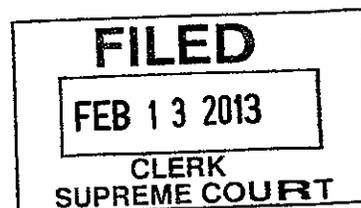


COMMONWEALTH OF KENTUCKY
SUPREME COURT
NO. 2012-SC-000071-D



ERVIN KLEIN, THOMAS C. RECHTIN,
EDDIE NOEL and DAVID MILES

APPELLANTS

vs.

JONATHAN MILLER
In his official capacity as the Secretary of the
Finance and Administration Cabinet

MARY LASSITER
In her official capacity as State Budget Director

and

RICHARD MOLONEY
In his official capacity as Commissioner of the
Department of Housing, Buildings and Construction

APPELLEES

APPEAL FROM COURT OF APPEALS
NO. 2010-CA-000750

APPELLANTS' REPLY BRIEF

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CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of Appellants' Reply Brief was served via ordinary mail this 12th day of February, 2013, upon Hon. M. Stephen Pitt and Hon. Christopher W. Brooker, Wyatt, Tarrant & Combs, 500 West Jefferson Street, Suite 2800, Louisville, KY 40202; and Hon. Thomas Wingate, Franklin Circuit Court, 669 Chamberlin Ave., Frankfort, KY 40601. Appellants did not withdraw the record from the Franklin Circuit Court Clerk.


Mark D. Guilfoyle

STATEMENT OF POINTS AND AUTHORITIES

Armstrong v. Collins, 709 S.W.2d 437 (Ky. 1986)..... 1, 2, 3, 4, 5, 6, 8, 10

2008 Ky. Acts c. 127, p. 372 2

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Kentucky Constitution, Section 181..... 5, 9

City of Shelbyville v. Com., 706 S.W.2d 426 (Ky. App. 1986) 5

KRS 335.140..... 5

KRS 48.310(2)..... 6, 7, 8

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Withers v. University of Kentucky, 939 S.W.2d 340 (Ky. 1997)..... 7

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<i>Com. v. White</i> , 3 S.W.3d 353 (Ky. 1999)	7
<i>Fox v. Grayson</i> , 317 S.W.3d 1 (Ky. 2010)	8
<i>Henderson v. Lockett</i> , 163 S. W. 199 (Ky. 1914).....	8, 9, 10
<i>Kentucky River Authority v. City of Danville</i> , 932 S.W.2d 374 (Ky. App. 1996) ..	9
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Appendix 1: Acts of the 1984 General Assembly, Part VIII, Fund Transfer

Appellees' Brief repeatedly and wrongly ascribes holdings to the *Armstrong* opinion that simply do not exist. The words "excess funds" never appear in *Armstrong*. And this Court never said in *Armstrong* that "adequate devices" include the ability to transfer police power fees from agency accounts to the General Fund. The "adequate devices" language in *Armstrong* pertains to the legislature's ability *in general* to suspend or modify existing statutes in a budget bill:

If revenues become inadequate, the General Assembly must be empowered to use adequate devices to balance the budget. Provisions in the budget document which effectively suspend and modify existing statutes which carry financial implication certainly are consistent with those duties and responsibilities.

709 S.W.2d at 443. Yet, Appellees maintain that "adequate devices" for enacting a balanced budget under *Armstrong* is a blanket authority without limitations (Brief at 1, 2, 3, 5, 7, 12, 14, 19, 23, 25, 27) and that only the General Assembly, not this Court, is the final authority on the "practice of transferring excess funds from agency accounts to the General Fund." (Brief at 30) There are limits, and this Court is the arbiter of those limits.

Appellees pose only one question to the Court: When police power fees "happen to generate marginally more revenue than is needed to cover the regulatory costs, can the Commonwealth . . . transfer that 'excess' revenue to the General Fund to help balance the budget?" (Brief at 1) They answer their own question by emphasizing -- repeatedly in their Brief -- that 5% of the regulatory

costs constitutes “marginally more revenue.” (Brief at 1, 2, 3, 21, 22)¹ Appellees expressly conclude that “transfers of marginal ‘excess funds’” are constitutionally valid under *Armstrong*. (Brief at 2, 3, 22) But, the term “marginal excess funds” never appears in *Armstrong*. So, while the proffered example of 5% excess is easy to grasp, it is completely manufactured. In this case, over \$10 million in HBC fees is at issue -- hardly a marginal amount of money.² More specifically, \$10,195,200.00 in HBC fees were transferred beginning in FY 2008-09 when the *entire* restricted fund budget for HBC operations was \$15,826,400.00. (2008 Ky. Acts c. 127, p 372) That amounts to a 64% sweep of HBC fees -- hardly a marginal percentage. Appellees’ proffered 5% formulation is fabricated and patently violated in this case.³

Appellees also greatly exaggerate the scope of *Armstrong*’s holding:

... the fee-based HBC accounts are identical in nature to the 47 fee-based agency accounts that this Court held were properly subject to excess revenue transfers in *Armstrong*.

¹ Appellees theorize that, when the annual cost of a regulatory activity is \$100,000.00 and the fees produce \$5,000.00 in “excess funds,” then the “excess” revenue can be transferred to the General Fund “to help balance the budget.” (Brief at 1)

² The list of 47 “agency and special funds” at issue in *Armstrong* is attached as **Appendix 1**. Again, the budget bill did not declare the amounts transferred as “excess,” and it is striking how small some of the transfers were. The larger transfers from workers’ compensation funds and retirement systems, of course, were struck down in *Armstrong*.

³ Any pretense that the transferred HBC fees are “excess” is destroyed by Commissioner Moloney’s testimony that fee increases were needed *after* the \$10 million transfers. (Moloney Depo. at 31-32)

(Brief at 17) Appellees assert that *Armstrong*, therefore, provides an “iron shield” against any challenge to the transfers. (Brief at 12) But that is not the holding of *Armstrong*, and Appellees fail to mention *Thompson v. KRA*, 710 S.W.2d 854 (Ky. 1986). The 47 agency and special funds in *Armstrong* were not all “fee-based” -- **most** of the money transferred was “employee contributions” and “insurance company assessments.” 709 S.W.2d 446 n.11. Those transfers were declared illegal in *Armstrong* and *Thompson*:

	FY 1984-85 Transfers	FY 1985-86 Transfers
Total Budget Transfers	\$5,388,500.00	\$5,751,000.00
Transfers declared illegal:		
KERS	\$59,300.00	\$59,300.00
CERS	\$32,200.00	\$32,200.00
State Police Retirement System	\$5,200.00	\$5,200.00
Workers' Compensation	\$354,400.00	\$387,700.00
Teachers' Retirement System	\$285,500.00	\$285,500.00
Workers' Claims Special Fund	\$1,188,000.00	\$1,195,000.00
Reinsurance Association	\$1,908,000.00	\$2,072,000.00
Total Illegal Transfers	\$3,832,600.00	\$4,037,700.00
Legal Transfers	\$1,555,900.00	\$1,713,300.00

Moreover, some of the 47 transfers were from agencies funded in whole or in part by General Fund appropriations (*e.g.*, Kentucky Development Finance Authority, OSHA Review Commission, Law Enforcement Foundation, Firefighters Foundation, Fire and Tornado Insurance Fund). There is simply no basis for saying that HBC fees are “identical in nature” to the 47 agency and special funds addressed in *Armstrong*.

Regarding fee-based accounts declared transferable in *Armstrong*, there are additional reasons why even they may not be equated with HBC fees. First, there is precious little analysis of trust and agency fund transfers in *Armstrong* -- the entire analysis fits on one page, *viz.*, 709 S.W.2d at 446. The Court began by observing that trust and agency accounts may be funded by “fees, rentals, sales, bond proceeds, gifts or other income.” (*Id.*) There is accordingly a great variety of sources of funding for trust and agency accounts, and that reality precludes Appellees’ one size fits all approach to equating HBC fees to the 47 funds addressed in *Armstrong*. Entirely absent from the analysis in *Armstrong* is any mention of the transferability *of police power fees*. That is the narrow question presented here, and *Armstrong* simply does not provide the answer. Thus, Appellants do not seek to “overturn” *Armstrong*. (*See* Brief at 3) This case needs to be decided following the Sections 15 and 51 jurisprudence set forth in *Armstrong* **and** considering the distinction between private funds and public funds set forth in *Haydon Bridge* **and** recognizing this Court’s pronouncements on police power fees in *Lockett* and its progeny.

Second, HBC fees are not included in KRS 48.315. This Court in *Armstrong* relied on the fact that the accounts that were transferable **were** listed in KRS 48.315:

Not only does the budget document provide for the transfers, but they are also authorized by statute.
KRS 48.315.

(*Id.* at 446)⁴ KRS 48.315 acts as a self-imposed limit on the legislature's right to transfer certain accounts, and Appellees do not even attempt to respond to Appellants' multiple arguments in regards to the statute. (See Appellants' Brief at 20-26)

Instead, Appellees rely on four transfers from agencies not included in KRS 48.315 and upheld in *Armstrong*. (Brief at 19) Those examples are inapposite. First, two of the funds (OSHA Review Commission under KRS 154.150 and the Firefighters Foundation under KRS 94A.220) were financed with General Fund appropriations, thus unquestionably subjecting them to transfer to the General Fund. Second, transfer from the Fish and Wildlife Fund (KRS 150.150) for purposes other than regulation or protection of fish, birds, or wild animals has been declared violative of Section 181. *City of Shelbyville v. Env. Prot. Cabinet*, 706 S.W.2d 426, 430 (Ky. App. 1986). Finally, while *Armstrong* appears to have sanctioned the transfer of \$200 each year from the Board of Hearing Aid Dealers (KRS 335.160), the Court appears to have overlooked that KRS 48.315 includes a reference to "KRS 335.140," the statute that creates that

⁴ *Armstrong* concludes:

. . . the power to use a budget bill to repeal, amend, modify and suspend existing statutes . . . must be exercised within all constitutional proscriptions, including those of Section 51. The General Assembly, in the questioned statute hereinbefore described **and relying on its own specific statutory authority [viz., KRS 48.315], did precisely that.** (*Id.* at 448) (emphasis added)

very Board. At any rate the *Armstrong* Court clearly believed that the permitted transfers were “authorized by” KRS 48.315 as quoted above.

In another attempt to circumvent KRS 48.315, Appellees cite this Court’s analysis of KRS 48.310(2) on page 703 of *Haydon Bridge*, as authority to transfer HBC fees to the General Fund. (Brief at 19-20) *Haydon Bridge* fully supports Appellants’ argument on police power fees. Specifically, this Court ruled that the General Assembly “had the authority under KRS 48.310(2) and KRS 48.315 and Sections 15 and 51 of the Kentucky Constitution” to ***suspend appropriations of General Fund tax revenues***, namely coal severance taxes. 304 S.W.3d at 705. However, transfers of assessments, namely workers compensation Special Funds, “were not authorized by KRS 48.310(2) or KRS 48.315, and . . . were improper suspensions under Section 15, and as ‘amendments,’ rather than ‘suspensions,’ were subject to the ‘publication’ requirement of Section 51 of the Kentucky Constitution. There having been no publication, the transfers were, and are, invalid.” (*Id.*)⁵ Transfer of HBC fees is identical.

Furthermore, the Court noted that “the limited validity of KRS 48.315, as well as KRS 48.310(2)” may not be disregarded. (*Id.* at 703) The Court concluded that the “amounts taken from *the possession* of the KWCFB or BRF and transferred to the general fund and Mines and Minerals appear to be in violation in KRS 342.1227(2), unless otherwise authorized by KRS 48.310(2) or

⁵ This conclusion squares with the Court’s earlier observation that “there is nothing in the language of KRS 48.310(2) which overrides the restriction in *Armstrong* against the invasion of private agency funds or public funds commingled with private funds and incapable of differentiation.” 304 S.W.3d at 703. Appellees omit that sentence from their analysis.

KRS 48.315.” (*Id.* at 704) (italics in original) Likewise, amounts in ***the possession*** of the HBC may not be transferred to the General Fund; HBC fees did not come ***from*** the General Fund, and therefore the transfers to the General Fund were improper suspensions under Section 15 and were subject to the publication requirement of Section 51 of the Kentucky Constitution. (*Id.* at 705)

Finally, Appellees note that KRS 48.315 was first enacted in 1984 and KRS 48.310(2) was added in 1990, and they state that “it seems clear that the legislature intended to retain the statutory authority ‘to suspend’ ***any*** statute.” (Brief at 20). However, the General Assembly most recently amended and reenacted KRS 48.315 in the 2010 session. (Acts 2010, c. 85 Sec. 18) The last reenactment of KRS 48.310 was in 2001. (Acts 2001, c. 58, Sec. 6) Basic principles of statutory construction control here. First, “where two statutes concern the same or similar subject matter, the specific shall prevail over the general.” *Withers v. University of Kentucky*, 939 S.W.2d 340, 345 (Ky. 1997). Second, the later amendment and reenactment of KRS 48.315 prevails over the pre-existing KRS 48.310(2) since both statutes cover the same matter. *Kotila v. Com.*, 114 S.W.3d 226, 238 (Ky. 2003). Third, the more specific of two conflicting statutes controls the more general. *Maynes v. Com.*, 361 S.W.3d 922, 931 (Ky. 2012). Fourth, “[w]here there is an apparent conflict between the two statutes, the Court is obliged to attempt to harmonize the interpretation of the law so as to give effect to both statutes.” *Com. v. Stambaugh*, 327 S.W.3d 435, 438 (Ky. 2011), citing *Com. v. White*, 3 S.W.3d 353, 354 (Ky. 1999). The General Assembly has amended KRS 48.315 four times without changing KRS 48.310. (*See* Appellants’ Brief at 22). These Acts of the General Assembly show that KRS

48.315 trumps KRS 48.310(2) and evince a clear intent that the enumerated statutes in KRS 48.315 are not limitless, as Appellees claim. “The enumeration of certain specified things in a constitutional provision will usually be construed to exclude all things not enumerated.” *Fox v. Grayson*, 317 S.W.3d 1, 11 (Ky. 2010).

As noted, the propriety of transfers of police power fees (like HBC and charitable gaming) was not addressed in *Armstrong*. Instead, the controlling authority for regulatory fees is *Henderson v. Lockett*, 163 S. W. 199 (Ky. 1914) and its progeny. A fee imposed under the police power may not exceed the amount sufficient to compensate the regulatory agency “for issuing the license and for exercising a supervisory regulation over the subjects thereof. Anything in addition to this amounts to a tax for revenue, and cannot be upheld as a valid exercise of the police power.” (*Id.* at 201) While *Lockett* did not hold that police power fees may not be transferred to the General Fund -- the precise issue presented here -- it unquestionably establishes that police power fees may not be used to supplement the tax needs of general government. Appellees fail to acknowledge or rebut that tenet. And note that *Lockett* said “**anything**” above the costs of regulation amounts to a tax for revenue -- there is no 5% rule under *Lockett* either.

Moreover, Appellees completely misread *Lockett* as **authorizing transfer** as long as the police power fee bears a “reasonable relationship” to the agency costs for issuing licenses and exercising regulatory supervision. (Brief at 12–14) The *Lockett* Court defined a reasonable fee as:

A question of fact, depending on the particular circumstances, the cost of issuing the license certificate, together with the cost of registering, supervising, and keeping in control the subjects of the license.

(*Id.* at 201) The plain language of *Lockett* preempts Appellees' claim that police power fees may be transferred to the General Fund if the fees bear a "reasonable relationship" to the regulatory costs. Furthermore, *Lockett* distinguished license fees collected under Constitution Section 181 as a *revenue measure*. (*Id.* at 200) Police power fees are simply not revenue measures. Accordingly, under *Lockett*, **anything** -- even a red penny-- imposed under the police power "amounts to a tax for revenue, and cannot be upheld as a valid exercise of the police power." (*Id.* at 201)

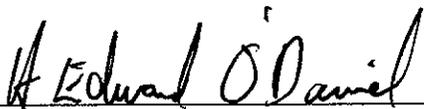
Appellees agree with this Court's ruling in *Haydon Bridge* that assessments are private funds. (Brief at 15) Assessments are charges to particular individuals or property . . . imposed in proportion to the particular benefits." (*Id.* at 698) Fees are charges for "a particular service . . . for the purpose of fulfilling statutory mandates." *Kentucky River Authority v. City of Danville*, 932 S.W.2d 374, 376-377 (Ky. App. 1996) Despite the identical nature of the two, Appellees contend that fees are "public funds" while assessments are "private funds." (Brief at 9)⁶ Appellees never seriously respond to the cases cited by Appellants that equate fees with assessments. (*See* Appellants' Brief at 17-19).

⁶ The general operations of state government are paid from "the General Fund," which consists of all monies not otherwise restricted. KRS 48.010(13)(a). Fees and assessments are "restricted as to purpose by statute." KRS 48.010(13)(f).

Appellees are well aware of the consequences of holding police power fees as "public funds." They state that because HBC funds are "restricted," they may be spent only on the restricted purpose up to the amount of the cost to regulate. (Brief at 22) That is wishful thinking. If this Court declares HBC fees to be "public funds," the legislature may henceforth easily suspend the "restriction" in KRS 198B.030(7) just as easily as it has already suspended the no lapse provision in that same statute.⁷

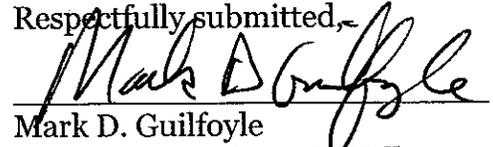
CONCLUSION

This case presents an opportunity to reconcile *Lockett*, *Armstrong*, and *Haydon Bridge*. *Armstrong* did not confront the *Lockett* line of cases and most certainly did not hold **expressly** that police power fees may be transferred to the General Fund. If the legislature wants to regulate industries through the imposition of revenue measures, it has Section 181 at its disposal. Once the choice is made to use police power fees, however, those funds are off limits to transfer under *Lockett* and *Haydon Bridge*.



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⁷ Justice Vance predicted "unfortunate consequences" in his *Armstrong* dissent flowing from the erosion of Section 51 by judicial interpretation. 709 S.W.2d at 453. *Armstrong* sanctioned transfers of hundreds and thousands of dollars. This case involves \$10 million. If this Court holds police power fees to be public funds, nothing could stop the legislature from entirely de-funding ("temporarily" of course) HBC, the Public Service Commission, or Fish and Wildlife, to name a few.

Appendix

1. Acts of the 1984 General Assembly, Part VIII, Fund Transfer (Transfers from 47 agency and special funds addressed in *Armstrong v. Collins*)