COMMONWEALTH OF KENTUCKY
SUPREME COURT
NO. 2010-CA-000658
SC

DOCTORS' ASSOCIATES, INC. — APPELLANT

v. APPEAL FROM THE COURT OF APPEALS
NO. 2010-CA-00283-WC

UNINSURED EMPLOYERS' FUND; — APPELLEES
TONDA MICHELLE BROWN;
UBC (DBA SUBWAY); HON. JOHN B. COLEMAN,
ADMINISTRATIVE LAW JUDGE;
AND WORKERS' COMPENSATION BOARD

* * * * *

BRIEF OF APPELLANTS

* * * * *

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CERTIFICATE OF SERVICE

I hereby certify pursuant to CR 76.12(6) that the Record on Appeal was not withdrawn by Appellants. I hereby certify that this Brief has been served on this 3rd day of January, 2011, to James R. Carpenter, Assistant Attorney General, Uninsured Employers Fund, 1024 Capital Center Drive #200, Frankfort, KY 40601; Hon. Kevin Mullins, 48 East Main Street, Whitesburg, KY 41858; Watash, Inc., 714 Hwy 2034, Ermine, KY 41815; Hon. John B. Coleman, ALJ, 107 Coal Hollow Road, Ste. 100, Pikeville, KY 41501; and the Honorable Dwight T. Lovan, Commissioner, Department of Workers Claims, 657 Chamberlin Ave., Frankfort, KY 40601.

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I. INTRODUCTION

This appeal addresses matters of statutory construction and the proper scope of review by the Court of Appeals in a matter in which the Administrative Law Judge properly concluded that Appellant, Doctor's Associates, Inc. ("DAI"), did not constitute an up-the-ladder employer pursuant to KRS 342.610(2)(b). While the Workers Compensation Board affirmed that ruling, the Court of Appeals applied an incorrect standard of review and also misinterpreted the controlling statute in rejecting the ALJ's factual findings in favor of DAI, and in reversing and remanding for further proceedings.

II. STATEMENT CONCERNING ORAL ARGUMENT

Appellants request oral argument. This is an appeal of right pursuant to CR 76.36(7)(a), following an appeal to the Court of Appeals by the Uninsured Employers Fund in a workers' compensation action filed by Tonda Mechelle Brown. Brown allegedly sustained injuries from a slip and fall while working at a Subway Restaurant in Whitesburg, Kentucky. That restaurant was owned and operated by Watash, Inc. ("Watash"), a franchisee under a franchise with Appellant, DAI. Watash had allowed its workers compensation coverage to lapse prior to Brown's work-related injury, and the Uninsured Employers Fund was joined to the action and settled Brown's claim. The Uninsured Employers Fund joined DAI as a party defendant under the theory that DAI was an up-the-ladder contractor. After extensive discovery, the Administrative Law Judge concluded DAI did not constitute an up-the-ladder employer pursuant to KRS 342.610(2)(b), and the Workers Compensation Board affirmed that ruling. The Court of Appeals subsequently rejected the ALJ's factual findings in favor of DAI, and reversed and remanded for further proceedings, from which this appeal by DAI follows.

To the extent this Court finds it necessary to address the question of whether up-the-ladder liability under KRS 342.610(2)(b) applies to all franchisor-franchisee relationships, such ruling will affect not only Appellant DAI, but also will affect all other franchisors doing business in the Commonwealth. In addition, this case presents questions of the proper standard of review on appeal and whether the Court of Appeals disregarded controlling rules of appellate review established by this Court.

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IV. STATEMENT OF THE CASE

1. Proceedings before the Workers' Compensation Administrative Law Judge

Tonda Mechelle Brown ("Brown") was employed by Watash, Inc. ("Watash") at a Subway Restaurant in Whitesburg, Kentucky. On May 17, 2000, while retrieving ice from an ice machine at work, Brown slipped and fell on water in front of a mop sink. She claimed she injured her back, neck and knee. See October 18, 2000 Deposition of Brown (located in the Workers Compensation Board Record (hereinafter "WC Record")), at 00135. After learning that Watash had allowed its workers compensation coverage to lapse prior to her injury, Brown joined the Uninsured Employers' Fund (the "Fund") as a party defendant to her workers compensation claim. The Fund subsequently settled Brown's workers compensation claim. See WC Record, at 00513-00516.

Discovery disclosed that the principal shareholder of Watash, William Ihrig, operated his Whitesburg, Kentucky Subway Restaurant pursuant to a franchise agreement with franchisor Doctor's Associates, Inc. ("DAI")[1]. On November 15, 2000, the Fund filed its first motion to add DAI as a party defendant, alleging that DAI "is in the business of making money by selling Subway sandwiches." See WC Record, at 00057. DAI made a special appearance to oppose its joinder. DAI asserted that it was not Brown's employer but only a franchisor with respect to the Whitesburg restaurant, Subway #7984, that DAI neither owned nor operated that restaurant at the time of Brown's injury, and that it was not involved in the restaurant's day-to-day operations. See WC Record, at 00061-00066. The Administrative Law Judge ("ALJ") overruled the Fund's initial motion to join DAI.

[1] For purposes of this appeal, DAI will refer to Watash and/or its principal shareholder Ihrig collectively as "Watash."

In February of 2001, the Fund renewed its motion to join DAI. WC Record, at 00191. The Fund acknowledged in its second motion that DAI had ceased operating restaurants in 1974, "and instead became a franchising operation. Today there are over 14,800 'Subway' stores throughout the world." WC Record, at 00191. The Fund also conceded that DAI "has little direct contact with franchisees other than receiving their royalty payments," that "DAI requires its franchisees to deal with several affiliates," and that a franchise fee "is DAI's primary source of income." WC Record, at 00192. Nevertheless, the Fund persisted in its contention that DAI was in the business of selling sandwiches, and that this fact made it liable as a contractor pursuant to KRS 342.610(2)(b). On April 4, 2001, the ALJ again denied the Fund's motion. WC Record, at 00262-00263.

Undaunted, the Fund conducted additional discovery to explore the franchise relationship, serving written discovery on DAI, taking the deposition of Watash owner Ihrig, and also taking the deposition of an independent agent for DAI, David Lee. Lee stated in his deposition that, in exchange for entering into a franchise agreement with DAI, the franchisee got to use the Subway name. WC Record, at 00234. In exchange for royalty payments, franchisees were also allowed access to certain operating manuals, methods and recipes. WC Record, at 00234. DAI did not set hours of operation or prices for items sold at the restaurants and did not participate in hiring or firing decisions. WC Record, at 00235, 00248, 00249.

On December 16, 2002, the Fund again renewed its motion to join DAI as a party defendant, (WC Record, at 00395-00398), reasserting that the "business of DAI is selling Subway sandwiches." In opposing the motion, DAI pointed out that the franchise relationship is different than the contractor/subcontractor relationship. DAI noted the application of 16 CFR §436, promulgated by the Federal Trade Commission, which requires three elements for every

franchise: 1) a franchise fee; 2) a trademark license; and 3) substantial control over the franchisee's method of doing business. WC Record, at 00401. DAI asserted that its business was that of selling franchises and not sandwiches, and that business advice and assistance was mandatory to the franchise relationship based on the franchise agreement between the franchisor and franchisee. WC Record, at 00402.

By Order dated January 27, 2003, the ALJ noted that it was "still under the belief that a franchisor/franchisee relationship is not the same as a contractor/subcontractor relationship." WC Record, at 00406. The ALJ noted further that Watash purchased a franchise from DAI, which purchase

> includes the right to use the Subway name and the right to obtain knowledge on how to conduct the business from Doctor's Associates Inc. This is done on a monthly basis through inspections on site as well as the availability by telephone for questions from the franchisee. The franchisee continues making payments from a percentage of the business of the business for the continued right to use the trademark as well as the continued access to business practices. This is different from a contractor/subcontractor relationship wherein a contractor simply hires a subcontractor to perform part of a business. Usually there is a specialized skill and the subcontractor is utilized to perform a part of a business operation."

WC Record, at 00406-00407. Thus, the ALJ again overruled the Fund's motion.

On February 24, 2003, the Fund filed a fourth motion to join DAI as a party defendant. WC Record, at 00471-00476. The Fund framed the issue in this motion as "whether or not making and selling Subway brand sandwiches is a part of the business of DAI." In opposition, DAI noted that this was the fourth occasion by which the Fund had sought DAI's joinder. WC Record, at 00478. DAI noted that it stopped selling sandwiches in 1974, and now franchised 18,000 Subway stores worldwide. DAI stated that, other than a few employees working in a product test store, its 650 employees were exclusively in the franchising business devoted to the

marketing and sale of franchises. DAI later clarified the record to acknowledge a second company-owned store, also outside of Kentucky, required under a contract with the United States military. WC Record, at 00202.

By Order dated April 4, 2003, the ALJ granted the Fund's motion to join DAI, stating that, while it was not convinced that KRS §342.610(2) places liability on franchisors, it was allowing joinder of DAI in the interest of judicial economy to permit DAI to protect its interests in the event this issue was appealed. WC Record, at 00485-00486.

Six years later, following final settlement of Brown's Workers Compensation claim, the ALJ entered an April 15, 2009 Benefit Review Conference Order and Memorandum, directing both the Fund and DAI to file briefs on the contested issue of whether DAI "has up-the-ladder liability under KRS 342.610". WC Record, at 00521.

In briefing the issue of DAI's up-the-ladder liability, the Fund and DAI provided the ALJ with extensive information taken from the discovery record.[2] While the Fund again contended that DAI was "in the business of selling sandwiches," DAI demonstrated that it was not in the business of selling sandwiches, and that it had not contracted with its franchisee Watash to have work performed of a kind that is a regular or recurrent part of the work of the trade, business, occupation, or profession of DAI. DAI pointed out that there was no evidence in the record establishing DAI as controlling Watash's day-to-day functions or operations, and that DAI has never operated a company owned store in Kentucky. WC Record, at 00538-00539. DAI stated, "To restate emphatically, DA is not in the business of making sandwiches. These facts are undisputed. The Fund, who has the burden herein, has failed to establish any set of facts or

[2] After DAI was joined the Fund engaged in discovery and never asked to engage in further discovery or to supplement the record after discovery closed.

evidence that would even allude to DA's supervision of the day to day operations of Watash that resulted in the injuries to Plaintiff." WC Record, at 00540.

On July 2, 2009, the ALJ entered its Opinion and Order, WC Record, 00545-00548, stating that the "only issue for decision is whether Doctors has up-the-ladder liability under KRS §342.610." In its Analysis and Conclusions, the ALJ stated that DAI is a corporation that owns the trademark "Subway" and serves as a franchisor licensing other corporations and individuals to operate Subway stores. The ALJ, in its role as fact-finder, concluded that DAI was not in the business of selling sandwiches, stating that the "vast majority" of DAI's business was as a franchisor. WC Record, at 00546. The franchise agreement required Ihrig to maintain certain standards of product and abide by chain-wide policies and procedures for store operation, including maintaining appropriate insurance. The ALJ stated that DAI retained the right to inspect the business on a monthly basis to ensure franchise standards were met. The franchisee was required to pay a percentage of income to DAI for the right to use the trade name. A portion of those proceeds were used for advertising benefitting all franchisees. DAI did not participate in employment decisions or the day-to-day operation of the business. WC Record, at 00547.

The ALJ then decided that these facts did not satisfy the requirements of KRS §342.610 to impose up-the-ladder liability on DAI. The ALJ noted that, generally, a franchise gives the right to a private person or corporation to market a product or name brand. The ALJ stated, "In this instance, the franchise agreement gave Watash the right to operate a Subway shop in Whitesburg Kentucky for a price. If the relationship had been that of subcontractor and contractor, one would think Doctors would be paying Watash to operate the shop. Instead, it was Watash, who was paying Doctors for the right to operate the shop." The ALJ concluded that, in his view of the facts, this was "clearly a much different arrangement than that which is

contemplated in KRS §342.610." Therefore, the ALJ dismissed the Fund's claim against DAI. WC Record, at 00548.

The Fund filed a Petition for Reconsideration, but limited the scope of its Petition to a request that the ALJ reconsider two case citations it had offered in support of its position. WC Record, at 00549-00550. Notably, the Fund did not object to any of the stated factual findings of the ALJ or insist that the ALJ provide any additional findings of fact to support its conclusions. The ALJ denied this Petition as a mere reargument of the claim, WC Record at 00556.

2. Proceedings before the Workers Compensation Board

The Fund appealed the ALJ's ruling to the Workers Compensation Board ("the Board"), which affirmed the ALJ by Order entered January 15, 2010. WC Record, at 604-00614. Like the ALJ, the Board framed the issue as whether DAI had "up the ladder" liability based on the franchisor/franchisee relationship between DAI and Watash. The Board reviewed the evidence relied upon by the ALJ in making his determination of no liability, including interrogatory responses of DAI and depositions taken by the Fund. At page 7 of its Opinion, the Board acknowledged the Fund's argument that DAI contracted with Watash to sell sandwiches rather than franchises. The Board outlined a variety of duties imposed on the parties by the franchise agreement in agreeing with the ALJ that it did not appear KRS §342.610 intended to encompass the franchisor-franchisee relationship. Rejecting the Fund's contentions, the Board stated, "**DAI clearly is in the business of developing franchises for the purpose of securing royalties rather than actually operating sandwich shops.** It is more of a service provider to restaurants and cannot be viewed as being primarily or even significantly in the business of making and selling sandwiches." Opinion, at 9 (emphasis added). Thus, the Board affirmed the ALJ.

3. Appeal to the Kentucky Court of Appeals

The Fund next appealed to the Kentucky Court of Appeals, which reversed the prior holdings of the ALJ and Board and remanded for further proceedings. See Record on Appeal (hereinafter "Appeal Record"), at 87-109. In its brief before the Court of Appeals, the Fund reframed the issue that had been decided by the ALJ and affirmed by the Board, from the question of whether DAI had up-the-ladder liability under KRS §342.610(2) to whether KRS §342.610(2) applied to ANY franchise relationship (and not just the one before the court). Appeal Record, at 7. In contrast, DAI noted in its brief that the Fund was ignoring the facts established in this case, including its failure to demonstrate that DAI was in the business of selling sandwiches rather than franchises. DAI stated, "The UEF failed to establish, factually, any situation whereby DAI could be considered a contractor. It merely asserts, without evidence in the record, that DAI is in the 'business of selling sandwiches.' The uncontroverted evidence in the record is that DAI is in the business of selling franchises and not in the business of making or selling sandwiches." Appeal Record at 70-84 (DAI Court of Appeals Brief, at pp. 3-4).

Unfortunately, the Court of Appeals failed to recognize that the Fund had altered the issue on appeal, incorrectly assumed that the ALJ had decided this case in the abstract rather than on specific facts, and evaluated the Fund's appeal solely on the question of whether KRS §342.610 applies to franchises across the board. In so doing, the Court of Appeals failed to address what should have been the proper issues on appeal: whether the Fund had met its burden of proof below; and whether the ALJ and Board had overlooked or misconstrued controlling statutes or precedent or committed an error in assessing the evidence so flagrant as to cause gross injustice. Western Baptist Hospital v. Kelly, 827 S.W.2d 685, 687-88 (Ky. 1992).

As the Court of Appeals exceeded the scope of its authority in considering and deciding the wrong issue on appeal, it must be reversed, and the judgment in DAI's favor reinstated. Moreover, even if the Court of Appeals properly considered the issue of whether KRS §342.610(2) applies to franchise relationships as a general rule, its interpretation of this statute as applied to DAI was in error.

V. ARGUMENT

A. THE COURT OF APPEALS EXCEEDED THE SCOPE OF ITS AUTHORITY AND IMPROPERLY SUBSTITUTED ITS OPINION OF THE FACTS FOR THOSE OF THE ALJ.

1. The Court of Appeals improperly disregarded the ALJ's factual findings

In workers' compensation matters, the ALJ serves as a finder of fact. Ira A. Watson Dept. Store v. Hamilton, 34 S.W.3d 48, 52 (Ky. 2000). The claimant (here the Fund) bears the burden of proving every element of a workers' compensation claim. Williams v. White Castle Systems, 173 S.W.3d 231, 235 (Ky. 2005). In order for that burden to be sustained before the ALJ, **the Fund (and not DAI) was required** to introduce no less than substantial evidence of each element of its claim. "Substantial evidence" has been defined as some evidence of substance and relevant consequence, having the fitness to induce conviction in the minds of reasonable people. Special Fund v. Francis, 708 S.W.2d 641 (Ky. 1986); Smyzer v. B.F. Goodrich Chemical Co., 474 S.W.2d 367 (Ky. 1971). Substantial evidence also has been equated to evidence which would be sufficient to survive a motion for a directed verdict if the matter were being tried to a jury. Kentucky Utilities Co. v. Hammons, 284 Ky. 437, 145 S.W.2d 67, 71 (1940). Although substantial evidence is sufficient to support an essential finding of fact, it will not necessarily require a favorable finding, even in instances where the contrary evidence is less than substantial. Lee v. International Harvester Co., 373 S.W.2d 418 (Ky. 1963). Only evidence

which is so overwhelming that no reasonable person would fail to be persuaded by it will compel a particular finding. Francis, supra.

Thus, as the stated issue in the ALJ's Benefit Review Conference Order and Memorandum was whether DAI had up-the-ladder liability under KRS §342.610, it was the Fund's obligation to prove to the ALJ by substantial evidence that the franchise agreement between DAI and Watash satisfied the requirements of KRS §342.610(2)(b). The ALJ was not required by law to find that substantial evidence existed in support of DAI's position, as DAI did not have the burden of proof below. The ALJ considered the evidence as proffered by the Fund and found in favor of DAI.

In this case, the Court of Appeals completely disregarded the ALJ's factual findings that DAI was in the business of selling franchises and not in the business of operating restaurants and selling sandwiches, which factual finding was dispositive of the claims asserted against the DAI by the Fund. By remanding the Court of Appeals improperly shifted the burden of proof to DAI to prove a negative – that it had no up-the-ladder liability.

In its brief on appeal, the Fund failed to demonstrate any way in which the ALJ had misconstrued the controlling statute, relying generally on the legal proposition that the Workers Compensation Act should be liberally construed to affect its remedial purpose. Taking issue with the ALJ's application of the facts to the statute, the Fund recognized, "if the Board and ALJ were correct, this very common business relationship (franchise) would have been specifically excluded in the statute." Appeal Record, at 9. Despite the ALJ's factual findings, the Fund continued to argue that DAI was in the business of selling sandwiches. Appeal Record, at 10.

When a decision by the fact-finder favors the person with the burden of proof, his burden as losing party on appeal is to show there was evidence of substance to support the finding,

meaning evidence that would permit the fact-finder to reasonably find as it did. However, if the fact-finder finds against the person with the burden of proof, as the ALJ did in this case in finding against the Fund and in DAI's favor, "his burden on appeal is infinitely greater. It is insufficient to show that there was some evidence of substance which would have justified finding in his favor; appellant must show that the evidence was such that the finding against him was unreasonable because the finding cannot be labeled 'clearly erroneous' if it reasonably could have been made." Francis, supra at 643.

Contrary to the conclusions of the Court of Appeals, the ALJ and Board did not decide this case in a vacuum based on general legal principles as to whether KRS §342.610(2)(b) extended to all franchise relationships. Rather, based on the specific facts about the business relationship between DAI and the employer Watash, the ALJ and the Board considered whether DAI qualified as a contractor under KRS §342.610. The ALJ rejected the contention of the Fund that DAI was in the business of making sandwiches and agreed with DAI that it was in the business of franchising. With this underlying factual determination reached in DAI's favor, the balance of the ALJ's analysis under KRS §342.610 was simple. The work performed by DAI was franchising, and the work performed by Watash was operating a restaurant and selling sandwiches. Thus, DAI did not contract with Watash to perform work of a kind which is a regular and recurrent part of DAI's business, and could not be considered a contractor under the relevant statutory language. Any discussion by either the ALJ or Board regarding applicability of KRS §342.610 to franchisors generally was dicta and didn't control the specific holding in this case.

Even if KRS §342.610 could extend to a franchise relationship in the appropriate context, the ALJ found that it did not apply to DAI under the particular factual circumstances presented.

The ALJ's controlling factual determination was that DAI was in the business of selling franchises and not sandwiches. Remarkably, the Court of Appeals held at page 19 of its Opinion that the ALJ was "required, at a minimum, to clearly set forth facts in support of" its conclusion that the relationship between DAI and Watash did not fall under the purview of KRS §342.610(2)(b). But, the ALJ's Analysis and Conclusions made clear that it did not believe DAI was in the business of selling sandwiches, and the Board then evaluated the evidence behind that conclusion and affirmatively stated this factual conclusion at page 9 of its Opinion. The ALJ's Order did not rely exclusively on its legal reasoning that all franchise relationships are exempt from the Workers' Compensation Act. Rather, the ALJ specifically considered the facts of this particular franchise relationship in concluding that DAI did not qualify as a "contractor" under the statutory language of KRS §342.610(2)(b).

2. The Board properly followed its standard of review

On appeal, the Workers' Compensation Board again framed the issue as follows: "The sole issue presented to the ALJ was whether DAI had 'up the ladder' liability based upon the franchisor/franchisee relationship between DAI and Watash." Opinion, at p. 2. Despite the manner in which this case was characterized by the Court of Appeals, neither the ALJ nor the Board decided this case in general legal terms applicable to all franchise relationships, but rather on the specific facts presented by the depositions and language of the franchise agreement between DAI and Watash.

Pursuant to KRS §342.285(2), the Board was confined in its review to determining whether the ALJ had acted in excess of his powers; whether its Order was procured by fraud; was not in conformity with KRS Chapter 342; was clearly erroneous on the basis of the reliable,

probative and material evidence in the record; or was arbitrary or capricious or characterized by abuse of discretion. See Osborne v. Pepsi-Cola, 816 S.W.2d 643, 645 (Ky. 1991).

The Board properly followed its standard of review in considering the evidence before the ALJ. See also Western Baptist Hospital v. Kelly, 827 S.W.2d 685, 687 (Ky. 1992), where the Court held, "The WCB is supposed to decide whether the evidence is sufficient to support a particular finding made by the ALJ, or whether such evidence as there was before the ALJ should be viewed as uncontradicted and compelling a different result. These are judgment calls. No purpose is served by second-guessing such judgment calls, let alone third-guessing them."

In affirming the ALJ, the Board noted the following facts contained in the evidence of record supporting the ALJ's conclusions. DAI is a corporation that owns the trademark "Subway" and serves as a franchisor licensing other corporations and individuals to operate Subway shops. DAI does operate two stores of its own, a test store in Connecticut and a second store in New Jersey operated pursuant to contract with the U.S. Navy, which it intends to return to the franchise community as soon as possible[3]. DAI franchises 14,800 stores to franchisees. The franchise agreement with Ihrig/Watash allowed the franchisee to operate a restaurant as "Subway." The franchisee had to maintain certain product standards and follow chain-wide policies and procedures. It had to procure insurance and name DAI as an additional insured. DAI had a right of inspection, and was entitled to a percentage of income for the right to use the trade name. A portion of this income was utilized for advertising benefiting all franchisees. DAI did not participate in hiring or firing employees or daily operations. DAI granted the franchisee access to its recipes, formulas, food preparation procedures, business methods, forms, policies and knowledge pertaining to operation of a sandwich shop.

[3] Since discovery was completed in the workers compensation action, DAI has greatly increased the number of franchises for which it acts as franchisor, with 33,700 Subway franchises in operation. Moreover, DAI no longer operates any company-owned stores.

The Board did not conduct any fact-finding itself, but rather examined the available evidence as set forth in the record and concluded it was sufficient to support the ALJ's findings. In so doing, the Board referenced evidence in the record but not specifically recited in the ALJ's decision, including the deposition testimony of David Lee, who discussed DAI's store audits and franchise sales, and stated the operating manuals did not give any direction in firing employees, store hours or prices. The Board quoted extensively from the ALJ's legal conclusions. The Board noted that the Fund filed a motion for reconsideration, which the ALJ considered and overruled. The Board noted that the Fund was contending DAI contracted with Watash to sell sandwiches, and that DAI controlled and directed "a great many of the details associated with running the sandwich shop including the purchase/maintenance of insurance." The Board noted that the Fund had argued that, since DAI gets a royalty for all sales, it must be viewed as being in the business of sandwich sales.

Quoting the statute, the Board concluded "that the Legislature did not intend for KRS §342.610 to include the relationship between a franchisor and a franchisee." However, that conclusion was not the sole or determinative basis for the opinion reached by the ALJ and the Board. The Board stated what typically occurs in a contractor/subcontractor relationship then noted, in the specific factual circumstances of this case, no money flowed to Watash from DAI. Rather, Watash paid DAI for the right to operate a business in DAI's trademark name. The Board characterized the relationship as, "essentially a contract for DAI to provide services to its franchisees in return for the 8% royalty paid by the franchisee to the franchisor." The Board noted that the bulk of DAI's income comes from franchising and not from operating restaurants. The Board stated, "DAI clearly is in the business of developing franchises for the purpose of securing royalties rather than actually operating sandwich shops. It is more of a service provider

to restaurants and cannot be viewed as being primarily or even significantly in the business of making and selling sandwiches." Opinion, at p. 9 (Emphasis added).

3. The Court of Appeals exceeded its scope of review, and improperly "second guessed" the ALJ in remanding for further findings.

Supreme Court Rule 1.030(8)(a) provides:

> The Court of Appeals is bound by and shall follow applicable precedents established in the opinions of the Supreme Court and its predecessor court.

In any case in which the Court of Appeals disregards the decisions of the Supreme Court, this Court is required to reverse it as exceeding the scope of its authority. Special Fund v. Francis, 708 S.W.2d 641 (Ky. 1986). In Francis, this Court held that in order for a reviewing court to reverse findings of the Workers Compensation Board unfavorable to a claimant and upon which he has the burden of proof, the test is whether the evidence **compelled** a finding in his favor. "The rule has been followed consistently until the present time." Id. at 643.

In Western Baptist Hospital v. Kelly, 827 S.W.2d 685 (Ky. 1992), this Court considered a case procedurally similar to this one, in which the ALJ, Board and Court of Appeals all found against a claimant, and the claimant pursued a further appeal to the Supreme Court. The Court noted, "The appellants called upon the Court of Appeals to 'second guess' the WCB's view of the evidence, and now they call upon us to 'third guess' both the WCB and the Court of Appeals on the same evidence." In reversing, the Court of Appeals improperly "second guessed" and substituted its view of the facts for those of the ALJ and Board. In Kelly, the court noted that the losing party had not pointed to evidence overlooked by the Board but rather argued over reasonable inferences from the evidence. The Court stated:

> The 1988 statutory restructuring of the Workers' Compensation Law intended appeal to the WCB to be the functional equivalent of appellate review in the Court of Appeals. See KRS 342.285-.290. These statutes worked fundamental changes. The ALJs were created and empowered to function the same as a trial court trying

> a case without a jury. The WCB was divested of the fact-finding function and restructured to carry out the same functions as an intermediate court reviewing the decisions of a court of original jurisdiction, to perform the error correcting function normally assigned to the Kentucky Court of Appeals, lacking only the power of constitutional review.

Id. at 687. The Court stated that, following Vessels v. Brown-Forman Distillers, 793 S.W.2d 795 (Ky. 1990), the losing party in the Court of Appeals was entitled to appear as a matter of right in the Kentucky Supreme Court. However, as to the appropriate standard of review at each level, the Court stated:

> The WCB is entitled to the same deference for its appellate decisions as we intend when we exercise discretionary review of Kentucky Court of Appeals decisions in cases that originate in circuit court. **The function of further review in the Court of Appeals is to correct the Board only where the Court perceives the Board has overlooked or misconstrued controlling statutes or precedent, or committed an error in assessing the evidence so flagrant as to cause gross injustice.** The function of further review in our Court is to address new or novel questions of statutory construction, or to reconsider precedent when such appears necessary, or to review a question of constitutional magnitude.

Id. at 687-688 (emphasis added).

In its Opinion below, the Court of Appeals initially recognized the constraints on its authority on review. Appeals Record, at p. 92. Yet, the Court of Appeals failed to identify any factual evidence presented by the Fund but overlooked by the ALJ or Board, much less any error by the ALJ in assessing the factual evidence so flagrant as to cause injustice. In this regard, the Court of Appeals did not identify any overlooked factual evidence offered by the Fund to support its assertion that DAI sold sandwiches and thus satisfied the requirements of the relevant statutory language, much less "evidence so strong as to compel a finding in his favor". Francis, supra at 643. To the extent the Court of Appeals believed DAI was engaged in the business of selling sandwiches, as it suggested at page 18 of its Opinion, it was improperly substituting its view of the evidence for that of the ALJ and Board, or in other words, second guessing their

view of that factual evidence. The Court of Appeals stated, "Thus, **if** selling Subway sandwiches to the public is a regular and recurrent part of DAI's business, then Watash was unquestionably performing work that DAI otherwise would have had to perform for itself and with its own employees, and Watash would fit the definition of a 'subcontractor,' as defined under KRS §342.610(2)(b)." Given the ALJ's findings below, the question of whether selling sandwiches was a regular and recurrent part of DAI's business has been conclusively determined and was no longer at issue, as the ALJ already concluded that DAI was not in the business of selling sandwiches. While both the ALJ and Board specifically found that DAI was in the business of selling franchises, the Court of Appeals disregarded those factual findings in directing the ALJ to "clearly set forth facts in support of this ultimate conclusion." Opinion, at p. 19.

By disregarding the ALJ's factual conclusions and directing the ALJ to revisit the evidence, the Court of Appeals engaged in a "second guessing" of the ALJ's factual findings rather than identifying a flagrant error in assessing the evidence. Indeed, by directing the ALJ at page 20 of its Opinion to take additional proof on these issues, the Court of Appeals basically shifted the burden of proof on DAI to prove a negative (that it is NOT a contractor under the statute) when controlling case law demonstrates it is the burden of the Fund to show applicability of the statute, and not the burden of either DAI or the ALJ to show its inapplicability.

The claimant in a Workers' Compensation proceeding has the burden of proof. Kentland Elkhorn Coal Co. v. Johnson, 549 S.W.2d 308, 309 (Ky. App. 1977). If the Board rules against a party having the burden of proof, the test is whether the evidence was so overwhelming as to compel a finding in his favor. Id. Conversely, if the Board finds in favor of a party having the burden of proof, the question on appeal is whether the Board's findings are supported by substantial evidence. Id.; Smyzer v. B.F. Goodrich Chemical Co., 474 S.W.2d 367 (Ky. 1971).

The Court of Appeals here confused the burden of proof related to what a prevailing party with the burden of proof must demonstrate on appeal versus what an unsuccessful party such as the Fund must demonstrate. In so doing, the Court of Appeals shifted the obligation of supporting the ALJ's findings by substantial evidence from the Fund, which had the burden of proof below, to DAI, which did not have the burden of proof to show by substantial evidence it was not a contractor.

The Court of Appeals also imposed obligations on the ALJ on remand to support its ruling by substantial evidence. In support of its ruling, the Court of Appeals cited to administrative law rulings in other contexts, such as American Beauty Homes Corp. v. Louisville and Jefferson County Planning and Zoning Commission, 379 S.W.2d 450 (Ky. 1964)(a zoning case); and Bowling v. Natural Resources, 891 S.W.2d 406 (Ky. 1994) (a Kentucky Personnel Board case). These cases are inapt.

The General Assembly by statute and this Court have established the proper procedures for the ALJ to follow in resolving claims before the Workers Compensation Board. When the party with the burden of proof is unsuccessful before the ALJ, the issue on appeal is whether the evidence compels a different decision, and not whether the ALJ's decision was supported by substantial evidence. As stated in Lanter v. Kentucky State Police, 171 S.W.3d 45, 51 (Ky. 2005), "KRS §342.285 designates the ALJ as the finder of fact; therefore, the courts have determined that the ALJ, rather than the Board or a reviewing court, has the sole discretion to determine the quality, character, and substance of the evidence. When the party with the burden of proof does not succeed before the ALJ, that party's burden on appeal is to show that the favorable evidence was so compelling that the decision to the contrary was unreasonable." "Compelling evidence is evidence so overwhelming that no reasonable person could reach the

conclusion of the ALJ." Neace v. Adena Processing, 7 S.W.3d 382, 385 (Ky. App. 1999). When the evidence is conflicting, the ALJ has the sole authority to believe or disbelieve various parts of the evidence, regardless of whether it comes from the same witness or the same adversary party's total proof. Caudill v. Maloney's Discount Stores, 560 S.W. 2d 15, 16 (Ky. 1977). So long as any evidence supports the ALJ's opinion, it cannot be said that the evidence compels a different result. Special Fund v. Francis, 708 S.W.2D 641 (Ky. 1986).

As stated in Snawder v. Stice, 576 S.W.2d 276 (Ky. App. 1979):

> The claimant in a workman's compensation case has the burden of proof and the risk of persuading the board in his favor. There is a vast difference between what the board is free to do and what it can be forced to do under a given state of evidence. There are some cases in which no evidence whatever is required in 'support' of a negative finding, and among them are those in which the claimant's evidence would justify a favorable finding but would not require one as a matter of law. If the board finds against a claimant who had the burden of proof and the risk of persuasion, the court upon review is confined to determining whether or not the total evidence was so strong as to compel a finding in claimant's favor.

Id. at 279-280 (citations omitted).

By directing that the ALJ reopen the evidence and only reach its conclusion that DAI was not a contractor under KRS §342.610 by substantial evidence, the Court of Appeals disregarded this authority, placed an improper burden on the ALJ in its fact-finding capacity, and essentially shifted the burden of proof to DAI to show it was not a contractor by substantial evidence, when by law, the burden was properly on the Fund to prove its claim against DAI.

4. The Court of Appeals was prohibited from directing the ALJ to revisit its factual findings.

The Court of Appeals also took issue with the purported failure of the ALJ to make findings of fact to support of the ALJ's legal conclusion that KRS §342.610(2)(b) did not apply in this instance, based upon the Court's belief that such findings be supported by substantial evidence of record. See Opinion, at p. 20. This ruling likewise was in error.

KRS §342.285(1) provides that an ALJ's decision is "conclusive and binding as to all questions of fact" unless a petition of reconsideration is filed seeking findings of fact to support a conclusion. In Eaton Axle Corporation v. Nally, 688 S.W.2d 334 (Ky. 1985), this Court noted first, "the appellate standard of review in workers' compensation cases has always been that there be sufficient evidence of probative value to justify the finding of the Board and the appellate court shall not substitute its judgment for that of the Board." Id. at 336. Noting that a multitude of cases were being remanded to the Board (now to the ALJ) for Findings of Fact to the point that this was consuming an inordinate amount of the Courts' time, the Court in Eaton Axle decreed:

> It is our opinion that KRS 342.281 should be utilized as a statutory counterpart of CR 52.04 and that before beginning the appellate process which utilizes the court system, the claimant, employer or other party involved in the case before the Workers' Compensation Board seeks an appeal on errors which are patent upon the face of the award, order or decision, he *must* first file a Petition for Reconsideration pursuant to KRS 342.281...
>
> It is the decision of this court that prospectively, from the date of this opinion, **no** award, **order or decision of the Workers' Compensation Board shall be reversed or remanded on appeal to any court because of failure of said Board to make findings or an essential fact** unless said failure is brought to the attention of the Board by Petition for Rehearing pursuant to KRS 342.281.

Id. at 338 (emphasis added). In Osborne, supra, the Court adopted the holding of Eaton to the new statutory scheme in which the ALJ rather than the Board was the finder of fact, noting:

> Our jurisprudential system embodies a fundamental concept that one waives error at the trial level by failing to properly and timely object or otherwise bring the error to the attention of the trier of fact... When we decided Eaton Axle, the Workers' Compensation Board decided claims... Now, under appropriate circumstances, a petition for reconsideration must bring patent errors on the face of an award to the attention of the administrative law judge. Absent a petition for reconsideration, the administrative law judge's findings shall be conclusive and binding on all questions of fact. KRS §342.285(2)...

Id. at 645. See also Senninger v. Kentucky Farm Bureau, 2010 Ky. Unpub. LEXIS 61 (Ky. 2010); and Bullock v. Goodwill Coal Co., 214 S.W.3d 890, 894 (Ky. 2007), stating, "A failure to provide an explanation when one is required is an error of omission that is patent on the face of the opinion. The omission does not necessarily render... the findings and opinions erroneous, but it prevents a meaningful appellate review of the decision. It is an error that an ALJ may correct on petition for reconsideration and that Eaton Axle Corp. v. Nally, supra, requires be raised before the appellate process begins."

The ALJ and the Board determined that DAI was in the business of selling franchises, not sandwiches, and as such, that the work performed by Watash was not a regular and recurrent part of DAI's business under KRS §342.610. If the Fund believed that the ALJ's findings were insufficient, the Fund should have filed a Petition for Reconsideration bringing this deficiency to the ALJ's attention. Instead, the Fund's Petition failed to raise this point and focused instead exclusively on the application of two additional cases. Thus, the Court of Appeals erred in directing that the ALJ revisit this issue on remand. The ALJ has already resolved this factual issue in DAI's favor. Pursuant to Eaton Axle and Osborne, the Order of the ALJ may not be reversed or remanded because of any alleged failure of the ALJ to make such findings of essential fact.

In summary, the ALJ determined that DAI was in the business of selling franchises, not sandwiches, and therefore, found that DAI was not a "contractor" under KRS §342.610(2)(b) as a matter of law. The ALJ reached this determination based on its evaluation of the specific facts relating to DAI's business relationship with Watash rather than on a blanket legal conclusion that KRS §342.610 does not apply to franchisees. As such, its findings must be affirmed absent

proof from the Fund that the favorable evidence was so overwhelming that it compelled a favorable ruling for the Fund.

In reversing the ALJ and the Fund, the Court of Appeals failed to take into account the Fund's burden of proof to its consideration of the issues, and mischaracterized the ALJ's decision as driven exclusively by a general legal determination that KRS §342.610 does not apply to franchisors. In fact, the ALJ's decision was based on its consideration of KRS §342.610 to the specific facts of this case and what must be demonstrated to establish a contractor-subcontractor relationship under the statute. Moreover, the Court of Appeals improperly directed the ALJ to reopen the evidence and provide additional findings of fact, when the Fund waived this issue by failing to properly raise it in a Petition for Reconsideration before the ALJ. Therefore, the holding of the Court of Appeals must be reversed at this time, and judgment entered in DAI's favor.

B. IN ANY EVENT, DAI DOES NOT QUALIFY AS A CONTRACTOR UNDER KRS §342.610(2)(A).

DAI assumes that the Fund will argue that the Court of Appeals reversed and remanded because it believed the ALJ misconstrued the controlling statute, KRS §342.610(2)(b), to extend to all franchise relationships. As noted above, DAI disagrees with that characterization that the ALJ's opinion relied upon the general legal conclusion that KRS §342.610 exempts all franchises, rather than on the specific conclusion that the statute did not apply to DAI's franchise agreement with Watash. However, even if this Court agreed with the Court of Appeals that the ALJ had intended to construe KRS §342.610(2)(b) broadly to exempt all franchise arrangements, DAI would still be entitled to judgment[4] in its favor on two separate grounds. First, the plain

[4] Under Kentucky law, an appeals court can affirm for any reason sustainable by the record. See Emberton v. GMRI, Inc., 299 S.W.3d 565, 576 (Ky. 2009); Kentucky Farm Bureau Mutual Ins. Co. v. Gray, 814 S.W.2d 928, 930 (Ky. App. 1991).

language of KRS §342.610(2)(b) does not apply to franchise agreements as they are typically executed and as they were executed in this case; and second, even if the ALJ erred in construing the statute broadly, DAI would not qualify as a statutory contractor pursuant to KRS §342.610 under the terms of the specific franchise relationship between it and Watash.

1. KRS §342.610(2)(b) does not apply to franchise agreements.

In asserting its indemnity claim against DAI, the Fund relied exclusively on the provisions of KRS §342.610(2)(b). That statute provides in relevant part:

> A contractor who subcontracts all or any part of a contract and his carrier shall be liable for the payment of compensation to the employees of the subcontractor unless the subcontractor primarily liable for the payment of such compensation has secured the payment of compensation as provided for in this chapter... A person who contracts with another:
>
> * * *
>
> (b) To have work performed of a kind which is a regular or recurrent part of the work of the trade, business, occupation, or profession of such person
>
> shall for the purposes of this section be deemed a contractor, and such other person a subcontractor.

Courts interpret statutory language with regard to its common and approved usage. KRS §446.080. Courts refer to the language of the statute rather than speculating as to what may have been intended but was not expressed. Commonwealth v. Allen, 980 S.W.2d 278, 280 (Ky. 1998). In other words, a court "may not interpret a statute at variance with its stated language." Id. Therefore, any statutory analysis must begin with the plain language of the statute.

In its brief below, the Fund argued and the Court of Appeals agreed that KRS §342.610(2)(b) should be interpreted broadly to "affect its remedial purpose" "in favor of those for whose protection the enactment was made." Appeal Record, at 6. However, a liberal interpretation of KRS §342.610(2)(b) beyond its plain language would not assist injured workers

in any case in which their employers had failed to secure workers compensation coverage (as those workers are otherwise protected by the Fund), but rather would only assist the Fund in its subrogation efforts against alleged statutory contractors. The dominant purpose of the movement to adopt Workers' Compensation laws in the early 20th Century was not to abrogate existing common law remedies for the protection of workers. Rather, it was to provide social insurance to compensate victims of industrial accidents because it was widely believed the existing remedies at the time were inadequate to protect them. See Boggs v. Blue Diamond Coal Co., 590 F. 2d 655 (6th Cir. 1979). Accordingly, courts have construed coverage provisions of workers' compensation laws liberally while **narrowly construing the (tort) immunity provisions**. Id. at 658-659.

In this case, the Fund's interpretation of KRS §342.610(2)(b) is contrary to the rules of construction of workers compensation statutes. If the Fund were to prevail against DAI on the basis that KRS §342.610(2)(b) imposes up-the-ladder liability to franchisors, DAI would be deemed a statutory contractor but would also be considered immune from tort liability from injured employees of its franchisees. Such result would ultimately be antithetical to the goals of workers protection, as it would abrogate existing common law remedies for the protection of workers. Thus, the provisions of KRS §342.610(2) should be narrowly construed to avoid giving tort immunity to franchisors such as DAI.

In Papa John's International v. McCoy, 244 S.W.3d 44, 55 (Ky. 2008), this Court characterized franchises as business relationships in which "a franchisor typically concentrates its control on the quality and operational requirements relating to its trade or service mark, as opposed to the day-to-day operations and management of the business..." This definition is also consistent with the definition of "franchise" set forth in 16 C.F.R. §436.1(h).

As KRS §342.610(2)(b) states, in order for an entity to qualify as a "contractor" for workers' compensation purposes, it must "contract with another" "to have work performed of a kind [of work] which is a regular or recurrent part of the work of the trade, occupation or profession of such person." As the only contract between DAI and Watash was the franchise agreement; it is the terms of the franchise agreement which controls. That franchise agreement did not direct Watash to perform any franchising work for DAI. Rather, it granted Watash the right to use DAI's trademarks and recipes in a restaurant owned and exclusively operated by Watash, in exchange for a royalty in the form of a percentage of Watash's gross receipts.

One of the factors considered by the ALJ in finding that this franchise relationship did not meet the terms of the statute was that, under the franchise agreement, DAI made no payments to Watash for services rendered but instead only received royalties from Watash in exchange for Watash's use of DAI's intellectual property. In order to qualify as a "contractor" under KRS §342.610(2)(b), DAI must have contracted with Watash to "have work performed." While the term "work" is not defined at KRS §342.610, it is defined at KRS §342.0011 as follows:

> "Work" means providing services to another in return for remuneration on a regular and sustained basis in a competitive economy.

This statutory definition of "work" contemplates that one party will provide services to a second party, and that second party will provide remuneration[5] to the first party in exchange for those services. The franchise agreement between Watash and DAI does not direct Watash to perform any work for DAI. Rather, the agreement provides Watash the right to use DAI's trademarks, recipes and other intellectual property in exchange for royalties derived by Watash in the utilization of that intellectual property. The "work" at issue which caused Brown's injuries was the selling of sandwiches, which was the business of Watash, not DAI. DAI's intellectual

[5] "Renumeration" is not defined in the statute, but is typically defined as the act of payment or compensation. See Black's Law Dictionary (Second Pocket Edition).

property is not a service provided by Watash to DAI; in any event it is undisputed that DAI's intellectual property did not cause or contribute to Brown's injuries.

The term "services" is not defined at KRS §342.0011, or elsewhere in the Workers Compensation Act. Generally, Black's Law Dictionary defines "services" as analogous to employment, or "duty or labor to be rendered by one person to another." An exchange of intellectual property, such as trade marks and recipes, in exchange for royalties does not appear to be a service rendered. In Davis v. Ford Motor Company, 244 F. Supp. 2d 784 (W.D. Ky. 2003), the court recognized the distinction drawn between services (such as cleaning or repairing at the defendant's place of business) and other forms of contractual obligations. Just as the ALJ concluded in this case with respect to the payment of royalties, the court in Davis noted that "specifically omitted from the definition of 'work' is any mention of the supply of goods, materials, or products." Id. at 787. Just as the Budd employee performed no services at the Ford plant in Davis, the injured employee herein provided no services to DAI at DAI's premises, or otherwise pursuant to contract with her employer Watash. Rather, Watash received "goods or materials" in the form of intellectual property from DAI in exchange for royalties derived from Watash's sale of sandwiches.

In Elkhorn-Hazard Coal Land Corp. v. Taylor, 539 S.W.2d 101, 103 (Ky. 1976), this Court read the "contractor" provision narrowly and "limited in application" to "persons who contract with another." Yet, oddly, the Court of Appeals in this case directed the ALJ on remand to disregard the contractual language between DAI and Watash and "to put aside that Watash purchased a 'franchise' from DAI, and to instead look to the nature of the lasting relationship that was created between DAI and Watash thereafter." Opinion, at p. 18. Respectfully, this is NOT the test for liability under KRS §342.610(2)(b) which specifically requires the existence of

a contract whereby the purported contractor arranges to have the subcontractor perform work of a kind which is a regular or recurrent part of the work of the trade, business, occupation or profession of the purported contractor.

The plain definition of "work" as used at KRS §342.610(2)(b) contemplates a party providing services to a second party **in exchange for** that second party providing the first party remuneration or compensation on a regular basis. The statutory definition of "work" does not fit a franchise situation, as no work in the form of services was provided by DAI to Watash in exchange for Watash's payment of royalties to DAI.

The Board in its opinion evaluated the language of KRS §342.610(2)(b) and concluded that the work of Watash was not "of a kind which is a regular and recurrent part of the work" of Watash, as DAI is in the business of developing franchises for securing royalties and Watash was in the business of operating a restaurant. The Court of Appeals improperly substituted its evaluation of the facts for those of the ALJ and the Board. In this case, DAI did not make any payments or provide any remuneration to the alleged subcontractor, Watash. Rather, in exchange for DAI providing it with the right to use its intellectual property, Watash made payment to DAI.

In summary, the utilization of the terms "work", "services" and "remuneration" in KRS §342.610(2)(b) and KRS §342.0011 specifically contemplate that the contractor to be held liable for workers compensation benefits provide the payment to a subcontractor in exchange for services provided by that subcontractor. This interpretation makes sense when one considers that it is the services provided by the subcontractor that likely results in the injury to the subcontractor's employee, which necessitates the legal fiction created by the statute in which the contracting non-employer is "deemed" liable as a contractor. To the extent the injured employee

was employed by the contractor, the contractor would already be liable as an employer under the Workers Compensation Act. An interpretation of this statute that holds a contractor liable for providing services (if intellectual property could be so characterized as services) in exchange for payment by the subcontractor would be nonsensical, as the payment of remuneration would rarely if ever result in injury to an employee.

In general matters of statutory construction, "the express mention of certain conditions of entitlement [in a statute] implies the exclusion of others." Hearn v. Comm., 80 S.W.3d 432, 438 (Ky. 2002). Following that general rule of statutory construction, the ALJ had noted that, "If the Legislature had intended for KRS 342.610 to encompass the relationship between a franchisor and a franchisee, it would have been very easy to include such language in the statute." Turning this rule of statutory construction on its head, the Court of Appeals conceded that franchise agreements are not addressed at KRS §342.610, or anywhere else in Kentucky's statutory scheme. Yet, while the Fund has the burden of proof and while the Court of Appeals noted that the Fund had failed to define the term "franchise", the Court of Appeals took it upon itself to compare a franchise to a "business opportunity" rather than defining it as it was defined under the terms of the franchise contract, the only relevant document at issue. Then, while the business opportunities statute stated that transactions qualifying as franchises under federal regulation were actually **exempted** from its definition of business opportunities agreements, the Court of Appeals concluded that this meant the terms have been "associated" with each other.

As the Court of Appeals noted, the term "franchise" is not defined under Kentucky law. Rather, it is defined at 16 C.F.R. §436.1(h), which provides:

> Franchise means any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:

(1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark;

(2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and

(3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.

Undefined statutory terms are to be accorded their common, every day meaning. Wilfong v. Com., 175 S.W.3d 84, 96 (Ky. App. 2004). The Court of Appeals ignored the common meaning of franchise by searching for one that would support its result oriented opinion, and strained to find it in the Business Opportunity Act (KRS §367.801 through KRS §367.819). That Act, however, does not pertain to franchises but rather to "business opportunities" as defined therein. While that Act does not define the term "franchise," it does state that contracts meeting the definition of franchise as set forth in 16 C.F.R. §436.1(h) are **exempted** from its provisions. Bizarrely, the Court of Appeals concludes that an exemption from the Business Opportunity Act represented an "association" of the terms "business opportunity" and "franchise." Having formed an improper association between the two types of business transactions, the court then opined that because Chapter 367 does not provide any guidance concerning the ongoing relationship between the parties after the business opportunity, that Act "does not inform the question of whether the relationship between DAI and Watash could also constitute a contractor-subcontractor relationship pursuant to KRS §342.610(2)(b)." Opinion, at pp. 12-13.

Respectfully, this is a classic straw man argument. While no one mentioned application of Chapter 367 or "business opportunities" below, the Court of Appeals declared that such

relationships are not per se exempt from KRS §342.610, and then aligned them with franchises (rather than exempting franchises from such analyses), to conclude that the ALJ must have committed error in finding "franchisors" exempt from liability under the Workers Compensation Act. While a business opportunity is defined to include the sale of goods, supplies or services for the start of a business, the subject franchise agreement by its terms involves only an exchange of intellectual property for royalties and would otherwise be exempt from the terms of Chapter 367.

In summary, the plain language of KRS §342.610(2)(b) requires that a contractor to be liable for compensation must have a contract with a subcontractor to perform work performed for the contractor, and that work must be a regular and recurrent part of the type of work performed by that contractor. In order to qualify as work, the "work" must be a service rendered by the subcontractor in exchange for remuneration by the contractor. Under franchise agreements, the franchisor does not make any payments to the franchisee in exchange for services rendered, so the franchise arrangement does not satisfy the plain language of the statute and franchisors cannot be deemed statutory contractors.

2. Even if KRS §342.610(2)(b) could arguably apply to some types of franchise agreements, DAI does not qualify as a contractor under the facts of this case.

In this case, the ALJ identified the "trade, occupation or profession" of DAI as being the business of franchising. Thus, under the plain terms of KRS §342.610(2)(b), DAI could only be a contractor and Watash a subcontractor to the extent that DAI contracted with Watash to perform the kind of work which is a regular or recurrent part of franchising.

This case is analogous to Elkhorn-Hazard Coal Land Corp. v. Taylor, 539 S.W.2d 101 (Ky. 1976), which was affirmed most recently by this Court in General Electric v. Cain, 236 S.W. 3d 579, 586 (Ky. 2007). In Elkhorn-Hazard, the appellant Elkhorn-Hazard entered into a

contract with M& A Coal, whereby M & A leased from Elkhorn-Hazard the right to mine coal in exchange for the payment of royalties. As in this case, the Fund contended that the contract for royalties between Elkhorn-Hazard and M & A made Elkhorn-Hazard a contractor under KRS §342.610(2)(b). After considering cases from other jurisdictions, including a case in which a gas station operated under lease did not make the lessor a statutory employee, the Court stated:

> There is no basis in the record for a conclusion that Elkhorn-Hazard was conducting a mining business through the use of a lease or that it was conducting any work through the use of a lease which is a regular part of its business operations and which normally would have been accomplished through the use of its own employees.
>
> It does not appear to us that the lease can be construed as a contract to have work done for Elkhorn-Hazard. The work performed by M & A Coal Company was done for itself in a proprietary capacity. M & A Coal Company was mining the coal for its own use and not for Elkhorn-Hazard.

Id. at 104. In like manner, DAI's sole benefit from Watash's restaurant operations were the royalties received by DAI under the franchise agreement. Just as in Elkhorn-Hazard, DAI earns a profit from royalties as a result of others conducting work, but DAI is not engaged in that particular work itself. There was no evidence that DAI was operating a restaurant through the use of its franchise agreement. The work performed by Watash was done for itself, and DAI did not control the prices set by Watash or any other aspect of its business operations.

The Court of Appeals did not consider Elkhorn-Hazard, but found dispositive an earlier case it decided that had disregarded Elkhorn-Hazard. In R.O. Giles Enterprises v. Mills, 275 S.W.3d 211 (Ky. App. 2008), the court declined to analyze up-the-ladder liability under Elkhorn-Hazard on the grounds that "the unambiguous statute, when analyzed with the facts, compel us to determine that substantial evidence exists to satisfy the legal elements of up-the-ladder contractor status in this case, without reference to Elkhorn-Hazard."

The Court of Appeals here held that the facts in R.O. Giles "appear[ed] to be analogous to the one at bar" and that the two cases "share a number of similarities," but overlooked a critical difference between that case and this one. In R.O. Giles, at issue was a contract for the removal of timber. KRS §342.610(2)(a) expressly provides that a person who contracts with another "to have work performed consisting of... the cutting or removal of timber from land... shall for purposes of this section be deemed a contractor." Due to the plain language of the statute as it pertained to timber removal, the court in R.O. Giles found it unnecessary to consider Elkhorn-Hazard. Of course, this case has nothing to do with the removal of timber and involves a completely different subsection of KRS §342.610(2), so that this case is in no way analogous to the facts of R.O. Giles. The court's holding in R.O. Giles had nothing to do with the flow of work in exchange for remuneration under KRS §342.610(2)(b).[6] The cases are not comparable but rather clearly factually and statutorily distinguishable.

As KRS §342.610(2)(b) imposes liability for certain types of contracts, it is logical to assume the express terms of a given contract would dictate whether the statute applied to impose liability. The ALJ scrutinized the subject contract between DAI and Watash, noting that DAI was a corporation which owed the trademark "Subway," and that while it operated 2 stores outside of Kentucky at the time the vast majority of its business was as a franchisor. The ALJ stated that the contract between DAI and Watash imposed a variety of obligations on the franchisee, and that in exchange for meeting those obligations and paying DAI a percentage of its income, DAI granted Watash the right to use its trade name. While the ALJ stated its impressions of how a franchise generally works, it then stated, "In this instance, the franchise

[6] Also overlooked by the Court of Appeals in its reliance on R.O. Giles is that the ALJ and Board found in favor of the Fund in that case, so that the purported contractor had the burden of proof of demonstrating error by the ALJ, whereas the burden was on the Fund in this appeal to demonstrate substantial evidence to the contrary of the ALJ's ruling.

agreement gave Watash the right to operate a Subway shop in Whitesburg, Kentucky for a price." The ALJ stated that this contract appeared to it to be "a much different arrangement than that which is contemplated in KRS §342.610. Unlike the situation with the removal of timber set forth at KRS §342.610(2)(a), the ALJ noted that the Legislature had not specifically included language holding a franchisor liable at KRS §342.610(2)(b). However, it is clear that the ALJ's conclusions were based on the specific contractual relationship between DAI and Watash and were not a blanket ruling excluding KRS §342.610(2)(b) from all franchise relationships. Rather, the ALJ defined its use of the term "franchise" based on the specific contractual relationship at issue herein, and concluded that the statute did not extend to that relationship.

KRS §342.610(2)(b) contains two separate pre-conditions to liability: the existence of a contract between a contractor and subcontractor requiring the subcontractor to perform work for the contractor; and the requirement that the work that is the subject of that contract be work which is a regular or recurrent part of the work of the "trade, business, occupation, or profession" of the contractor. To reach the "regular or recurrent" part of the statutory analysis, the factfinder must first determine the existence of an underlying qualifying contract. As demonstrated above, DAI's franchise agreement with Watash is not a qualifying contract for work, so that it is unnecessary to remand this case for factual findings as to whether the contract pertained to a regular or recurrent part of DAI's work. The ALJ has already concluded that DAI's work is franchising and that operating a restaurant is not a regular or recurrent part of that work, and its conclusions in this regard cannot be challenged on appeal.

C. HAVING SETTLED WITH BROWN, THE FUND HAS NO SUBROGATION OR REIMBURSEMENT RIGHTS AGAINST DAI EVEN IF IT WERE ULTIMATELY DEEMED A CONTRACTOR UNDER KRS §342.610.

As noted above, the sole issue in this case before both the ALJ and the Board was whether DAI has up-the-ladder liability as a contractor under KRS §342.610(2)(b). This issue is relevant because the injured employee Brown's employer, Watash, Inc., had failed to maintain workers' compensation coverage and the Fund was required by law to pay Brown's workers compensation claim. Under appropriate circumstances, KRS §342.610(2)(b) makes a statutorily defined contractor liable for the payment of compensation benefits to the employees of the subcontractor when the primarily liable subcontractor fails to maintain such coverage.

Conversely, the Fund's liability is considered a secondary liability which comes into play only after execution is unsatisfied against those who have primary responsibility to pay workers' compensation benefits. Davis v. Goodin, 639 S.W.2d 381 (Ky. App. 1982). Pursuant to KRS §342.760(4), the Fund is entitled by statute to reimbursement for those payments made **from the uninsured employer of the injured employee**. KRS §342.760(4), by its express terms, does not authorize the Fund to seek reimbursement from a statutory contractor under KRS §342.610(2)(b).

Upon learning that her employer did not maintain workers compensation insurance, Brown could have asserted a claim against DAI pursuant to KRS §342.610(2)(b) arguing that DAI was a statutory contractor, or she could have assigned her right to make such claim to the Fund. She did neither. The Fund, and not Brown, sought DAI's joinder to this case, and the time for Brown to make either a workers' compensation claim or a tort claim against DAI has long since lapsed. Under Kentucky law, an employee is allowed two years after the date of injury to seek workers compensation. KRS §342.185. In addition, in Waters v. Transit

Authority of River City, 799 S.W.2d 56 (Ky. App. 1990), the court stated that the employer or compensation carrier's rights against a third party tortfeasor were entirely derivative of the injured employee's tort claim, so that an insurer seeking reimbursement pursuant to KRS §342.700 was required to bring suit against the responsible third party within the same time frame that the injured employee could have filed suit for his personal injuries.

KRS §342.760(4) provides that the Fund is responsible when there has been a default in payment due to the failure of an employer to secure compensation, and that, "[s]uch employer shall be liable for payment into the fund of all the amounts authorized to be paid therefrom under the authority of this subsection including reimbursement of the special fund of all liability apportioned to it and for the purposes of enforcing this liability the Department of Labor, for the benefit of the fund, shall be subrogated to all the rights of the person receiving such compensation from the fund."

To the extent DAI is found liable for compensation benefits pursuant to KRS §342.610(2)(b), it is immune from a claim for tort liability from Brown pursuant to KRS §342.690(1). Likewise, the Fund does not have a direct right of reimbursement or subrogation from DAI, as KRS §342.760(4) provides that the Fund is only responsible for the payment of compensation when there has been a default of an employer due to that employer's failure to secure payment of compensation as provided by KRS Chapter 342, and the Department of Labor "shall be subrogated to all the rights of the person receiving such subrogation from the fund."

On the subject of subrogation, all subrogation rights are derivative and the insurer only acquires the rights of its insured. A subrogee is substituted in place of its insured; it does not acquire greater rights. Fireman's Fund Ins. v. Government Employees Ins., 635 S.W.2d 475 (Ky. 1982), overruled on other grounds by Perkins v. Northeast Log Homes, 808 S.W.2d 809, 817

(Ky. 1991). Brown has not to date asserted any claims against DAI, and is time-barred from making such claims at this time.

Under the authority of Davis v. Goodin, 639 S.W.2d 381 (Ky. App. 1982), the Fund is secondarily liable, and has potential but speculative liability, to an employee, until there is a default of all responsible employers. As the Court stated, "Pursuant to KRS 446.020(1), a default as mentioned in KRS 342.760(4) and 803 KAR 25:010(24) must be a default of all the employers and not just one of them before statutory liability attaches to the uninsured employers' fund." In this case, DAI is not in default and has not been in default. Yet, the Fund accepted responsibility for Brown's claim and settled it before pursuing this appeal. See WC Record, at 513-516. While the Fund attempted to preserve its rights against DAI in the settlement agreement, DAI did not consent to any such preservation and the Fund's rights against DAI are otherwise controlled by statute.

Having accepted responsibility for Brown's workers compensation payments prior to the establishment of default on the part of DAI, the Fund has no right of reimbursement from DAI at this time, even if DAI's liability under KRS §342.610(2)(b) were otherwise established. As KRS §342.760(4) provides, only a defaulting employer, and not a statutory contractor under KRS §342.610(2)(b), is liable for reimbursement of the Fund's payments to an employee. To the extent the Fund is subrogated to the rights of the injured employee Brown pursuant to KRS §342.760(4), Brown no longer has a claim in either tort or under the Workers Compensation Act against DAI having failed to assert a timely claim against DAI, so the Fund is likewise time-barred as subrogee from pursuing DAI.

DAI notes the longstanding rule in Kentucky that an appeals court can affirm for any reason sustainable by the record. See Emberton v. GMRI, Inc., 299 S.W.3d 565, 576 (Ky.

2009); Kentucky Farm Bureau Mutual Ins. Co. v. Gray, 814 S.W.2d 928, 930 (Ky. App. 1991). Any remand at this point would be moot, as Brown has been fully compensated by the Fund, and the Fund has no legal rights of subrogation from DAI. Therefore, the holding of the Court of Appeals must be set aside and judgment entered in DAI's favor.

D. A VICARIOUS LIABILITY ANALYSIS IS IRRELEVANT TO THE ISSUES BEFORE THE COURT.

Because a concurring opinion of the Court of Appeals invoked the possibility of DAI being held vicariously liable, DAI finds it necessary to address those arguments in the event this matter is remanded for further proceedings.

The case of Papa John's International v. McCoy, 244 S.W.3d 44 (Ky. 2008), referenced in the lower court's concurring opinion, involved the potential vicarious liability of the franchisor, Papa John's, for a tort claim asserted against an employee of the franchisee, RWT. While there is no precise definition of what constitutes a franchise under Kentucky law, this Court nevertheless elected to examine the vicarious liability claim in the context of general franchisor/franchisee arrangements. The Court noted:

> Because a franchisor typically concentrates its control on the quality and operational requirements relating to its trade or service mark, as opposed to the day-to-day operations and management of the business, "the perceived fairness of requiring a principal who closely controls the physical conduct of the agent to answer the harm caused by the agent is diminished in this context."

Id. at 55. The Court in Papa Johns adopted a rule for franchisors that allowed vicarious liability for the conduct of a franchisee "only if the franchisor has control or a right of control over the daily operation of the specific aspect of the franchisee's business that is alleged to have caused the harm." Id.

The ALJ in this case found that DAI lacked any control over the day-to-day operations of Watash, which would have included the operations around the sink and ice machine that resulted

in employee Brown's slip and fall injury. Thus, while these vicarious liability principles are completely irrelevant to the dispute before this Court, their application even if relevant would not support a claim against DAI.

Finally, the concurring opinion suggested that DAI could somehow face exposure due to franchise requirements that the franchisee maintain insurance and make DAI an additional insured on its policy. As the concurring opinion has interjected suggestions of duty, breach of duty and vicarious liability into the equation for the ALJ's consideration, it is worth noting that Kentucky law would not support such a conclusion in this case.

It has long been the rule in Kentucky that a person who is neither a party nor a third-party beneficiary of a contract may not enforce it or **derive any benefit from it**. Sexton v. Taylor County, 692 S.W.2d 808 (Ky. App. 1985). The court in Sexton elaborated:

> It is the law of this jurisdiction that no stranger to a contract may sue for its breach **unless** the contract was made for his benefit. Parties for whom these contracts are made fall into two classes—donee beneficiaries and creditor beneficiaries.
>
> In Guarantee Electric Company v. Big Rivers Electric Corporation, 669 F. Supp. 1371 (W.D. Ky. 1987), the court stated the rule as follows, "The only parties having such rights [under a contract] are donee beneficiaries and creditor beneficiaries."

The Sixth Circuit Court of Appeals in King v. National Industries, Inc., 512 F.2d 29, 33 (6th Cir. 1975), described each third party class with contractual rights as follows:

> One is a donee beneficiary if the purpose of the promisee in buying the promise is to make a gift to the beneficiary. A person is a creditor beneficiary if the promisee's expressed intent is that the third party is to receive the performance of the contract in satisfaction of any actual or supposed duty or liability of the promisee to the beneficiary.
>
> In order to be either a donee or creditor beneficiary, it must be proven that the contract in question was made for the **actual and direct benefit of the third party**.

Id. at 810 (emphasis added). See also Krahwinkel v. Commonwealth Aluminum Corp., 183 S.W.3d 154, 162 (Ky. 2005) ("Under Kentucky law, before a third person who is not a party to a contract can derive benefit from that contract, the third person must show that the contract was made and entered into directly or primarily for the benefit of the third person." (Lambert, C.J., concurring) (citing Long v. Reiss, 160 S.W.2d 668 (Ky. 1942)).

The obvious reason that DAI requires all franchisees to include it as an additional insured on any insurance policies procured is for the protection of DAI in cases such as the one at bar, and not for the protection of employees. Neither the Fund nor Brown has asserted that the franchise agreement was entered into for the benefit of the franchisor's employees.

As the Court in Ostendorf v. Clark Equipment, 122 S.W.3d 530 (Ky. 2003), has held, imposition on a party who has assumed a duty to act is premised upon reliance, so that liability may be imposed only if:

> (a) his failure to exercise reasonable care increases the risk of such harm, or
>
> (b) he has undertaken to perform a duty by the other to the third person, or
>
> (c) the harm is suffered because of reliance of the other or the third person upon the undertaking.

Id. at 538. None of these factors are present to enable either the Fund or Court to conclude DAI owed any duties to procure workers compensation or to assure such coverage was in place prior to Brown's injury. Indeed, Watash's failure to maintain insurance for its injured workers and to protect DAI evidences lack of control by DAI.

VI. CONCLUSION

For the reasons stated herein, appellant DAI respectfully requests that the September 3, 2010 Opinion of the Court of Appeals be reversed, and the Orders of the ALJ and Workers Compensation Board dismissing the claims of the Uninsured Employers' Fund against Doctors'

Associates, Inc., be reinstated, and that DAI be dismissed as a party to this Workers Compensation claim as a matter of law.

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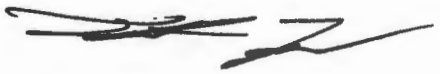

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