

Commonwealth Of Kentucky

Court Of Appeals

NO. 1998-CA-002002-MR

HOLY ANGELS ACADEMY, INC.

APPELLANT

v.

APPEAL FROM FRANKLIN CIRCUIT COURT
HONORABLE WILLIAM L. GRAHAM, JUDGE
ACTION NO. 97-CI-01401

DEPARTMENT OF CHARITABLE GAMING,
PUBLIC PROTECTION AND REGULATION CABINET,
f/k/a DIVISION OF CHARITABLE GAMING,
JUSTICE CABINET

APPELLEE

OPINION
AFFIRMING

** ** * * *

BEFORE: GARDNER, MILLER, AND SCHRODER, JUDGES.

SCHRODER, JUDGE: This is an appeal from an order affirming an administrative decision denying appellant's application to renew its charitable gaming license. Appellant argues that the statutes and regulations upon which the denial was based are unconstitutional on several grounds. Upon reviewing appellant's arguments in light of the record herein and the applicable law, we reject those arguments and, thus, affirm.

Appellant, Holy Angels Academy, Inc. ("Holy Angels"), is a nonprofit Catholic school founded in Louisville. The

school's charitable purpose is to teach academic subjects as well as the doctrines of the Roman Catholic Church. Appellant raises money for the school through charitable gaming, primarily by operating a bingo. In order to lawfully operate the bingo, appellant applied for and was granted a charitable gaming license through appellee, the Department of Charitable Gaming, Public Protection Cabinet, f/k/a the Division of Charitable Gaming, Justice Cabinet (the "Department"). The license was valid from February 9, 1996 through February 9, 1997.

One of the duties of the Department is to review charitable gaming operations by licensees to assure compliance with the charitable gaming laws. During a standard review of appellant's operations for the third and fourth quarters of 1996, the Department discovered that appellant was in violation of KRS 238.550(4)¹ which at that time provided as follows:

At least forty percent (40%) of the adjusted gross receipts resulting from the conduct of charitable gaming during each two (2) consecutive calendar quarters shall be retained by the charitable organization and used exclusively for purposes consistent with the charitable, religious, educational, literary, civic, fraternal, or patriotic functions or objectives for which the licensed charitable organization received and maintains federal tax-exempt status or consistent with its status as a common school, as an institution of higher education, or as a state college or university. No net receipts shall inure to the private benefit or financial gain of any individual.

¹KRS 238.550(4) was repealed and reenacted in modified form at KRS 238.536(1), effective April 1, 1998.

The Department found that appellant retained no receipts (0%) from its gaming operations during the third and fourth quarters of 1996. In fact, it was found that appellant lost \$5,100 during that period. On February 5, 1997, pursuant to KRS 238.535(12), the Department denied appellant's application to renew its charitable gaming license, citing the violation of KRS 238.550(4). KRS 238.535(12) provides as follows:

In order to continue to qualify for licensure, a charitable organization shall continuously meet the requirements set forth in KRS 238.550(3) and (4). If a charitable organization is unable to meet those requirements, the division shall revoke the charitable organization's license or deny its application for renewal licensure by administrative action as provided in KRS 238.560.

Thereafter, appellant instituted an administrative appeal, and a hearing was held on April 22, 1997. At the hearing, it was undisputed that appellant did not retain 40% of adjusted gross receipts as required by the statute. Witnesses for appellant instead testified regarding the financial hardship it faced in carrying out its bingo operations. They testified that appellant's expenses were considerable due to the fact that it did not have its own facility on which to conduct its bingo sessions; as a result, it had to rent halls therefor. They further testified that attendance had been very low, in part, because of the holiday season. On August 18, 1997, the hearing officer issued an order recommending that appellant's application for license renewal be denied. Appellant filed exceptions, and on September 11, 1997, the Secretary of the Department issued its final order denying appellant's application for renewal. An

appeal by appellant to the Franklin Circuit Court followed. On July 10, 1998, the circuit court entered its opinion and order affirming the Department's denial of license renewal. Holy Angels now appeals to this Court.

Appellant first argues that KRS 238.550(4), referred to by the parties as the "40% rule", violates its equal protection and substantive due process rights afforded by the Fourteenth Amendment to the United States Constitution, as well as Section 2 of the Kentucky Constitution. Appellant maintains that the 40% rule, as a bright-line threshold, is arbitrary, unreasonable, and discriminates against the smaller, less financially sound charitable organizations. Further, appellant claims that the 40% rule operates to favor some charities over others, unreasonably classifies less profitable charities as "commercial", and does not allow for the natural fluctuations in the charitable gaming industry.

In response to the 1992 amendment to the Kentucky Constitution allowing charitable gaming, the General Assembly passed the Charitable Gaming Act in 1994. The Act set forth a comprehensive scheme for the conduct, oversight, and regulation of charitable gaming. The purpose of the Act, as stated in KRS 238.550, was to:

comply with constitutional requirements by establishing an effective and efficient mechanism for regulating charitable gaming which includes defining the scope of charitable gaming activities, setting standards for the conduct of charitable gaming which insure honesty and integrity, providing the means of accounting for all moneys generated through the conduct of charitable gaming, and providing for suitable

penalties for violations of laws and administrative regulations.

The intent of the Act, as also stated in KRS 238.550, is as follows:

The intent of this chapter is to prevent the commercialization of charitable gaming, to prevent participation in charitable gaming by criminal and other undesirable elements, and to prevent the diversion of funds from legitimate charitable purposes. In order to carry out the purpose and intent, the provisions of this chapter, and any administrative regulations promulgated in accordance with this chapter, shall be construed in the public interest and strictly enforced.

In regulating economic and business rights, rather than fundamental rights, substantive due process under the Fourteenth Amendment to the United States Constitution requires that a statute be rationally related to a legitimate state objective. Stephens v. State Farm Mutual Auto. Insurance Co., Ky., 894 S.W.2d 624 (1995); Kentucky Div., Horsemen's Benevolent & Protective Association, Inc. v. Turfway Park Racing Association Inc., 832 F. Supp. 1097 (E.D. Ky. 1993), reversed on other grounds, 20 F.3d 1406 (6th Cir. 1994). The same standard applies to claims alleging equal protection violations. Cecil v. Duck Head Apparel Co. Inc., 895 F. Supp. 155 (W.D. Ky. 1995). Likewise, under Section 2 of the Kentucky Constitution, which has been held to be broad enough to encompass equal protection, see Kentucky Milk Marketing and Antimonopoly Com'n v. Kroger Co., Ky., 691 S.W.2d 893 (1985), a statute regulating economic matters must be rationally related to a legitimate state objective. Lost Mountain Mining v. Fields, Ky. App., 918 S.W.2d 232 (1996).

The Charitable Gaming Act has already withstood a constitutional challenge before this Court in Commonwealth v. Louisville Atlantis Community/Adapt, Inc., Ky. App., 971 S.W.2d 810 (1997). In that case, numerous charitable gaming organizations challenged the constitutionality of various portions of the Act, including: the provision requiring that all net receipts from charitable gaming be used for charitable or other approved purposes; the fees required to be paid by the charitable organizations; the three-year residency and threshold requirement for charitable organizations; and restrictions on allowable expenses of the charitable organizations, including rent restrictions. In upholding the constitutionality of the Act, this Court stated:

Charitable gaming is an exception to the constitutional prohibition against lotteries and gift enterprises. Since the state may prohibit gambling entirely, it may clearly put limits on charitable gaming which may not be put on other legitimate enterprises. Keeping charitable gaming from becoming commercial, preventing participation by criminals, and preventing the diversion of funds from legitimate charitable purposes are all legitimate state objectives. The statute is not an arbitrary exercise of state power.

Id. at 816. The Court also recognized the state's interest in assuring that charitable gaming receipts benefit the charity, not individuals. Id. at 820. The Court specifically rejected the plaintiffs' argument that the rent restrictions discriminated against smaller charities that are not wealthy enough to own their own facility and must rent space. Id.

In support of its position, appellant cites Village of Schaumburg v. Citizens For a Better Environment, 444 U.S. 620,

100 S. Ct. 826, 63 L. Ed. 2d 73 (1980) and other similar federal cases striking down laws which required charities to use a certain percentage of its contributions for "charitable purposes" in order for the charity to be allowed to solicit contributions. However, the basis of the Court's ruling in those cases was the violation of First Amendment rights to free speech and free exercise of religion, which the Court found was necessarily a part of the solicitation of charitable contributions. The present case does not involve the solicitation of contributions, but rather, the generation of funds for the charity solely through charitable gaming which is not a right guaranteed by the Kentucky or United States Constitution.

As in Louisville Atlantis, 971 S.W.2d 810, we deem the 40% rule at issue to be rationally related to the state's legitimate and express interest in preventing charitable gaming from becoming commercial and failing to benefit the charity. While the 40% rule has the unfortunate result of making it more difficult for smaller charitable organizations to participate in charitable gaming, the 40% rule applies equally to all charities and the legislature has seen fit to regulate charitable gaming in this manner. Accordingly, we reject appellant's claim that the 40% rule violates its substantive due process and equal protection rights.

Appellant's final argument is that the 40% rule is special legislation in violation of Section 59 of the Kentucky Constitution. Special legislation has been explained as follows:

A classification renders a statute special where it is made to depend, not upon any

natural, real or substantial distinction, inhering in the subject matter, such as suggests the necessity or propriety of different legislation in regard to the class specified, but upon purely artificial, arbitrary, illusory, or fictitious conditions, so as to make the classification unreasonable, and unjust. Sometimes, it is said that a law is special where its classification is not based upon some reasonable and substantial difference in kind, situation, or circumstance bearing a proper relation to the purpose of the statute, but which embraces less than the entire class of persons to whose condition such legislation would be necessary or appropriate, having regard to the purpose for which the legislation was designed.

Reid v. Robertson, 304 Ky. 509, 200 S.W.2d 900, 903 (1947), quoting 50 A.J., section 7, page 21. More recently, our Supreme Court has described special legislation as "legislation which arbitrarily or beyond reasonable justification discriminates against some persons or objects and favors others." Miles v. Shauntee, Ky., 664 S.W.2d 512, 516 (1983).

Appellant does not allege that the 40% rule is not applied uniformly to all charitable organizations. Rather, appellant maintains that the 40% rule imposes stricter burdens on smaller charities that do not own their own facilities in that it fails to take into consideration the resources or expenses of the charity or the size of its gaming operations. We do not see that the rule imposes stricter burdens on any charity or that it is conditioned upon any artificial or arbitrary standard. As stated earlier, the purpose of the rule is to insure that the funds generated by charitable gaming are actually retained by the charity and used for charitable purposes. There is no indication that the 40% rule is designed to keep smaller charities from

participating in charitable gaming. In fact, the fact that the rule is based on a percentage of gross receipts, rather than a flat amount, should account for some differences in the size of the operations. Thus, the 40% rule does not constitute special legislation.

For the reasons stated above, the judgment of the Franklin Circuit Court is affirmed.

ALL CONCUR.

BRIEF FOR APPELLANT:

Robert G. Stevens
James A. Dietz
Covington, Kentucky

BRIEF FOR APPELLEE:

Christopher M. Hill
Julie A. Cobble
Frankfort, Kentucky