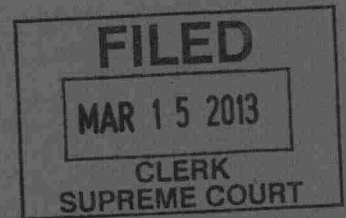


SUPREME COURT OF KENTUCKY
FILE NO.: 2012-SC-000416-DG



KENTUCKY HORSE RACING COMMISSION

APPELLANTS

v.

THE FAMILY TRUST FOUNDATION OF
KENTUCKY, INC., d/b/a THE FAMILY
FOUNDATION, ET AL.

APPELLEES


BRIEF FOR KENTUCKY HORSE RACING COMMISSION

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I hereby certify that a true and accurate copy of the foregoing 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; Laura M. Ferguson, Esq., and Douglas M. Dowell, Esq., Office of Legal Services for Revenue, P.O. Box 423, Frankfort, KY 40601-0423, and E. Jeffrey Mosley, Esq., Finance and Administration Cabinet, 702 Capitol Avenue, Rm 392, Frankfort, KY 40601, Counsel for Kentucky Department of Revenue; 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 and Kentucky Downs, LLC; 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 and Ellis Park Race Course, Inc.; 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 14 day of March, 2013.


Peter F. Ervin

INTRODUCTION

This is an appeal from an Opinion of the Court of Appeals which vacated the trial court's findings on a question of law regarding the legality of regulations of the Kentucky Horse Racing Commission in order that the action may be remanded for discovery.

STATEMENT CONCERNING ORAL ARGUMENT

The Kentucky Horse Racing Commission requests that the Court conduct oral arguments in order that the exchange between the Court and counsel may better flesh out the positions of the parties.

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STATEMENT OF THE CASE

Case Summary:

The Kentucky Horse Racing Commission ("Commission") has the express statutory duty to foster and encourage pari-mutuel wagering on horse racing in Kentucky. The General Assembly unequivocally granted the Commission plenary regulatory power so that it can fulfill its statutory mandate. Consistent with that mandate, the Commission adopted regulations authorizing wagering on historical horse races. Historical horse races are replays of previously run horse races that meet specifically defined regulatory criteria. Whether the wagering is on the replay or on the race when it was originally run, the governing regulations require that all such wagering be (1) pari-mutuel and (2) contingent on the outcome of a horse race.

In the action before the Franklin Circuit Court, the Commission and other Appellants¹ sought the trial court's judgment as to whether the regulations were a valid exercise of the Commission's statutory authority.² Appellee, Family Trust Foundation of Kentucky, Inc. ("Foundation") was permitted to intervene to assert a challenge to the legality of these regulations.³ Instead, the Foundation attempted to obfuscate the purely legal question by demanding discovery that is irrelevant and immaterial to the underlying declaratory action. The trial court, not misled by the Foundation's efforts to confuse the issues, affirmed the legality of the regulations.

¹ Together with the Commission and the Kentucky Department of Revenue, Appellants include all licensed race tracks in the Commonwealth: Appalachian Racing, LLC; Churchill Downs Incorporated; Ellis Park Race Course, Inc.; Keeneland Association, Inc.; Kentucky Downs, LLC; Lexington Trots Breeders Association, LLC; Players Bluegrass Downs, Inc.; and Turfway Park, LLC.

² Petition for Declaration of Rights (the "Petition"); Franklin Circuit Court Record, pp. 1-192 (hereinafter R., ____).

³ Order Granting Family Foundation's Motion for Leave to Intervene; R., 476-478.

The Court of Appeals fell prey to the Foundation's tactics and confused the issues. In a 2-1 decision, the majority of the court did not address the legality of the regulations at all. Rather, it focused on a question raised by the Foundation that is not at issue in this proceeding: whether a particular form of wagering on historical horse racing, *Instant Racing*⁴ complies with the Regulations. In order to answer that irrelevant question, the majority vacated the trial court's Opinion and remanded the case to conduct discovery on the *Instant Racing* machines currently operating at two licensed Kentucky race tracks.⁵

In contrast, Judge Combs was not persuaded by the Foundation's effort to change the subject of the case. She observed that, "Family Foundation has made excellent and persuasive arguments about virtually every aspect of instant racing. Nonetheless, the narrow issue remains: did the Racing Commission act within the scope of its broad delegation of authority"⁶ Judge Combs correctly concluded: "all issues before [the Court] were purely legal issues precluding the need for—or recourse to—discovery"⁷ and "historic [horse] races clearly fall within the scope and rules of pari-mutuel betting."⁸

The circuit court and Judge Combs are correct. The Petition presents pure questions of law for which no discovery is required. Intervention by the Foundation did nothing to alter this fact. Because the case presents only questions of law, remand to the Court of Appeals is unnecessary and this Court may decide those questions now.⁹

⁴ Instant Racing is a patented form of historical horse racing.

⁵ At its July 14, 2011 meeting, the Commission approved Kentucky Downs' application to offer Instant Racing. The Commission approved Ellis Park's application to offer Instant Racing at its October 24, 2011 meeting. As part of the approval process in both cases, the Commission approved AmTote to provide the totalizator services for the Instant Racing Machines.

⁶ Court of Appeals Opinion Vacating and Remanding, Appendix 1, p. 11-12.

⁷ *Id.*

⁸ *Id.* at p. 17.

⁹ *Cumberland Valley Contractors, Inc. v. Bell County Coal Corp.*, 238 S.W.3d 644, 647 (Ky. 2007)

Because the Regulations are in full accord with the Commission's express statutory authority to regulate horse racing and pari-mutuel wagering thereon, the Court of Appeals should be reversed and the Franklin Circuit Court affirmed.

Facts and procedural history.

KRS Chapter 230 sets forth the Commission's plenary authority over horse racing and pari-mutuel wagering. The General Assembly articulated the broad statutory purpose underlying KRS Chapter 230 in KRS 230.215(1), which states,

[I]t is hereby declared the intent of the Commonwealth to foster and to encourage the horse breeding industry within the Commonwealth ... [and] to foster and to encourage the business of legitimate horse racing with pari-mutuel wagering thereon in the Commonwealth on the highest possible plane.

KRS 230.215(2) further vests the Commission with:

... forceful control of horse racing in the Commonwealth with plenary power to promulgate administrative regulations prescribing conditions under which all legitimate horse racing and wagering thereon is conducted in the Commonwealth so as to encourage the improvement of the breeds of horses in the Commonwealth [and] to regulate and maintain horse racing ... in the Commonwealth of the highest quality....

To ensure the Commission can fulfill this sweeping legislative mandate, the General Assembly charged the Commission with the express responsibility to "regulate the conduct of horse racing and pari-mutuel wagering on horse racing...."¹⁰ KRS 230.260 further grants the Commission jurisdiction over all facets of the horse racing industry, including horse race meetings, training centers, advanced deposit wagering entities, totalizator companies, and equine medical manufacturers and retailers. KRS 230.361 requires the Commission to, "promulgate administrative regulations governing

¹⁰ KRS 230.225(1).

and regulating mutuel wagering on horse races under what is known as the pari-mutuel system of wagering.”

There are only limited parameters on the Commission’s power to regulate pari-mutuel wagering on horse races. For example, pari-mutuel wagering can only be conducted by a person licensed under KRS Chapter 230 to conduct a race meeting and only upon the licensed premises; pari-mutuel wagering must be conducted through a totalizator or other mechanical equipment approved by the Commission¹¹, but the Commission may not require that any particular make of equipment be used.¹² Beyond these few express requirements, however, the legislature has entrusted the Commission with the power and the discretion to fulfill its statutory mandates in accordance with the broad legislative purpose underlying KRS Chapter 230.

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 a form of pari-mutuel wagering on historical horse races. On January 5, 2010, the office of the Attorney General issued Ky. OAG 10-001 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).”¹³ Rather, the Opinion concluded that “to the extent Instant Racing is not permissible in Kentucky, it is because Instant Racing does not constitute pari-mutuel wagering under the current administrative regulations.”¹⁴

¹¹ A “totalizator” is the device used to pool wagers. “Totalizator” is defined as follows: “[T]he system, including hardware, software, communications equipment, and electronic devices that accepts and processes the cashing of wagers, calculates the odds and prices of the wagers, and records, displays, and stores pari-mutuel wagering information.” 810 KAR 1:001 Section 1(78).

¹² KRS 230.361(1).

¹³ OAG 10-001, p. 7; R., p. 24.

¹⁴ OAG 10-001, p. 8; R., p. 25.

After careful consideration of both its statutory mandate "to foster and to encourage the business of legitimate horse racing with pari-mutuel wagering thereon" and the Attorney General's opinion, the Commission drafted amendments to six administrative regulations and promulgated three new administrative regulations (the "Regulations") to make it clear that wagering on historical horse races *does* constitute pari-mutuel wagering.¹⁵

Contrary to the majority's apparent view, the Regulations do not specifically address *Instant Racing* or any other specific medium of presentation of historical horse racing. Rather, they authorize the concept of wagering on historical horse races, treating any such wager as an "exotic wager."¹⁶ The Regulations enumerate certain requirements that must be satisfied in order for wagering on historical horse races to be permitted. Most notably, they unequivocally require wagers on historical horse races to be pari-mutuel, stating that, "[T]he only wagering permitted on a live or historical horse race shall be under the pari-mutuel system of wagering. All systems of wagering other than pari-mutuel shall be prohibited."¹⁷

Kentucky law defines pari-mutuel wagering as "a system or method of wagering approved by the commission in which patrons are wagering among themselves and not against the association"¹⁸ and amounts wagered are placed in one or more designated

¹⁵ The Commission adopted three sets of three regulations – one set for thoroughbreds, one set for standardbreds, and one set for quarter horse, appaloosa and Arabian breeds. While each set contains certain unique provisions relative to that particular breed, each set contains identical salient provisions regarding pari-mutuel wagering on live and historical horse racing. All citations herein to the Regulations are to those pertaining to the thoroughbreds. R., pp. 27-190.

¹⁶ "Exotic wager" means any pari-mutuel wager placed on a live or historical horse race other than a win, place, or show wager placed on a live horse race. 810 KAR 1:001(24). R., p. 95.

¹⁷ 810 KAR 1:011, Section 1; R., p. 106.

¹⁸ An "Association" is a licensed race track. KRS 230.210(5).

wagering pools and the net pool is returned to the winning patrons.” 801 KAR

1:001(48). The Regulations further mandate that:

- A payout to a winning patron from a wager on an historical horse race shall be paid from money wagered by patrons and shall not constitute a wager against the association;
- An association conducting wagering on an historical horse race shall not conduct wagering in such a manner that patrons are wagering against the association, or in such a manner that the amount retained by the association as a commission is dependent upon the outcome of any particular race or the success of any particular wager; and
- An association shall only pay a winning wager on an historical horse race out of the applicable pari-mutuel pool and shall not pay a winning wager out of the association's funds. Payment of a winning wager shall not exceed the amount available in the applicable pari-mutuel pool.¹⁹

The Regulations also establish specific criteria for the historical horse races that may be wagered upon, stating that any historical race offered for pari-mutuel wagering must have been run at a licensed pari-mutuel facility located in the United States; must have concluded with official results; and must have concluded without scratches, disqualifications, or dead-heat finishes.²⁰ If a requested historical horse race exotic wager is not pari-mutuel, or does not satisfy each of the criteria described above, it cannot and will not be approved pursuant to the Regulations.

The Regulations include other provisions that ensure the pari-mutuel nature of the wagers on historical horse races, requiring that racing associations offering such wagers maintain at least two terminals offering each type of wager on an historical horse race.²¹ By requiring at least two terminals for each type of wager, the Commission ensures that

¹⁹ 810 KAR 1:011, Section 4; R., p. 109.

²⁰ 810 KAR 1:001, Section 1(32); R., p. 96.

²¹ 810 KAR 1:011, Section 3(7); R., p. 108.

patrons are wagering against each other. The Regulations also include various provisions that ensure the integrity of the wagering.²²

The Commission unanimously approved the Regulations in an open public meeting on July 20, 2010.²³ That same day, the Regulations were filed with the Legislative Research Commission, initiating the legislative review process mandated by KRS Chapter 13A.²⁴ As required by the statutes, the Commission solicited public comments on the Regulations and scheduled a public hearing. The Commission received numerous public comments, including both verbal and written comments submitted by the Foundation. Again, as required by KRS Chapter 13A, the Commission filed a Statement of Consideration in which it responded to each public comment. The Regulations completed the administrative review process and went into effect on July 1, 2011.

In conjunction with the filing of the Regulations, Appellants filed the Petition pursuant to KRS 418.020 and KRS 23A.010.²⁵ In the Petition, Appellants asked the Franklin Circuit Court for a judicial determination regarding:

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;

²² All wagering on historical horse races must incorporate the following elements: a patron may only wager on an historical horse race on a terminal approved by the commission; an historical horse race shall be chosen at random; prior to the patron making his or her wager selections, the terminal shall not display any information that would allow the patron to identify the historical race on which he or she is wagering; the terminal shall make available true and accurate past performance information on the historical horse race to the patron prior to making his or her wager selections, and that information shall be current as of the day the historical horse race was actually run; after a patron finalizes his or her wager selections, the terminal shall display a video replay of the race, or a portion thereof, and the official results of the race; and the identity of the race shall be revealed to the patron after the patron has placed his or her wager. 810 KAR 1:011, Section 3(7); R., p. 108.

²³ Brief of the Kentucky Horse Racing Commission in Support of Petition for Declaration of Rights, p. 1; R., p. 423.

²⁴ Id.

²⁵ R., pp. 1-192.

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.²⁶

By Order dated July 26, 2010, the Franklin Circuit Court found that Appellants' Petition presented a ripe and justiciable controversy and ordered briefs to be submitted within thirty days.²⁷ Soon thereafter, the Foundation moved to intervene in the case and, in the absence of any objection, was allowed to do so.²⁸ Immediately upon being granted leave to intervene, the Foundation moved the trial court for clarification regarding whether it could conduct discovery.²⁹ Recognizing that the Petition did not present any issues necessitating discovery, the trial court held that,

[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 the Petitioners. Due to the nature of an agreed case and the fact that the questions presented by Petitioners are legal, not factual, the Court declines to allow discovery at this juncture.³⁰

On December 29, 2010, following briefing and oral argument, Judge Wingate entered a final and appealable Opinion and Order holding that:

1. The Regulations are a valid and lawful exercise of the Commission's statutory authority to regulate pari-mutuel wagering on horse racing.

²⁶ Petition, pp. 5, 6; R., pp. 5, 6.

²⁷ Order Scheduling Briefing; R., pp. 193-197. The Order Scheduling Briefing is attached as Exhibit J to Appellant's Brief.

²⁸ Order Granting Family Foundation's Motion for Leave to Intervene; R., 476-478.

²⁹ Family Foundation's Motion to Modify the Second Scheduling Order and for Clarification of the Court's Instruction Regarding Discovery; R., pp. 482-485.

³⁰ Order; R., pp. 599-601.

2. The licensed operation of pari-mutuel wagering on historical horse races does not contravene statutory prohibitions on gambling found in KRS Chapter 528.
3. 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, is a valid and lawful exercise of its statutory authority.³¹

The Foundation appealed both the trial court's decision on the merits and its order denying discovery.³² The Court of Appeals, in its majority opinion, held that while the trial court properly exercised jurisdiction over the action, the parties also "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."³³ Then without reference to any standard of review or analysis of the trial court's conduct, the majority concluded that the trial court's denial of discovery on this issue constituted an abuse of discretion. But the question of whether a specific type of historical horse race wager passed muster was not before either the circuit court or the Court of Appeals. The issue on appeal was that pleaded by the parties and defined by the trial court, which was the Commission's authority to promulgate regulations classifying wagers on historical horse racing as pari-mutuel wagers, not whether a particular device complies with the regulations. Judge Combs recognized this fact in her dissent, concluding:

[I] agree with the trial court that all issues before it were purely legal issues precluding the need for - - or recourse to - - discovery.

³¹ Opinion and Order, Appendix 2, pp. 16, 17; R., pp. 808, 809.

³² Notice of Appeal by the Family Trust Foundation of Kentucky, Inc. d/b/a The Family Foundation; R., pp. 811-840.

³³ Court of Appeals Opinion Vacating and Remanding, Appendix 1, p. 10.

ARGUMENT

This review is of a 2-1 Opinion of the Court of Appeals which vacates the trial court's findings on a question of law in order that the action may be remanded for discovery. The contradiction is obvious.

Historical horse racing is a pari-mutuel form of wagering where a bettor can wager on a previously run, but unidentifiable, horse race that is recorded and displayed on video. The trial court affirmatively decided the legal question of whether a regulation permitting pari-mutuel wagering on historical horse racing fell within the regulatory authority of the Commission. But the majority of the Court of Appeals did not address this legal question, instead they became confused by extraneous materials and red herring factual inquiries filed in the Court of Appeals by the Foundation. The factual inquiries are immaterial to the outcome of this action because the question of the legality of the regulation can and must be determined from the language of the regulation and the statutory authority of the Commission. The question is: what does the regulation require, **not** the hypothetical of whether a particular game or subsequent set of facts might comply with the regulation. The Foundation succeeded in obscuring the real issue in the Court of Appeals.

While the last half-century has seen an evolution in the mode and manner of how one can wager on a horse race, two things have remained constant and are required by the subject regulation: 1) all wagers must be pari-mutuel, meaning pooled and paid among the bettors only, without the track having a stake in the outcome; and 2) the result of the wager must be contingent on the outcome of a horse race. Historical horse racing merely presents another form of exotic wager. Its pari-mutuel character remains fixed

and its dependence on a horse race inseparable. For this reason, the Court of Appeals should be reversed and the trial court judgment should be affirmed.³⁴

I. The Court of Appeals Incorrectly Decided The Validity of the Commission's Regulations.

A. The trial court correctly determined that discovery was not required to decide these questions of law.

Under the circumstances of this case, it would be particularly unjust to vacate the judgment entered on a question of law in favor of discovery on a fact question that is irrelevant to the pleaded issues. The lawfulness of the patented game *Instant Racing* or any other specific historical racing game (including those being offered at Kentucky Downs³⁵), was not before either the circuit court or the Court of Appeals. Pursuant to the Commission Regulations, specific games require review and approval of the Commission before they can be offered,³⁶ and approval of such games may be challenged in a proper proceeding seeking review of the Commission's decision. This case presents the question of the facial validity of the Regulations under the Commission's statutory authority and controlling case law. Neither the Petition nor the Foundation's intervening papers raise a challenge to the application of those Regulations to a specific approval of a particular wager.

The only issues addressed in the circuit court's order were purely legal set forth in the Petition. Questions as to the validity of the regulations required the Court to look no

³⁴ Each of the arguments that follow have been properly preserved for review either by inclusion in the Appellant's brief filed in the Court of Appeals or, in relationship to the Court of Appeals decision, in the Appellant's Motion for Discretionary Review.

³⁵ The Foundation submitted various materials relating to the games being offered at Kentucky Downs which were not part of the record before the Circuit Court, and therefore not part of the record to be considered on appeal. CR 76.12(4)(c)(vii). The Commission's approval of those games was not before the Circuit Court, nor has the Foundation initiated an action in any court to challenge that approval.

³⁶ 810 KAR 1:011(2).

further than the four corners of the enabling statutes and the regulation. Factual issues the Foundation attempted to raise are readily dismissed. Because the Regulations specifically require that all wagers on historical horse races be conducted in accordance with the pari-mutuel system of wagering, discovery related to the “nature of the gaming schemes”³⁷ is irrelevant to the narrow legal question of the validity of those Regulations.

It is a red herring for the Foundation to argue that *Instant Racing* or a particular mode of wagering cannot be pari-mutuel, because if it is not pari-mutuel, it is not permitted by the regulation. It is a diversion for the Foundation to argue that a horse race is not a horse race unless a patron can watch the race in real time, because the conclusion defies logic and attempts to read a requirement into the statute³⁸ that is not there. It is a distraction for the Foundation to argue that the odds are predetermined on historical horse races because predetermined odds would be prohibited by any form of pari-mutuel wagering. It is a red herring for the Foundation to argue that viewing terminals for historical horse races are illegal gambling devices because the law exempts pari-mutuel wagering – and all apparatus involved in such activity – from application of the gambling statute.

“In the construction and interpretation of administrative regulations, the same rules apply that would be applicable to statutory construction and interpretation.” *Revenue Cabinet v. Gaba*, 885 S.W.2d 706, 707 (Ky. App. 1994) (citing *Revenue Cabinet v. Joy Technologies*, 838 S.W.2d 406, 409 (Ky. App. 1992)). The validity of administrative regulations is determined as a matter of law examining the scope of agency authority. *PSC v. Conway*, 324 S.W.3d 373, 376 (Ky. 2010). In this

³⁷ Foundation’s Brief in the Court of Appeals, pp. 11-13.

³⁸ KRS 230.215.

circumstance, the trial court correctly reasoned there should be no discovery because: 1) the questions presented were legal questions and not factual ones; and 2) the court's findings addressed the legality of pari-mutuel wagering on "historical horse racing" and "not on any particular game or scheme."³⁹ Justice requires that this Court act in harmony with the purpose of KRS 418.020 and render judgment on the merits of the action as pleaded by the parties.

B. Even if discovery were necessary or appropriate, the Court of Appeals majority fails to support its findings as a matter of law.

Before any judgment could be vacated for an abuse of discretion, there must be some finding of a breach of the standard of review. In matters involving discovery or admission of evidence, that standard is abuse of discretion. *Manus, Inc., v. Terry Maxedon Hauling, Inc.*, 191 S.W.3d 4, 8 (Ky. App. 2006). "The test for abuse of discretion is whether the trial judge's decision was arbitrary, unreasonable, unfair or unsupported by sound legal principles." *Goodyear Tire and Rubber, Co. v. Thompson*, 11 S.W.3d 575, 581 (Ky. 2000).

The trial court's refusal to allow discovery into irrelevant matters is supported by sound legal principles and is neither arbitrary nor unreasonable or unfair. To the contrary, the trial court merely refused to let the tail wag the dog. When the Appellee intervened, its Response neither pleaded nor alleged any fact or defense that would change the character of the litigation.⁴⁰ The action remained a KRS 418.020 action capable of being decided from briefs and pleadings without resort to discovery. Factual circumstances that may arise after implementation and application of the regulations may

³⁹ Franklin Circuit Court Opinion and Order, Appendix 2, p. 2, Note 2.

⁴⁰ Response to Joint Petition, R. pp. 491-499.

give rise to another action, but such facts were neither existent nor necessary for determination of the action *sub judice*.

Likewise, the Foundation's request for discovery regarding the process and manner by which the Regulations were formulated is irrelevant to the legal questions in this case. It is undisputed that the Regulations were duly promulgated by a Commission vote in full accordance with KRS Chapter 230 and 13A. "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).

II. The Circuit Court Correctly Upheld The Regulations As A Lawful Exercise Of The Commission's Statutory Authority.

Well-settled legal principles control the judicial evaluation of any administrative regulation. "Regulations are presumed to be valid..."⁴¹ "[A]dministrative regulations that are duly adopted and properly filed have the full force and effect of law, as long as they are consistent with the policy set forth in the enabling legislation."⁴² When determining whether a regulation is within the agency's statutory authority, the Court must "ascertain the intention of the legislature from the words used in enacting the statute rather than surmising what may have been intended but was not expressed."⁴³

Moreover, it is well-established that when interpreting the scope of an agency's delegated statutory powers, the "agency's construction of its statutory mandate ... is

⁴¹ *Ky. Airport Zoning Comm'n v. Ky Power Co.*, 651 S.W.2d 121, 124 (Ky. App. 1983).

⁴² *Flying J Travel Plaza v. Transp. Cabinet, Dept. of Highways*, 928 S.W.2d 344, 347 (Ky. 1996).

⁴³ *Id.*

entitled to respect and is not to be overturned unless it is clearly erroneous.”⁴⁴ Due to an agency’s expertise and institutional experience implementing the general mandates of the legislature, “[g]reat deference is always given to an administrative agency in the interpretation of a statute which is within its specific province.”⁴⁵

Finding nothing “clearly erroneous” in the Commission’s interpretation of its enabling statutes, the circuit court correctly found (and Judge Combs, in her dissenting opinion, agreed) that the Regulations represent a valid exercise of the Commission’s plenary power to regulate pari-mutuel wagering on horse racing in Kentucky.⁴⁶

A. The Regulations Fall Within The Commission’s Express Statutory Authority Under KRS Chapter 230.

Although the Foundation argues that the Commission is without the statutory authority to promulgate the Regulations, the Commission’s enabling statutes plainly state otherwise. KRS Chapter 230 expresses a broad legislative purpose “to encourage the horse breeding industry through the allowance of pari-mutuel wagering subject to regulation by the Kentucky Racing Commission.”⁴⁷ KRS 230.215(1) specifically states that it is the “policy and intent of the Commonwealth to foster and to encourage the business of legitimate horse racing with pari-mutuel wagering thereon in the Commonwealth on the highest possible plane.”

KRS Chapter 230 vests the Commission with broad statutory powers to prescribe rules governing pari-mutuel wagering to effectuate this legislative purpose. Under KRS 230.225(1), the Commission is “created as an independent agency of state government to

⁴⁴ *Homestead Nursing Home v. Parker*, 86 S.W.3d 424, 426 (Ky. App. 1999).

⁴⁵ *Beshear v. Ky. Util. Co.*, 648 S.W.2d 535, 537 (Ky. App. 1982).

⁴⁶ Opinion and Order, Appendix 2, pp. 4-14; R., pp. 796-807.

⁴⁷ *Ky. Off-Track Betting, Inc. v. McBurney*, 993 S.W.2d 946, 948 (Ky. 1999).

regulate the conduct of horse racing and pari-mutuel wagering on horse racing, and related activities within the Commonwealth of Kentucky.” KRS 230.215(2) vests the Commission with “plenary power to promulgate administrative regulations prescribing conditions under which all legitimate horse racing and wagering thereon is conducted in the Commonwealth so as to encourage the improvement of the breeds of horses in the Commonwealth...” “Plenary” power is that which is “full, complete, absolute, perfect, unqualified.”⁴⁸ It is hard to imagine a greater delegation of authority over horse racing and pari-mutuel wagering thereon.

The Commission’s authority to promulgate administrative regulations defining permissible pari-mutuel wagering is further defined by KRS 230.361(1), which states:

The racing commission shall promulgate administrative regulations governing and regulating mutuel wagering on horse races under what is known as the pari-mutuel system of wagering. The wagering shall be conducted only by a person licensed under this chapter to conduct a race meeting and only upon the licensed premises. The pari-mutuel system of wagering shall be operated only by a totalizator or other mechanical equipment approved by the racing commission. The racing commission shall not require any particular make of equipment.

Kentucky courts have repeatedly and consistently recognized the unique breadth of authority conferred upon the Commission by the General Assembly. The highest Kentucky Court has stated, “[t]he Kentucky State Racing Commission is more than an administrative agency having the quasi-judicial function of finding the facts and applying the law to the facts...” It is “vested with extensive authority over all persons on racing premises” and is “charged with the duty of protecting substantial public interest”⁴⁹ in the

⁴⁸BLACKS LAW DICTIONARY at 1154 (6th ed. 1990).

⁴⁹ *Ky. State Racing Comm’n v. Fuller*, 481 S.W.2d 298, 301 (Ky. 1972).

racine industry. Thus, "[t]he Commission is vested with broad powers to regulate thoroughbred racing and to prescribe rules and regulations relative to racing."⁵⁰

This broad power has always been understood to include the power to prescribe the types and methods of wagering that are permitted at licensed racing associations.⁵¹ At issue in the *Latonia* case was the validity of a Commission rule prohibiting bookmaking at race tracks and recommending the Paris Mutual or auction pool system.⁵² The Court upheld both the rule and the authorizing statute in spite of claims that there had been excessive delegation of legislative power. The Court stated that the legislature properly articulated a general policy of permitting some wagering at approved racing associations to promote the state's horse industry, and left it to the Commission to determine the appropriate methods and conditions for such wagering:

From the whole act, the evil which it sought to correct and the good it aimed to promote, it will be read that the Legislature invests the racing commission with the power to ascertain the fact whether a given applicant for license is so situated as to conduct orderly, lawful public races, to ascertain and set forth the particular states of fact that will promote the breeding of thoroughbred horses, and the conducting of legitimate races, and to prohibit the evil of unlawful gambling on the race courses; it being the purpose of the Legislature to encourage the first two, and to prohibit the other. The Legislature declares what is the law, the commission ascertains the facts-that is, the situation-upon which the law is applied.⁵³

⁵⁰ *Jacobs v. State Racing Comm'n*, 562 S.W.2d 641, 643 (Ky.App. 1977).

⁵¹ *State Racing Comm'n v. Latonia Agricultural Ass'n*, 136 Ky. 173, 123 S.W. 681 (1909).

⁵² *Id.* at 682.

⁵³ *Id.* at 686.

B. The Definition Of "Pari-Mutuel" Is Consistent With The Well-Established Meaning Of The Term And The Express Statutory Authority Granted To The Commission.

The phrases "pari-mutuel wagering" and "pari-mutuel system of wagering" are legally defined as follows:

"Pari-mutuel wagering," "mutuel wagering," or ["pari-mutuel system of wagering" each means a system or method of wagering approved by the commission in which patrons are wagering among themselves and not against the association and amounts wagered are placed in one or more designated wagering pools and the net pool is returned to the winning patrons.⁵⁴

In *Commonwealth v. Kentucky Jockey Club*, 238 Ky. 739, 38 S.W.2d 987 (Ky. 1931) which upheld legislation authorizing pari-mutuel wagering on horse races, Kentucky's highest court described how such wagering works:

French pool or Paris mutual is a machine or contrivance used in betting.... In French pool the operator of the machine does not bet at all. He merely conducts a game, which is played by the use of a certain machine, the effect of which is that all who buy pools on a given race bet as among themselves; the wagers of all constituting a pool going to the winner or winners. The operator receives 5 per cent of the wagers as his commission.⁵⁵

The Commission's definition of pari-mutuel wagering plainly comports with the controlling judicial interpretation of the term. The Commission's definition of "pari-mutuel" is also consistent with definitions of the term found in federal law, model industry regulation, and in other states prominent in the horse racing industry. The Interstate Horse Racing Act of 1978 ("IHA") provides:

"Pari-mutuel" means any system whereby wagers with respect to the outcome of a horserace are placed with, or in, a wagering pool conducted

⁵⁴ 810 KAR 1:001(49); R., p. 99.

⁵⁵ *Id.* at 991, (internal quotation marks and citations omitted). (The "machine or contrivance" referred to in this decision was an early variant of the same totalizator required for all pari-mutuel wagering on all forms of horse racing in Kentucky.)

by a person licensed or otherwise permitted to do so under State law, and in which the participants are wagering with each other and not against the operator.⁵⁶

The Association of Racing Commissioners International ("RCI"), the pre-eminent industry standard-setting body of which the Commission was a founding member,⁵⁷ similarly defines "pari-mutuel wagering" as:

a form of wagering on the outcome of an event in which all wagers are pooled and held by a pari-mutuel pool host for distribution of the total amount, less the deductions authorized by law, to holders of tickets on the winning contestants.⁵⁸

Other states prominent in the horse racing industry also define the term in similar fashion.⁵⁹

In its analysis of what the term "pari-mutuel" means, the circuit court expressly rejected the five-part test advanced by the Foundation, stating that "Kentucky decisional law, federal law, and industry usage" were more instructive on that issue.⁶⁰ Because the definition of "pari-mutuel" found in the Regulations is consistent with Kentucky precedent, industry usage and federal law, the circuit court correctly held it is a permissible one and should be upheld.⁶¹

C. Historical Horse Racing Constitutes "pari-mutuel wagering" on "horse races" Within The Meaning of KRS Chapter 230.

⁵⁶ 15 U.S.C. § 3002(13).

⁵⁷ The RCI was founded in 1934 by the racing commissions of seven states, including Kentucky. Its members now include 35 states and five neighboring territories or countries.

⁵⁸ RCI Model Rules-004-007(M); R., p. 431.

⁵⁹ See, e.g., Florida: "Pari-mutuel" means a system of betting on races or games in which the winners divide the total amount bet, after deducting management expenses and taxes, in proportion to the sums they have wagered individually and with regard to the odds assigned to particular outcomes. West's F.S.A. § 550.002(22); California: "Parimutuel wagering" is a form of wagering in which bettors either purchase tickets of various denominations, or issue wagering instructions leading to the placement of wagers, on the outcome of one or more horse races. The association distributes the total wagers comprising each pool, less the amounts retained for purposes specified in this chapter, to winning bettors based on the official race results. West's Ann.Cal.Bus. & Prof.Code § 19411; *Id.*

⁶⁰ Opinion and Order, Appendix 2, p. 12; R., p. 804.

⁶¹ *Id.*, p. 13; R., p. 805.

By definition, any wager on an historical horse race under the Commission's Regulations is a pari-mutuel wager since the Regulations permit only pari-mutuel wagering on historical horse races.⁶² Consistent with KRS 230.361, the Regulations require that all wagering on historical horse races must take place through a totalizator or other mechanical equipment approved by the Commission⁶³ and must be conducted upon licensed premises approved by the Commission.⁶⁴ Payouts on winning historical horse race wagers must come only from the applicable pari-mutuel pool and cannot be made from the Association's funds, as an Association can have no financial stake in the outcome of any wager.⁶⁵ The Foundation's rhetoric notwithstanding, all wagers authorized by the Regulations must be and are "pari-mutuel" as required by Chapter 230.

Likewise, the wagering on historical horse races authorized by the Regulations constitutes wagering on "horse races" under KRS Chapter 230. The Regulations define "historic horse race" as any "horse race that was previously run at a licensed pari-mutuel facility located in the United States and that concluded with official results."⁶⁶ As noted by the Circuit Court, the fact that the horse race was not being run for the first time at the time of the historical horse race wager did not run afoul of any requirement found in KRS Chapter 230.⁶⁷ The statute does not limit wagering to live horse races. Relying on this Court's holding in *Flying J Travel Plaza, supra*, that the court "must ascertain the intention of the legislature from the words used in enacting the statute rather than

⁶² 810 KAR 1:011, Section 1(1); R., p. 106.

⁶³ 810 KAR 1:011, Section 3(7); R., p. 108.

⁶⁴ 810 KAR 1:011, Section 3(2), (3); R., p. 107.

⁶⁵ 810 KAR 1:011, Section 4 (1), (2); R., p. 109.

⁶⁶ 810 KAR 1:001, Section 1(32); R., p. 96.

⁶⁷ Opinion and Order, Appendix 2, p. 9; R., p. 801.

surmising what may have been intended but was not expressed,”⁶⁸ the trial court reasoned:

Viewing an “historical horse race” as a horse race is not as farcical a leap as the Family Foundation urges. Should an individual miss an opportunity to watch the running of the Kentucky Derby at Churchill Downs, and, instead, watches a tape of the Derby on the evening news, that individual is still watching the Kentucky Derby. He is still watching a horse race, without having traveled through time or interrupted the space-time continuum. Historical horse races are horse races; as long as the integrity of the system is preserved by the concealment of identifying information, and as long as the wagering on the race is pari-mutuel in nature, the legislative purpose of Chapter 230 is not frustrated.⁶⁹

The racing industry’s pre-eminent regulatory standards association has recognized that historical horse race wagering is a legitimate form of pari-mutuel wagering. Indeed, in its Model Rules for Pari-Mutuel Wagering, RCI expressly includes rules for several forms of *Instant Racing* pools among its model rules for other well-established exotic pari-mutuel wagers.⁷⁰ While the Regulations do not expressly mention or authorize *Instant Racing*, the RCI’s recognition of it in their pari-mutuel wagering rules demonstrates industry acceptance of wagering on historical horses races as a valid form of pari-mutuel wagering.

Importantly, the Attorney General found nothing in KRS Chapter 230 which precludes the Commission from authorizing pari-mutuel wagering on historical horse races. OAG 10-001. That opinion flatly stated “we do not find that pari-mutuel wagering [on historical horse races] is prohibited by Kentucky’s Horse Racing and

⁶⁸ *Id.*, at p. 347.

⁶⁹ *Id.* The Regulations also require that each wager on an historical horse race, like any other exotic wager, be brought before the Commission for review and approval before a racing association may offer it to the public. This ensures the Commission can evaluate each requested wager to confirm that it meets the standards necessary to constitute a pari-mutuel wager on a horse race, and will not adversely impact the safety or integrity of horse racing or pari-mutuel wagering in the Commonwealth. 810 KAR 1:120, Section 2; R., pp. 126, 127.

⁷⁰ See ACRI Model Rules, ACRI-004-155(A) (“Instant Racing Pools”); Brief of the Kentucky Horse Racing Commission in Support of Petition for Declaration of Rights, p. 9; R., p. 431.

Showing Act (KRS 230),” and “there is nothing in Kentucky’s Act that clearly prohibits wagering under these conditions.”⁷¹ Instead, the Attorney General concluded that “[t]o the extent Instant Racing is not permissible in Kentucky, it is because Instant Racing does not constitute pari-mutuel wagering under the current administrative regulations.”⁷²

The Regulations directly address the Attorney General’s concerns by authorizing wagering on historical horse racing within the pari-mutuel framework. Accordingly, the Regulations are well within the Commission’s express statutory authority, fully consistent with the Commission’s express statutory mandate and in complete accord with the broad legislative purpose underlying KRS Chapter 230.

D. Historical Horse Race Wagering Pools Serve The Same Purpose As Other Exotic Pari-Mutuel Wagering Pools.

In addition to his conclusion that the existing Commission regulations did not address wagering on historical horse races, the Attorney General noted that specific pari-mutuel pools required for historic horse race wagers were not provided for in the existing administrative regulations.⁷³ The new and amended Regulations address this fact, including specific requirements for the pools that pertain to wagering on historical horse races. Indeed, the pools associated with wagering on historical horse races serve the same functional purpose as those used in other exotic wagers approved by the Commission.

Pari-mutuel wagering has evolved considerably since the straight “match race” bet – where all monies were placed into a single win pool on a single race. Racing associations continue to develop innovative wagering opportunities to engage the betting

⁷¹ OAG 10-001, pp. 7, 8; R., pp. 24, 25.

⁷² OAG 10-001, p. 8; R., p. 25.

⁷³ OAG 10-001, pp. 8, 9; R., pp. 25, 26.

public. Pursuant to its statutory mandate, the Commission has the obligation to review and, if appropriate, approve new forms of wagering, consistent with its duties to protect the integrity of the horse racing industry and to “foster and encourage [that industry and] pari-mutuel wagering thereon.”⁷⁴

Over the years, the Commission has authorized various exotic wagers like the Daily Double⁷⁵ or Pick Six⁷⁶ that involve a pari-mutuel pool comprised of monies bet on multiple horse races that may be run on different days, and in some cases, at different race tracks. Such approvals are completely consistent with the Commission’s statutory mandate: nothing in KRS Chapter 230 requires all patrons to be wagering on the same race in order for the bet to constitute a pari-mutuel wager. Indeed, each of these approved exotic wagers is simply a variation on the centuries-old definition of a pari-mutuel wager: patrons betting against each other, and not against the house, for a pool of money. Historical horse racing is merely another variation on that theme.

E. The Commission’s Interpretation of Its Authority Should Be Upheld.

The Commission is confident that its broad delegation of “plenary” power to regulate “pari-mutuel” wagering on horse races unambiguously encompasses the power to authorize pari-mutuel pools on historic horse races. Even if there were an ambiguity as to whether “pari-mutuel wagering on horse races” includes historical horse race pools,

⁷⁴ KRS 230.215(1).

⁷⁵ The Daily Double is a wager where a participant selects the first place finishers in two separate races, often the first two races on the same day or the last two races on the same day. The Commission has also approved daily double bets that span two different race days such as the Oaks/Derby wager at Churchill Downs.

⁷⁶ The Pick Six is a wager where a participant selects the first place finisher in each of six races designated by the racing association and approved by the Commission. The Commission has approved Pick 6 wagers that include races run on different days and at different tracks.

the Commission's interpretation would be entitled to judicial deference under the "*Chevron* doctrine."⁷⁷

The *Chevron* doctrine holds that an administrative agency's interpretation of its enabling statutes is controlling so long as it reflects a "permissible construction of the statute," even if other permissible interpretations also exist.⁷⁸ The doctrine recognizes that agencies have unique experience with their own enabling statutes, often work directly with the legislature when those statutes are amended, and possess particularized expertise in the field to which those statutes are addressed. Accordingly, the agencies are best situated to understand the intended meaning of a particular provision.

This Court expressly recognized the *Chevron* doctrine in *Board of Trustees of Judicial Form Retirement System v. Attorney General*.⁷⁹ The Court of Appeals has recently reaffirmed this principle in *Commonwealth ex rel. Stumbo v. Kentucky Public Service Commission*.⁸⁰ In the latter case, the Court of Appeals affirmed a PSC order permitting utilities to include their out-of-state affiliates' environmental compliance costs in their rates pursuant to KRS 278.183. Because the statute was "ambiguous, or at least silent upon the issue" of whether those costs could be included in the utilities' rates, the Court of Appeals held that it was "appropriate in our review to give deference to the Commission's interpretation as described in *Chevron*."⁸¹

⁷⁷ *Chevron U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984).

⁷⁸ *Id.* at 843 ("[I]f the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.").

⁷⁹ 132 S.W.3d 770, 787 (Ky. 2003).

⁸⁰ 243 S.W.3d 374 (Ky. App. 2007).

⁸¹ *Commonwealth ex rel. Stumbo*, 243 S.W.3d at 380. See also *Com. Ex rel. Beshear v. Ky. Util. Co.*, 648 S.W.2d 535, 537 (Ky. App. 1982); *Homestead Nursing Home v. Parker*, 86 S.W.3d 423, 426 (Ky. App. 1999).

Under *Chevron*, the Court must uphold the Regulations if it concludes that the Commission has adopted a “permissible” interpretation of its statutory authority. The Commission’s conclusion that monies wagered on historical horse races fall within the meaning of the statutory terms “pari-mutuel wagering” on “horse races” unquestionably meets this standard. Nothing in the text of KRS Chapter 230 prohibits pari-mutuel wagering on completed horse races. Similarly, nothing in the text of Chapter 230 defines “pari-mutuel” to exclude the use of “seed pools,” wagering pools that combine bets placed on different races, or any other necessary feature of historical race pools.

III. The Circuit Court Correctly Determined That Prohibitions on Illegal Gambling Do Not Apply.

The Foundation’s argument that the terminals used to place wagers on historical horse races as illegal gambling devices is nothing more than a tautologizing contrivance. KRS Chapter 528 is the section of the Kentucky Penal Code that prohibits various gambling activities and devices. However, KRS 436.480 expressly prohibits the application of KRS Chapter 528 “to pari-mutuel wagering authorized under the provisions of KRS Chapter 230.” Because the historical horse race pools approved by the Commission are “pari-mutuel wagering authorized under the provisions of KRS Chapter 230,” the plain language of KRS 436.480 pre-empts the application of any prohibitions on illicit gambling contained in Chapter 528 to wagering on historical horse races.

The Circuit Court obviously understood the interplay between KRS 436.480 and KRS Chapter 230 when it stated that,

[T]he issue turns not on the appearance or construction of the machine, but on the nature of pari-mutuel wagering. The Court has found that pari-mutuel wagering on historical horse racing, as set forth in the regulations,

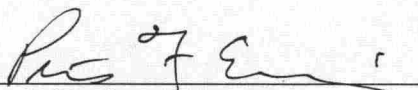
is pari-mutuel wagering authorized under the provisions of KRS Chapter 230. Therefore, pari-mutuel wagering on historical horse racing does not contravene the statutory prohibitions on gambling found in KRS Chapter 520 (sic).⁸²

This Court should reaffirm this reasoning on review.

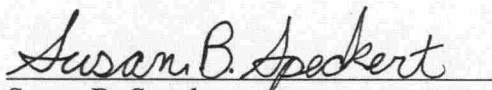
CONCLUSION

For the foregoing reasons, the Appellant, Kentucky Horse Racing Commission, respectfully requests this Court to reverse the opinion of the Court of Appeals Opinion and reinstate and affirm the judgment of the Franklin Circuit Court.

Respectfully Submitted,



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⁸² Opinion and Order, Appendix 2, pp. 14, 15; R., pp. 806, 807.