they generate.

From their business perspective, let's sell as many products as we possibly can, so they label their items as single-use devices. The hospitals look at that and say that's a huge increase for us now. Now, instead of us reprocessing it internally, now we are told by the manufacturer we had to reprocess or we are only allowed to use it once. Then the hospitals started internally reprocessing these items.

That worked for a while, and as the process grew and developed, then these companies like Sterilmed developed. We said we will come in and do it for you and do it for cheaper. Then the FDA, when this market grew, the FDA came and said, Okay, we need to establish guidelines so everybody is clear on how this process worked, what are the requirements, what are the processes, here are the devices that can't be reprocessed because there maybe some risk there. So they establish guidelines, or what they thought should be. What should happen with the market. Again, they, themselves, said these are guidelines, these aren't regulations. It doesn't supercede

another regulation or another guideline.

ADMINISTRATIVE LAW JUDGE GEARY: So Sterilmed sold products also?

MR. BHOLAT: Yes.

ADMINISTRATIVE LAW JUDGE GEARY: What kind of products?

MR. BHOLAT: They sold parts, repair parts, if an instrument was broken before it was used, they do repair services. During that time -- I know currently they do sell other reused devices now, but at that time they were selling -- in the listing invoices, so when we pulled all of the invoices and transactions that were purchased by the hospital from Sterilmed, there were two types of transactions, reprocessing and repairs. So an instrument was sent to Sterilmed, a repair was done to the instrument, there was a parts charge and labor charge.

ADMINISTRATIVE LAW JUDGE GEARY: You are saying when you pulled invoices for the purposes of the audit?

MR. BHOLAT: When we did the review, we pulled every single transaction and those invoices were provided.

ADMINISTRATIVE LAW JUDGE GEARY: Thank you. After my co-panelists ask questions, I'll give the Department an opportunity to respond to the factual statements that were made by Mr. Bholat, I'm going to give you a chance to do that. I have no further questions. I'll ask my co-panelists if they have any.

ADMINISTRATIVE LAW JUDGE CHO: I just have one quick question. It goes back to the processing of SUDs, the ones that Sterilmed was able to reprocess, however, the hospital decides not to purchase those products, and then I believe you stated that those products are then destroyed or discarded by Sterilmed; correct?

MR. BHOLAT: That is what we understand, yes. I represent the hospital, but from what I understand, yes.

ADMINISTRATIVE LAW JUDGE CHO: You mentioned that there are fees associated with the reprocessing of each SUD, in that case, does the hospital have to pay for the fee with regard to the ones that were discarded or does Sterilmed eat the fees?

MR. BHOLAT: If the hospital determines they don't want to purchase an item, then there is no payment between the two parties.

ADMINISTRATIVE LAW JUDGE CHO: I was just checking on that. Thank you. That was my only question.

ADMINISTRATIVE LAW JUDGE GEARY: Judge Cheng?

ADMINISTRATIVE LAW JUDGE CHENG: Yes, I do have a few questions. Do you know how much of the merchandise, that after processing, were returned back to the hospitals, like, percentage wise?

MR. BHOLAT: I do not have any that information. My understanding is a large percentage of them are reprocessed. Because the hospitals want to preprocess because it's 20 to 30

percent of the cost of buying a new one.

ADMINISTRATIVE LAW JUDGE GEARY: You just said a large percentage are reprocessed, the question was how many went back to the hospital.

MR. BHOLAT: We don't know.

ADMINISTRATIVE LAW JUDGE CHENG: A question about the price sheet, which is Exhibit A3 attached to the agreement. Just to clarify, are these the processed devices or do these include parts that were sold, the brand new stuff that were sold by Sterilmed?

MR. BHOLAT: There's 300 pages of items, so I didn't go through every single item that were included in that.

ADMINISTRATIVE LAW JUDGE GEARY: We only have one page.

MR. BHOLAT: Right. It was just too voluminous to keep all of them. From what I understand, it is the reprocessed items, I don't know if parts were included in that. I didn't do that analysis. So I'm not sure.

ADMINISTRATIVE LAW JUDGE CHENG: So when Sterilmed collected these devices from the hospitals, did Sterilmed log these items in their own inventory, like, these devices belong to the Sterilmed as a part of its inventory?

MR. BHOLAT: So according to the information that they published at that time, they were very specific in saying that device ownership was with the hospital, they tracked their own inventory. It was placed in inventory, it was identified where

it came from, who the hospital was. It actually came from which department. Every hospital has multiple departments, so if it came from OR, it would be the OR Department. So they knew exactly where it came from, who it was for, who, in their words, the owners were of those instruments.

ADMINISTRATIVE LAW JUDGE CHENG: So the answer is no, they didn't take them into their own inventory.

MR. BHOLAT: Correct.

ADMINISTRATIVE LAW JUDGE CHENG: Do you know if Sterilmed, in selling these items, claimed a cost of goods sold on them?

MR. BHOLAT: I do not know that. I did not look at Sterilmed's accounting books and reports at all. I don't have access to that information.

ADMINISTRATIVE LAW JUDGE CHENG: On the purchase invoices, were the repair items separated from the actual devices? Were they on separate invoices?

MR. BHOLAT: Separate invoices include parts and labor. I did not see one invoice that had a commingling of services. They had a separate invoice numbering system. They look different, slightly as well.

ADMINISTRATIVE LAW JUDGE CHENG: Okay. For the Department, you said that the way the price list was structured, or the invoices were structured, can't be a sale of -- couldn't be provided services, it had to be a sale of goods or TTP because of the price list; is that correct?

MS. HE: No. Our position is not based on the price list, but rather on the totality of the group purchasing agreement. All the sections I went through, especially the title transfer, warranty of merchantable title, then the purchasing orders, invoices, and everything just kind of tied together to show that whole transaction, the structuring, is consistent with all the legal consequences of all these other provisions about title transfer, title warranty, everything else.

MR. CLAREMON: We would have the attachment A3, it's presented a list of products with each type of TTP having an associated price with it. In terms of looking at it, it does support the idea of a sales contract of TTPs and not a sales product.

ADMINISTRATIVE LAW JUDGE CHENG: But standing alone, it wouldn't --

MR. CLAREMON: Standing alone, it looks like a list of tangible personal property sold. I think if you looked at this, you would think it was a sales contract and these are things you could buy. And as we pointed out, the sales here are sterile reprocessing, so when you are talking about repair items or repair parts, there's no indications that there were other types of sales taking place, so our understanding is this is a list of reprocessed items only.

ADMINISTRATIVE LAW JUDGE CHENG: How is this different from a dry cleaning price list, like shirts, four dollars, pants, ten

dollars? It's per item; right?

MS. HE: That's why we are saying our position is not based on the A3 list, that's not the crux of our position. Our crux is really based on the title transfer and warranty of the title and then everything else we went through, and this A3, it significantly refutes the customer's argument that the contract covers services. When you look at this whole thing, it didn't say you reprocessed this thing, it's one price, if you buy these products, it's this price. It's not like dry cleaning where you say you are dry cleaning a pair of pants, that's the dry cleaning. But here, when you look at the document list, it says this product costs this much, you're getting the document.

ADMINISTRATIVE LAW JUDGE CHENG: Okay.

MS. HE: I'm sorry. You're getting the product.

ADMINISTRATIVE LAW JUDGE CHENG: Mr. Bholat, so take the first item on the list, knife hook straight, do you know the list price of $18.77, is that close to what a brand new knife hook straight would be?

MR. BHOLAT: No. A brand new one would be three to four times that, at least double.

ADMINISTRATIVE LAW JUDGE CHENG: Okay. Thank you.

ADMINISTRATIVE LAW JUDGE GEARY: Anything else, Judge Cho?

JUDGE CHO: Nothing else here.

ADMINISTRATIVE LAW JUDGE GEARY: Anything else from the Department?

MS. HE: Yes. We would like to offer to respond to what Appellant brought up during the judges' questions. Basically, with the guarantee of your own products back, what the Appellant just said kind of confirms what the Department has been saying all along, that guarantee doesn't dictate the customer had ownership; in fact, the opposite is true, as Appellant was saying because it was a great selling point for Sterilmed, at that point.

So back during the claim period, Sterilmed was only the second largest reprocessing company in the industry, Ascend was the largest one and they got bought by original equipment manufacturer. So to make itself competitive and to attract customers, Sterilmed, with its ownership of all the SUDs, decided it's a better business model to let the customer get whatever products from themselves back to make themselves stand out.

So that's before 2013, that's their business model, their choice, their say. Just because the customer always got whatever they were sending in doesn't mean the customer had the ownership. The document had reference to the business model change clearly proves it's the other way around. Sterilmed just decided to exercise its ownership over SUDs a different way before 2013 to better attract customers and to make themselves more competitive. And after 2013, it exercised the ownership of SUDs a different way because of the higher rate of products that

were reprocessable, that went through all the trouble and spending all the money and not getting any order, it decided it's more economical for them to the change to a different business model.

Again, regardless of which model it chose, it always had ownership of this reprocessed SUDs. So that's what makes this transaction of a sales and purchase transaction. It is a transfer of title and then transfer title back to the customer as backed by the warranty -- title warranty, title transfer document, return to goods policy, everything, and the GPO, of course, that's the only legal document on file.

As you mentioned, Sterilmed was the second largest reprocessor and the group purchasing hospital network, that was a very huge tax pay as well. So it's the only legal document between very sophisticated parties. They are using all these words, sale, title transfer, warranty of title, in the legally significant document that means something, unlike the web page documents saying, you get whatever you have back. Even on those, you also get it back.

The tracking of everything is not really to track ownership for the sake of tracking ownership, but you look at all the archived web pages, taxpayer, the hospital provided, the main reason, again, is for marketing, for being customer friendly, so you can track the projection rates to gather your future purchasing decisions so you can see how many you can purchase at

a fraction of the cost of the new devices from the original equipment manufacturer, and then you decide to hold on those purchases and wait for Sterilmed to process your products at just a fraction of the cost of the new device from the original equipment manufacturer. Then you decide to hold on those purchases and wait for Sterilmed to process your products with a fraction of the money of those.

Then in other places in the web page, the tracking allows the device to be effortlessly entered into the hospital system for immediate use. To easily use the products. You scan it. This is for the hospital staff to spend minimum time entering it into the computer system. All the tracking, bar coding, everything, it was just a customer-friendly service for the hospital to more easily use the products. You scan it, you show us which Department has what product and how they use it.

Everything is about providing a service to the customer to -- I should say, the customer service with better tracking. But that's separate from the transactions of the transfer of the SUDs. So they're not tracking it for the purpose of tracking who had what, they are tracking so the customer can find it more easily to scan the SUD into the system to use it right away without having to type in the different codes for the different department and each hospital for different surgeons.

All those steps are saved with the tracking. So that's the crux of the whole point of tracking. That's not for tracking

ownership. As we already said, the contract proves Sterilmed had ownership. The business model changed notification shows Sterilmed had ownership. All the documents of legal significance show that Sterilmed had ownership, and then they transferred back to the hospital when they send the products back.

ADMINISTRATIVE LAW JUDGE GEARY: I've just been informed that Judge Cheng has one more question.

ADMINISTRATIVE LAW JUDGE CHENG: So the Department's position is that title transferred when the items were picked up and shipped to Sterilmed. I'm curious as to whether you believe that the hospitals relinquished all control, not just possession, but control of the devices given that Sterilmed couldn't, prior to 2013, resell the items to a third party. It had to have either been sold back to the hospitals or if the hospitals said, We don't want these, they had to be destroyed. So it seems like the hospitals made the call on all of the items that were collected.

MS. HE: The Department disagrees with that. As we said, the business model update clearly show that Sterilmed was the one calling the shots. Before 2013, Sterilmed was not selling to other customers for used SUD, reprocessable, but not ordered by DCHS here. It did not sell not because it could not sell, it just decided not to, and the obvious reason, like I said, it's a business model, it's easier to attract customers, make it stand

out to fend out competition for the largest reprocessor at the time, which was bought by another medical equipment manufacturer.

Then the other possible reason is because reprocessing was kind of an ever-developing industry, it was very complicated with the FDA regulation. As mentioned in the FDA document, they were subject to the safety recall requirements, the tracking reporting about medical incidents resulting from the use of the reprocessed SUDs, so maybe because back then there was also a technological limitation on them to officially track who had what, and to report any incidents arising from the use of the document, so they were commingling them.

As they develop the business and they got better in doing the whole thing -- that they get a better handle how to track this thing to answer to the FDA's requirement on the tracking medical instruments reporting and other things, so there were a variety of reasons that could have happened that dictated why they did it that way. The why really doesn't matter for sales and use tax purposes. It's what happened. What happened is there was a title transfer and they had control as shown by the document as to why --

MR. CLAREMON: And the point that they could make that change without the change to the contract contemplates that they could have sold it to other hospitals during our refund period. There's been no evidence presented that there was a change to

the contract.

ADMINISTRATIVE LAW JUDGE CHENG: But only after the hospital said, No, we don't want those back. That was the decision that the hospitals made only after the hospital said we don't want those back, then at that point, Sterilmed could do that.

MR. CLAREMON: Again, that was a policy that they would give them 30 days, then after those 30 days, they would sell to someone else. The fact that they are changing the policy, it's not necessarily a requirement of the contract that they gave them right of first refusal, it's what they announced as their policy, but it's not contractual obligation.

MS. HE: There was no -- from the customer at Sterilmed at any point there was inaction the hospital never said to Sterilmed, No, we don't want any of these products back, you can do whatever.

MR. BHOLAT: Sure, they did. They issued the PO. They made that decision, they said, We want it, we want it back.

MS. HE: They failed to make the purchase, that's an inaction, not an affirmative action of saying, No, we are exercising our control over the SUDs by saying we are abandoning them, now you can do whatever. There was never any of that saying that happened here. They didn't have a no.

ADMINISTRATIVE LAW JUDGE CHENG: So to you, control means you have to actively say, No, I don't want these. It's not just

saying, I want these and saying nothing about the rest of them.

MS. HE: And then who can decide what to do with the rest of them because control is basically -- who decides? Who exercises the ultimate say in the disposal of the products?

ADMINISTRATIVE LAW JUDGE CHENG: Okay. Thank you.

ADMINISTRATIVE LAW JUDGE GEARY: Thank you to both parties for appearing this morning and being so patient this morning and waiting for their hearing to be called. This concludes the hearing. The judges are taking the matter under submission, within 100 days of today's date, because I'm closing the record now, we will issue a written decision and send copies to the parties so you will know what the decision is. This hearing is adjourned. Thank you.

(Hearing adjourned at 12:30 p.m.)

REPORTER'S CERTIFICATION

I, the undersigned, a Hearing Reporter for the State of California, do hereby certify:

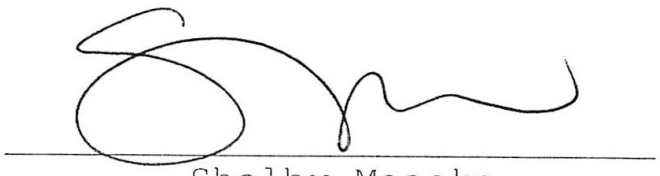
That the foregoing proceedings were taken before me at the time and place herein set forth; that any witnesses in the foregoing proceedings, prior to testifying, were duly sworn; that a record of the proceedings was made by me using machine shorthand, which was thereafter transcribed under my direction; that the foregoing transcript is a true record of the testimony given.

Further, that if the foregoing pertains to the original transcript of a deposition in a federal case, before completion of the proceedings, review of the transcript [] was [] was not requested.

I further certify I am neither financially interested in the action nor a relative or employee of any attorney or party to this action.

IN WITNESS WHEREOF, I have this date subscribed my name.

Dated: February 21, 2019



Shelby Maaske,
Hearing Reporter