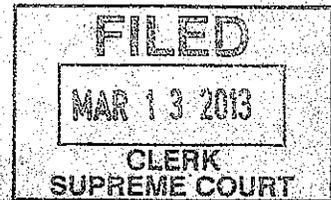


COMMONWEALTH OF KENTUCKY  
SUPREME COURT OF KENTUCKY  
2012-SC-000415-DG



THE KENTUCKY DEPARTMENT OF REVENUE,

APPELLANT

vs. APPEAL FROM THE KENTUCKY COURT OF APPEALS  
CIVIL ACTION NO. 11-CI-00164

THE FAMILY TRUST FOUNDATION OF KENTUCKY,  
INC. (D/B/A THE FAMILY FOUNDATION)

APPELLEE

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BRIEF FOR APPELLANT, THE KENTUCKY DEPARTMENT OF REVENUE

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Laura M. Ferguson  
Douglas M. Dowell  
Office of Legal Services for Revenue  
P.O. Box 423  
Frankfort, KY 40602-0423  
Telephone: (502) 564-3112

Jeff Mosley  
Finance and Administration Cabinet  
702 Capitol Avenue  
Frankfort, KY 40601  
Telephone: (502) 564-6660  
*Counsel for Appellant*

**CERTIFICATE OF SERVICE**

I do hereby certify that a copy of the foregoing Brief for Appellant, the Kentucky Department of Revenue was served via U.S. mail on the following: Stanton L. Cave, Esq., Law Office of Stan Cave, P.O. Box 910457, Lexington, KY 40591-0457, Counsel for the Family Trust Foundation of Kentucky, Inc. d/b/a The Family Foundation; Susan Bryson Speckert, Kentucky Horse Racing Commission, 4063 Ironworks Parkway, Building B, Lexington, KY 40511 and Peter F. Ervin, Public Protection Cabinet, 500 Mero Street, Capitol Plaza Tower, 5<sup>th</sup> Floor, Frankfort, KY 40601, Counsel for Kentucky Horse Racing Commission; William A. Hoskins, Esq., Jay Ingle, Esq., Jackson & Kelly PLLC, 175 East Main St., Ste 500, Lexington, KY 40507, Attorneys for Appalachian Racing, LLC, Lexington Trots Breeders Association, LLC, Kentucky Downs, LLC and Ellis Park Race Course, Inc.; William M. Lear, Jr., Shannon Bishop Arvin, Christopher L. Thacker, Stoll Keenon Ogden PLLC, 300 West Vine Street, Suite 2100, Lexington, KY 40507-1801, Counsel for Keeneland Association, Inc., Players Bluegrass Downs, Inc., and Turfway Park, LLC; Sheryl G. Snyder, Jason P. Renzelmann, Frost Brown Todd LLC, 400 West Market Street, 32<sup>nd</sup> Floor, Louisville, KY 40202, Counsel for Churchill Downs Incorporated; Hon. Thomas Wingate, Judge, Franklin Circuit Court, 669 Chamberlin Ave., Frankfort, KY 40601, and Sam Givens, Clerk, Kentucky Court of Appeals, 360 Democrat Drive, Frankfort, KY 40601 on this the 12<sup>th</sup> day of March, 2013.

  
Laura M. Ferguson

## INTRODUCTION

This is an agreed case pursuant to KRS 418.020 to determine whether certain regulations by the Kentucky Horse Racing Commission and the Department of Revenue regarding pari-mutuel wagering on historical horse races is a valid exercise of their regulatory powers and whether such pari-mutuel wagering contravenes the statutory prohibitions on gambling contained in Chapter 528 of the Kentucky Revised Statutes.

**STATEMENT CONCERNING ORAL ARGUMENT**

The Department believes that oral argument would be helpful in assisting this Court with the legal issues in this case.

**STATEMENT OF POINTS AND AUTHORITIES**

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## STATEMENT OF THE CASE

The Department of Revenue (“the Department”) limits its Statement of the Case to the facts that concern the Department, and presumes that the Kentucky Horse Racing Commission (the “Commission”) and the race track associations can speak for themselves with respect to the portions of the Statement of the Case that concern them.

In 2009, with the horse racing industry in a state of economic decline, Senator Damon Thayer asked the Kentucky Attorney General to issue an opinion regarding the legality of Instant Racing, which is one form of pari-mutuel wagering on historical horse races. On January 5, 2010, the office of the Attorney General issued Ky. OAG 10-001 (the “AG Opinion”) in which it opined that “[W]e do not find that pari-mutuel wagering [on historical horse races] is prohibited by Kentucky’s Horse Racing and Showing Act (KRS 230).”<sup>1</sup> Rather, the AG Opinion concluded that the current regulatory scheme did not provide that wagering on historical horse racing was pari-mutuel wagering.

In response to the AG Opinion, on July 20, 2010, the Commission approved new and amended administrative regulations authorizing licensed race track associations to offer pari-mutuel wagering on historical horse races (the “Commission Regulations”).<sup>2</sup> On the same day, the Department amended Revenue Form 73A100, “Race Track Pari-Mutuel and Admissions Report” (the “Form”) to specify that tracks offering such wagering were subject to the pari-mutuel excise tax set forth in KRS 138.510(1). R. 191-92. On August 12, 2010, the Department filed an amendment to 103 KAR 3:050, the

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<sup>1</sup> Ky, OAG 10-001, p. 7; Circuit Court Record at p. 24 (hereinafter, the “R. \_\_\_”).

<sup>2</sup> 810 KAR 1:001, §1(32). The Commission adopted three sets of regulations – one for thoroughbreds, one for standardbreds, and one for quarterhorse, appaloosa and Arabian breeds. While each set contains certain unique provisions relative to that particular breed, each set contains identical salient provisions regarding the pari-mutuel wagering on historical horse racing. For ease of reference, this Brief cites only the thoroughbred regulations. The Commission Regulations completed the administrative review process and went into effect on July 1, 2011.

Miscellaneous Taxes Forms Regulation (the “Revenue Regulation,” and collectively with the Commission Regulations, the “Regulations”), which incorporated the Form by reference.<sup>3</sup>

Also on July 20, 2010, the Department, along with the Commission and eight race track associations, filed a Petition for Declaration of Rights pursuant to KRS 418.020 (the “Petition”), which asked the Franklin Circuit Court (the “Circuit Court”) for an advance determination of three issues:

1. Whether the filing of administrative regulations authorizing pari-mutuel wagering on historical horse races is a valid and lawful exercise of the Commission’s statutory authority to regulate pari-mutuel wagering on horse racing;
2. Whether the licensed operation of pari-mutuel wagering on historical horse races, as authorized by the above-referenced administrative regulations, contravenes the statutory prohibitions on gambling contained in Chapter 528 of the Kentucky Revised Statutes; and
3. Whether the Department of Revenue’s determination that revenue generated by pari-mutuel wagering on historical horse races is subject to the pari-mutuel tax, as set forth in KRS 138.510 was a valid and lawful exercise of its statutory authority to interpret and enforce the tax laws of the Commonwealth.<sup>4</sup>

On July 26, 2010, the Circuit Court found that the Petition presented a ripe and justiciable controversy and ordered briefing on the merits.<sup>5</sup> Shortly thereafter, the Family Trust Foundation of Kentucky, Inc. (d/b/a The Family Foundation) (“Appellee”) moved to intervene, which was unopposed. The Circuit Court granted the motion to intervene<sup>6</sup>, but recognizing that the Petition did not present any issues necessitating discovery, denied Appellee’s motion for discovery, holding that:

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<sup>3</sup> The Revenue Regulation was originally promulgated, and now amended, pursuant to KRS 131.130(3), which authorizes the Department to “prescribe forms necessary for the administration of any revenue law by the promulgation of an administrative regulation pursuant to KRS Chapter 13A incorporating the forms by reference.” The Revenue Regulations completed the administrative review process and went into effect on July 1, 2011.

<sup>4</sup> Petition, pp. 5, 6; R. 5, 6.

<sup>5</sup> Order Scheduling Briefing; R. 193-197. The Order is attached as Tab 2 to the Appendix.

[W]hile we allowed the Family Foundation to intervene in this case, its intervention does not change the fundamental nature of this case, nor should the intervention broaden the scope of our inquiry beyond the legal questions presented by Petitioners. Due to the nature of an agreed case and the fact that the questions are legal, not factual, the Court declines to allow discovery at this juncture.<sup>7</sup>

After the issues were fully briefed, the Circuit Court heard oral argument on December 14, 2010, and later granted the Petition by its Opinion and Order of December 29, 2010 (“Opinion and Order”). R. 793-810. The Circuit Court emphasized that the questions presented concerned only the Regulations themselves, not any particular game:

While the term “Instant Racing” was used in the AG Opinion and has been used at times in this case, including by the Court, this Opinion and Order addresses the legality of pari-mutuel wagering on “historical horse races” as set forth in the Regulations promulgated by the Commission and no on any particular game or scheme.<sup>8</sup>

Accordingly, the Circuit Court focused its review on the construction of the Commission’s and the Department’s statutory authority and the facial validity of the Regulations themselves: “In addressing the validity of a regulation with respect to its governing statute, the court must determine whether the regulations are consistent with the policy set forth in the enabling legislation.”<sup>9</sup> The Circuit Court concluded that the Regulations were within the scope of both the Commission’s and the Department’s statutory authority.<sup>10</sup> Appellee filed its notice of appeal on January 20, 2011.<sup>11</sup>

At the Court of Appeals, in its Brief, Appellee referred to matters that occurred after the Opinion and Order was entered and were not in the record in support of its

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<sup>6</sup> Order Granting Family Foundation’s Motion for Leave to Intervene; R. 476-478.

<sup>7</sup> Order; R. 599-601.

<sup>8</sup> Opinion and Order, p. 2, n.2; R. 793-810. The Opinion and Order is attached as Tab 3 to the Appendix.

<sup>9</sup> Opinion and Order, p. 4; R. 796.

<sup>10</sup> Opinion and Order, p. 14, 16-17; R. 806, 808-809.

<sup>11</sup> Notice of Appeal by the Family Trust Foundation of Kentucky, Inc. d/b/a The Family Foundation; R. 811-840.

contention that discovery was warranted with respect to the electronic gaming machines being used by the tracks. Brief of the Appellant, pp. 2-3, Exhibit E.

The Court of Appeals, in its majority opinion rendered on June 15, 2012 (“Opinion”), essentially agreed that the Circuit Court “. . . acted within its jurisdiction in deciding the issues presented in the petition for declaratory rights.” Opinion, p. 7.<sup>12</sup> The Court of Appeals then shifted gears and ruled on an issue not in the Petition, holding that the “parties had a right to develop proof and to present evidence to establish that the wagers made by patrons at electronic gaming machines do or do not meet the definition of pari-mutuel wagering on a horse race.” Opinion, p. 10. The Court of Appeals then concluded that the denial of discovery on this issue constituted abuse of discretion. Id., pp. 10-11. However, this issue was not before either the Circuit Court or the Court of Appeals, as the issues on appeal were the Commission’s authority to promulgate regulations classifying wagers on historical horse racing as pari-mutuel wagers and the Department’s authority to promulgate regulations taxing pari-mutuel wagers on historical horse racing, not whether a particular device should be approved pursuant to those regulations. The majority opinion failed to address this point. On the other hand, Judge Combs, in her dissent, noted that:

However, I agree with the trial court that all issues before it were purely legal issues precluding the need for - - or recourse to - - discovery. Therefore, I file this dissent.

Opinion and Order, pp. 11-12 (Combs, J., dissenting). Judge Combs further noted the Appellee’s various arguments regarding instant racing were not before the Court of Appeals and held that, “[n]onetheless, the narrow legal issue remains: did the Racing Commission act within the scope of its broad delegation of authority by the General

Assembly pursuant to KRS 230.215(2) . . .” Id. The Department filed a Motion for Discretionary Review on July 18, 2012 (“Motion for Discretionary Review”), which was granted by this Court on January 11, 2013.

### ARGUMENT

This brief only addresses the issues in this case to the extent they apply to the Department’s interpretation that KRS 138.510(1) applies to pari-mutuel wagering on historical horse races.

#### **I. THE CIRCUIT COURT PROPERLY HELD THAT THE ISSUES IN THIS CASE WERE PURELY LEGAL ISSUES AND DISCOVERY WAS NOT WARRANTED.<sup>13</sup>**

The only issues addressed in the Circuit Court’s order were the three purely legal issues set forth in the Petition. Two of the issues involved the validity of the Regulations, which required the Court to look no further than the four corners of those documents. The validity of administrative regulations is a matter of statutory interpretation concerning the scope of agency authority. Kentucky Pub. Serv. Comm’n v. Commonwealth ex rel. Conway, 324 S.W.3d 373, 376 (Ky. 2010). As a result, discovery related to the nature of the terminals used to place wagers on historical horse races that may or may not be approved at a later date after the regulations are in full force and effect is both irrelevant to that issue and unlikely to lead to any admissible evidence pertaining to that issue. The third issue is whether the Commission Regulations ran afoul of KRS Chapter 528, and again, any discovery relating to a terminal that may or may not be approved is both irrelevant to that issue and unlikely to lead to any admissible evidence pertaining to that third issue. Discovery that neither relates to the issues raised in the

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<sup>12</sup> The Opinion is attached as Tab 1 to the Appendix.

<sup>13</sup> This issue was preserved for review on pages 6-8 of the Brief of the Appellee, Kentucky Department of Revenue, filed October 21, 2011; and on pages 7-10 in the Motion for Discretionary Review.

pleadings, nor is reasonably calculated to lead to the discovery of admissible evidence is not allowed. Carpenter v. Wells, 358 S.W.2d 524 (Ky. 1962). The majority opinion below did not address the fact that the discovery sought did not pertain to any of these legal issues. The dissent, however, correctly concluded that these were purely legal issues, and therefore no discovery was warranted.

Similarly, the Appellee's request for discovery regarding the process and manner by which the Regulations were formulated is also irrelevant to the legal questions in this case. "It is firmly settled that the courts will not inquire into the motives which impel or the expediency or wisdom of legislative or administrative action, for that does not affect its legality or validity." Louisville & Jefferson County Metro. Sewer Dist. v. Joseph E. Seagram & Sons, Inc., 307 Ky. 413, 211 S.W.2d 122, 125 (1948). See also, United States v. O'Brien, 391 U.S. 367, 382-84 (1968); Moore v. Ward, 377 S.W.2d 881, 883, 885 (Ky. 1964). Similarly, a California appellate court held that "Respondents' contention that the regulations promulgated by the state commission are not authorized raises a legal question . . . There is no need for discovery with respect to this contention." Trancentury Properties, Inc. v. State of California, 41 Ca. App. 3d 835, 842, 116 Cal. Rptr. 487, 491 (Cal. App. 1974) (emphasis supplied). The Circuit Court correctly denied discovery in this case, and there is no reversible error resulting from that denial. As a result, discovery was not warranted on this issue, and the Court of Appeals' decision to remand this case for discovery should be reversed.

Moreover, this case is an agreed case pursuant to KRS 418.020. The very nature of an agreed case implies that discovery is unnecessary. As the statute provides:

Parties to a question which might be the subject of a civil action may, without action, state the question and the facts upon which it depends, and

present a submission thereof to any court which would have jurisdiction if an action had been brought.

KRS 418.020. (emphasis supplied) As stated above, the questions presented in this case did not include whether a particular machine or device satisfied the Commission Regulations, only the validity of the Regulations themselves, which involve purely legal issues. While the Appellee intervened in this case, the intervention did not change the legal issues before the Circuit Court. The scope of the Petition remained the same.

Given the nature of this case, an agreed case pursuant to KRS 418.020, and that the issues presented were strictly legal in nature, the Circuit Court did not exceed its broad power or abuse its discretion in declining to allow the Appellee to pursue discovery into matter that were irrelevant and had no bearing on the issues before the Circuit Court. Armstrong v. Biggs, 302 S.W.2d 565, 568-69 (Ky. 1957). The purpose of KRS 418.020 is to provide a streamlined process by which legal issues may be decided. The Court of Appeals erred as a matter of law in concluding that discovery was warranted in this case.

**II. THE CIRCUIT COURT CORRECTLY HELD THAT THE DEPARTMENT MAY TAX PARI-MUTUEL WAGERING ON HISTORICAL HORSE RACING.<sup>14</sup>**

The majority opinion of the Court of Appeals did not address this issue since it had already, and erroneously, held the case should be remanded for further discovery, as discussed in Section I, above.<sup>15</sup> The Circuit Court held that KRS 138.510 is a statute concerning wagering, and the terms used therein must be construed in light of that

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<sup>14</sup> This issue was preserved for review on pp. 4-6 of the Brief of the Appellee, Kentucky Department of Revenue, filed October 21, 2011; and on p. 10 in the Motion for Discretionary Review.

<sup>15</sup> The dissenting opinion held that the Department could not tax pari-mutuel wagering on historical horse racing, focusing on (i) broadcasting and (ii) the Commission Regulations' use of the terms live races and historical horse races in reaching this conclusion. However, broadcasting is not a term used anywhere in the Regulations or the governing statutes for the Regulations, and other forms of live racing, such as simulcasting, are also broadcast. The correct focus of KRS 138.510 is on wagering, not broadcasting, and no one has argued at any point in this case that the language in the Commission Regulations prevents the taxation of pari-mutuel wagering on historical horse racing pursuant to KRS 138.510.

particular context. See, Opinion and Order, p. 16. The Circuit Court was correct in this approach, as a statute must be “read as a whole and in context with other parts of the law” and “any language in the act is to be read in light of the whole act.” Petitioner F v. Brown, 306 S.W.3d 80, 85-86 (Ky. 2010). See also, Maynes v. Commonwealth, 361 S.W.3d 922, 924 (Ky. 2012) (“We presume that the General Assembly intended for the statute to be construed as a whole, for all of its parts to have meaning, and for it to harmonize with related statutes.”) From the perspective of a wagerer, a historic horse race is very much “live” – the wagerer does not know the outcome of the historical horse race in advance of wagering on the race any more than a wagerer at a track knows the outcome of a race physically conducted at that track. The Circuit Court correctly held that in this instance, the patron was still engaged in pari-mutuel wagering on the contingent outcome of an event that was effectively “live”, and therefore, the Department had authority to tax pari-mutuel wagering on historical horse racing pursuant to KRS 138.510.

Such a holding is also consistent with the structure and definitional provisions of KRS 138.510(1) and KRS 138.511(3). The term “live races” is not defined in either KRS Chapters 138 or 230. However, the term “daily average live handle” is defined in KRS 138.511(3), which applies to KRS 138.510 through KRS 138.550. Specifically, KRS 138.511(3) provides:

“Daily average live handle” means the total wagered at a track on live racing and does not include money wagered:

- (a) At a receiving track;
- (b) At a simulcast facility;
- (c) On telephone account wagering;
- (d) Through advance deposit wagering<sup>16</sup>; or
- (e) At a track participating as a receiving track or simulcasting facility

<sup>16</sup> See KRS 230.210(19), (20). The term “track” is defined in KRS 230.210(9).

displaying simulcasts and conducting interstate wagering as permitted by KRS 230.3771 and 230.3773.

Pursuant to this statute, all pari-mutuel wagers are amounts wagered at a track on live racing. Certain types of wagers are then backed out of the calculation pursuant to paragraphs (a) through (e) of the KRS 138.511(3).<sup>17</sup>

The phrase “wagered at a track on live racing” as used in KRS 138.511(3) to define daily average live handle must include more than races physically held at the track where the pari-mutuel wager is being placed. To construe it otherwise would render paragraphs (a) through (e) meaningless. “And, it is axiomatic that, when interpreting a provision of a statute, a court should not, if possible, adopt a construction that renders a provision meaningless or ineffectual . . . .” Schoenbachler v. Minyard, 110 S.W.3d 776, 783 (Ky. 2003), citing Brooks v. Meyers, 279 S.W.2d 764, 766 (Ky. 1955); see also Combs v. Hubb Coal Corp., 934 S.W.2d 250, 252 (Ky. 1996). Rather the definition of “daily average live handle” establishes that the phrase “wagered at a track on live racing” includes all forms of pari-mutuel wagering at a track, unless statutorily excepted. As a result, the Circuit Court properly upheld the Department’s interpretation.

In addition, an administrative agency’s interpretation of a statute that it is charged with implementing is entitled to substantial deference under Kentucky law. As long as the agency’s interpretation is in “the form of an adopted regulation or formal adjudication,” Bd. of Trustees of the Judicial Form Ret. Sys. v. Att’y Gen., 132 S.W.3d 770, 787 (Ky. 2003), Kentucky courts review it pursuant to the doctrine established in Chevron U.S.A., Inc. v. Natural Res. Def. Council Inc., 467 U.S. 837 (1984). See

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<sup>17</sup> Some of the types of pari-mutuel wagering which are backed out pursuant to paragraphs (a) through (e) of KRS 138.511(3) are expressly made subject to the excise tax imposed by KRS 138.510(2). Wagering on historical horse races is not made expressly subject to this excise tax.

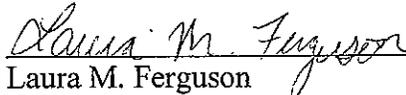
Kentucky Pub. Serv. Comm'n v. Commonwealth ex rel. Conway, 324 S.W.3d 373, 376 (Ky. 2010) (deference is afforded to an administrative agency's interpretation of the statutes and rules it implements); Louisville/Jefferson County Metro Gov't v. TDC Group, LLC, 283 S.W.3d 657, 661 (Ky. 2009).

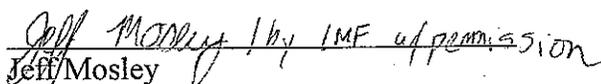
The Department is statutorily charged with "exercis[ing] all administrative functions of the state in relation to the state revenue and tax laws," KRS 131.030(1), and its duties include "advis[ing] on all questions respecting the construction of state revenue laws and the application thereof to various classes of taxpayers and property." KRS 131.130(4). It is specifically responsible for "enforc[ing] the provisions of and collect[ing] the [pari-mutuel] tax . . . required by KRS 138.510." KRS 138.530. The Circuit Court correctly found that the Department's interpretation was a reasonable one, and that holding should be affirmed.

### CONCLUSION

WHEREFORE, for the reasons previously stated, the Department respectfully requests that this Court REVERSE the Opinion of the Court of Appeals and AFFIRM the Order of the Circuit Court.

Respectfully submitted,

  
\_\_\_\_\_  
Laura M. Ferguson  
Douglas M. Dowell  
Office of Legal Services for Revenue  
P.O. Box 423  
Frankfort, KY 40602-0423  
Telephone: (502) 564-3112  
and

  
\_\_\_\_\_  
Jeff Mosley  
Finance and Administration Cabinet

702 Capitol Ave., Room 392  
Frankfort, KY 40601  
COUNSEL FOR APPELLANT,  
KENTUCKY DEPARTMENT OF  
REVENUE

## APPENDIX

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