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

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REPLY BRIEF OF APPELLANT

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CERTIFICATE OF SERVICE

I hereby certify pursuant to CR 76.12(6) that Appellant has not withdrawn the Record on Appeal. I hereby certify that this Reply Brief has been served on this 15th day of March, 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; Hon. Forrest Ragsdale, 400 West Market Street, Ste. 1800, Louisville, Kentucky; Hon Aaron D. Van Oort, 2200 Wells Fargo Center, 90 South 7th Street, Minneapolis, MN 55402-3901; and the Honorable Dwight T. Lovan, Commissioner, Department of Workers Claims, 657 Chamberlin Ave., Frankfort, KY 40601.

Todd S. Page

STATEMENT OF POINTS AND AUTHORITIES

PAGE(S)

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.

Initially, Doctors' Associates, Inc. ("DAI") notes that the Fund in its Brief inaccurately refers to DAI as a "parent company of the Subway sandwich shops." See Fund Brief, at p. 1. It is factually and legally undisputed that DAI was not the parent company of the employer and restaurant operator Watash. Rather, the relationship between DAI and Watash was solely that of franchisor and franchisee. By contract, the franchisee was given the right to use DAI's trademarks and service marks and other intellectual property in exchange for the franchisee's payment of royalties, with the royalties calculated on a percentage of the franchisee's overall sales. This relationship is quite different than that of corporate parent and subsidiary[1]. DAI has no parent-subsidiary relationship with any of its franchisees.

As DAI has noted, the decision in DAI's favor by the ALJ was based on the ALJ's application of the facts in the record to the statutory language of KRS §342.610(2)(b). As the ALJ recited in its Opinion and Order, "The only issue for decision is whether Doctors has up-the-ladder liability under K.R.S. 342.610." In concluding that DAI did not have up-the-ladder liability, the ALJ based its decision on the facts of this case as presented by DAI or the Fund. The ALJ's findings included its factual determination that DAI's relationship with Watash was not that of contractor and subcontractor, and that the "vast majority" of DAI's business was that

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[1] If this were a parent-subsidiary case, the Court would likely find pertinent the analysis in the cases of Boggs v. Blue Diamond Coal Co., 590 F. 2d 655 (6th Cir. 1979) and Moore v. Addington Mining, 2004 Ky. App. LEXIS 16 (Ky. App. 2004), both cases involving workers compensation claims in the parent-subsidiary context. As the court in Moore recognized, separate corporate identities should be recognized and not disregarded. Parent-subsidiary relationships often lack a contractual nexus sufficient to allow the parent to be characterized as a "contractor" pursuant to KRS §342.610. See Boggs, supra at 661.

of a franchisor collecting royalties and not in the business of selling sandwiches. The Workers Compensation Board's decision affirming the ALJ was even more explicit, with the Board noting based on its independent review of the evidence in the record 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).

Any broader declaration by the ALJ and the Board that KRS §342.610(2)(b) does not apply to franchise relationships of any ilk was clearly dicta. See Harp v. Commonwealth, 266 S.W. 3d 813, 826 n. 1 (Ky. 2008) (Scott, J., concurring) (defining dicta as "a statement in an opinion which is unnecessary to the ultimate determination."); and Williams v. West, 258 S.W.2d 468, 471 (Ky. 1958). The decisions of the ALJ and the Board were based on the specific factual record and not contingent on the broader legal conclusion that KRS §342.610(2)(b) does not apply to franchises generally. Thus, it was improper for the Court of Appeals to focus on that dicta as its sole basis for reversal, and in so doing, to disregard and reject those factual findings in DAI's favor and to remand this matter for further factual findings.

A precondition to liability under KRS §342.610(2)(b) was that DAI subcontract with Watash 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 DAI. The ALJ found from its evaluation of the evidentiary record that the selling of sandwiches was not a regular or recurrent part of DAI's business, as DAI was in the business of franchising and collecting royalties and not in the business of selling sandwiches. Any subsequent discussion by the ALJ and Board of whether

KRS §342.610(2)(b) was intended to apply to franchise agreements was unnecessary to the ALJ's ultimate determination in DAI's favor that selling sandwiches was not a regular and recurrent part of DAI's business, and being mere dicta, was not a proper basis for reversal by the Court of Appeals.

As noted, the ALJ considered the specific evidence presented in the factual record, including that evidence upon which the Fund carried the burden of proof at the administrative level. Kentland Elkhorn Coal Co. v. Johnson, 549 S.W.2d 308, 309 (Ky. App. 1977). The Fund's evidence against DAI was unconvincing to the ALJ, and the ALJ concluded that DAI was not in the business of selling sandwiches. By ignoring the ALJ's factual findings and remanding the case for further evidence, the Court of Appeals' ruling gives the Fund an improper "second bite at the apple." Even if the ALJ had failed to make findings of essential fact, the Fund's failure to bring that error to the attention of either the ALJ or the Board resulted in this issue being waived, so that it was improper for the Court of Appeals to remand for further factual findings. See Osborne v. Pepsi-Cola, 816 S.W. 2d 643, 645 (Ky. 1991).

In reversing the ALJ and Board, the Court of Appeals clearly and impermissibly exceeded the scope of its review and substituted its impression of the facts for those of the fact-finding tribunal. As noted, the ALJ found that the vast majority of DAI's business was franchising, and the Board likewise found from its review of the same evidence that DAI was in the business of developing franchises for the purpose of securing royalties rather than actually operating sandwich shops or selling sandwiches. Yet, at page 18 of its Opinion, the Court of Appeals disregarded these factual findings in asserting that "if selling Subway sandwiches to the public is a regular 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 'subcontractor,' as defined under KRS 342.610(2)(b)." The ALJ and Board had correctly found that selling Subway sandwiches to the public was not a regular part of DAI's business. The Court of Appeals intentionally disregarded these factual findings by the ALJ and Board in reversing and remanding for additional proof regarding the nature of DAI's business. As noted, the burden was on the Fund to present the ALJ with such proof and then to object to the extent it believed the ALJ failed to make findings of fact regarding such proof, and the Fund failed to do both.

The function of the Court of Appeals on appeal was to correct "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." Western Baptist Hospital v. Kelly, 827 S.W.2d 685, 687-88 (Ky. 1992). The Fund did not argue, nor did the Court of Appeals demonstrate, any error by the ALJ in assessing the evidence "so flagrant as to cause gross injustice." While the Court of Appeals apparently concluded the ALJ had misconstrued the controlling statute as it relates to franchise agreements, DAI has demonstrated that the ALJ properly applied the terms of KRS §342.610(2)(b) in concluding that DAI did not regularly and recurrently sell sandwiches so as to qualify as a contractor under the statute. The Fund has not argued that the record lacks any evidence to support the ALJ's factual determination but rather disagrees with the ALJ's factual findings and has asked the appellate courts to reconsider those findings. However, "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." Snawder v. Stice, 576 S.W. 2D 276 (Ky. App. 1979). The Court of Appeals did not conclude, nor is there sufficient evidence to support such a conclusion, that DAI is regularly and recurrently in the business of selling sandwiches as opposed to selling franchises for royalties.

Indeed, it was factually undisputed at the time of Brown's injury that DAI owned only two company-operated stores (out of a total of 14,800 Subway franchises then in operation), and that neither of those stores was in Kentucky. That fact did not persuade the ALJ or Board that DAI was primarily or even significantly in the business of selling sandwiches, so that the Court of Appeals lacked legal authority to reverse and remand the findings and conclusions in DAI's favor.

DAI does not disagree with the Fund when it asserts at page 6 of its brief that the ALJ and Board concluded as a matter of law that DAI had no "up the ladder" liability for Brown's injuries. However, that legal conclusion was based on the ALJ's factual determinations of the nature of DAI's business and not the overarching legal conclusion that KRS §342.610(2)(b) does not apply to franchise agreements as a general principle. Thus, the findings and conclusions of the ALJ must be respected, and the Court of Appeals' decision to the contrary set aside.

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

Even if the conclusion of the ALJ and Board that KRS §342.610(2)(b) does not apply to franchise relationships was not mere dicta, DAI does not qualify as a statutory contractor under that statute and the terms of that statute do not apply to the agreement between DAI and Watash.

The Fund argues that the franchise agreement states that DAI is in the "sandwich business" so that fact alone should control. However, the agreement in totality makes it clear that it is a franchise agreement, and the terms of the agreement outline the mutual responsibilities of the franchisor and franchisee to provide royalties to DAI in exchange for the use of DAI's intellectual property. The fact that the royalties are derived from the sale of food no more makes DAI in the business of selling sandwiches than does a film distribution agreement with a theater make such distributor in the business of selling movie tickets. No one would reasonably contend

that a film distributor would be responsible for a work-related injury to a ticket taker, even though much of distributor's profits are derived from the royalties that come from such ticket sales.

In its analysis of the term "work" at page 8 of its brief, the Fund confuses the flow of services in exchange for remuneration required for something to qualify as "work". As DAI has noted, the statutory definition of "work" contemplates one party providing services to a second party, and that second party providing remuneration in exchange for those services. The only "services" provided under the franchise agreement were the transfer or intellectual property by DAI to Watash, in exchange for remuneration in the form of royalties. Moreover, this "work" was not the work that resulted in Brown's injuries as she was not injured in connection with DAI's intellectual property.

The Fund ignores the holding in Elkhorn-Hazard Coal Land Corp. v. Taylor, 539 S.W.2d 101 (Ky. 1976), yet that case is closely analogous to this one. In Elkhorn-Hazard, the lessor granted the right to mine coal in exchange for royalties. As the court should conclude in this case, the court in Elkhorn-Hazard concluded that the work performed by the lessee "was done for itself in a proprietary capacity ...for its own use and not for Elkhorn-Hazard." Id. at 104.

The Fund follows the Court of Appeals in relying upon R.O. Giles Enterprises v. Mills, 275 S.W.3d 211 (Ky. App. 2008). Yet, the court in Giles elected to disregard Elkhorn-Hazard as inapplicable on the basis that the claim in Giles involved the removal of timber and a specific provision of KRS §342.610(2)(a) likewise pertained to the cutting or removal of timber. The "work" in Giles was the same whether performed by landowners or the contractor- timber cutting for profit- whereas no such "work" commonality exists in the franchise relationship at issue herein. Neither, of course, does this case involve any removal of timber, so the basis of the court

in Giles ignoring Elkhorn-Hazard is absent under the facts of this case. Rather, it is Giles that is distinguishable and Elkhorn-Hazard that is controlling under the facts of this case.

The Fund concludes its brief at page 13 by addressing the "focal point" of the ruling of the Court of Appeals, which stated that "the question of whether a particular business opportunity or franchise relationship satisfies KRS §342.610(2)(b) must be answered on a case-by-case basis, by examining the specific relationship between the alleged contractor and subcontractor and determining whether, pursuant to that statute, the alleged subcontractor has performed work 'of a kind which is a regular or recurrent part of the work of the trade, business, occupation or profession of [the contractor]." Opinion Reversing and Remanding, at p. 14.

Of course, the problem in this appeal is that such "case by case" analysis is exactly what the ALJ and Board performed in finding for DAI and what the Court of Appeals failed to do in reversing. The ALJ considered the facts of this case and concluded that DAI was not in the business of selling sandwiches on a regular and recurrent basis so that DAI did not qualify as a statutory contractor, and the Board considered that same evidence and affirmed the ALJ. The Court of Appeals elected to disregard those specific factual findings in the context of this case in directing the ALJ to reconsider those particular findings and in concluding that the ALJ had reached its conclusions in a vacuum without any regard for the specific facts of this case. The findings that the Court of Appeals directed the ALJ to reach on remand had already been reached in DAI's favor, and a further consideration of these same facts only invites the ALJ to disregard its prior findings for an interpretation more in line with the Fund's view of the facts already presented. As noted, to the extent the ALJ should have made specific factual findings but failed to do so, the Fund has waived any such objection by failing to timely raise it when the case was last before the ALJ.

C. THE FUND HAS NO SUBROGATION OR REIMBURSEMENT RIGHTS AGAINST DAI.

The Fund elects to ignore the balance of DAI's arguments regarding its statutory subrogation or reimbursement rights, contending that those claims were not preserved below. However, as DAI noted in its initial brief, this Court can affirm the trial court for any reason sustainable by the record. Kentucky Farm Bureau Mutual Ins. Co. v. Gray, 814 S.W.2d 928, 930 (Ky. App. 1991). As this Court stated in Fischer v. Fischer, 197 S.W.3d 98, 103 (Ky. 2006), any failure to raise this issue in the Court of Appeals does not prevent DAI from presenting it here as it "had no duty to present it to the Court of Appeals since [DAI] defended the trial court decision and it had to be affirmed if it was sustainable on any basis." See also Emberton v. GMRI, 299 S.W.3d 565, 575-76 (Ky. 2009)("[W]e believe any contrary rule requiring the appellee on appeal to have briefed every conceivable alternative argument for affirming the trial court in the Court of Appeals would inundate our appellate courts with unnecessary cross-appeals and reading than they do or is necessary.").

In this case, both the ALJ and Workers Compensation Board properly concluded that DAI had no liability to the Fund, so it was not necessary for DAI to file a cross-claim in the Court of Appeals detailing other grounds upon which the lower tribunals could have based their decision in DAI's favor. Rather, by raising those issues in its brief before this Court, DAI has preserved those issues for this Court's consideration.

As DAI explained in its initial brief, KRS §342.760(4) authorizes the Fund to seek subrogation only from the uninsured employer of the injured employee and not from a statutory contractor. As Brown did not make an affirmative claim against DAI and as the Fund has now settled with Brown, the Fund has no direct right of reimbursement from DAI and DAI must be dismissed from this suit on that ground. To the extent that DAI's argument presents a

"loophole" in the statutory reimbursement scheme, this is a matter for the General Assembly to correct.

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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