

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, APPELLEE
INC. (D/B/A THE FAMILY FOUNDATION)

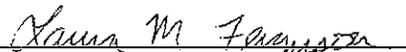
REPLY BRIEF FOR APPELLANT, KENTUCKY DEPARTMENT OF REVENUE

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CERTIFICATE OF SERVICE

I do hereby certify that a copy of the foregoing Reply 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, 5th 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, 32nd 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 24th day of May, 2013.


Laura M. Ferguson

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ARGUMENT

As an introductory matter, the Response Brief filed by Appellee also addresses issues in two related appeals (2012-SC-000414, 2012-SC-000416), that do not apply to this appeal, and is identical to the Response Briefs filed in those related cases. This reply brief only addresses the issues in the Response Brief that apply to this appeal, namely, the discovery issue and the Department's interpretation that KRS 138.510(1) applies to pari-mutuel wagering on historical horse races.

I. APPELLEE FAILED TO FILE A CROSS-MOTION FOR JUDICIAL REVIEW OF THE ORDER AND IS BARRED FROM REVISITING ISSUES DECIDED AGAINST IT.

In its Response Brief, Appellee attempts to revisit certain holdings that were made against it by the Court of Appeals. However, as this Court has repeatedly held, because the Appellee failed to file a cross-motion for discretionary review, it is barred from revisiting those issues here. Coleman v. Bee Line Courier Service, Inc., 284 S.W.3d 123, 128-29 (Ky. 2009); Lopez v. Commonwealth, 173 S.W.3d 905, 906 (Ky. 2005); Stringer v. Realty Unlimited, Inc., 97 S.W.3d 446, 448 (Ky. 2002); Stevens v. Stevens, 798 S.W.2d 136, 139 (Ky. 1990). The Court of Appeals specifically rejected Appellee's contention that there was no justiciable controversy in this case, holding that:

In this case, we are persuaded that it was acceptable for the lower court to entertain and to adjudicate the petition for declaratory rights. The racing associations were rightfully concerned about criminal consequences for themselves and their patrons (members of the general public) if historic racing were successfully challenged and determined to be illegal. This Court and the Supreme Court of Kentucky have both held that criminal safeguards are appropriate subject matter for the declaration of rights pursuant to KRS 418.020. See Hammond v. Smith, 930 S.W.2d 408 (Ky. App. 1996); Chambers v. Stengel, 37 S.W.3d 741 (Ky. 2001). The concern of the legitimacy is both immediate and prominent, thus satisfying the McConnell criteria. Additionally, the regulations have been enacted, and several racetracks have already implemented historic racing. The taxation at issue is occurring contemporaneously with this litigation and

appeal.

In addition to relying on the sound reasoning of McConnell, we also conclude that judicial review was proper under Legislative Research Comm'n v. Brown, 664 S.W.2d 907 (Ky. 1984) (the LRC case).

Opinion, p. 6. As a result, to the extent the Appellee wishes to revisit issues pertaining to justiciability and whether the criteria of KR 418.020 was met, such as whether (i) there are "immediate and prominent issues of public concern," (ii) there is exposure to criminal liability, or (iii) Appellee's intervention took this case outside of KRS 418.020¹, the Appellee was required to file a cross-motion for discretionary review. Having failed to do so, the Appellee is barred from reviving these issues in its Response Brief.

Similarly, to the extent the Appellee wishes to take discovery relating to issues it failed to preserve for review, such discovery should be barred as well.

Finally, the Appellee attempts to challenge the constitutionality of KRS 418.020. Response Brief, pp. 20, 26, fn. 9. However, the Appellee never challenged the constitutionality at either Circuit Court or the Court of Appeals, and never complied with CR 24.03 and KRS 418.075, which require notice to the Attorney General of such a challenge. This ". . . notification requirement is mandatory and should be strictly enforced." Homestead Nursing Home v. Parker, 86 S.W.3d 424, 425, fn. 1 (Ky. App. 1999), citing Maney v. Mary Chiles Hosp., 785 S.W.2d 480 (Ky. 1990). As a result, this question is also not before this Court.

II. THE CIRCUIT COURT PROPERLY HELD THAT THE ISSUES IN THIS CASE WERE PURELY LEGAL ISSUES AND DISCOVERY WAS NOT WARRANTED.

Once again, the Appellee tries to blur the line between issues that were before the Circuit Court, and issues that were not. There were only three issues before the Circuit

¹ Response Brief, pp. 24-29.

Court, two of which involved the validity of the Regulations, which required the Court to look no further than the four corners of those documents. The facial 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.

The Appellee also repeatedly makes blanket statements that it was entitled to discovery. But that right is not without limits. The Civil Rules “afford a trial court broad power to control discovery,” and a litigant is not “deprived of any meaningful ‘right to discovery’” when “[n]one of the factual information sought would affect the disposition of the case.” Ray v. Stone, 952 S.W.2d 220, 223 (Ky. App. 1997).

The Appellee’s complaint about a denial of discovery concentrates on two areas. Its first focus is on the devices that may or may not be approved at a later date. The appropriate time to challenge whether such devices should have been approved pursuant to the Commission Regulations is after they were approved by the Commission in a separate action; something the Appellee did not, and has not, done. Even if it had made such a challenge, that would be a separate case, and not part of this action. It is important to note that no device was approved until after the Circuit Court issued its decision, so in

terms of timing, it simply was not possible for that issue to be part of this case. As a result, the Court of Appeals' ruling that "...the parties had a right to develop proof and to present evidence to establish wagers made by patrons at electronic gaming machines do or do not meet the definition of pari-mutuel wagering on a horse race[.]" was misplaced. Opinion, p. 9. The discovery ordered by the Court of Appeals focuses on what the devices do, which is not part of this case, rather than the facial validity of the underlying Regulations, and as a result, the Opinion should be reversed with respect to this issue.

Second, the Appellee wishes to delve into the motives behind the promulgation of the Regulations. The majority of the so-called "facts" in dispute pertain to the two related appeals (with the Commission and the Race Tracks), and not to this case. With respect to the Department, the only "fact" that Appellee contends is in dispute is Paragraph 19 of the Joint Petition, which "alleges that instant racing may 'generate additional revenue.'" Response Brief, p. 24. How much revenue the tax may or may not generate has absolutely no bearing on the issue before the Circuit Court, which was whether the Revenue Regulation was validly promulgated. Again, the motives or wisdom behind the Regulations is neither relevant nor subject to discovery. Louisville & Jefferson County Metro. Sewer Dist. v. Joseph E. Seagram & Sons, Inc., 307 Ky. 413, 211 S.W.2d 122, 125 (1948) ("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"). The Circuit Court correctly decided that these were purely legal issues that did not warrant discovery, and did not abuse its discretion in reaching these conclusions.

The Appellee also makes much of a statement made in another brief, regarding

the Race Tracks' argument that "This case has never been an 'as applied' case . . ." and asserts (i) that this argument is frivolous, and (ii) that all of the Appellants, including the Department and the Racing Commission have somehow conceded something. Response Brief, p. 27. However, the Appellee has once again blurred the lines between the validity of the Regulations and the application of the Regulations to the approval of specific games, which are two separate and distinct issues. What was actually said was:

. . . the Foundation tried to change the question in this case from whether the Regulations as adopted by the Commission are valid, to an entirely different question that was never before the Franklin Circuit Court of whether the Regulations *as applied* in the approval of specific games at Kentucky Downs are consistent with the statutes.

Without acknowledging the distinction between these two questions, the majority of the Court of Appeals appears to have accepted the Foundation's reformulation of the case as an "as applied" challenge to the Regulations. This case has never been an "as applied" challenge to the Regulations. Nor could it be. At the time the case was filed, and at the time the Circuit Court rendered its Opinion, no Association had sought approval for wagering on historical horse races. Thus, the Regulations had not yet been applied. The only question before the Circuit Court was whether the Regulations were valid on their face.

Race Tracks Appellate Brief, pp. 8-9. 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 facial 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 the Circuit Court abused its discretion and holding discovery was warranted in this case.²

III. APPELLEE'S ARGUMENTS REGARDING AGENCY DEFERENCE ARE MISPLACED.

The Appellee erroneously states that agency deference does not apply because the agencies do not know if their actions are legal. The Department has asserted, and continues to assert, that it has properly acted through the promulgation of the Revenue Regulation. The Department joined the Race Tracks and the Commission in this action, as it was necessary in order to ensure that the commitment of resources by the Race Tracks to implement the Regulations would not be wasted, and that if the costly steps for implementation were taken, the benefits to the industry and the Commonwealth would in fact be realized.

Further, Appellee takes the quote "Nor does Chevron deference extend to an interpretation taken solely in connection with an agency's litigating position in a particular case or set of cases[.]" out of context. The Mid-America Court was addressing

² The Appellee also argues that summary/declaratory judgment was premature because discovery was not complete. Response Brief, p. 29-30. However, if the Circuit Court properly denied discovery, then this argument is moot.

a situation where an agency, in lieu of promulgating a regulation, takes a position solely through litigation. Mid-America Care Found. v. National Labor Relations Bd., 148 F.3d 638, 643 (6th Cir. 1998). Here, the Revenue Regulation was promulgated, and Chevron does apply. Bd. of Trustees of the Judicial Form Ret. Sys. v. Att’y Gen., 132 S.W.3d 770, 787 (Ky. 2003). The United States Supreme Court has recently re-affirmed that “. . . we have consistently held ‘that Chevron applies to cases in which an agency adopts a construction of a jurisdictional provision of a statute it administers.’ 1 R. Pierce, Administrative Law Treatise §3.5, p. 187 (2010).” City of Arlington v. Federal Commc’ns Comm’n, 569 U.S. ___, 2013 WL 2149789 (May 20, 2013).

Finally, the Homestead case cited by the Appellee on page 49 of its Response Brief also does not apply to the issue before this Court. The Homestead Court addressed the deference in the context of what standard to apply to its review of appellate decisions issued by the Workers Compensation Board, not deference in the context of administrative regulations. Homestead, 86 S.W.3d at 426. For all of these reasons, Appellee’s arguments against the application of Chevron are misplaced and should be rejected.

IV. THE CIRCUIT COURT CORRECTLY HELD THAT THE DEPARTMENT MAY TAX PARI-MUTUEL WAGERING ON HISTORICAL HORSE RACING.

In its Response Brief, the Appellee argues that (i) a subjective standard applied, and (ii) that the review of the Circuit Court was limited to KRS 138.510(1), and because of that, the Department does not have authority to promulgate the Revenue Regulation. Neither argument does anything to show that the Circuit Court erred by ruling in the Department’s favor and the Circuit Court’s ruling on this issue should be affirmed.

KRS 138.510(1), not KRS 138.511(3) is the statute which imposes the tax. However, that does not mean that the statute is looked at in isolation. Brown v. Revenue, 558 S.W.2d 635, 638 (Ky. App. 1977). KRS 138.511 is entitled “Definitions for KRS 138.510 to KRS 138.550.” (emphasis supplied) Therefore, it is entirely appropriate to look to KRS 138.511 in interpreting KRS 138.510, and that discussion is contained in greater detail in the Department’s Brief at pages 7-9. If this Court were to adopt Appellee’s argument, it would be impermissible to look at any related statutes, any caselaw, any rules of statutory construction or anything else in determining whether authority existed under a particular statute, which defies belief.

Appellee has also taken the word “subjective” out of context. It should also be noted that Appellee has used this same argument to support its position that wagering on historical horse races cannot constitute pari-mutuel wagering, and to the extent that argument fails in the pari-mutuel context, it must also fail here³. The Circuit Court correctly held that KRS 138.510 is a statute concerning wagering, and the terms used therein must be construed in light of that particular context. The Department referred to the perspective of the wagerer to establish that in this instance, just as in other pari-mutuel wagering, the wagerer does not know the outcome in advance of wagering on the historical horse race any more than a wagerer at a track knows the outcome of a race physically conducted at the track, and therefore, in both cases, the patron is wagering on a contingent outcome of an event that was effectively live. Appellee’s dismissive reference to delusional bettors does nothing to change that, nor does it do anything to show that the Circuit Court incorrectly decided this issue.

³ Response Brief, pp. 45-46.

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,

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