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NOT TO BE PUBLISHED

Commonwealth of Kentucky
Court of Appeals

NO. 2015-CA-000754-MR

OVWD, INC. F/K/A OHIO VALLEY
WHOLESALE DISTRIBUTORS, INC.

APPELLANT

v. APPEAL FROM BOYD CIRCUIT COURT
HONORABLE C. DAVID HAGERMAN, JUDGE
ACTION NO. 13-CI-00209

COMMONWEALTH OF KENTUCKY; HON.
LORI FLANERY, SECRETARY OF THE
FINANCE AND ADMINISTRATION
CABINET IN HER OFFICIAL CAPACITY;
AND HON. THOMAS B. MILLER,
COMMISSIONER OF THE
DEPARTMENT OF REVENUE IN HIS
OFFICIAL CAPACITY

APPELLEES

OPINION
AFFIRMING

** ** * ** * ** *

BEFORE: ACREE, J. LAMBERT, AND THOMPSON, JUDGES.

ACREE, JUDGE: The Boyd Circuit Court found that Appellant OVWD, Inc., f/k/a Ohio Valley Wholesale Distributors, Inc. (Ohio Valley) failed to exhaust its administrative remedies prior to filing this declaratory rights action challenging the validity of certain cigarette-tax assessments. The circuit court ultimately dismissed Ohio Valley's complaint for lack of jurisdiction. Ohio Valley challenges the circuit court's findings in this appeal. We affirm.

FACTS AND PROCEDURE

Ohio Valley is a Kentucky-licensed wholesale distributor of cigarettes and others products, both tobacco and non-tobacco. Its principal place of business is near Ashland, Kentucky. In early 2011, the Kentucky Department of Revenue conducted an audit which revealed, according to the Department, that Ohio Valley had underpaid more than eight million dollars in cigarette and other tobacco-product excise taxes. The Department issued notices of tax due. Ohio Valley protested the notices¹ and requested a conference with the Department.²

Ohio Valley took the position that no tax was due because no sale occurred within Kentucky. Instead, it sold cigarettes to two out-of-state companies, DT Distributors, Inc. (an Illinois wholesaler) and Sky Trading, Inc. (an Indiana wholesaler which also held an Illinois license). Both companies, Ohio Valley asserted, retained their own common carriers to pick up the cigarettes at Ohio Valley's Kentucky facility; the carriers then transported the cigarettes to

¹ Kentucky Revised Statute (KRS) 131.110(1) (affords taxpayers a forty-five day protest period after notice of an assessment).

² *Id.* § 131.110(2) (permits protesting taxpayer to request a conference with the Department).

locations outside Kentucky for sale in states other than Kentucky. The Department, taking an alternate view, claimed excise taxes were due because the cigarettes were actually sold to Superior Wholesale, LLC, a licensed resident wholesaler located in Lexington, Kentucky. According to the Department:

Although cover documents show the product being shipped to either DT Distributors . . . or Sky Trading . . . from [Ohio Valley's] facility in Kentucky, documents from the common carrier transporting the product from [Ohio Valley] show the product being diverted according to instructions from Superior Wholesale LLC to the state of New York. These products were never delivered to Illinois or Indiana. A representative from Superior Wholesale LLC ordered the products in question and physically supervised the loading of the product at [Ohio Valley's] warehouse. Payment for product was made by Superior Wholesale LLC to [Ohio Valley].

(R. at 254).

The conference ultimately proved unsuccessful and the Department advised Ohio Valley that it rejected its protest.

Before the Department could issue a final ruling,³ however, Ohio Valley, on March 4, 2013, filed suit in Boyd Circuit Court seeking a declaration that the taxes demanded by the Department had been assessed illegally, in contravention of the cigarette-tax statute, KRS 138.140, and in violation of both the state and federal constitutions. The Department deemed the suit frivolously premature because Ohio Valley had, in its opinion, failed to first exhaust its administrative remedies.

³ *Id.* § 131.110(3) (“After considering the taxpayer’s protest . . . the department shall issue a final ruling on any matter still in controversy[.]”).

Frustrated, the Department, on March 22, 2013, petitioned this Court for a writ mandating dismissal of Ohio Valley's complaint. The Department argued such relief was necessary because the law firm representing Ohio Valley had repeatedly filed declaratory judgment actions in tax cases knowing full well that the taxpayer-client was obliged first to bring his objections before the Kentucky Board of Tax Appeals. This Court denied the Department's petition, and the Kentucky Supreme Court affirmed. *Commonwealth, Fin. & Admin. Cabinet, Dep't of Revenue v. Hagerman*, No. 2013-SC-000624-MR, 2014 WL 4656824, at *1 (Ky. Sept. 18, 2014).

Back in the circuit court, Ohio Valley moved for a declaratory judgment while the Department simultaneously moved to dismiss Ohio Valley's petition. The circuit court, by order entered April 16, 2015, granted the Department's dismissal motion, finding the court lacked jurisdiction to consider Ohio Valley's declaration petition because Ohio Valley had failed to first exhaust its administrative remedies by appealing the Department's decision to the Board of Tax Appeals. This appeal followed.

STANDARD OF REVIEW

“The question of jurisdiction is ordinarily one of law, meaning that the standard of review to be applied is *de novo*.” *Appalachian Reg'l Healthcare, Inc. v. Coleman*, 239 S.W.3d 49, 53-54 (Ky. 2007); *Addison v. Addison*, 463 S.W.3d 755, 764 (Ky. 2015) (“Jurisdiction is a question of law which we review *de novo*.”).

ANALYSIS

Ohio Valley argues the circuit court erred when it found that Ohio Valley was required to first exhaust its administrative remedies before seeking judicial intervention. In its declaratory complaint, Ohio Valley alleged: (1) the Department acted arbitrarily in violation of Section 2 of the Kentucky Constitution when it made an *ultra vires* assessment of cigarette tax directly against Ohio Valley in excess of its statutory authority provided to in KRS Chapter 138; and (2) the Department “acted arbitrarily by interfering with the free flow of commerce . . . in violation of Section 2 of the Kentucky Constitution, the Commerce Clause of the United States Constitution, and the cigarette tax provisions of KRS Chapter 138[.]” (R. 7). Ohio Valley contends there are two independently applicable exceptions to the exhaustion requirement that apply in this case, thereby freeing Ohio Valley of the need to exhaust all administrative remedies. We are not convinced.

The exhaustion of administrative remedies doctrine “is a well-settled rule of judicial administration that has long been applied in this state.” *Kentucky Ret. Sys. v. Lewis*, 163 S.W.3d 1, 3 (Ky. 2005); KRS 13B.140(2) (“A party may file a petition for judicial review only after the party has exhausted all administrative remedies available within the agency whose action is being challenged, and within any other agency authorized to exercise administrative review.”). The rule is easily stated: “proper judicial administration mandates judicial deference until after exhaustion of all viable remedies before the agency

vested with primary jurisdiction over the matter.” *Bd. of Regents of Murray State Univ. v. Curris*, 620 S.W.2d 322, 323 (Ky. App. 1981). Generally speaking, “exhaustion of administrative remedies is a *jurisdictional prerequisite* to seeking judicial relief.” *Jefferson County Bd. of Educ. v. Edwards*, 434 S.W.3d 472, 476 (Ky. 2014) (citation omitted). Failure to fully exhaust all administrative remedies temporarily deprives the circuit court of jurisdiction over the claim. *Id.* Notably, “[t]he doctrine does not preclude judicial review, but rather delays it until after the expert administrative body has compiled a complete record and rendered a final decision.” *Lewis*, 163 S.W.3d at 3.

It is incontrovertible that the Board of Tax Appeals is statutorily vested with jurisdiction over tax-related appeals. KRS 131.340. And, in tax-related cases, the general rule, as the Department correctly points out, is that a taxpayer challenging an assessment must exhaust administrative remedies, including taking an appeal to the Board, as a prerequisite to proceeding in court. *See Revenue Cabinet v. Gillig*, 957 S.W.2d 206, 211 (Ky. 1997) (noting the KRS 131.110 protest and appeal provisions and reaffirming “the well established requirement that a taxpayer must exhaust his administrative remedies before resorting to the courts”).

Like virtually every rule of law, however, exceptions to the exhaustion doctrine exist. The exceptions arose, generally, to prevent parties from needlessly traversing the administrative process when doing so would amount to an exercise in futility. *See Popplewell’s Alligator Dock No. 1 v. Revenue Cabinet*,

133 S.W.3d 456, 471 (Ky. 2004). Our Supreme Court in *Lewis, supra*, recognized two exceptions to the general exhaustion of remedies rule.

First, a party is not required to exhaust all administrative remedies when attacking the constitutionality of a statute or regulation as void on its face. *Lewis*, 163 S.W.3d at 3; *Commonwealth v. DLX, Inc.*, 42 S.W.3d 624, 626 (Ky. 2001). “This is because an administrative agency cannot decide constitutional issues.” *DLX*, 42 S.W.3d at 626.

Second, exhaustion of remedies is likewise not required when a complaint “raises an issue of jurisdiction as a mere legal question, not dependent upon disputed facts, so that an administrative denial of the relief sought would be clearly arbitrary.” *Lewis*, 163 S.W.3d at 3 (quoting *Goodwin v. City of Louisville*, 309 Ky. 11, 215 S.W.2d 557, 559 (1948)).

Ohio Valley argues a third exception exists: a party need not exhaust all administrative remedies when an agency has acted in excess of its statutory authority. Ohio Valley cites this Court’s opinion in *Adkins v. Commonwealth*, 614 S.W.2d 950 (Ky. App. 1981) in support of its position.⁴ In *Adkins*, this Court admittedly stated that “exhaustion *may* not be required when an agency acts in excess of its powers.” *Id.* at 953 (emphasis added). But we find *Adkins* to be of little persuasive value. Our reasoning is threefold.

First, the language quoted above and cited favorably by Ohio Valley is nothing more than judicial dictum. Black’s Law Dictionary DICTUM (10th ed.

⁴ We are certainly aware that Ohio Valley cited other authority in support of its argument. We have carefully reviewed that authority and find it similarly inapplicable.

2014) (defining “judicial dictum” as “[a]n opinion by a court on a question that is directly involved, briefed, and argued by counsel, and even passed on by the court, but that is not essential to the decision and therefore not binding”). The so-called “exception” played no part in the Court’s ultimate analysis. In fact, immediately after its bold statement, the Court found the exception inapplicable to that particular case. Second, the Court cited no authority in support of the “exception.” Interestingly, our Supreme Court has not seen fit to include this “exception” when describing other exceptions to the exhaustion doctrine in recent opinions of the Court. *See, e.g., W.B. v. Commonwealth, Cabinet for Health & Family Servs.*, 388 S.W.3d 108, 112-13 (Ky. 2012); *Lewis*, 163 S.W.3d at 3; *Popplewell’s Alligator Dock*, 133 S.W.3d at 470-72. And, third, “[i]t is elementary that [the word] “may,” is permissive[.]” *Hardin County Fiscal Court v. Hardin County Bd. of Health*, 899 S.W.2d 859, 861 (Ky. App. 1995); *Temperance League of Kentucky v. Perry*, 74 S.W.3d 730, 737 (Ky. 2002) (Graves, J., dissenting). To the extent the exception does exist, it is permissive in nature.

Ohio Valley takes the position that direct judicial intervention is nonetheless necessary because the Board of Tax Appeals lacks the power to resolve whether the Department has the authority to assess a cigarette tax. We think it precisely the type of question the Board is designed to confront.

KRS 131.340 identifies the Board’s jurisdictional parameters. It states: “The Kentucky Board of Tax Appeals is hereby vested with exclusive jurisdiction to hear and determine appeals from final rulings, orders, and

determinations of any agency of state or county government affecting revenue and taxation.” KRS 131.340. Ohio Valley has claimed from the outset that the Department acted beyond the scope of its authority in assessing a cigarette tax. We see nothing preventing the Board from addressing this argument as a component of Ohio Valley’s administrative appeal of the Department’s decision.

And, significantly, courts later considering Ohio Valley’s constitutional claims would greatly benefit from the Board’s interpretation of the statutory scheme and an administrative record “contextualizing the operations of the statutory and regulatory process as it functions in day-to-day practice[.]” *W.B.*, 388 S.W.3d at 109. Kentucky courts have long yielded “great deference” to an agency’s interpretation of a statute the agency is charged with administering, provided the agency’s interpretation is offered by way of formal rulemaking or a formal adjudication. *Metzinger v. Kentucky Ret. Sys.*, 299 S.W.3d 541, 545 (Ky. 2009); *Com. ex rel. Beshear v. Kentucky Utilities Co.*, 648 S.W.2d 535, 537 (Ky. App. 1982). Contrary to Ohio Valley’s position, we infer from this an agency’s inherent authority to interpret those statutes within its specific province.

Ohio Valley further argues that the second claim contained in its declaratory complaint – *i.e.*, that the Department arbitrarily interfered with the free flow of commerce in violation of Section 2 of the Kentucky Constitution and the commerce clause when it attempted to administratively assess cigarette tax on sales to out-of-state customers – is a “mere legal question, not dependent upon disputed

facts,” and thus not subject to the exhaustion doctrine. Ohio Valley stresses that an agency cannot pass upon constitutional questions of law.

While persuasive at first blush, Ohio Valley’s argument misses the mark. Ohio Valley is not raising a facial challenge to Kentucky’s tax statutory scheme; at most, it is a legal question that turns on a disputed fact – whether the cigarettes at issue were sold to an in-state customer or out-of-state customers. Both sides have identified evidence in support of their respective positions. But neither party’s version of events has yet to be tested. In fact, no evidence has been taken in this case.

“[T]his is clearly one of those occasions when a better factual record would be indispensable to our resolution of the constitutional issues before us.” *W.B.*, 388 S.W.3d at 113. Again, the purpose of the exhaustion doctrine “is to allow an administrative agency to perform functions within its special competence—to make a factual record, to apply its expertise, and to correct its own errors so as to moot judicial controversies.” *Parisi v. Davidson*, 405 U.S. 34, 37, 92 S.Ct. 815, 818, 31 L.Ed.2d 17 (1972). Once the factual record is fully developed there lies the possibility that resolution of the factual controversies in this case will resolve the constitutional queries raised. The parties do not, and cannot, genuinely dispute that “[a] tax shall be paid on the sale of cigarettes *within the state [of Kentucky.]*” KRS 138.140(1) (emphasis added). If the administrative process reveals the sale was to an in-state customer, Ohio Valley’s constitutional interstate commerce argument becomes moot.

Despite the clever packaging of Ohio Valley’s claims in its declaratory complaint, the heart of the parties’ dispute centers on whether Ohio Valley made an in-state sale of cigarettes or an out-of-state sale. Kentucky’s declaratory-rights statutory scheme “clearly anticipates that there will be occasions when it will not be best to address the controversy at the time of the petition, and so authorizes the courts to defer consideration until the circumstances are more favorable for a resolution of the issue presented[.]” *W.B.*, 388 S.W.3d at 112; KRS 418.065 (“The court may refuse to exercise the power to declare rights[.]”). Ultimately, “there is no compelling reason for us to address the constitutional issues presented in this case in the absence of a well-developed administrative record by which we may understand the actual, as opposed to the hypothetical and abstract, application of the process under review.” *W.B.*, 388 S.W.3d at 115.

In sum, we find no exception to the exhaustion of administrative remedies doctrine fits this particular case such that Ohio Valley can seek immediate judicial intervention without first appealing the Department’s decision to the Board of Tax Appeals and exhausting its administrative remedies. And, even if such an exception exists, we think it premature to consider Ohio Valley’s constitutional claims in light of the underdeveloped factual record in this matter. Paraphrasing our Supreme Court:

Here, resolution of the administrative proceedings [would likely] avoid the necessity of addressing the constitutional issues under challenge. Therefore, balanced prudential considerations strongly favor deferment of our consideration of these issues until the

administrative procedures are completed because, first the constitutional questions may thereby be rendered moot and, second, allowing the administrative proceeding to run its course will provide a practical illustrative case by which we may judge the statutes and regulations underlying the proceedings.

Id. at 114.

CONCLUSION

For the foregoing reasons, we affirm the Boyd Circuit Court's April 16, 2015 order dismissing Ohio Valley's complaint for lack of jurisdiction on grounds that Ohio Valley failed to first exhaust its administrative remedies.

ALL CONCUR.

BRIEFS FOR APPELLANT:

Mark A. Loyd
Christie A. Moore
Kate B. Ward
Louisville, Kentucky

BRIEF FOR APPELLEES:

Stephen G. Dickerson
Frankfort, Kentucky