

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF:)
)
REDWOOD MEMORIAL HOSPITAL, INC.,) CASE NO. 21037436
)
APPELLANT.)
_____)

CERTIFIED COPY

TRANSCRIPT OF PROCEEDINGS

Sacramento, California

Tuesday, January 24, 2023

Reported by:

Maria Esquivel-Parkinson,
CSR No. 10621, RPR

Job No.:
40044 OTA(A)

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TRANSCRIPT OF PROCEEDINGS, taken at
400 R Street, Sacramento, California,
commencing at 9:30 a.m. and concluding
at 10:55 a.m. on Tuesday, January 24, 2023,
reported by Maria Esquivel-Parkinson,
CSR No. 10621, RPR, a Certified Shorthand
Reporter in and for the State of California.

1 APPEARANCES:

2
3 PANEL MEMBERS:

4
5 Teresa Stanley, Lead ALJ

6 Andrew Kwee

7 Mike Le

8
9 FOR THE APPELLANT:

10
11 Randy Ferris, Esq.

12 Mark Stefan, Representative

13 Sara Gaudreau, Representative

14
15 FOR THE CDTFA:

16
17 OFFICE OF TAX APPEALS
18 400 R Street
19 Sacramento, California

20 Amanda Jacobs

21 Scott Claremont, Tax Counsel

22 Jason Parker, Hearing Representative

I N D E X

E X H I B I T S

(Appellant's Exhibits 1 through 16 were admitted at
page 10)

(CDTFA's Exhibits A through F were admitted at
page 10)

P R E S E N T A T I O N

P A G E

By Mr. Ferris

11

By Ms. Jacobs

37

1 Sacramento, California; Tuesday, January 24, 2023

2 9:30 a.m.

3
4 ALJ STANLEY: Again, this is appeal --
5 appeals -- appeal of Redwood Memorial Hospital, Inc.
6 The case number is 21037436. The date is January 24th,
7 2023, and the time is about 9:30 a.m. here in
8 Sacramento, California.

9 Again, I'm Judge Teresa Stanley, and Judge
10 Andrew Kwee and Judge Mike Le are also on the panel. I
11 will conduct the proceedings, but the panel will equally
12 deliberate and issue a written opinion within a hundred
13 days after the record closes.

14 Let's have everybody identify themselves for
15 the record, starting with Appellant.

16 MR. FERRIS: Randy Ferris, Ernst & Young, for
17 Appellant.

18 MR. STEFAN: Mark Stefan, Ernst & Young for
19 Appellant.

20 MS. GAUDREAU: Sara Gaudreau, Ernst & Young,
21 for Appellant.

22 ALJ STANLEY: And CDTFA.

23 MS. JACOBS: Amanda Jacobs, Tax Counsel III,
24 with the California Department of Tax and Fee
25 Administration.

1 MR. CLAREMONT: Scott Claremont with the CDTFA.

2 MR. PARKER: And Jason Parker, chief of
3 headquarters operations bureau with CDTFA.

4 ALJ STANLEY: Okay. And I -- I just want
5 everybody to know that they can -- they can just jump in
6 if you have any questions about how the proceedings are
7 going or if you think I've missed something.

8 I'm going to welcome everyone to the Office of
9 Tax Appeals, or OTA as we lovingly call it. OTA is an
10 independent agency that has no affiliation with CDTFA or
11 any other tax agency. OTA is not a court, but we're an
12 independent appeals agency staffed with our own tax
13 experts.

14 The only evidence in OTA's record is what was
15 submitted in this appeal, which all three judges have
16 reviewed.

17 The proceedings are being livestreamed on
18 YouTube. Our stenographer Ms. Esquivel-Parkinson is
19 recording the proceeding so, once again, speak directly
20 into your microphone, speak loudly and clearly, and
21 hopefully she can catch every word.

22 The issues to be decided in this appeal are as
23 follows: The issue is whether Appellant is entitled to a
24 refund of the tax and/or tax reimbursement it paid on
25 its purchases of tangible personal property provided to

1 patients covered by Medicare Part A. And Appellant in
2 their prehearing conference statement listed five
3 subissues that I'm going to go ahead and read into the
4 record so that we can make sure that we consider those
5 in our deliberations and opinion.

6 It's Appellants understanding that the
7 following principal material facts and issues are in
8 dispute. Number one, whether for periods prior to
9 January 1st, 2019, title passage clauses and contracts
10 between medical service facilities and Medicare Part A
11 patients are relevant with respect to meeting the
12 requirements of the exemption provided under Revenue and
13 Taxation Code Section 6381 and regulation Section
14 1614(f).

15 And number two, whether a requirement for such
16 title passage clauses with Medicare Part A patients
17 would effectively and improperly invalidate the Medicare
18 Part A exemption because such a requirement would
19 impermissibly treat Medicare Part A patients as federal
20 instrumentalities.

21 Number three, whether if title passage clauses
22 with Medicare Part A patients are not relevant for
23 operating the Medicare Part A exemption for periods
24 prior to January 1st, 2019, a requirement that title
25 passage clauses exists in contracts between medical

1 service facilities and the United States Government
2 would effectively and improperly invalidate the
3 exemption because such title passage clauses have never
4 existed since the exemption first became operative in
5 1966.

6 Number four, whether Regulation Section 1503(b)
7 and 1591(f)(2) are interpretive regulations pursuant to
8 the classifications set forth in the Yamaha Corp. of
9 America vs. the State Board of Equalization and are
10 invalid to the extent they cannot be harmonized with the
11 Medicare Part A exemption provided under Revenue and
12 Taxation Code Section 6381 and Regulation 1614(f).

13 And lastly number five, whether any indicia of
14 an intent to make an exempt sale of medical supplies to
15 the United States Government under Medicare Part A is
16 required other than identifying the subject medical
17 supplies to the United States Government as part of the
18 established Medicare Part A reimbursement procedures and
19 receiving a corresponding payment from the United States
20 government.

21 Mr. Ferris, does this accurately represent the
22 issues as you see them?

23 MR. FERRIS: Yes, Judge Stanley.

24 ALJ STANLEY: And, Ms. Jacobs, does the CDTFA
25 agree that those are the issues that have been raised?

1 MS. JACOBS: Yes, we agree.

2 ALJ STANLEY: Okay. We also had some
3 prehearing stipulations in this case, and I'm going to
4 read those and make sure that the parties still agree.

5 Number one, the parties agree that no title
6 passage clauses exist between Appellant and Medicare
7 Part A patients for the claim period at issue and that
8 no title passage clauses exist between Appellant and the
9 United States Government for the claim period at issue.
10 That -- since this was proposed by Appellant I'll ask
11 you, Ms. Jacobs, does the Department still agree to
12 that?

13 MS. JACOBS: We do.

14 ALJ STANLEY: Okay. And CDTFA -- well, I
15 won't -- I won't need to read into the record the parts
16 that CDTFA did not agree to, but after the prehearing
17 conference CDTFA reviewed transactions in Appellant's
18 Exhibits 9 through 16 and agreed that those exhibits are
19 sufficient to establish that Appellant was charged tax
20 or tax reimbursement and that it paid the tax or tax
21 reimbursement to its vendors in these seven particular
22 transactions.

23 Is that correct, Ms. Jacobs?

24 MS. JACOBS: That's correct.

25 ALJ STANLEY: Okay.

1 MR. FERRIS: Judge Stanley, I should probably
2 add that if you add up all of the tax amounts for those
3 seven transactions, the amount is \$50.58.

4 ALJ STANLEY: Okay. Thank you for the
5 clarification or addition. So at the hearing -- at the
6 prehearing conference, we had Appellant's Exhibits 1
7 through 16 and CDTFA did not object, so if there's no
8 objection today, Ms. Jacobs?

9 MS. JACOBS: No objection.

10 ALJ STANLEY: Those will be entered into
11 evidence.

12 (Appellant's Exhibits 1 through 16 admitted.)

13 ALJ STANLEY: Despite the minutes and orders
14 that stated only eight of them would be.

15 So CDTFA submitted Exhibits A through F, and
16 Appellant did not object to those exhibits.

17 Is that still accurate, Mr. Ferris?

18 MR. FERRIS: Yes, it is.

19 ALJ STANLEY: Okay.

20 (CDTFA's Exhibits A through F admitted.)

21 ALJ STANLEY: And I want to point out for the
22 record and for the public that neither party is
23 presenting any witnesses today, so there will only be a
24 presentation and no witnesses will be sworn in under
25 oath or affirmation. We're going to start with

1 Appellant's presentation.

2 So, Mr. Ferris, when you're ready, you may
3 proceed.

4 PRESENTATION

5 MR. FERRIS, Attorney for Appellant:

6 Thank you. Honorable panel, Appellant is
7 seeking --

8 (Reporter interrupted)

9 MR. FERRIS: Honorable panel, Appellant is
10 seeking a refund for tax paid purchases resold
11 deductions arising from tax and reimbursement.
12 Appellant paid to its vendors on purchases of medical
13 supply items. Appellant later sold these items to the
14 federal government in nontaxable transactions pursuant
15 to the Medicare Part A exemption provided under Revenue
16 and Taxation Code Section 6381 and Sales and Use Tax
17 Regulation 1614, subdivision (f).

18 The Department denied Appellant's refund
19 because over the years since the party exemption first
20 became operative in 1966, the Department has
21 inadvertently lost connection with the statutory basis
22 for the Part A exemption unmoored from the statutory
23 basis for the Part A exemption, the Department now
24 clings to irrelevant language about patient title
25 passage clauses in regulation 1503(b)(2)(C) in hopes

1 that the OTA will defer to an administrative error made
2 by the Department's staff back in 2001.

3 Appellant respectfully urges the OTA not to
4 defer to this administrative error and to compel the
5 Department to return to the statutory mooring of Section
6 6381 as implemented by Regulation 1614(f).

7 There's an old story about the importance of
8 questioning the assumptions behind traditional
9 approaches that speaks to how the Department became
10 unmoored from the statutory basis of the party
11 exemption. In the story a young girl notices her mother
12 cutting off the ends of a roast before putting it into a
13 pot to cook in the oven. The child had seen her mother
14 do this before when preparing pot roast dinners, but she
15 had never thought to ask her mother about it. This time
16 she did.

17 Her mom replied, "That's a great question. You
18 know, I don't know why I always cut the ends off, but
19 that's the way your grandma always did it and I picked
20 it up from her. You should call your grandma and ask
21 her."

22 So the curious girl called up her grandma and
23 got the same response. Grandma cut off the pot roast
24 ends because she had noticed that her mother had always
25 cut the ends off. Fortunately, the curious and

1 persistent girl was blessed with longevity in her
2 family. So she called up her great grandmother. To the
3 girls delight, the great grandmother did not say that
4 she cut the ends off because that's the way her mother
5 always did it, nor did she offer some explanation like,
6 "I believe the meat would become more flavorful that
7 way." Rather, the great grandmother responded, "When
8 your great grandfather and I had our first apartment, we
9 had a small kitchen with a very small oven and the pot
10 roast wouldn't fit in the oven unless I cut the ends off
11 first."

12 So how did the Department become unmoored from
13 Section 6381, the statutory basis of the Part A
14 exemption resulting in the 2001 staff error that
15 asserted the title passage clauses with Part A patients
16 were relevant to the operation of the Part A exemption?
17 Or, in the folksy language of the pot roast story, how
18 did it come to pass that the Department started cutting
19 off the ends of the pot roast? A bit of historical
20 context is pertinent here.

21 At the time the existence of the Part A
22 exemption was first acknowledged in 1966 by Annotation
23 505.0820, the rule, since 1933, had been that medical
24 service facilities made retail sales of tangible
25 personal property, or TPP, when they made separately

1 stated charges for TPP on their billing documents.
2 That's why the 1966 annotation provided that the Part A
3 exemption was available for all TPP identified to the
4 federal government for billing purposes under Part A for
5 which payment was made by the federal government.

6 This 1966 annotation makes it clear that the
7 basis of the exemption is the existence of direct
8 contracts between the federal government and the medical
9 service facilities serving Part A patients and that the
10 Part A patients are not being treated as federal
11 instrumentalities. If Medicare patients were federal
12 instrumentalities then Part -- Medicare Part B
13 transactions would also be eligible for exemption, which
14 they are clearly not.

15 The Department's confusion apparently started
16 around 1970 when, without any reference to Part A
17 transactions or to Section 6381, the Department modified
18 the 1933 rule with a new rule under Regulation 1503.
19 This new rule provided that medical service facilities
20 made retail sales of TPP when they made separately
21 stated charges both for TPP and for charges to
22 administer the separately stated TPP to a patient. The
23 annotation cited by Department's Exhibit F make it clear
24 that during this time staff understandably focused on
25 how patients were being billed to determine whether a

1 retail sale of TPP had occurred or not. Unfortunately,
2 as discussed on in detail on pages 72 and 73 of
3 Appellant's Exhibit 2., this patient billing focus began
4 to taint the way staff started analyzing the
5 requirements for the Part A exemption.

6 Annotation 300.0130 is the most salient example
7 of this tainted analysis. Thus staff started focusing
8 on patient billing when analyzing the availability of
9 the Part A exemption without considering whether it was
10 proper to treat Part A patients as federal
11 instrumentalities. And just like that, the ends of the
12 pot roast were chopped off.

13 Having lost the tether to Section 6381, the
14 staff error that ultimately occurred in 2001 was
15 somewhat understandable. In 2001 staff proposed to
16 abandon the administered versus nonadministered rule
17 promulgated in 1970 and to replace it with the title
18 passage clause rule that is currently found in
19 Regulation 1503(b)(2)(c).

20 Title passage clauses have never existed in the
21 Part A contracts between the federal government and
22 participating medical service facilities. So when the
23 question arose during the 2001 interested parties
24 process as to whether the proposed title passage clause
25 rule could unintentionally abrogate the Part A

1 exemption, as explained in Department's Exhibit F,
2 staff's proposed solution to this problem was to suggest
3 that medical service facilities could operate the Part A
4 exemption by, quote, Including an explicit clause in the
5 contract between the facility and the patient
6 transferring title to medical supply items to the
7 patient, end quote.

8 In other words, mom had seen what grandma had
9 done with the mistaken focus on patient billing and
10 handed this patient-focused approach down to the next
11 generation with the improper solution of suggesting that
12 title passage clauses with Part A patients could somehow
13 be relevant to operating the Part A exemption.

14 And so here we are now, 20 -- over 20 years
15 later at a hearing where the OTA is being asked to defer
16 to staff's 2001 error. The Department's unmooring from
17 Section 6381 as at the statutory basis for the Part A
18 exemption is manifestly illustrated by the rulemaking
19 histories of regulations 1503 and 1591.

20 As reflected by the reference sections that
21 precede each of the Department's publicly available
22 Sales and Use Tax Regulations, regulations 1503 and 1591
23 do not reference Section 6381. Only Regulation 1614
24 references Section 6381 because Regulation 1614(f) is
25 the true quasi-legislative touchstone. Regulation

1 1614(f) is the quasi-legislative regulation that in 1980
2 officially codified the Part A exemption first
3 acknowledged in 1966 by Annotation 505.0820.

4 Regulation 1614(f) makes it clear that Medicare
5 patients cannot be treated as federal instrumentalities
6 by emphasizing that Part B transactions are not eligible
7 for exemption. Again, this is because the basis for the
8 exemption is the direct contract with the federal
9 government under Part A. The exemption is not based on
10 treating Part A patients as federal instrumentalities.
11 Even more telling, when the Department amended
12 Regulations 1503 and 1591 in the year 2021 to address
13 staff's concerns about how the Part A exemption was
14 being administered, the Department made no changes to
15 the quasi-legislative Medicare Part A exemption
16 provision set forth in the Regulation 1614(f).

17 Now, it should be noted that even though
18 Footnote 16 of the appeals bureau's initial decision
19 indicates that Part A patients cannot be treated as
20 federal instrumentalities and even though the appeals
21 bureau's supplemental decision rejecting using title
22 passage clauses with Part A patients to operate -- to
23 operate the Part A exemption, notwithstanding that, at
24 the prehearing conference the Department was unwilling
25 to concede that Part A patients cannot be treated as

1 federal instrumentalities.

2 It should also be noted that the Department's
3 Exhibit F cites and quotes the same U.S. Supreme Court
4 cases that Appellant relies on with regard to the
5 extremely narrow circumstances under which a person or
6 entity can be considered to be a federal
7 instrumentality. Per the holding of United States v.
8 New Mexico, Part A patients could only be federal
9 instrumentalities if they cannot be realistically viewed
10 as separate entities for purposes of operating the
11 exemption. That's why the appeals bureau's supplemental
12 decision was correctly adamant that Part A patients
13 could not be conflated with the federal government. And
14 this is also why the appeals bureau rejected the usage
15 of title passage clauses to operate the Part A
16 exemption.

17 All this raises the following obvious question:
18 If Part A patients are not federal instrumentalities,
19 why is the Department now defending the position that
20 the Part A exemption operates when direct sales of TPP
21 are made to Part A patients through express title
22 patient -- express title passage clauses with Part A
23 patients? Perhaps the Department was unwilling to
24 concede the Part A patients are not federal
25 instrumentalities because the Department is concerned

1 that if this panel considers the federal instrumentality
2 issue to be relevant, the Department is unlikely to
3 prevail on the merits. In other words, the Department's
4 reluctance to engage on the federal instrumentality
5 issue might be the Department's way of attempting to
6 have its chopped up pot roast and eat it too.

7 As discussed in more detail in Appellant's
8 briefs, under the classification set forth in the
9 California Supreme Court's Yamaha decision, Regulation
10 1614(f) is a quasi-legislative regulation because it
11 involves a discretionary rulemaking action to effectuate
12 the purpose of Section 6381. Section 6381 provides an
13 exemption only for direct retail sales of TPP to the
14 U.S. Government and its agencies and instrumentalities.

15 Section 6381 was enacted in 1943 and does not
16 expressly address the application of tax to transactions
17 involving medical patients insured by a federal program
18 like Medicare Part A. Medicare Parts A and B did not
19 come into existence until 23 years after Section 6381
20 was enacted. Thus to effectuate the purpose of Section
21 6381, the Department used quasi-legislative authority to
22 mandate the transactions that could theoretically be
23 considered to be sales of TPP to patients insured under
24 Part A must instead be considered to be direct exempt
25 sales to the federal government by operation of law.

1 In contrast, 21 years after the Part A
2 exemption was officially codified in Regulation 1614(f)
3 when the Department promulgated Regulation 1503(b)(2) in
4 2001, the Department was merely interpreting the general
5 application of the true object test set forth in
6 Regulation 1501 as applied to medical service
7 facilities. In fact, Regulation 1501 concludes with the
8 statement, quote, Examples of service enterprises and
9 regulations pertaining thereto will be found in
10 regulations which follow, end quote.

11 Given its close proximity to Regulation 1501 in
12 the California Code of Regulations, no doubt exists that
13 Regulation 1503(b) is further interpreting the
14 application of the true object test to the activities of
15 medical service facilities. As explained by the Supreme
16 Court in Yamaha, a regulation that construes another
17 regulation is an interpretive regulation. Accordingly,
18 Regulation 1503(b) must be an interpretive regulation,
19 not a quasi-legislative regulation. The OTA must follow
20 the regulatory classifications established by the
21 Supreme Court in Yamaha, and, if a conflict exists, must
22 give greater authoritative weight to the
23 quasi-legislative regulations.

24 When the OTA issued its precedential opinion in
25 Talavera in 2020, the OTA held that it cannot declare

1 quasi-legislative regulations invalid and must treat
2 them with the dignity of statutes. Because regulation
3 1614(f) is a quasi-legislative regulation and Regulation
4 1503(b)(2) is an interpretive regulation, the OTA is
5 precluded from deferring to the 2001 error of
6 Department's staff on which the Department's position in
7 the instant matter is based.

8 The OTA has the authority to invalidate the
9 application of Regulation 1503(b)(2) to Part A
10 transactions to the extent it conflicts with Section
11 6381 and Regulation 1614(f) because Regulation 1503 is
12 merely an interpretive regulation. This is so because
13 the OTA's own Regulation 301.04(a) is clear that the OTA
14 only lacks the jurisdiction to invalidate the statutes
15 and, per Talavera quasi-legislative regulations.
16 However, in this particular case, the OTA can uphold the
17 rule of law without having to invalidate any provision
18 of Regulation 1503(b)(2). Let me explain.

19 It is -- it is one thing to look at a Part A
20 transaction and say, okay. I see a transfer of
21 possession, whether constructive or actual, to a Part A
22 patient with consideration being paid by the federal
23 government. I could consider this to be an intent to
24 make the sale of TPP to a Part A patient with
25 third-party consideration being paid by the federal

1 government, but Regulation 1614(f) tells us that even
2 though I could theoretically characterize the
3 transaction as a sale to the Part A patient third-party
4 Section 6381 mandates that I, instead, consider the
5 transaction to be a direct sale to the federal
6 government with title passing directly to the federal
7 government by operation of law.

8 This approach which is faithful to Section 6381
9 and Regulation 1614(f) avoids treating the Part A
10 patient as a federal instrumentality. This approach
11 just acknowledges that the -- that the transaction could
12 be analyzed in more than one way, but that Section 6381
13 mandates that the transaction be treated as a direct
14 exempt sale to the federal government because of the
15 Part A contracts between the federal government and the
16 participating medical service facilities.

17 In contrast, given that title passage clauses
18 have never existed between participating medical service
19 facilities and the federal government, it is quite
20 another thing to say that the Part A exemption will only
21 operate if express title passage clauses exist between
22 Part A patients and medical service facilities.

23 Under this alternative scenario, there are not
24 two ways to analyze the facts. Here we have an
25 unambiguous direct transfer of title to TPP to Part A

1 patients that is then deemed to be a sale to the federal
2 government. Such a result would only be appropriate if
3 Part A patients were federal instrumentalities, but they
4 are not. This approach is not faithful to Section 6381
5 and Regulation 1614(f).

6 As discussed in more detail in Appellant's
7 briefs, there is a way that regulations 1614(f),
8 1503(b)(2), and 1591(f)(2)(A) can all be harmonized
9 without negating the Part A exemption provided under
10 Section 6381. Regulation 1503 provides rules for when
11 medical services facilities are consumers and for when
12 they are retailers. Regulation 1503(b)(1) says that one
13 needs to look at subdivision (b)(2) which is comprised
14 of subparagraphs (A) through (D) to determine when
15 medical service -- when a medical service facility is
16 acting as a retailer. Subparagraph (b)(2)(B) has no
17 relevance to the Part A exemption because this provision
18 only addresses certain sales of TPP to discharge
19 patients, for example items like wheelchairs and
20 crutches, who will then use the TPP off the premises of
21 the subject medical service facility.

22 Part -- Part A only applies to inpatient care.
23 To the extent transactions addressed by subparagraph
24 (b)(2)(B) are paid for by the federal government, such
25 sales would be taxable under Part B of the Medicare Act

1 if the transaction is not otherwise exempt. Thus
2 subparagraph (b)(2)(B) is inapplicable to Part A
3 transactions.

4 Subparagraph (b)(2)(D) is also inapplicable to
5 the instant appeal. This provision expressly provides
6 that it only addresses transactions occurring on and
7 after January 1st, 2019. The claim period at issue is
8 July 1st, 2013, through December 31st, 2018.

9 Accordingly, none of the transactions in dispute could
10 potentially be affected by subparagraph (b)(2)(D).

11 So what about the Department's misguided pot
12 roast recipe found in (b)(2)(C) which focuses on the
13 existence of title passage clauses to determine whether
14 a sale has occurred? Even though the Department was
15 unwilling to concede this point at the prehearing
16 conference, the Department knows that title passage
17 clauses have never existed between medical service
18 facilities and the federal government. That is why
19 staff's erroneous solution in 2001 was to improperly
20 suggest that medical service facilities could operate
21 the Part A exemption by entering into express title
22 passage clauses with their Part A patients.

23 In other words, staff was well aware that title
24 passage clauses with the federal government under Part A
25 had never been an option. Staff's erroneous solution

1 proposed in 2001 is inapplicable because Part A patients
2 are not federal instrumentalities. It should also be
3 noted that the appeals bureau expressly rejected this
4 erroneous solution in faithfulness to the
5 well-established canons of construction that preclude
6 relying on plain language interpretations that lead to
7 absurd results. So subparagraphs (C) and (D) cannot be
8 reasonably harmonized with Section 6381 and Regulation
9 1614(f). That leaves subparagraph (b)(2)(A) which
10 provides a medical service facility is the retailer of
11 property furnished to persons other than residents and
12 patients for a charge.

13 This is exactly what happens when a
14 participating medical service facility makes a direct
15 exempt sale to the federal government under Part A. In
16 short, only subparagraph (b)(2)(A) can be properly
17 harmonized with both Regulation 1614(f) and Regulation
18 1591(f)(2)(A) without illegally treating Part A patients
19 as federal instrumentalities in contradiction to the
20 statutory authority of 6381.

21 Putting all of this together, any transfer of
22 TPP to a Part A patient with consideration paid by the
23 federal government could be analyzed in more than one
24 way. Regulation 1614(f) tells us that even though we
25 could theoretically characterize the transaction as a

1 sale to the Part A patient with third-party
2 consideration paid by the federal government, Section
3 6381 mandates that we, instead, consider the transaction
4 to be a direct sale to the federal government.

5 This result is also consistent with the rule
6 that treats medical service facilities as retailers
7 under Regulation 1503(b)(2)(A). Moreover, this approach
8 has the virtue in interpreting the regulations at issue
9 in context harmonizing to the fullest extent possible
10 all provisions relating to the same subject matter. The
11 Department's focus on subparagraph (b)(2)(C) does not
12 provide a reasonable path to harmonization because it
13 contradicts the statutory basis of Regulation 1614(f) by
14 treating Part A patients as federal instrumentalities.

15 Finally, under the Department's harmonization
16 approach, any transfer of TPP -- any transfer of
17 possession of TPP to Part A patients, whether actual,
18 constructive, joint, or temporary, is sufficient indicia
19 of the requisite intent to make a direct exempt sale to
20 the federal government under Part A.

21 Using the broadest possible concept of transfer
22 of possession is consistent with the statutory
23 amendments the Department made to Regulation 1591 in
24 1999, which are now reflected in subdivision (f)(2)(A).
25 The referenced section of Regulation 1591 makes it clear

1 that Regulation 1591 is based, in part, on Section 6006,
2 which provides that any transfer of possession in any
3 manner or by any means whatsoever is sufficient for a
4 sale to occur. That is why the 1999 amendment found in
5 Regulation 1591(f)(2)(A) delineates such broad
6 categories of TPP eligible for the Part A exemption,
7 namely all medicines, devices, appliances and supplies
8 in which payment is made under Part A.

9 It would be inconsistent with the broad
10 categories of eligible TPP to limit the indicia of
11 intent to make direct exempt sales to the federal
12 government under Part A to the likely negligible amount
13 of transactions where actual sole possession of TPP is
14 fully and irrevocably transferred to Part A patients.

15 In sum, with respect to the operation of the
16 Part A exemption, to avoid absurd results like
17 effectively negating the exemption, the interpretive
18 regulations 1503(b)(2) and 1591(f)(2)(A) must always be
19 construed so that they harmonize with the
20 quasi-legislative Regulation 1614(f) and the statutory
21 basis for the exemption found in 6381.

22 Appellant's harmonization approach is
23 reasonable because it does not treat Part A patients as
24 federal instrumentalities and does not unduly restrict
25 the availability of the Part A exemption when medical

1 service facilities indicate their intent to make a
2 direct exempt sale to the federal government by
3 transferring possession of a medical supply item to a
4 Part A patient.

5 The Department's harmonization approach -- the
6 Department's harmonization approach is in direct
7 conflict with Section 6381 and must be rejected.
8 Accordingly, Appellant respectfully asks that the OTA
9 reverse the Department's action in this matter and grant
10 Appellant's refund. This concludes Appellant's opening
11 statement.

12 ALJ STANLEY: Okay. Thank you, Mr. Ferris.

13 Judge Kwee, do you have any questions?

14 ALJ KWEE: Could you go to Judge Le first and
15 then come back to me, please.

16 ALJ STANLEY: Sure.

17 Judge Le, do you have any questions for
18 Appellant?

19 ALJ LE: No questions at this time.

20 ALJ STANLEY: Judge Kwee, do you need a minute
21 still?

22 ALJ KWEE: Okay. Just to make sure I'm
23 understanding, are you also arguing that 1503(b)(2)(C)
24 is invalid and then making, I guess, an additional --
25 additional argument that the regulation can be

1 harmonized with 1614 so, like, you're making two
2 alternative arguments? Or were you only saying that the
3 latter, that we could harmonize it with the approach
4 that you --

5 MR. FERRIS: Right. Well, yeah. Appellant is
6 saying that (b)(2)(C) is irrelevant to Part A
7 transactions. Right? And the only reasons why it is
8 there is because of the staff error made in 2001 where
9 they suggested that title passage clauses with patients
10 could operate the Part A exemption.

11 So we believe that it is irrelevant to Part A
12 because Part A is -- is 1614(f) is -- clear that the
13 sale that's exempt is a direct sale to the United States
14 government. So a solution that involves setting up an
15 entirely separate retail transaction with the patient
16 that is then deemed to be a sale to the federal
17 government, that is treating the patient as a federal
18 instrumentality improperly.

19 So it's either irrelevant or to the extent --
20 and I guess what we're saying is to the extent OTA
21 thinks it is relevant, it needs -- even if it may be
22 relevant to non Part A transactions, right, the OTA
23 should invalidate it as applied to Part A transactions
24 because that approach is completely inconsistent with
25 1614(f) and 6381. So I don't know if I'm answering your

1 question or not.

2 ALJ KWEE: Okay. I think that helps clarify
3 it. So on the instance I think your main, primary
4 position is that this Regulation 1503 provision doesn't
5 apply to Medicare Part A, but to the extent that OTA
6 were to find that it does apply, then because this is
7 interpretive and 1614 is quasi-legislative, you'd ask us
8 to invalidate it to the extent of Part A Medicare under,
9 I guess, that would be the Savemart case which -- where
10 the Board determined that an interpretive regulation was
11 invalid. So I guess that would be the authority for OTA
12 to invalidate a portion of 1503. Is that -- I guess --

13 MR. FERRIS: That's correct. And again,
14 invalid as applied, you know, to Part A transactions.

15 ALJ KWEE: Right.

16 MR. FERRIS: But I think if the OTA focuses on
17 (b)(2)(A) as the correct harmonization approach, the
18 (b)(2)(C) can be left alone. It doesn't apply to Part A
19 transactions because it's describing a sale that could
20 never occur under 1614(f), so it -- so it clearly has no
21 factual application to a Part A transaction.

22 ALJ KWEE: Okay. And looks like there's been a
23 couple of approaches that were taken prior to 2001. You
24 had the administered nonadministered, then we have the
25 (b)(2)(C). And then I guess after 2019 we have

1 (b)(2)(D) where it looks at possession. Do you know the
2 reasoning? Was there any change in the -- from my
3 understanding of what you were saying, there's no change
4 in the law that resulted in the change in the approach
5 taken on the regulation and that's why you were giving
6 the example of the pot roast?

7 MR. FERRIS: Correct. Yeah. And, in fact, I
8 think what happened with the 2021 amendments makes it
9 clear that the Department also thinks that an error
10 occurred in 2001 and that's why they want to change the
11 focus to be more on possession. But they're making that
12 change because they realize that the 2001 suggestion
13 that title passage clauses with Part A patients
14 operating the Part A exemption was not the correct
15 solution, and that's why they're making the change that
16 they're making where they're basically saying the title
17 passage clause doesn't have any real substance, and so,
18 therefore, we're going to add possession as the
19 indicator of the sale. But even then they're still
20 treating the -- the Part A patient effectively as a
21 federal instrumentality because they're very focused on
22 a sale by transfer of possession to the Part A patient;
23 whereas, what Appellant is saying is that transfer of
24 possession is the indicia of the intent to make a sale
25 under 1614(f) a direct sale to the federal government.

1 It's not -- it's not a proxy sale.

2 Again, the transaction can be characterized in
3 multiple ways. You could view it as a direct sale to
4 the patient with third-party consideration paid by the
5 federal government. But 1614(f) says no, you can't.
6 That would only be correct if Medicare patients are
7 federal instrumentalities. They're not. That's why
8 Part B doesn't have any exemption because there -- you
9 have Medicare patients. And, again, you can have
10 third-party consideration being paid by the federal
11 government, but those are not exempt because there is no
12 direct contract with the federal government and the
13 hospitals with Part B.

14 So it -- I think that Exhibit F and what
15 they've done with their 2021 amendments actually
16 corroborates Appellant's position that the 2001 solution
17 was not correct, it was an error, and it was -- that
18 error is based on the patient-focused billing approach
19 that staff started using after the 1970 amendments to
20 1503. Right? And then that patient focus just kind of
21 bled into staff's consciousness, I guess. And so when
22 the question came up, what are we -- in 2001 we're
23 getting rid of administered/nonadministered and now
24 we're coming up with this new rule about title passage
25 clauses, how does that effect Part A. And then staff's

1 solution at that time because their minds were steeped
2 in this patient-billing focus, right, they just said,
3 well, just make it title passage clause with your
4 Medicare Part A patients. That will solve your problem
5 if you want to operate the exemption. But that's
6 because staff had lost its mooring, its connection to
7 the actual statutory basis of the exemption, which is
8 6381.

9 You know, and if staff had truly been aware of
10 the touchstone of 6381, they would have amended 1614(f)
11 at the same time that they amended 1503 and 1591. They
12 didn't. And that's because they have this blind spot
13 about where the exemption comes from. It comes from
14 6381. And that's -- that's what Appellant is calling
15 that. Appellant appreciates that it's a big deal for
16 the OTA to consider whether or not the Department has
17 been on the wrong path for over 50 years. We appreciate
18 that that is a big deal. But I think the record's clear
19 that they have been on the wrong path since after 1970
20 and they have been focused on the patient as a federal
21 instrumentality, and that's improper.

22 ALJ KWEE: Right. And I guess looking at it
23 from Appellant's perspective, you're asking us to look
24 at, you know, the indicia which is the transfer, the
25 possession, and the direct payment by the government. I

1 guess that kind of -- that seems to be I feel like at
2 issue there. I mean, is that a, you know, transfer of,
3 you know, a sale like a possession in lieu of title
4 aspect? I don't know. That's just another hard area I
5 guess to --

6 MR. FERRIS: Yeah. It's -- it is difficult.
7 There's always been a rule, right, for what is the --
8 what's the indicia of an intent to make a sale of
9 tangible personal property by a medical service
10 facility. From 1933 to 1970, the indicia was did you
11 separately state the TPP and charge for it in your
12 billing documents. That was the indicia. And when that
13 happened, the idea has to be that title to that tangible
14 personal property transferred to the patient. All
15 right.

16 In 1970 the indicia was changed to show that
17 you had an intent. To make a sale, you had to
18 separately state the TPP. And separately state an
19 administration service charge related to that TPP. Then
20 in 2001 the indicia was changed again to focus on title
21 passage clauses. And that may be well and good with
22 respect to non-Part A transactions, but it is not well
23 and it is not good and it is not proper to apply that
24 type of indicia to make a sale with actual explicit
25 title passage clauses to Part A patients as -- you know,

1 that -- that doesn't work because it turns the Part A
2 patient into a federal instrumentality. It can't do
3 that.

4 So Appellant is aware that there's always been
5 something -- some sort of sign of indicia. And I guess
6 with a hat tip to the Department's 2021 amendments, we
7 think it is, you know, proper to look at the transfer of
8 possession, again, with the broad concept of what that
9 might mean, a transfer of possession to -- to part -- to
10 the Part A patient as the indicia of the intent to make
11 that direct sale to the United States government.

12 And, again, it has the virtue also of excluding
13 things like items of TPP that are always under the, you
14 know, exclusive control and possession of medical staff.
15 Like surgical gloves, right? There's never going to be
16 any indicia of an intent to make a sale of those
17 surgical gloves through the transfer of possession to a
18 Part A patient. We're -- we're appreciative that the
19 Department has concerns about an overbroad application
20 of items of tangible personal property that could be
21 considered to be direct sales to the federal government
22 under Part A.

23 So the -- using the concept of possession and
24 transfer of possession, again, broadly to the Part A
25 patient, I think does -- is consistent with the true

1 historical background to how medical service facilities
2 have been taxed. And, you know, again, sometimes
3 they're consumers and sometimes they're retailers. And
4 there's always been a rule about what's the indicia of
5 the intent to shift from being the consumer to being the
6 retailer.

7 And so Appellant believes that its -- its
8 approach to that indicia to -- to make a sale is --
9 it's -- is much sounder and more consistent and
10 completely consistent with Regulation 1614(f) and 6381,
11 whereas, the title passage clauses are not.

12 ALJ KWEE: Okay. Thank you. I will turn it
13 back to Judge Stanley.

14 ALJ STANLEY: Thank you. I -- I had a similar
15 question about the harmonization versus invalidation of
16 regulations, so I don't need that question answered any
17 further, but I did wonder about your point with the
18 '21 -- 2021 amendments. Do you -- did you review the
19 legislative history to see if there's anything in there
20 that would enlighten us about why the Department made
21 those amendments?

22 MR. FERRIS: I think -- I mean, the Department,
23 I'm sure, will address that themselves, but it's --
24 Exhibit F makes it clear that they -- they think that
25 the solution of 2001 to focus on patient title -- title

1 passage clauses was -- was not correct because they
2 don't think patient title clauses have sufficient
3 substance. That's what they say in Exhibit F.

4 ALJ STANLEY: Okay. Thank you.

5 And, Judge Le, you don't have any follow-up
6 questions?

7 ALJ LE: I do not. Thank you.

8 ALJ STANLEY: Okay. Then let's turn it over to
9 the Department for their presentation. You may proceed
10 when you're ready, Ms. Jacobs.

11 PRESENTATION

12 MS. JACOBS, Tax Counsel:

13 Good morning. There we go.

14 Appellant, a California corporation, operated a
15 25-bed critical care access hospital which rendered
16 medical services to patients insured under Medicare Part
17 A. The tangible personal property, or TPP, at issue in
18 this case is not medicine as defined by Section 6369(b),
19 but rather medical equipment and supplies.

20 Appellant claims that paid tax or tax
21 reimbursement on the TPP and that the TPP was furnished
22 or used in a provision of services to patients insured
23 under Medicare Part A. During the claim period of
24 July 1st, 2013, through December 31st, 2018, it is
25 undisputed that none of Appellant's contracts with its

1 patients or with US government contained a title passage
2 clause. The issue in this appeal, as stated in the
3 prehearing conference minutes and orders, is whether
4 Appellant is entitled to a refund of a tax and/or tax
5 reimbursement it paid on its purchases of TPP provided
6 to patients covered by Medicare Part A, or stated
7 differently, whether Appellant consumed or resold the
8 TPP to the U.S. Government in connection with services
9 rendered to its Medicare Part A patients during the
10 liability period.

11 Regulation 1503 sets forth the application of
12 tax to medical service facilities, including hospitals.
13 1503(b)(1) states, "Operative April 1st, 2001, except as
14 provided in subdivision (b)(2) medical service
15 facilities are service providers to their patients and
16 residents, including patients and residents insured
17 pursuant to Part A of the Medicare Act, and are the
18 consumers of tangible personal property furnished in
19 connection with those services."

20 Subdivision (b)(2)(C) goes on to state, quote,
21 a medical service facility is the retailer of any
22 property furnished in connection with its medical
23 services if its contract with the medical service
24 facility's resident or patient or other customer
25 specifically provides that title to the subject tangible

1 personal property passes to the resident or patient or
2 other customer. When the contract has a provision
3 passing title to the subject tangible personal property
4 to the resident or patient or other customer, the
5 medical services facility may purchase such property for
6 resale, and tax applies to the charge by the medical
7 service facility unless its sale is otherwise exempt
8 from tax, end quote.

9 We note that these rules are generally to the
10 benefit of medical service facilities in that it
11 simplifies their transactions with patients and sets the
12 measure of tax on the cost to them unless they
13 specifically intended to be a retailer.

14 As described in Exhibit D, the version of
15 Regulation 1503 in effect prior to April 1st, 2001,
16 distinguishes -- distinguished between whether medical
17 service facilities made separately stated charges for
18 administered and nonadministered items, and the
19 Department and interested parties agreed to the default
20 rulemaking medical service facilities the consumer of
21 the TPP was preferable. See Exhibit D, page 8.

22 As you know, according to Section 6381 sales of
23 TPP to U.S. Government are exempt from tax. With regard
24 to TPP furnished to patients insured under Medicare Part
25 A, Regulation 1591(f)(2)(A) states, Tax does not apply

1 to the sale of items to a person insured under Medicare
2 Part A because, quote, such sales are considered exempt
3 sales to the United States Government, end quote.
4 Similar language is included in Regulation 1614(f). And
5 this language first appeared in this forum in the 1980
6 amendments to 1614.

7 1591(f)(2)(A) goes on to state, quote, Under
8 Part A the healthcare provider has a contract with the
9 U.S. Government to provide certain services. Therefore,
10 to the extent allowed pursuant to Regulation 1503, sales
11 of medicines, devices, appliances, and supplies in which
12 payment is made under Part A qualify as exempt sales to
13 the United States Government, end quote.

14 In sum, Regulations 1591 and 1614 apply the
15 exemption set forth in 63 -- in Section 6381 to sales of
16 TPP to Medicare Part A patients which are considered to
17 be sales to the U.S. Government, but for those
18 provisions to apply, there must be a sale in the first
19 place. Neither regulation proscribes any rules or
20 requirements for when such a sale is made by a medical
21 service facility. Certainly, neither states that all
22 TPP furnished or used in the provision of services to a
23 Part A patient constitutes a sale. Rather, as with all
24 medical service facility transactions, when a sale is
25 made to a Part A patient is determined by Regulation

1 1503.

2 In addition to being explicitly stated in
3 Regulations 1503(b)(1) and 1591(f)(2)(A) this basic
4 interplay between the three regulations is clearly
5 described in Annotations 300.0130 dated November 25th,
6 1991, and the backup letter to Annotation 300.0007.200
7 dated April 30th, 1992.

8 As discussed in those annotations, an exempt
9 sale to the U.S. Government only took place subject to
10 the administered versus nonadministered provisions which
11 had been in effect since 1970. Even under that rubric,
12 furnishing administered TPP for a separately stated
13 charge did not constitutes a sale.

14 The application of Regulation 1503 to Medicare
15 Part A transactions was also discussed in the 2001
16 rulemaking documents for the amendments to Regulation
17 1503 the a title passage provision. Specifically, the
18 July 26th, 2000, formal issue paper, Exhibit D, which
19 states on page 4 that the Medicare Part A exemption
20 would not apply when a medical service facility acts as
21 a consumer, however, medical service facilities will
22 still have the option to be a retailer by including an
23 explicit clause in the contract between the facility and
24 the patient transferring title to medical supplies items
25 to the patient. In other words, the intent of the 2001

1 amendments was to replace the administered versus
2 nonadministered provisions the title passage provision
3 set forth in subdivision (b)(2)(C) with regard to
4 Medicare Part A transactions.

5 So pursuant to Regulation 1503, Appellant is
6 the consumer of the TPP it furnished to all patients
7 unless one of the specific exceptions set forth in
8 subdivision (b)(2) applies. Because Appellant's
9 contracts did not contain title passage clauses to
10 either the patient or the U.S. Government subdivision
11 (b)(2)(C) does not apply. Therefore, under the express
12 language of Regulations 1503, 1591, and 1614, Appellant
13 was the consumer, not the retailer, of the TPP at issue.
14 And for these reasons the appeal should be denied. Now
15 I will turn to some of Appellant's arguments.

16 Appellants cites -- Appellant cites to one
17 sentence from Annotation 505.0820. This annotation
18 simply distinguishes between the two types of Medicare
19 at that time: Part A, where there's a payment by the
20 U.S. Government, and Part B, where there's
21 reimbursement. This is the same distinction between
22 Medicare Parts A and B recognized in Regulations 1591
23 and 1614, which effectively supercede this annotation.

24 As I have discussed, Appellant's interpretation
25 is contrary to the plain language of these relevant

1 regulations and the actual administration of tax going
2 back as far as 1970 when the administered versus
3 nonadministered distinction was adopted. If anything,
4 it was the promulgation of those rules in 1970 that
5 signals an original intent with regard to Medicare Part
6 A transactions.

7 Furthermore, Regulations 1614 and 1503 is --
8 are not in conflict as Appellant argues. 1614 relates
9 to an exemption describing what type of sale is
10 considered an exempt sale to the U.S. Government. And
11 1503 defines when such a sale occurs. Appellant's
12 assertion that 1614 is more specific is essentially
13 meaningless because the two regulations have entirely
14 different effects.

15 Furthermore, Yamaha Corporation of America vs.
16 State Board of Equalization does not state that a
17 quasi -- quasi -- quasi-legislative regulation controls
18 when interpreting two valid regulations, and Appellant
19 has not offered any other authority for that
20 proposition. Rather, for the purpose of judicial review
21 of a particular regulation, Yamaha classifies types of
22 regulations on a spectrum between quasi-legislative and
23 interpretive for determining the standard of review a
24 court should apply in assessing the validity of
25 regulation.

1 We also note that Yamaha specifically discusses
2 as quasi-legislative a regulation that, like 1503,
3 determines when a sale occurs by requiring objective
4 evidence of the transaction. Nor do we agree that a
5 regulation applying a broad statute to a specific type
6 of transaction as the relevant provisions of regulation
7 1591 and 1614 do here is necessarily quasi-legislative.

8 Appellant has also argued that the only
9 relevant provision of 1503 to this case is (b)(2)(A)
10 which states, that, quote, a medical service facility is
11 the retailer of property furnished to persons other than
12 residents and patients for a charge, end quote.

13 This argument has no basis in either the
14 language of the regulation or its history. Subdivision
15 (b)(2)(A) by its plain language is discussing
16 transactions with persons who are not patients who
17 might, for example, purchase nonprescription medicine,
18 medical supplies, or other TPP at the hospital pharmacy.

19 There is nothing in the regulatory materials
20 or, again, in the actual application of the law since
21 2001 to suggest that this provision applies to
22 transactions involving patients at all. And given that
23 this is the only scenario in which Appellant's theory
24 would apply, Appellant is essentially asking us to
25 consider it to be an unstated Medicare provision that

1 was intended to exempt all Medicare sales without
2 actually mentioning Medicare and without any comment to
3 that effect in the ruling-making file.

4 This is especially absurd given that the
5 regulatory materials do specifically mention Medicare
6 Part A with the respect to the subdivision (b)(2)(C)
7 title passage provision, which leads us to Appellant's
8 argument that by allowing title passage clauses to
9 patients we are somehow finding patients to be federal
10 instrumentalities.

11 Appellant is attempting to complicate the issue
12 when the plain language of 1591 and 1614 is clear. 1591
13 and 1614 state that sales of TPP to Medicare Part A
14 patients are considered exempt sales to the U.S.
15 Government, not that they are sales to the U.S.
16 Government. And by its own provision, 1591 directs us
17 to 1503 to determine when such sales occur. Nowhere in
18 these regulations or their histories does the word
19 "instrumentalities" appear. The Department is bound to
20 follow its own regulations. And as an administrative
21 agency, OTA does not have authority to find the
22 Department's validly promulgated regulations invalid.
23 See Government Code Sections 11350(b) and 15672 as well
24 as the cases *Newco Leasing Incorporated vs. State Board*
25 *of Equalization*, 143 Cal.App. 3d 120 and *Appeal of*

1 Talavera. 2020-OTA-022P and Appeal of Micelle
2 Laboratories, Incorporated, 2020-OTA-290P.

3 We also note that Appellant's various arguments
4 are somewhat at odds with each other. On the one hand,
5 Appellant argues that a sale to the patient cannot be
6 considered a sale to the U.S. Government pursuant to the
7 express language of Regulations 1591 and 1614, but
8 Appellant also argues that despite there being no title
9 passage clause between hospitals and the U.S. Government
10 title must pass as a matter of law. Appellant
11 apparently has no issue with there being a reasonable
12 interpretation of this exemption. It just doesn't agree
13 with the one expressly set forth in law and actually
14 followed for decades.

15 In sum, because Appellant's contracts did not
16 contain title passage clauses under the express language
17 of Regulation 1503, Appellant was the consumer, not the
18 retailer, of the TPP at issue. Therefore, Appellant is
19 not entitled to a refund regardless of whether
20 possession of the TPP transferred to the patient.
21 However, as we've discussed in our January 21st, 2022
22 brief and Exhibit E, to the extent OTA considers whether
23 possession of the specific items have transferred, we do
24 not concede that possession transferred with every item
25 Appellant put forward in Exhibit 4. And, in fact,

1 there's no evidence that possession transferred for
2 those items.

3 And on a related note, despite our concession
4 that Exhibits 9 through 16 are sufficient to establish
5 that Appellant was charged and paid the tax or tax
6 reimbursement in those seven transactions, we still
7 cannot concede that there is any entitlement to the
8 refund amount requested because the Department has not
9 conducted a full refund examination, as we discussed in
10 our briefs.

11 For the reasons I have outlined, we maintain
12 that Appellant has not met its burden of proving that it
13 is entitled to a refund for the tax or tax reimbursement
14 it paid on its purchase and consumption of the TPP at
15 issue and request that this appeal be denied. Thank
16 you.

17 ALJ STANLEY: Thank you, Ms. Jacobs.

18 Judge Le, do you have any questions for the
19 Department?

20 ALJ LE: Yes. One question.

21 What is the Department's position on whether
22 1614(f) is a quasi-Legislative reg or interpretive reg?

23 MR. CLAREMONT: As -- as Ms. Jacobs alluded to,
24 it's a -- generally a quasi-legislative regulation is
25 one where there's an express grant of quasi-legislative

1 authority. That doesn't appear to be the case here.
2 It's a regulation that's interpreting a broad exemption
3 for a specific set of facts. So although we don't think
4 it's relevant for this matter because we think with all
5 the regulations at issue are valid, we're not sure. As
6 Yamaha discusses, it falls in a spectrum. It's not just
7 one or the other. So we're not -- we don't really have
8 a clear answer to where on that spectrum it falls.

9 ALJ LE: Okay. So it sounds like you're saying
10 on that spectrum it falls closer to the interpretive
11 side?

12 MR. CLAREMONT: Yeah. We believe it's an
13 interpretive reg in that it is interpreting a broad
14 exemption for a specific factual situation.

15 ALJ LE: Okay. Thank you. And same question
16 for 1503.

17 MR. CLAREMONT: Again, I don't -- I don't know
18 if -- again, we don't have necessarily a ranking on that
19 spectrum. We do think it also falls within that
20 spectrum. As Yamaha discusses with regard to another
21 regulation that discusses when a sale takes place,
22 Yamaha discusses that other regulation. And I don't
23 have the specific regulation on point. It had to do
24 with -- but it does have to do with when there's
25 objective indication that a sale takes place and it was

1 discussing this quasi-legislative. But there's also
2 interpretive elements, so we do think it also falls in
3 that spectrum. But I don't think we have an answer
4 necessarily, because we aren't a court, as to where
5 exactly they fall relative to each other on that
6 spectrum.

7 ALJ LE: Thank you.

8 No further questions.

9 ALJ STANLEY: Judge Kwee, do you have any
10 questions?

11 ALJ KWEE: Yeah, I have a question for CDTFA.

12 So from your opening presentation, my
13 understanding is CDTFA's position -- and following up on
14 Judge Le's question -- is that OTA lacks jurisdiction to
15 decline to follow a portion of 1503(b)(2)(C) regardless
16 of whether it's interpretive or quasi-legislative. Is
17 that a correct understanding of CDTFA's position?

18 MS. JACOBS: That's correct.

19 ALJ KWEE: Okay. Thank you. I also did want
20 to get a little clarification on the 1503(b)(2)(A), (B),
21 (C), (D). Is -- and I'm just wondering, so with
22 Medicare Part A, would that only fall under, you know,
23 like a (b)(2)(C) scenario or is it possible Medicare
24 Part A could fall under 1503(b)(2)(A) or (b)(2)(B)? You
25 know (b)(2)(A) was the medical service facility where

1 they're retail or furnishing property to persons other
2 than residents. Could that even apply to Medicare Part
3 A?

4 MR. CLAREMONT: Again, I -- I'm -- we're not
5 experts in the scope of the actual administration of
6 Medicare Part A. It appears that it would not --
7 (b)(2)(A) would not apply because, in our opinion, what
8 (b)(2)(A) is simply saying is that before you get to
9 patients and residents it's simply kind of an almost
10 obvious rule that sales to non patients and nonresidents
11 are retail sales, or furnishing to non patients and
12 nonresidents outside of that the service of inpatient
13 medical care. I do think (b)(2)(B) -- and I don't know,
14 but (b)(2)(B) appears like it could apply because it
15 could be a property that is furnished to a patient while
16 they are receiving inpatient care but that there is an
17 intention to take it outside the hospital. But, again,
18 we are not experts in the scope of the Medicare
19 programs.

20 ALJ KWEE: Okay. I was just trying to, I
21 guess, clarify my understanding of the focus of the
22 dispute was really centered on the title passage
23 provision in (b)(2)(C) or if there was, I guess, a mix
24 where Medicare Part A -- but I guess maybe that's not --
25 not too important to the issue. So thank you for the

1 clarification. I don't believe I have any further
2 questions so I will turn it back to Judge Stanley.

3 ALJ STANLEY: Okay. I don't have any
4 questions, so what we're going to do is go ahead and
5 give Mr. Ferris the opportunity to respond and give --
6 have the final word.

7 MR. FERRIS: Thank you. I guess I would start
8 by saying in terms of quasi-legislative regulations I --
9 I'm pretty familiar with the Sales and Lease Tax
10 Regulations. I can't think of an example of a more bold
11 and brash quasi-legislative move by the Board of
12 Equalization than when they promulgated 1614(f) and said
13 that, you know, this -- the Medicare Part A program that
14 had been established, what, 23 years earlier, that that,
15 once it became operative in 1966, that those were going
16 to be considered to be direct sales, exempt sales to the
17 federal government. That is very bold, very brash.
18 That is uber gap-filling discretionary power of an
19 enormous scale that they did to do that. It wasn't just
20 a mere, oh, we're interpreting 6381. I mean it -- that
21 was -- that was a true exercise of discretionary power
22 to call out a new exemption that isn't expressly
23 specifically, you know, prom -- enacted by the
24 legislature. It is consistent with 6381, but the fact
25 that they did that was very much a quasi-legislative

1 move.

2 And 1503 and 1591 are nowhere in that scale of
3 boldness. They're just piggybacking. 1591(f)(2)(A)
4 just piggybacking off of 1614(f) and 1503 until their
5 2021 amendments, had no reference to Part A at all. And
6 I think it's very telling when they say that the way
7 they read 1614(f) and 1591(f)(2)(A), I believe I heard
8 the Department say that they are not sales to the
9 federal government, they're just considered to be sales
10 to the federal government but they're not sales to the
11 federal government. And if they are not sales to the
12 federal government, they can't be exempt because it's
13 only exempt if they are direct sales to the federal
14 government under 6381.

15 This is exactly proving our central point here.
16 And the staff's thinking is still tainted by this idea
17 that the focus on the patient can be the solution to how
18 to operate the Part A exemption. It cannot. It has to
19 be a direct sale to the federal government. It can't
20 just be considered to be. If it's not actually a sale
21 to the federal government, it can't be exempt.

22 So Appellant would like to close by emphasizing
23 how important it is for the OTA to reach and rightly
24 decide the legal issues in this case to avoid any
25 possibility of getting bogged down in factual disputes

1 about burden of proof with respect to all the
2 transactions related to the \$27,213 refund amount at
3 issue. In Exhibits 9 through 16, Appellant has
4 documented the tax for tax reimbursement. It s charged
5 by and paid to Appellant's vendors with respect to the
6 seven exemplar transactions where actual or constructive
7 possession of TPP was transferred to Part A patients.

8 Had this appeal followed a typical path, prior
9 to reaching the OTA all of e transactions that comprise
10 the \$27,213 refund amount would have been validated as
11 part of the appeals bureau process, but this has been
12 kind of an unusual path we've been exclusively focused
13 on the legal issues that are at issue. But it should be
14 noted that the Department has never questioned whether
15 Appellant routinely pays tax and tax reimbursements to
16 its vendors for the medical supply items it purchases
17 does not meet the definition of medicine, nor does the
18 Department dispute that Appellant has a Part A contract
19 with the federal government.

20 So, accordingly, if Appellant prevails on the
21 legal merits of this appeal, Appellant believes it would
22 be appropriate to grant the full requested refund in the
23 amount of \$27,213. However, if the OTA rules in
24 Appellant's favor on the legal merits but would feel
25 somehow constrained as to granting the full requested

1 refund amount, the tax amount at issue for the seven
2 exemplar transactions, as previously stated and as
3 substantiated in Exhibits 9 through 16, is \$50.58.

4 The Department has conceded that the -- this
5 amount of tax was charged and paid, and the
6 substantiating documentation that's been provided is
7 consistent with the type of documentation that the
8 Department would be looking at if they were auditing
9 this.

10 So I'm not -- I'm not sure what other
11 additional things they need to see. Either they're a
12 participating hospital under Part A and they paid tax --
13 they were charged tax and paid tax and then made exempt
14 sales to the federal government and -- or they didn't.
15 That's pretty much what needs to be looked at. There's
16 not fixed assets, irrelevant, you know, trial --
17 everything else that they've listed in their laundry
18 list or boilerplate of things that they would like to
19 look at are not relevant to substantiating that \$50.58
20 amount.

21 Now, as to reaching the legal merits, Appellant
22 urges the OTA to provide further clarification with
23 respect to the precedential Talavera opinion to make it
24 clear that the OTA is fully committed to following the
25 classification for regulations set forth by the

1 California Supreme Court in Yamaha. Talavera was
2 correctly decided because the bad debt regulation at
3 issue, Regulation 1642 in Talavera, that -- that
4 regulation is clearly a quasi-legislative regulation.
5 However, it would be very injurious to taxpayers if the
6 logic of Talavera were applied to interpretive
7 regulations like Regulation 1503(b)(2) and
8 1591(f)(2)(A).

9 The legislature created the OTA to be a level
10 playing field for tax disputes where the controlling
11 statutes would be applied in an impartial manner
12 consistent with the rule of law. Upholding the
13 Department's harmonization approach which mistakenly
14 relies on irrelevant plain language found in
15 interpretive regulation 1503(b)(2)(C) would be
16 inconsistent with Section 6381.

17 Under Yamaha, it cannot be the case that any
18 regulation the Department promulgates under Section 7051
19 is entitled to be treated with the dignity of a statute
20 by the OTA. If the OTA were to disagree with
21 Appellant's harmonization approach, the OTA must
22 invalidate the application of Regulation 1503(b)(2)(C)
23 with respect to Part A transactions.

24 Perhaps the biggest problem with the
25 Department's improper harmonization approach is found in

1 Department's Exhibit F. In the 2019 issue paper, the
2 Department proposed the adoption of subparagraph
3 (b)(2)(D), which, starting in 2019, requires both title
4 and possession of TPP to transfer to Part A patients to
5 operate the Part A exemption. The issue paper is clear.
6 The Department proposed this rule because the Department
7 does not believe the title passage clauses between
8 participating medical service facilities and Part A
9 patients have any real substance.

10 Accordingly, the Department's proposed
11 harmonization approach with respect to subparagraph
12 (b)(2)(C) lacks a rational basis for the tax treatment
13 distinction that results between medical services
14 facilities that have title passage clauses with Part A
15 patients for periods prior to January 1st, 2019, and
16 those that don't, like Appellant.

17 Classifications that have no rational basis
18 result in a legal discrimination and are invalid. This
19 is true whether the discriminatory tax classification is
20 created by a statute or by a regulation or by an
21 erroneous interpretation of a statute or regulation.

22 As discussed in more detail in Appellant's
23 briefs, while the OTA does not have the authority to
24 invalidate a discriminatory statute or a
25 quasi-legislative regulation, the OTA does have the

1 authority and the responsibility to interpret statutes
2 and regulations in a manner that avoids discriminatory
3 effect and preserves validity. In short, as the
4 California Supreme Court held in *Hughes v. Board of*
5 *Architectural Examiners*, the OTA is obligated to avoid
6 interpretations that would lead to invalidation in the
7 courts.

8 The law establishing that the Department's
9 subparagraph (b)(2)(C) harmonization approach would lead
10 to invalidation by the courts is clear. In *Maranville*
11 *v. State Board of Equalization*, the California Court of
12 Appeal held that, quote, Section 1 of the 14th Amendment
13 to the Constitution of the United States applies to
14 state and local tax statutes. While the State may
15 classify broadly the subjects of taxation, it must do so
16 on a rational basis so that all persons similarly
17 circumstanced will be treated alike. Rules of the
18 agency empowered to enforce a tax which result in
19 illegal discrimination are invalid, end quote.

20 Under *Yamaha*, no reasonable California court
21 would defer to the Department taking the position that
22 title passage clauses with Part A patients have
23 substance, albeit unconstitutional discriminatory
24 substance, through December 31st of 2018 but then lose
25 their substance on January 1st, 2019. The OTA must also

1 decline to extend such deference to the Department.

2 To be clear, Appellant is not asking the OTA to
3 rule on the constitutionality of a statute or a
4 quasi-legislative regulation. Appellant is merely
5 asking the OTA to observe its duty to reject erroneous
6 interpretations of the governing statute that would
7 create unnecessary constitutional infirmities, which is
8 what would occur if the OTA were to bless the
9 Department's subparagraph (b)(2)(C) harmonization
10 approach.

11 In short, the existence or nonexistence of
12 title passage clauses between participating medical
13 service facilities and Part A patients cannot be the
14 determining factor for when the Part A exemption
15 operates and when it does not.

16 In conclusion, pursuant to Section 6381 and
17 quasi-legislative Regulation 1614(f), Part A patients
18 cannot be treated as federal instrumentalities.
19 Accordingly, medical service facilities cannot lose the
20 benefits of the Part A exemption because they do not
21 have title passage clauses with their Part A patients to
22 create direct sales of TPP to Part A patients.

23 To be faithful to its calling established by
24 the legislature, the OTA cannot defer to the
25 administrative error committed by the Department staff

1 in 2001 when it first suggested the solution of using
2 patient title passage clauses to operate the Part A
3 exemption. Regulation 1503b)(2)(C) is either irrelevant
4 through the operation of the Part A exemption or it is
5 invalid to the extent it is applied to Part A
6 transactions.

7 The OTA was not created to follow or defer to
8 interpretive recipes created by the Department decades
9 ago that contradict the controlling statutory law. It's
10 time to reject the Department's harmonization recipe and
11 put the whole pot roast in the oven. Accordingly,
12 Appellant respectfully asks the OTA to reverse the
13 Department's action in this matter. Thank you.

14 ALJ STANLEY: Thank you, Mr. Ferris.

15 Judge Le, do you have any questions?

16 ALJ LE: No further questions. Thank you.

17 ALJ STANLEY: And, Judge Kwee, do you have any
18 follow-up questions?

19 ALJ KWEE: I have no final questions. Thank
20 you.

21 ALJ STANLEY: I'm just going to ask the
22 Department to clarify the one piece that was -- that was
23 raised in the closing statement about the seven
24 transactions totaling \$50.58. In the Department's
25 response to Exhibits 9 through 16, while they agreed,

1 they did say that as part of a refund examination, the
2 Department generally obtains confirmation from the
3 purchaser that it had not already received a refund of
4 the tax or tax reimbursement from the seller.

5 Is the Department proposing that if the OTA
6 grants that refund, it would be conditional on the
7 Department doing some follow-up?

8 MR. PARKER: Generally speaking, we would look
9 into whether the vendors were audited and whether
10 similar transactions were refunded to a vendor. If
11 we're only talking about the -- the limited transactions
12 that we have here, we'd probably feel pretty comfortable
13 in granting the \$50 refund for those seven transactions.

14 ALJ STANLEY: Okay. Thank you.

15 Okay. This -- this concludes the hearing and
16 the record is now closed and the matter is submitted for
17 deliberation. The panel will meet to jointly deliberate
18 and decide the appeal, and we will issue a written
19 opinion no later than a hundred days from today.

20 I want to thank you all for your participation.
21 And we are going to reconvene at 1:00 p.m. today.

22 Thank you.

23 (Conclusion of the proceedings at 10:55 a.m.)

24 ---oOo---

REPORTER'S CERTIFICATE

STATE OF CALIFORNIA)

COUNTY OF SACRAMENTO) ss.

I, MARIA ESQUIVEL-PARKINSON, do hereby certify that I am a Certified Shorthand Reporter, and that at the times and places shown I recorded verbatim in shorthand writing all the proceedings in the following described action completely and correctly to the best of my ability:

LOCATION: OFFICE OF TAX APPEALS
400 R Street


CASE: In the Matter of the Appeal of Redwood Memorial Hospital, Inc.

DATE: Tuesday, January 24, 2023

I further certify that my said shorthand notes have been transcribed into typewriting, and that the foregoing pages 1 through 60 constitute an accurate and complete transcript of all my shorthand writing for the dates and matter specified.

I further certify that I have complied with CCP 237(a)(2) in that all personal juror identifying information has been redacted if applicable.

IN WITNESS WHEREOF, I have subscribed this certificate at Sacramento, California on this 10th day of February, 2023.


Maria Esquivel-Parkinson
CSR No. 10621, RPR

<hr/>	10621 2:20	1614 11:17 16:23	31:10,12 32:16,22
\$	10:55 2:18 60:23	29:1 30:7 40:6,14	34:20 36:25 38:13
<hr/>	11 4:12	42:12,23 43:7,8,	39:15 41:15,25
\$27,213 53:2,10,	11350(b) 45:23	12 44:7 45:12,13	44:21 59:1
23	120 45:25	46:7	2013 24:8 37:24
\$50 60:13	143 45:25	1614(f) 7:14 8:12	2018 24:8 37:24
\$50.58 10:3 54:3,	14th 57:12	12:6 16:24 17:1,4,	57:24
19 59:24	1501 20:6,7,11	16 19:10 20:2	2019 7:9,24 24:7
<hr/>	1503 14:18 16:19,	21:3,11 22:1,9	30:25 56:1,3,15
(22 17:12 21:11	23:5,7 25:9,17,24	57:25
(A) 23:14	23:10 30:4,12	26:13 27:20	2020 20:25
(B) 49:20	32:20 33:11 38:11	29:12,25 30:20	2020-OTA-022P
(b)(2) 23:13 38:14	39:15 40:10 41:1,	31:25 32:5 33:10	46:1
(b)(2)(a) 25:9,16	14,17 42:5,12	36:10 40:4 47:22	2020-OTA-290P
30:17 44:9,15	43:7,11 44:2,9	51:12 52:4,7	46:2
49:25 50:7,8	45:17 46:17 48:16	58:17	2021 17:12 31:8
(b)(2)(b) 23:24	52:2,4	1642 55:3	32:15 35:6 36:18
24:2 49:24 50:13,	1503(b) 8:6 20:13,	1933 13:23 14:18	52:5
14	18	34:10	2022 46:21
(b)(2)(c) 24:12	1503(b)(1) 23:12	1943 19:15	2023 2:18 5:1,7
26:11 29:6 30:18,	38:13 41:3	1966 8:5 11:20	21 20:1 36:18
25 38:20 42:3,11	1503(b)(2) 20:3	13:22 14:2,6 17:3	21037436 2:6 5:6
45:6 49:23 50:23	21:4,9,18 23:8	51:15	21st 46:21
56:12 57:9 58:9	27:18 55:7	1970 14:16 15:17	23 19:19 51:14
(b)(2)(d) 24:4,10	1503(b)(2)(a)	32:19 33:19	24 2:18 5:1
31:1 56:3	26:7 49:20,24	34:10,16 41:11	24th 5:6
(b)(2)applies	1503(b)(2)(c)	43:2,4	25-bed 37:15
42:8	11:25 15:19 28:23	1980 17:1 40:5	25th 41:5
(C) 25:7 49:21	49:15 55:15,22	1991 41:6	26th 41:18
(D) 23:14 25:7	15672 45:23	1992 41:7	<hr/>
49:21	1591 16:19,22	1999 26:24 27:4	3
(f) 11:17	17:12 26:23,25	1:00 60:21	<hr/>
(f)(2)(a) 26:24	27:1 33:11 40:14	1st 7:9,24 24:7,8	300.0007.200
<hr/>	42:12,22 44:7	37:24 38:13 39:15	41:6
-	45:12,16 46:7	56:15 57:25	300.0130 15:6
<hr/>	52:2	<hr/>	41:5
---ooo--- 60:24	1591(f)(2) 8:7	2	301.04(a) 21:13
<hr/>	1591(f)(2)(a) 23:8	2 15:3	30th 41:7
1	25:18 27:5,18	20 16:14	31st 24:8 37:24
1 4:4 10:6,12 57:12	39:25 40:7 41:3	2000 41:18	57:24
10 4:4,6	52:3,7 55:8	2001 12:2 13:14	
	16 4:4 9:18 10:7,	15:14,15,23 16:16	
	12 17:18 47:4	20:4 21:5 24:19	
	53:3 54:3 59:25	25:1 29:8 30:23	

37 4:13

3d 45:25

4

4 41:19 46:25

400 2:16

5

50 33:17

505.0820 13:23
17:3 42:17

6

6006 27:1

63 40:15

6369(b) 37:18

6381 7:13 8:12
11:16 12:6 13:13
14:17 15:13
16:17,23,24
19:12,15,19,21
21:11 22:4,8,12
23:4,10 25:8,20
26:3 27:21 28:7
29:25 33:8,10,14
36:10 39:22 40:15
51:20,24 52:14
55:16 58:16

7

7051 55:18

72 15:2

73 15:2

8

8 39:21

9

9 9:18 47:4 53:3
54:3 59:25

9:30 2:17 5:2,7

A

a.m. 2:17,18 5:2,7
60:23

abandon 15:16

abrogate 15:25

absurd 25:7
27:16 45:4

access 37:15

accurate 10:17

accurately 8:21

acknowledged
13:22 17:3

acknowledges
22:11

Act 23:25 38:17

acting 23:16

action 19:11 28:9
59:13

activities 20:14

acts 41:20

actual 21:21
26:17 27:13 33:7
34:24 43:1 44:20
50:5 53:6

adamant 18:12

add 10:2 31:18

addition 10:5
41:2

additional 28:24,
25 54:11

address 17:12
19:16 36:23

addressed 23:23

addresses 23:18
24:6

administer 14:22

administered
15:16 17:14 30:24
39:18 41:10,12
42:1 43:2

**administered/
nonadministered**
32:23

administration
5:25 34:19 43:1
50:5

administrative
12:1,4 45:20
58:25

admitted 4:4,5
10:12,20

adopted 43:3

adoption 56:2

affected 24:10

affiliation 6:10

affirmation 10:25

agencies 19:14

agency 6:10,11,
12 45:21 57:18

agree 8:25 9:1,4,
5,11,16 44:4
46:12

agreed 9:18 39:19
59:25

ahead 7:3 51:4

albeit 57:23

alike 57:17

ALJ 3:5 5:4,22 6:4
8:24 9:2,14,25
10:4,10,13,19,21
28:12,14,16,19,
20,22 30:2,15,22
33:22 36:12,14
37:4,7,8 47:17,20
48:9,15 49:7,9,11,
19 50:20 51:3

59:14,16,17,19,21
60:14

allowed 40:10

allowing 45:8

alluded 47:23

alternative 22:23
29:2

Amanda 3:20
5:23

amended 17:11
33:10,11

amendment 27:4
57:12

amendments
26:23 31:8 32:15,
19 35:6 36:18,21
40:6 41:16 42:1
52:5

America 8:9
43:15

amount 10:3
27:12 47:8 53:2,
10,23 54:1,5,20

amounts 10:2

analysis 15:7

analyze 22:24

analyzed 22:12
25:23

analyzing 15:4,8

and/or 6:24 38:4

Andrew 3:6 5:10

annotation 13:22
14:2,6,23 15:6
17:3 41:6 42:17,
23

annotations
41:5,8

answering 29:25

apartment 13:8

apparently 14:15
46:11

appeal 2:5 5:4,5
6:15,22 24:5 38:2
42:14 45:25 46:1
47:15 53:8,21
57:12 60:18

appeals 2:1 3:17
5:5 6:9,12 17:18,
20 18:11,14 25:3
53:11

APPEARANCES
3:1

appeared 40:5

appears 50:6,14

Appellant 2:7 3:9
5:15,17,19,21
6:23 7:1 9:6,8,10,
19 10:16 11:5,6,9,
12,13 12:3 18:4
28:8,18 29:5
31:23 33:14,15
35:4 36:7 37:14,
20 38:4,7 42:5,12,
16 43:8,18 44:8,
24 45:11 46:5,8,
10,17,18,25 47:5,
12 52:22 53:3,15,
18,20,21 54:21
56:16 58:2,4
59:12

appellant's 4:4
9:17 10:6,12 11:1,
18 15:3 19:7 23:6
27:22 28:10 32:16
33:23 37:25 42:8,
15,24 43:11 44:23
45:7 46:3,15 53:5,
24 55:21 56:22

Appellants 7:6
42:16

appliances 27:7
40:11

application 19:16
20:5,14 21:9
30:21 35:19 38:11
41:14 44:20 55:22

applied 20:6
29:23 30:14 55:6,
11 59:5

applies 23:22
39:6 44:21 57:13

apply 30:5,6,18
34:23 39:25
40:14,18 41:20
42:11 43:24 44:24
50:2,7,14

applying 44:5

appreciates
33:15

appreciative
35:18

approach 16:10
22:8,10 23:4 26:7,
16 27:22 28:5,6
29:3,24 30:17
31:4 32:18 36:8
55:13,21,25 56:11
57:9 58:10

approaches 12:9
30:23

April 38:13 39:15
41:7

Architectural
57:5

area 34:4

argued 44:8

argues 43:8 46:5,
8

arguing 28:23

argument 28:25
44:13 45:8

arguments 29:2
42:15 46:3

arising 11:11

arose 15:23

asks 28:8 59:12

aspect 34:4

asserted 13:15

assertion 43:12

assessing 43:24

assets 54:16

assumptions
12:8

attempting 19:5
45:11

Attorney 11:5

audited 60:9

auditing 54:8

authoritative
20:22

authority 19:21
21:8 25:20 30:11
43:19 45:21 48:1
56:23 57:1

availability 15:8
27:25

avoid 27:16 52:24
57:5

avoids 22:9 57:2

aware 24:23 33:9
35:4

B

back 12:2 28:15
36:13 43:2 51:2

background 36:1

backup 41:6

bad 55:2

based 17:9 21:7
27:1 32:18

basic 41:3

basically 31:16

basis 11:21,23
12:10 13:13 14:7
16:17 17:7 26:13
27:21 33:7 44:13
56:12,17 57:16

began 15:3

believes 36:7
53:21

benefit 39:10

benefits 58:20

big 33:15,18

biggest 55:24

billed 14:25

billing 14:1,4
15:3,8 16:9 32:18
34:12

bit 13:19

bled 32:21

bless 58:8

blessed 13:1

blind 33:12

Board 8:9 30:10
43:16 45:24 51:11
57:4,11

bogged 52:25

boilerplate 54:18

bold 51:10,17

boldness 52:3

bound 45:19

brash 51:11,17

briefs 19:8 23:7
47:10 56:23

broad 27:5,9 35:8
44:5 48:2,13

broadest 26:21

broadly 35:24
57:15

burden 47:12
53:1

bureau 6:3 18:14
25:3 53:11

bureau's 17:18,
21 18:11

C

Cal.app. 45:25

- California** 2:2,16,
21 3:18 5:1,8,24
19:9 20:12 37:14
55:1 57:4,11,20
- call** 6:9 12:20
51:22
- called** 12:22 13:2
- calling** 33:14
58:23
- canons** 25:5
- care** 23:22 37:15
50:13,16
- case** 2:6 5:6 9:3
21:16 30:9 37:18
44:9 48:1 52:24
55:17
- cases** 18:4 45:24
- catch** 6:21
- categories** 27:6,
10
- CDTFA** 3:15 5:22
6:1,3,10 8:24
9:14,16,17 10:7,
15 49:11
- CDTFA's** 4:5
10:20 49:13,17
- centered** 50:22
- central** 52:15
- Certified** 2:20
- change** 31:2,3,4,
10,12,15
- changed** 34:16,
20
- characterize**
22:2 25:25
- characterized**
32:2
- charge** 25:12
34:11,19 39:6
41:13 44:12
- charged** 9:19
47:5 53:4 54:5,13
- charges** 14:1,21
39:17
- chief** 6:2
- child** 12:13
- chopped** 15:12
19:6
- circumstanced**
57:17
- circumstances**
18:5
- cited** 14:23
- cites** 18:3 42:16
- claim** 9:7,9 24:7
37:23
- claims** 37:20
- Claremont** 3:21
6:1 47:23 48:12,
17 50:4
- clarification** 10:5
49:20 51:1 54:22
- clarify** 30:2 50:21
59:22
- classification**
19:8 54:25 56:19
- classifications**
8:8 20:20 56:17
- classifies** 43:21
- classify** 57:15
- clause** 15:18,24
16:4 31:17 33:3
38:2 41:23 46:9
- clauses** 7:9,16,
21,25 8:3 9:6,8
11:25 13:15 15:20
16:12 17:22
18:15,22 22:17,21
24:13,17,22,24
29:9 31:13 32:25
34:21,25 36:11
37:1,2 42:9 45:8
46:16 56:7,14
57:22 58:12,21
59:2
- clear** 14:6,23 17:4
21:13 26:25 29:12
31:9 33:18 36:24
45:12 48:8 54:24
56:5 57:10 58:2
- clings** 11:24
- close** 20:11 52:22
- closed** 60:16
- closer** 48:10
- closes** 5:13
- closing** 59:23
- Code** 7:13 8:12
11:16 20:12 45:23
- codified** 17:2
20:2
- comfortable**
60:12
- commencing**
2:17
- comment** 45:2
- committed** 54:24
58:25
- compel** 12:4
- completely** 29:24
36:10
- complicate** 45:11
- comprise** 53:9
- comprised** 23:13
- concede** 17:25
18:24 24:15 46:24
47:7
- conceded** 54:4
- concept** 26:21
35:8,23
- concerned** 18:25
- concerns** 17:13
35:19
- concession** 47:3
- concludes** 20:7
28:10 60:15
- concluding** 2:17
- conclusion** 58:16
60:23
- conditional** 60:6
- conduct** 5:11
- conducted** 47:9
- conference** 7:2
9:17 10:6 17:24
24:16 38:3
- confirmation**
60:2
- conflated** 18:13
- conflict** 20:21
28:7 43:8
- conflicts** 21:10
- confusion** 14:15
- connection**
11:21 33:6 38:8,
19,22
- consciousness**
32:21
- consideration**
21:22,25 25:22
26:2 32:4,10
- considered** 18:6
19:23,24 35:21
40:2,16 43:10
45:14 46:6 51:16
52:9,20
- considers** 19:1
46:22
- consistent** 26:5,
22 35:25 36:9,10
51:24 54:7 55:12
- constitutes**
40:23 41:13
- Constitution**
57:13
- constitutional**
58:7
- constitutionality**
58:3

constrained 53:25	37:14 43:15	debt 55:2	16 26:23 31:9
construction 25:5	correct 9:23,24 30:13,17 31:7,14 32:6,17 37:1 49:17,18	decades 46:14 59:8	33:16 35:19 36:20,22 37:9 39:19 45:19 47:8, 19 52:8 53:14,18 54:4,8 55:18 56:2, 6 57:21 58:1,25 59:8,22 60:2,5,7
constructive 21:21 26:18 53:6	correctly 18:12 55:2	December 24:8 37:24 57:24	Department's 12:2 14:15,23 16:1,16,21 18:2 19:3,5 21:6 24:11 26:11,15 28:5,6,9 35:6 45:22 47:21 55:13,25 56:1,10 57:8 58:9 59:10, 13,24
construed 27:19	corroborates 32:16	decide 52:24 60:18	describing 30:19 43:9
construes 20:16	cost 39:12	decided 6:22 55:2	detail 15:2 19:7 23:6 56:22
consumed 38:7	Counsel 3:21 5:23 37:12	decision 17:18,21 18:12 19:9	determine 14:25 23:14 24:13 45:17
consumer 36:5 39:20 41:21 42:6, 13 46:17	couple 30:23	declare 20:25	determined 30:10 40:25
consumers 23:11 36:3 38:18	court 6:11 18:3 20:16,21 43:24 49:4 55:1 57:4,11, 20	decline 49:15 58:1	determines 44:3
consumption 47:14	Court's 19:9	deductions 11:11	determining 43:23 58:14
contained 38:1	courts 57:7,10	deemed 23:1 29:16	devices 27:7 40:11
context 13:20 26:9	covered 7:1 38:6	default 39:19	differently 38:7
contract 16:5 17:8 32:12 38:23 39:2 40:8 41:23 53:18	create 58:7,22	defending 18:19	difficult 34:6
contracts 7:9,25 14:8 15:21 22:15 37:25 42:9 46:15	created 55:9 56:20 59:7,8	defer 12:1,4 16:15 57:21 58:24 59:7	dignity 21:2 55:19
contradict 59:9	critical 37:15	deference 58:1	dinnings 12:14
contradiction 25:19	crutches 23:20	deferring 21:5	direct 14:7 17:8 18:20 19:13,24 22:5,13,25 25:14 26:4,19 27:11 28:2,6 29:13 31:25 32:3,12 33:25 35:11,21 51:16 52:13,19 58:22
contradicts 26:13	CSR 2:20	defined 37:18	directly 6:19 22:6
contrary 42:25	curious 12:22,25	defines 43:11	directs 45:16
contrast 20:1 22:17	customer 38:24 39:2,4	definition 53:17	
control 35:14	cut 12:18,23,25 13:4,10	deliberate 5:12 60:17	
controlling 55:10 59:9	cutting 12:12 13:18	deliberation 60:17	
controls 43:17	<hr/> D <hr/>	deliberations 7:5	
cook 12:13	date 5:6	delight 13:3	
Corp 8:8	dated 41:5,7	delineates 27:5	
corporation	days 5:13 60:19	denied 11:18 42:14 47:15	
	deal 33:15,18	Department 5:24 9:11 11:18,20,23 12:5,9 13:12,18 14:17 17:11,14,24 18:19,23,25 19:2, 21 20:3,4 24:14,	

disagree 55:20
discharge 23:18
discretionary
 19:11 51:18,21
discrimination
 56:18 57:19
discriminatory
 56:19,24 57:2,23
discussed 15:2
 19:7 23:6 41:8,15
 42:24 46:21 47:9
 56:22
discusses 44:1
 48:6,20,21,22
discussing 44:15
 49:1
dispute 7:8 24:9
 50:22 53:18
disputes 52:25
 55:10
distinction 42:21
 43:3 56:13
distinguished
 39:16
distinguishes
 39:16 42:18
documentation
 54:6,7
documented
 53:4
documents 14:1
 34:12 41:16
doubt 20:12
duty 58:5

E

earlier 51:14
eat 19:6
effect 32:25 39:15
 41:11 45:3 57:3

effectively 7:17
 8:2 27:17 31:20
 42:23
effects 43:14
effectuate 19:11,
 20
elements 49:2
eligible 14:13
 17:6 27:6,10
emphasizing
 17:6 52:22
empowered
 57:18
enacted 19:15,20
 51:23
end 16:7 20:10
 39:8 40:3,13
 44:12 57:19
ends 12:12,18,24,
 25 13:4,10,19
 15:11
enforce 57:18
engage 19:4
enlighten 36:20
enormous 51:19
entered 10:10
entering 24:21
enterprises 20:8
entities 18:10
entitled 6:23 38:4
 46:19 47:13 55:19
entitlement 47:7
entity 18:6
Equalization 8:9
 43:16 45:25 51:12
 57:11
equally 5:11
equipment 37:19
Ernst 5:16,18,20
erroneous 24:19,

25 25:4 56:21
 58:5
error 12:1,4 13:14
 15:14 16:16 21:5
 29:8 31:9 32:17,
 18 58:25
Esq 3:11
Esquivel-
parkinson 2:19
 6:18
essentially 43:12
 44:24
establish 9:19
 47:4
established 8:18
 20:20 51:14 58:23
establishing
 57:8
evidence 6:14
 10:11 44:4 47:1
examination
 47:9 60:1
Examiners 57:5
Examples 20:8
exceptions 42:7
excluding 35:12
exclusive 35:14
exclusively
 53:12
exemplar 53:6
 54:2
exempt 8:14
 19:24 22:14 24:1
 25:15 26:19 27:11
 28:2 29:13 32:11
 39:7,23 40:2,12
 41:8 43:10 45:1,
 14 51:16 52:12,
 13,21 54:13
exemption 7:12,
 18,23 8:3,4,11
 11:15,19,22,23
 12:11 13:14,16,22
 14:3,7,13 15:5,9

16:1,4,13,18 17:2,
 7,8,9,13,15,23
 18:11,16,20 19:13
 20:2 22:20 23:9,
 17 24:21 27:6,16,
 17,21,25 29:10
 31:14 32:8 33:5,7,
 13 40:15 41:19
 43:9 46:12 48:2,
 14 51:22 52:18
 56:5 58:14,20
 59:3,4
exercise 51:21
Exhibit 14:23
 15:3 16:1 18:3
 32:14 36:24 37:3
 39:14,21 41:18
 46:22,25 56:1
exhibits 4:4,5
 9:18 10:6,12,15,
 16,20 47:4 53:3
 54:3 59:25
exist 9:6,8 22:21
existed 8:4 15:20
 22:18 24:17
existence 13:21
 14:7 19:19 24:13
 58:11
exists 7:25 20:12,
 21
experts 6:13 50:5,
 18
explain 21:18
explained 16:1
 20:15
explanation 13:5
explicit 16:4
 34:24 41:23
explicitly 41:2
express 18:21,22
 22:21 24:21 42:11
 46:7,16 47:25
expressly 19:16
 24:5 25:3 46:13
 51:22

extend 58:1

extent 8:10 21:10
23:23 26:9 29:19,
20 30:5,8 40:10
46:22 59:5

extremely 18:5

F

facilities 7:10 8:1
13:24 14:9,19
15:22 16:3 20:7,
15 22:16,19,22
23:11 24:18,20
26:6 28:1 36:1
38:12,15 39:10,
17,20 41:21 56:8,
14 58:13,19

facility 16:5
23:15,21 25:10,14
34:10 38:21 39:5,
7 40:21,24 41:20,
23 44:10 49:25

facility's 38:24

fact 20:7 31:7
46:25 51:24

factor 58:14

facts 7:7 22:24
48:3

factual 30:21
48:14 52:25

faithful 22:8 23:4
58:23

faithfulness 25:4

fall 49:5,22,24

falls 48:6,8,10,19
49:2

familiar 51:9

family 13:2

favor 53:24

federal 7:19 11:14
14:4,5,8,10,11
15:10,21 17:5,8,
10,20 18:1,6,8,13,

18,24 19:1,4,17,
25 21:22,25 22:5,
6,10,14,15,19
23:1,3,24 24:18,
24 25:2,15,19,23
26:2,4,14,20
27:11,24 28:2
29:16,17 31:21,25
32:5,7,10,12
33:20 35:2,21
45:9 51:17 52:9,
10,11,12,13,19,21
53:19 54:14 58:18

Fee 5:24

feel 34:1 53:24
60:12

Ferris 3:11 4:12
5:16 8:21,23 10:1,
17,18 11:2,5,9
28:12 29:5 30:13,
16 31:7 34:6
36:22 51:5,7
59:14

field 55:10

file 45:3

final 51:6 59:19

Finally 26:15

find 30:6 45:21

finding 45:9

fit 13:10

fixed 54:16

flavorful 13:6

focus 15:3 16:9
26:11 31:11 32:20
33:2 34:20 36:25
50:21 52:17

focused 14:24
31:21 33:20 53:12

focuses 24:12
30:16

focusing 15:7

folksy 13:17

follow 20:10,19
45:20 49:15 59:7

follow-up 37:5
59:18 60:7

Footnote 17:18

formal 41:18

Fortunately
12:25

forum 40:5

forward 46:25

found 15:18 20:9
24:12 27:4,21
55:14,25

full 47:9 53:22,25

fullest 26:9

fully 27:14 54:24

furnished 25:11
37:21 38:18,22
39:24 40:22 42:6
44:11 50:15

furnishing 41:12
50:1,11

G

gap-filling 51:18

Gaudreau 3:13
5:20

general 20:4

generally 39:9
47:24 60:2,8

generation 16:11

girl 12:11,22 13:1

girls 13:3

give 20:22 51:5

giving 31:5

gloves 35:15,17

good 34:21,23
37:13

governing 58:6

government 8:1,
15,17,20 9:9

11:14 14:4,5,8
15:21 17:9 18:13
19:14,25 21:23
22:1,6,7,14,15,19,
23:2,24 24:18,24
25:15,23 26:2,4,
20 27:12 28:2
29:14,17 31:25
32:5,11,12 33:25
35:11,21 38:1,8
39:23 40:3,9,13,
17 41:9 42:10,20
43:10 45:15,16,23
46:6,9 51:17 52:9,
10,11,12,14,19,21
53:19 54:14

grandfather 13:8

grandma 12:19,
20,22,23 16:8

grandmother
13:2,3,7

grant 28:9 47:25
53:22

granting 53:25
60:13

grants 60:6

great 12:17 13:2,
3,7,8

greater 20:22

guess 28:24
29:20 30:9,11,12,
25 32:21 33:22
34:1,5 35:5 50:21,
23,24 51:7

H

hand 46:4

handed 16:10

happened 31:8
34:13

hard 34:4

harmonization
26:12,15 27:22
28:5,6 30:17
36:15 55:13,21,25

56:11 57:9 58:9
59:10
harmonize 27:19
29:3
harmonized 8:10
23:8 25:8,17 29:1
harmonizing
26:9
hat 35:6
headquarters
6:3
healthcare 40:8
heard 52:7
hearing 3:22 10:5
16:15 60:15
held 20:25 57:4,12
helps 30:2
historical 13:19
36:1
histories 16:19
45:18
history 36:19
44:14
holding 18:7
Honorable 11:6,9
hopes 11:25
hospital 2:6 5:5
37:15 44:18 50:17
54:12
hospitals 32:13
38:12 46:9
Hughes 57:4
hundred 5:12
60:19

I

idea 34:13 52:16
identified 14:3
identify 5:14

identifying 8:16
Ill 5:23
illegal 57:19
illegally 25:18
illustrated 16:18
impartial 55:11
impermissibly
7:19
implemented
12:6
importance 12:7
important 50:25
52:23
improper 16:11
33:21 55:25
improperly 7:17
8:2 24:19 29:18
inadvertently
11:21
inapplicable
24:2,4 25:1
included 40:4
including 16:4
38:12,16 41:22
inconsistent
27:9 29:24 55:16
Incorporated
45:24 46:2
independent
6:10,12
indication 48:25
indicator 31:19
indicia 8:13 26:18
27:10 31:24 33:24
34:8,10,12,16,20,
24 35:5,10,16
36:4,8
infirmities 58:7
initial 17:18
injurious 55:5

inpatient 23:22
50:12,16
instance 30:3
instant 21:7 24:5
instrumentalities
7:20 14:11,12
15:11 17:5,10,20
18:1,9,18,25
19:14 23:3 25:2,
19 26:14 27:24
32:7 45:10,19
58:18
instrumentality
18:7 19:1,4 22:10
29:18 31:21 33:21
35:2
insured 19:17,23
37:16,22 38:16
39:24 40:1
intended 39:13
45:1
intent 8:14 21:23
26:19 27:11 28:1
31:24 34:8,17
35:10,16 36:5
41:25 43:5
intention 50:17
interested 15:23
39:19
interplay 41:4
interpret 57:1
interpretation
42:24 46:12 56:21
interpretations
25:6 57:6 58:6
interpreting 20:4,
13 26:8 43:18
48:2,13 51:20
interpretive 8:7
20:17,18 21:4,12
27:17 30:7,10
43:23 47:22
48:10,13 49:2,16
55:6,15 59:8

interrupted 11:8
invalid 8:10 21:1
28:24 30:11,14
45:22 56:18 57:19
59:5
invalidate 7:17
8:2 21:8,14,17
29:23 30:8,12
55:22 56:24
invalidation
36:15 57:6,10
involves 19:11
29:14
involving 19:17
44:22
irrelevant 11:24
29:6,11,19 54:16
55:14 59:3
irrevocably
27:14
issue 5:12 6:23
9:7,9 19:2,5 24:7
26:8 34:2 37:17
38:2 41:18 42:13
45:11 46:11,18
47:15 48:5 50:25
53:3,13 54:1 55:3
56:1,5 60:18
issued 20:24
issues 6:22 7:7
8:22,25 52:24
53:13
item 28:3 46:24
items 11:13 16:6
23:19 35:13,20
39:18 40:1 41:24
46:23 47:2 53:16

J

Jacobs 3:20 4:13
5:23 8:24 9:1,11,
13,23,24 10:8,9
37:10,12 47:17,23
49:18

January 2:18 5:1,
6 7:9,24 24:7
46:21 56:15 57:25

Jason 3:22 6:2

joint 26:18

jointly 60:17

Judge 5:9,10 8:23
10:1 28:13,14,17,
20 36:13 37:5
47:18 49:9,14
51:2 59:15,17

judges 6:15

judicial 43:20

July 24:8 37:24
41:18

jump 6:5

jurisdiction
21:14 49:14

K

kind 32:20 34:1
50:9 53:12

kitchen 13:9

Kwee 3:6 5:10
28:13,14,20,22
30:2,15,22 33:22
36:12 49:9,11,19
50:20 59:17,19

L

Laboratories
46:2

lacks 21:14 49:14
56:12

language 11:24
13:17 25:6 40:4,5
42:12,25 44:14,15
45:12 46:7,16
55:14

lastly 8:13

laundry 54:17

law 19:25 21:17
22:7 31:4 44:20
46:10,13 55:12
57:8 59:9

Le 3:7 5:10 28:14,
17,19 37:5,7
47:18,20 48:9,15
49:7 59:15,16

Le's 49:14

lead 3:5 25:6 57:6,
9

leads 45:7

Lease 51:9

Leasing 45:24

leaves 25:9

left 30:18

legal 52:24 53:13,
21,24 54:21 56:18

legislative 36:19

legislature 51:24
55:9 58:24

letter 41:6

level 55:9

liability 38:10

lieu 34:3

limit 27:10

limited 60:11

list 54:18

listed 7:2 54:17

livestreamed
6:17

local 57:14

logic 55:6

longevity 13:1

looked 54:15

lose 57:24 58:19

lost 11:21 15:13
33:6

loudly 6:20

lovingly 6:9

M

made 12:1 13:24,
25 14:5,20 17:14
18:21 26:23 27:8
29:8 36:20 39:17
40:12,20,25 54:13

main 30:3

maintain 47:11

make 7:4 8:14 9:4
14:23 21:24 26:19
27:11 28:1,22
31:24 33:3 34:8,
17,24 35:10,16
36:8 54:23

makes 14:6 17:4
25:14 26:25 31:8
36:24

making 28:24
29:1 31:11,15,16

mandate 19:22

mandates 22:4,
13 26:3

manifestly 16:18

manner 27:3
55:11 57:2

Maranville 57:10

Maria 2:19

Mark 3:12 5:18

material 7:7

materials 44:19
45:5

matter 2:5 21:7
26:10 28:9 46:10
48:4 59:13 60:16

meaningless
43:13

means 27:3

measure 39:12

meat 13:6

medical 7:10,25
8:14,16 11:12
13:23 14:8,19
15:22 16:3,6
19:17 20:6,15
22:16,18,22
23:11,15,21
24:17,20 25:10,14
26:6 27:25 28:3
34:9 35:14 36:1
37:16,19 38:12,
14,21,22,23 39:5,
6,10,16,20 40:20,
24 41:20,21,24
44:10,18 49:25
50:13 53:16 56:8,
13 58:12,19

Medicare 7:1,10,
16,17,19,22,23
8:11,15,18 9:6
11:15 14:11,12
17:4,15 19:18
23:25 30:5,8 32:6,
9 33:4 37:16,23
38:6,9,17 39:24
40:1,16 41:14,19
42:4,18,22 43:5
44:25 45:1,2,5,13
49:22,23 50:2,6,
18,24 51:13

medicine 37:18
44:17 53:17

medicines 27:7
40:11

meet 53:17 60:17

meeting 7:11

MEMBERS 3:3

Memorial 2:6 5:5

mention 45:5

mentioning 45:2

mere 51:20

merits 19:3 53:21,
24 54:21

met 47:12

Mexico 18:8

Micelle 46:1
microphone 6:20
Mike 3:7 5:10
minds 33:1
minute 28:20
minutes 10:13
38:3
misguided 24:11
missed 6:7
mistaken 16:9
mistakenly 55:13
mix 50:23
modified 14:17
mom 12:17 16:8
mooring 12:5
33:6
morning 37:13
mother 12:11,13,
15,24 13:4
move 51:11 52:1
multiple 32:3

N

narrow 18:5
necessarily 44:7
48:18 49:4
negating 23:9
27:17
negligible 27:12
Newco 45:24
non-part 34:22
nonadministered
15:16 30:24 39:18
41:10 42:2 43:3
nonexistence
58:11
nonprescription
44:17

nonresidents
50:10,12
nontaxable 11:14
note 39:9 44:1
46:3 47:3
noted 17:17 18:2
25:3 53:14
noticed 12:24
notices 12:11
notwithstanding
17:23
November 41:5
number 5:6 7:8,
15,21 8:6,13 9:5

O

oath 10:25
object 10:7,16
20:5,14
objection 10:8,9
objective 44:3
48:25
obligated 57:5
observe 58:5
obtains 60:2
obvious 18:17
50:10
occur 27:4 30:20
45:17 58:8
occurred 15:1,14
24:14 31:10
occurring 24:6
occurs 43:11 44:3
odds 46:4
offer 13:5
offered 43:19
Office 2:1 3:17
6:8

officially 17:2
20:2
opening 28:10
49:12
operate 16:3
17:22,23 18:15
22:21 24:20 29:10
33:5 52:18 56:5
59:2
operated 37:14
operates 18:20
58:15
operating 7:23
16:13 18:10 31:14
operation 13:16
19:25 22:7 27:15
59:4
operations 6:3
operative 8:4
11:20 38:13 51:15
opinion 5:12 7:5
20:24 50:7 54:23
60:19
opportunity 51:5
option 24:25
41:22
orders 10:13 38:3
original 43:5
OTA 6:9,11 12:1,3
16:15 20:19,24,25
21:4,8,13,16 28:8
29:20,22 30:5,11,
16 33:16 45:21
46:22 49:14 52:23
53:9,23 54:22,24
55:9,20,21 56:23,
25 57:5,25 58:2,5,
8,24 59:7,12 60:5
OTA's 6:14 21:13
outlined 47:11
oven 12:13 13:9,
10 59:11
overbroad 35:19

P

p.m. 60:21
pages 15:2
paid 6:24 9:20
11:10,12 21:22,25
23:24 25:22 26:2
32:4,10 37:20
38:5 47:5,14 53:5
54:5,12,13
panel 3:3 5:10,11
11:6,9 19:1 60:17
paper 41:18 56:1,
5
Parker 3:22 6:2
60:8
part 7:1,10,16,18,
19,22,23 8:11,15,
17,18 9:7 11:15,
22,23 13:13,15,
16,21 14:2,4,9,10,
12,16 15:5,9,10,
21,25 16:3,12,13,
17 17:2,6,9,10,13,
15,19,22,23,25
18:8,12,15,18,20,
21,22,24 19:18,24
20:1 21:9,19,21,
24 22:3,9,15,20,
22,25 23:3,9,17,
22,25 24:2,21,22,
24 25:1,15,18,22
26:1,14,17,20
27:1,6,8,12,14,16,
23,25 28:4 29:6,
10,11,12,22,23
30:5,8,14,18,21
31:13,14,20,22
32:8,13,25 33:4
34:25 35:1,9,10,
18,22,24 37:16,23
38:6,9,17 39:24
40:2,8,12,16,23,
25 41:15,19 42:4,
19,20 43:5 45:6,
13 49:22,24 50:2,
6,24 51:13 52:5,
18 53:7,11,18
54:12 55:23 56:4,

- 5,8,14 57:22
58:13,14,17,20,
21,22 59:2,4,5
60:1
- participating**
15:22 22:16,18
25:14 54:12 56:8
58:12
- participation**
60:20
- parties** 9:4,5
15:23 39:19
- parts** 9:15 19:18
42:22
- party** 10:22 11:19
12:10
- pass** 13:18 46:10
- passage** 7:9,16,
21,25 8:3 9:6,8
11:25 13:15
15:18,20,24 16:12
17:22 18:15,22
22:17,21 24:13,
16,22,24 29:9
31:13,17 32:24
33:3 34:21,25
36:11 37:1 38:1
41:17 42:2,9 45:7,
8 46:9,16 50:22
56:7,14 57:22
58:12,21 59:2
- passes** 39:1
- passing** 22:6 39:3
- path** 26:12 33:17,
19 53:8,12
- patient** 11:24
14:22 15:3,8 16:5,
7,9 18:22 21:22,
24 22:3,10 25:22
26:1 28:4 29:15,
17 31:20,22 32:4,
20 33:20 34:14
35:2,10,18,25
36:25 37:2 38:24
39:1,4 40:23,25
41:24,25 42:10
46:5,20 50:15
- 52:17 59:2
- patient-billing**
33:2
- patient-focused**
16:10 32:18
- patients** 7:1,11,
16,19,22 9:7
13:15 14:9,10,11,
25 15:10 16:12
17:5,10,19,22,25
18:8,12,18,21,23,
24 19:17,23 22:22
23:1,3,19 24:22
25:1,12,18 26:14,
17 27:14,23 29:9
31:13 32:6,9 33:4
34:25 37:16,22
38:1,6,9,15,16
39:11,24 40:16
42:6 44:12,16,22
45:9,14 50:9,10,
11 53:7 56:4,9,15
57:22 58:13,17,
21,22
- payment** 8:19
14:5 27:8 33:25
40:12 42:19
- pays** 53:15
- period** 9:7,9 24:7
37:23 38:10
- periods** 7:8,23
56:15
- persistent** 13:1
- person** 18:5 40:1
- personal** 6:25
13:25 34:9,14
35:20 37:17 38:18
39:1,3
- persons** 25:11
44:11,16 50:1
57:16
- perspective**
33:23
- pertaining** 20:9
- pertinent** 13:20
- pharmacy** 44:18
- picked** 12:19
- piece** 59:22
- piggybacking**
52:3,4
- place** 40:19 41:9
48:21,25
- plain** 25:6 42:25
44:15 45:12 55:14
- playing** 55:10
- point** 10:21 24:15
36:17 48:23 52:15
- portion** 30:12
49:15
- position** 18:19
21:6 30:4 32:16
47:21 49:13,17
57:21
- possession**
21:21 26:17,22
27:2,13 28:3 31:1,
11,18,22,24 33:25
34:3 35:8,9,14,17,
23,24 46:20,23,24
47:1 53:7 56:4
- possibility** 52:25
- pot** 12:13,14,23
13:9,17,19 15:12
19:6 24:11 31:6
59:11
- potentially** 24:10
- power** 51:18,21
- precede** 16:21
- precedential**
20:24 54:23
- preclude** 25:5
- precluded** 21:5
- preferable** 39:21
- prehearing** 7:2
9:3,16 10:6 17:24
24:15 38:3
- premises** 23:20
- preparing** 12:14
- presentation**
4:10 10:24 11:1,4
37:9,11 49:12
- presenting** 10:23
- preserves** 57:3
- pretty** 51:9 54:15
60:12
- prevail** 19:3
- prevails** 53:20
- previously** 54:2
- primary** 30:3
- principal** 7:7
- prior** 7:8,24 30:23
39:15 53:8 56:15
- problem** 16:2
33:4 55:24
- procedures** 8:18
- proceed** 11:3
37:9
- proceeding** 6:19
- proceedings**
2:15 5:11 6:6,17
60:23
- process** 15:24
53:11
- program** 19:17
51:13
- programs** 50:19
- prom** 51:23
- promulgated**
15:17 20:3 45:22
51:12
- promulgates**
55:18
- promulgation**
43:4
- proof** 53:1
- proper** 15:10
34:23 35:7

properly 25:16
property 6:25
 13:25 25:11 34:9,
 14 35:20 37:17
 38:18,22 39:1,3,5
 44:11 50:1,15
proposed 9:10
 15:15,24 16:2
 25:1 56:2,6,10
proposing 60:5
proposition
 43:20
proscribes 40:19
provide 26:12
 40:9 54:22
provided 6:25
 7:12 8:11 11:15
 14:2,19 23:9 38:5,
 14 54:6
provider 40:8
providers 38:15
proving 47:12
 52:15
provision 17:16
 21:17 23:17 24:5
 30:4 37:22 39:2
 40:22 41:17 42:2
 44:9,21,25 45:7,
 16 50:23
provisions 26:10
 40:18 41:10 42:2
 44:6
proximity 20:11
proxy 32:1
public 10:22
publicly 16:21
purchase 39:5
 44:17 47:14
purchaser 60:3
purchases 6:25
 11:10,12 38:5
 53:16

purpose 19:12,20
 43:20
purposes 14:4
 18:10
pursuant 8:7
 11:14 38:17 40:10
 42:5 46:6 58:16
put 46:25 59:11
putting 12:12
 25:21

Q

qualify 40:12
quasi 43:17
quasi-legislative
 16:25 17:1,15
 19:10,21 20:19,23
 21:1,3,15 27:20
 30:7 43:17,22
 44:2,7 47:22,24,
 25 49:1,16 51:8,
 11,25 55:4 56:25
 58:4,17
question 12:17
 15:23 18:17 30:1
 32:22 36:15,16
 47:20 48:15
 49:11,14
questioned
 53:14
questioning 12:8
questions 6:6
 28:13,17,19 37:6
 47:18 49:8,10
 51:2,4 59:15,16,
 18,19
quote 16:4,7 20:8,
 10 38:20 39:8
 40:2,3,7,13 44:10,
 12 57:12,19
quotes 18:3

R

raised 8:25 59:23
raises 18:17
Randy 3:11 5:16
ranking 48:18
rational 56:12,17
 57:16
reach 52:23
reaching 53:9
 54:21
read 7:3 9:4,15
 52:7
ready 11:2 37:10
real 31:17 56:9
realistically 18:9
realize 31:12
reasonable 26:12
 27:23 46:11 57:20
reasoning 31:2
reasons 29:7
 42:14 47:11
received 60:3
receiving 8:19
 50:16
recipe 24:12
 59:10
recipes 59:8
recognized 42:22
reconvene 60:21
record 5:13,15
 6:14 7:4 9:15
 10:22 60:16
record's 33:18
recording 6:19
Redwood 2:6 5:5
reference 14:16
 16:20,23 52:5

referenced 26:25
references 16:24
reflected 16:20
 26:24
refund 6:24
 11:10,18 28:10
 38:4 46:19 47:8,9,
 13 53:2,10,22
 54:1 60:1,3,6,13
refunded 60:10
reg 47:22 48:13
regard 18:4 39:23
 42:3 43:5 48:20
regulation 7:13
 8:6,12 11:17,25
 12:6 14:18 15:19
 16:23,24,25 17:1,
 4,16 19:9,10 20:2,
 3,6,7,11,13,16,17,
 18,19 21:2,3,4,9,
 11,12,13,18 22:1,
 9 23:5,10,12 25:8,
 17,24 26:7,13,23,
 25 27:1,5,20
 28:25 30:4,10
 31:5 36:10 38:11
 39:15,25 40:4,10,
 19,25 41:14,16
 42:5 43:17,21,25
 44:2,5,6,14 46:17
 47:24 48:2,21,22,
 23 55:2,3,4,7,15,
 18,22 56:20,21,25
 58:4,17 59:3
regulations 8:7
 16:19,22 17:12
 20:9,10,12,23
 21:1,15 23:7 26:8
 27:18 36:16 40:14
 41:3,4 42:12,22
 43:1,7,13,18,22
 45:18,20,22 46:7
 48:5 51:8,10
 54:25 55:7 57:2
regulatory 20:20
 44:19 45:5
reimbursement
 6:24 8:18 9:20,21

11:11 37:21 38:5 42:21 47:6,13 53:4 60:4	7:12 15:5 40:20	8:11 11:15	46:5,6 48:21,25 52:19,20
reimbursements 53:15	requires 56:3	reverse 28:9 59:12	sales 11:16 13:24 14:20 16:22 18:20 19:13,23,25 23:18,25 27:11 35:21 39:22 40:2, 3,10,12,15,17 45:1,13,14,15,17 50:10,11 51:9,16 52:8,9,10,11,13 54:14 58:22
reject 58:5 59:10	requiring 44:3	review 36:18 43:20,23	salient 15:6
rejected 18:14 25:3 28:7	requisite 26:19	reviewed 6:16 9:17	Sara 3:13 5:20
rejecting 17:21	resale 39:6	rid 32:23	Savemart 30:9
related 34:19 47:3 53:2	resident 38:24 39:1,4	rightly 52:23	scale 51:19 52:2
relates 43:8	residents 25:11 38:16 44:12 50:2, 9	roast 12:12,14,23 13:10,17,19 15:12 19:6 24:12 31:6 59:11	scenario 22:23 44:23 49:23
relating 26:10	resold 11:10 38:7	routinely 53:15	scope 50:5,18
relative 49:5	respect 7:11 27:15 34:22 45:6 53:1,5 54:23 55:23 56:11	RPR 2:20	Scott 3:21 6:1
relevance 23:17	respectfully 12:3 28:8 59:12	rubric 41:11	section 7:13 8:6, 12 11:16 12:5 13:13 14:17 15:13 16:17,23,24 19:12,15,19,20 21:10 22:4,8,12 23:4,10 25:8 26:2, 25 27:1 28:7 37:18 39:22 40:15 55:16,18 57:12 58:16
relevant 7:11,22 13:16 16:13 19:2 29:21,22 42:25 44:6,9 48:4 54:19	respond 51:5	rule 13:23 14:18, 19 15:16,18,25 21:17 26:5 32:24 34:7 36:4 50:10 55:12 56:6 58:3	sections 16:20 45:23
relies 18:4 55:14	responded 13:7	rulemaking 16:18 19:11 39:20 41:16	seeking 11:7,10
reluctance 19:4	response 12:23 59:25	rules 23:10 39:9 40:19 43:4 53:23 57:17	seller 60:4
relying 25:6	responsibility 57:1	ruling-making 45:3	sentence 42:17
rendered 37:15 38:9	restrict 27:24		separate 18:10 29:15
replace 15:17 42:1	result 23:2 26:5 56:18 57:18	S	separately 13:25 14:20,22 34:11,18 39:17 41:12
replied 12:17	resulted 31:4		service 7:10 8:1 13:24 14:9,19 15:22 16:3 20:6,8, 15 22:16,18,22
reported 2:19	resulting 13:14		
reporter 2:21 11:8	results 25:7 27:16 56:13		
represent 8:21	retail 13:24 14:20 15:1 19:13 29:15 50:1,11	Sacramento 2:16 3:18 5:1,8	
Representative 3:12,13,22	retailer 23:16 25:10 36:6 38:21 39:13 41:22 42:13 44:11 46:18	sale 8:14 15:1 21:24 22:3,5,14 23:1 24:14 25:15 26:1,4,19 27:4 28:2 29:13,16 30:19 31:19,22, 24,25 32:1,3 34:3, 8,17,24 35:11,16 36:8 39:7 40:1,18, 20,23,24 41:9,13 43:9,10,11 44:3	
request 47:15	retailers 23:12 26:6 36:3		
requested 47:8 53:22,25	return 12:5		
required 8:16	Revenue 7:12		
requirement 7:15,18,24			
requirements			

23:15,21 24:17,20 25:10,14 26:6 28:1 34:9,19 36:1 38:12,14,15,21,23 39:7,10,17,20 40:21,24 41:20,21 44:10 49:25 50:12 56:8 58:13,19	solve 33:4	24 57:11,14	56:2,11 57:9 58:9
services 23:11 37:16,22 38:8,19, 23 39:5 40:9,22 56:13	sort 35:5	stated 10:14 14:1, 21,22 38:2,6 39:17 41:2,12 54:2	subparagraphs 23:14 25:7
serving 14:9	sounder 36:9	statement 7:2 20:8 28:11 59:23	substance 31:17 37:3 56:9 57:23, 24,25
set 8:8 17:16 19:8 20:5 40:15 42:3,7 46:13 48:3 54:25	sounds 48:9	states 8:1,15,17, 19 9:9 18:7 29:13 35:11 38:13 39:25 40:3,13,21 41:19 44:10 57:13	substantiated 54:3
sets 38:11 39:11	speak 6:19,20	statute 44:5 55:19 56:20,21,24 58:3, 6	substantiating 54:6,19
setting 29:14	speaking 60:8	statutes 21:2,14 55:11 57:1,14	sufficient 9:19 26:18 27:3 37:2 47:4
shift 36:5	speaks 12:9	statutory 11:21, 22 12:5,10 13:13 16:17 25:20 26:13,22 27:20 33:7 59:9	suggest 16:2 24:20 44:21
short 25:16 57:3 58:11	specific 42:7 43:12 44:5 46:23 48:3,14,23	steeped 33:1	suggested 29:9 59:1
Shorthand 2:20	specifically 38:25 39:13 41:17 44:1 45:5 51:23	Stefan 3:12 5:18	suggesting 16:11
show 34:16	spectrum 43:22 48:6,8,10,19,20 49:3,6	stenographer 6:18	suggestion 31:12
side 48:11	spot 33:12	stipulations 9:3	sum 27:15 40:14 46:15
sign 35:5	staff 12:2 13:14 14:24 15:4,7,14, 15 21:6 24:23 29:8 32:19 33:6,9 35:14 58:25	story 12:7,11 13:17	supercede 42:23
signals 43:5	staff's 16:2,16 17:13 24:19,25 32:21,25 52:16	Street 2:16 3:17	supplemental 17:21 18:11
similar 36:14 40:4 60:10	staffed 6:12	subdivision 11:17 23:13 26:24 38:14,20 42:3,8, 10 44:14 45:6	supplies 8:14,17 27:7 37:19 40:11 41:24 44:18
similarly 57:16	standard 43:23	subissues 7:3	supply 11:13 16:6 28:3 53:16
simplifies 39:11	Stanley 3:5 5:4,9, 22 6:4 8:23,24 9:2,14,25 10:1,4, 10,13,19,21 28:12,16,20 36:13,14 37:4,8 47:17 49:9 51:2,3 59:14,17,21 60:14	subject 8:16 23:21 26:10 38:25 39:3 41:9	Supreme 18:3 19:9 20:15,21 55:1 57:4
simply 42:18 50:8,9	start 10:25 51:7	subjects 57:15	surgical 35:15,17
situation 48:14	started 13:18 14:15 15:4,7 32:19	submitted 6:15 10:15 60:16	sworn 10:24
small 13:9	starting 5:15 56:3	subparagraph 23:16,23 24:2,4, 10 25:9,16 26:11	
sold 11:13	state 2:2,21 8:9 34:11,18 38:20 40:7 43:16 45:13,		<hr/> T <hr/>
sole 27:13			taint 15:4
solution 16:2,11 24:19,25 25:4 29:14 31:15 32:16 33:1 36:25 52:17 59:1			tainted 15:7 52:16
			takes 48:21,25

taking 57:21
Talavera 20:25
 21:15 46:1 54:23
 55:1,3,6
talking 60:11
tangible 6:25
 13:24 34:9,13
 35:20 37:17
 38:18,25 39:3
tax 2:1 3:17,21
 5:23,24 6:9,11,12,
 24 9:19,20 10:2
 11:10,11,16 16:22
 19:16 37:12,20
 38:4,12 39:6,8,12,
 23,25 43:1 47:5,
 13 51:9 53:4,15
 54:1,5,12,13
 55:10 56:12,19
 57:14,18 60:4
taxable 23:25
taxation 7:13
 8:12 11:16 57:15
taxed 36:2
taxpayers 55:5
telling 17:11 52:6
tells 22:1 25:24
temporary 26:18
Teresa 3:5 5:9
terms 51:8
test 20:5,14
tether 15:13
theoretically
 19:22 22:2 25:25
theory 44:23
thereto 20:9
thing 21:19 22:20
things 35:13
 54:11,18
thinking 52:16
thinks 29:21 31:9

third-party 21:25
 22:3 26:1 32:4,10
thought 12:15
time 5:7 12:15
 13:21 14:24 28:19
 33:1,11 42:19
 59:10
tip 35:6
title 7:9,16,21,24
 8:3 9:5,8 11:24
 13:15 15:17,20,24
 16:6,12 17:21
 18:15,21,22 22:6,
 17,21,25 24:13,
 16,21,23 29:9
 31:13,16 32:24
 33:3 34:3,13,20,
 25 36:11,25 37:2
 38:1,25 39:3
 41:17,24 42:2,9
 45:7,8 46:8,10,16
 50:22 56:3,7,14
 57:22 58:12,21
 59:2
today 10:8,23
 60:19,21
totaling 59:24
touchstone
 16:25 33:10
TPP 13:25 14:1,3,
 20,21,22 15:1
 18:20 19:13,23
 21:24 22:25
 23:18,20 25:22
 26:16,17 27:6,10,
 13 34:11,18,19
 35:13 37:17,21
 38:5,8 39:21,23,
 24 40:16,22 41:12
 42:6,13 44:18
 45:13 46:18,20
 47:14 53:7 56:4
 58:22
traditional 12:8
transaction
 21:20 22:3,5,11,
 13 24:1 25:25
 26:3 29:15 30:21

32:2 44:4,6
transactions
 9:17,22 10:3
 11:14 14:13,17
 17:6 19:16,22
 21:10 23:23 24:3,
 6,9 27:13 29:7,22,
 23 30:14,19 34:22
 39:11 40:24 41:15
 42:4 43:6 44:16,
 22 47:6 53:2,6,9
 54:2 55:23 59:6,
 24 60:10,11,13
TRANSCRIPT
 2:15
transfer 21:20
 22:25 25:21
 26:16,21 27:2
 31:22,23 33:24
 34:2 35:7,9,17,24
 56:4
transferred 27:14
 34:14 46:20,23,24
 47:1 53:7
transferring 16:6
 28:3 41:24
treat 7:19 15:10
 21:1 27:23
treated 14:10
 17:5,19,25 22:13
 55:19 57:17 58:18
treating 17:10
 22:9 25:18 26:14
 29:17 31:20
treatment 56:12
treats 26:6
trial 54:16
true 16:25 20:5,14
 35:25 51:21 56:19
Tuesday 2:18 5:1
turn 36:12 37:8
 42:15 51:2
turns 35:1
type 34:24 43:9
 44:5 54:7

types 42:18 43:21
typical 53:8

U

U.S. 18:3 19:14
 38:8 39:23 40:9,
 17 41:9 42:10,20
 43:10 45:14,15
 46:6,9
uber 51:18
ultimately 15:14
unambiguous
 22:25
unconstitutional
 57:23
understandable
 15:15
understandably
 14:24
understanding
 7:6 28:23 31:3
 49:13,17 50:21
undisputed
 37:25
unduly 27:24
unintentionally
 15:25
United 8:1,15,17,
 19 9:9 18:7 29:13
 35:11 40:3,13
 57:13
unmoored 11:22
 12:10 13:12
unmooring 16:16
unnecessary
 58:7
unstated 44:25
unusual 53:12
unwilling 17:24
 18:23 24:15
uphold 21:16

Upholding 55:12

urges 12:3 54:22

usage 18:14

V

valid 43:18 48:5

validated 53:10

validity 43:24
57:3

validly 45:22

vendor 60:10

vendors 9:21
11:12 53:5,16
60:9

version 39:14

versus 15:16
36:15 41:10 42:1
43:2

view 32:3

viewed 18:9

virtue 26:8 35:12

W

ways 22:24 32:3

weight 20:22

well-established
25:5

whatsoever 27:3

wheelchairs
23:19

witnesses 10:23,
24

wondering 49:21

word 6:21 45:18
51:6

words 16:8 19:3
24:23 41:25

work 35:1

written 5:12 60:18

wrong 33:17,19

Y

Yamaha 8:8 19:9
20:16,21 43:15,21
44:1 48:6,20,22
55:1,17 57:20

year 17:12

years 11:19 16:14
19:19 20:1 33:17
51:14

young 5:16,18,20
12:11

Youtube 6:18