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NOT TO BE PUBLISHED

Commonwealth Of Kentucky

Court of Appeals

NO. 2005-CA-001588-MR

JAMES M. BAKER — APPELLANT

v.

APPEAL FROM FRANKLIN CIRCUIT COURT
HONORABLE ROBERT G. JOHNSON, JUDGE
ACTION NO. 01-CI-01664

COMMONWEALTH OF KENTUCKY,
KENTUCKY RETIREMENT SYSTEMS
AND BOARD OF TRUSTEES OF
KENTUCKY RETIREMENT SYSTEMS — APPELLEES

OPINION AND ORDER
REVERSING AND REMANDING

** ** ** ** **

BEFORE: ACREE AND VANMETER, JUDGES; KNOPF, SENIOR JUDGE.[1].

ACREE, JUDGE: This is an appeal from a judgment of the Franklin Circuit Court affirming a decision by the Board of Trustees of the Kentucky Retirement Systems. The Systems found that James Baker, a state retiree who had returned to state employment, was not entitled as a retiree to payment in full from the Systems of the monthly

[1] Senior Judge William L. Knopf sitting as Special Judge by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and KRS 21.580.

contribution toward his health insurance premiums, because he was also receiving a similar contribution from his new employer.

At its core, this case pits Baker's right to a specified retirement health care benefit against the Systems' policy ostensibly created to administer those benefits. Its resolution requires us to examine issues of Kentucky administrative law and statutory construction. Some are issues of first impression in Kentucky.

In summary, we find that Baker's right to the claimed retirement health care benefit is statutory and inviolable, that Baker did not waive that right, and that the Systems' policy is void because it violates provisions of Kentucky Revised Statutes (KRS) Chapter 13A. Therefore, we reverse.

FACTS

Baker retired from his employment with the Legislative Research Commission after more than 27 years of service to the state. He immediately re-entered full-time state employment as general counsel to the Kentucky Teacher's Retirement Systems (KTRS). Consequently, Baker simultaneously enjoyed the benefits of his retirement from state government and the benefits of his employment by state government. In common parlance, he was a "double-dipper."[2]

[2] Ky. OAG 04-001, 2004 WL 220675 (Ky. A.G.). The subject of this Kentucky Attorney General Opinion is the "Constitutionality of a retroactive amendment to KRS 61.637(7)(a), commonly referred to as the 'double-dipping' provision." While the term "double-dipper" has developed a negative connotation, this well-reasoned Opinion of the Attorney General correctly points out that there is nothing unlawful about the practice of double-dipping in the absence of legislative prohibition. The Opinion answered a legislative query whether such a prohibition could be created and made retroactive. In summary, the Attorney General stated that "retrospectively prohibiting the practice of 'double dipping' would necessarily 'impair the obligations' of the 'inviolable contract' of the Commonwealth created by KRS 61.510 to 61.705 [state retirement benefits] in violation of the Contract Clause of the United States Constitution

Baker's double set of benefits included eligibility for group health insurance offered both through the Systems and through KTRS. He was also entitled to a separate specific contribution from each of these entities toward payment of his health insurance premium. Each such contribution is referred to in statute as a "state contribution."[3] For each of the years 1991 to 1995, the state contributions to which Baker was entitled were more than sufficient to fully pay the premium for the health insurance coverage option Baker selected.

During these five years, Baker coordinated his available state contributions by means of "cross-referencing" the benefits entitlements. "Cross-referencing" is a practice applicable in group insurance plans to indicate that multiple benefits sources will contribute to the payment of a single insurance premium. Cross-referencing often occurs when a husband and wife both work for the same employer. However, cross-referencing with one's self occurs when one employee is entitled to contributions from two independent sources, as is the case before us.

Prior to 1996, regardless of whether a state employee cross-referenced, he forfeited any amount of state contribution that exceeded the premium for the coverage

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and Section 19 of the Kentucky Constitution. Thus, the General Assembly can only prohibit the practice of 'double dipping' on a prospective basis."

[3] The legislature requires each entity participating in the Kentucky Group Health Insurance Plan, including the Systems and KTRS, to pay "an amount at least equal to the state contribution rate[,]" determined as part of the state budget process, for each employee or retiree, as the case may be. KRS 18A.225(2)(h). This is the minimum established by the legislature. A participating agency is not prohibited from paying more than the state contribution rate for each employee or retiree. The Systems was a participating agency which, by statute, was required to pay "[t]he premium in full" for retirees entitled to full benefits. KRS 61.702(3)(1995), *recodified at* KRS 61.702(3)(a)5.

option he selected. And so it was with Baker. When Baker cross-referenced prior to 1996, he forfeited the excess of the total of the two contributions beyond the lower cost of his premium. However, an amendment to the group health insurance plan made it possible for each state employee, including Baker, to make full use of the state contribution, including the amount that exceeded the employee's premium. That amendment, effective in 1996, allowed state employees, for the first time, to participate in a medical Flexible Spending Account, or FSA.

Medical FSAs are creatures of federal statute, authorized as part of the Internal Revenue Code, Title 26 United States Code (U.S.C.) § 125. Such accounts provide tax savings to employees whose employers establish cafeteria plans that include a written plan document and an established "flexible spending account." Under this system, each employee estimates his out-of-pocket medical expenses for the upcoming year. Each pay period, by payroll deduction, the employer deducts a *pro rata* portion of this annual estimate from the employee's gross income and deposits the amount into the FSA. When the employee incurs a medical expense not covered by his insurance, he submits a receipt to the FSA administrator who reimburses the employee from the FSA.

Kentucky's legislature authorized FSAs in 1990 when it enacted KRS 18A.227, entitled "Flexible benefits plan for employees and retirees." Its title indicates the legislature's intent that FSAs be available to state retirees. Unfortunately, the legislature's desire was thwarted because the federal law authorizing FSAs requires that "all participants are employees[.]" 26 U.S.C. § 125(d)(1)(a). Baker, however, was both a retiree and an employee. Therefore, he could participate in the state's FSA program.

The possibility of benefiting from the new FSA program caused Baker to more closely consider the manner in which he cross-referenced his two health insurance premium funding sources. During the open enrollment period in November 1995, he contacted an insurance coordinator at the System's offices in Frankfort and asked if there were any policies or procedures affecting the manner in which his two premium payment sources could be coordinated. He also asked the same question of a representative of Plan Source, the state's health insurance purchasing alliance. Both representatives told him they knew of no applicable policies.

Baker then met with the KTRS Payroll Officer, Annie Martin (Martin). Just as with the representatives Baker previously asked, Martin was unaware of any policy affecting how Baker could coordinate his two premium payment sources.

A representative of the Systems would later testify, however, that Martin should have known of a longstanding, unwritten, Personnel Cabinet policy that required a double-dipper's employer to pay its full state contribution, as required by KRS 18A.225(2)(h), before the Systems paid any portion of its state contribution obligation. The Systems would then pay only the balance remaining necessary to fully fund the premium selected, not to exceed the state contribution rate for that year. This unwritten policy was created when the combination of the two state contributions exceeding the cost of the premium was forfeited. The policy was obviously for the benefit of the agencies rather than the retiree since it primarily determined which agency was entitled to retain the forfeited amount. Under this policy, the Systems always retained the unused

and forfeited amount. No agency ever considered how adding an FSA program to employee benefits would affect the policy, or *vice versa*.

The legislature imposed upon the Personnel Cabinet the responsibility for developing an FSA program for eligible employees. KRS 18A.227(2). The Cabinet was not prohibited from developing a program that would have excluded excess state contributions as a source for funding an employee's FSA account. But it did not do so. The program the Cabinet developed specifically authorized an employee to direct the excess state contributions, previously forfeited, into his own FSA account. (R. 174, 177).

Unaware of what Martin allegedly should have known, and believing he had informed himself as fully as possible, Baker decided on a health insurance coverage option for himself and his family, for 1996, that cost $245.92 per month. Because he was entitled to $175.50 per month (the state contribution rate for 1996) from each of his premium payment sources for a total of $351.00, he planned to have the difference, $105.08, deposited into his FSA.

All parties understood throughout this case, and this Court does not question, that FSAs cannot be funded from retirement benefits. This led Baker to ensure that the only funding source for his FSA was by payroll deduction out of the gross pay he received from his employer, KTRS. He accomplished this by carefully completing the required human resources paperwork both at KTRS and the Systems.

The actual insurance application process required Baker to indicate his intent to cross-reference on two separate enrollment forms provided by the health plan administrator, Plan Source. He completed the first form, entitled “Employee Enrollment

Application," with Martin's assistance. The forms anticipated the circumstance of spouses cross-referencing with one another and had blanks on the form for that purpose. However, owing apparently to the infrequency with which "cross-referencing with self" occurred, no similar blanks were provided for that purpose. With Martin's assistance, however, Baker indicated his intent to "cross-reference with self," and identified the other payment source as "KERS" (that is, the Kentucky Employees' Retirement System), by writing those words near the blanks provided for spousal cross-referencing.

Consistent with Baker's desire to have the Systems pay his insurance retirement benefit in full first, Payroll Officer Martin made notations in the margin of the form as follows:

245.92	70.42
- 175.50 KERS	- 175.50 KTRS
70.42	- 105.08

Nothing in the record contradicts the interpretation given by all parties to these figures. Martin first wrote Baker's monthly premium payment due of $245.92. Then, Martin indicated Baker's intent that the state contribution from the Systems (identified by Martin as "KERS"), in the amount of $175.50, was to be paid in full toward the insurance premium first, leaving a balance due on the premium of $70.42. The next column shows the balance of $70.42 being paid by the KTRS state contribution of $175.50. The excess of the KTRS state contribution was then available to be paid, lawfully, into Baker's FSA. Baker signed the form on November 20, 1995, and Martin signed it the following day.

Martin filed copies of this form with KTRS, and sent copies to Plan Source and the Systems.[4]

Baker also completed a second enrollment form, this one with the Systems, entitled "Retiree Enrollment Application." He indicated on this form his intent to "cross-reference with self" and identified KTRS as the other source of premium payment. He signed and dated this form on November 20, 1995, as well. Copies were sent to Plan Source and KTRS.

On December 7, Baker completed a second form provided by KTRS, designed to "[d]etermine if you are eligible for an Employer Contribution toward your Medical Spending Account." The form was created by Flexible Employee Benefits Company, Inc. (FEBCO), the flexible spending account firm chosen by the Personnel Cabinet to administer the FSA program. The form had a line to be completed for the "Cost of Health Insurance Plan." Baker filled in that line with the figure "$70.42," indicating the amount remaining to be paid by KTRS after the Systems paid $175.50 toward the $245.92 premium. The balance, $105.08, was identified on the form as Baker's "monthly employer contribution to the Medical [Flexible] Spending Account."

On December 8, Martin met with a representative of FEBCO to complete the paperwork necessary to ensure that KTRS transmitted $105.08 to FEBCO each month to be deposited in the FSA on Baker's behalf. Despite all of these efforts, this was not how Baker's health insurance premium and FSA were funded.

[4] As developed *infra,* the question whether the Systems received a copy of the form that included Martin's calculations is the only fact issue the Board determined in a manner contrary to the fact-finding of the hearing officer.

Beginning in January 1996, the two agencies, KTRS and the Systems, applied Baker's benefits in a completely uncoordinated fashion. KTRS followed Baker's and Martin's allocation figures and paid $70.42 to Plan Source toward the $245.92 premium, followed by a $105.08 payment to FEBCO for Baker's FSA. The Systems, however, did not pay the full $175.50 contribution. Instead, the Systems paid only $70.42 to Plan Source toward Baker's premium and retained $105.08 of Baker's monthly entitlement in its own coffers. When Plan Source combined the payments actually received from KTRS and the Systems, it had only $140.84 per month to pay toward Baker's $245.92 monthly premium. This left the premium payment short $105.08 each month.

We would be remiss if we did not pause at this juncture and note that this dispute never would have arisen if the Systems had simply paid to Plan Source the $175.50 contribution in full toward Baker's health insurance premium. Whether the Systems considered its payment to have been prior or subsequent to KTRS' payment of $70.42 is irrelevant. The key point here is that none of the Systems' contribution would have funded Baker's FSA. Consequently, there could have been no assertion, despite the Systems' counsel's continued insistence, that retirement funds were used to fund an FSA in violation of 26 U.S.C. § 125.[5] This, unfortunately, did not occur.

[5] The Systems' attorney called this statute, 26 U.S.C. § 125, "[t]he elementary and uncontested provision of law governing this case." His prime exception to the hearing officer's recommendation was that the hearing officer "demonstrates that he fails to understand the most basic and elementary issue in this case" – "that Kentucky Retirement Systems may not provide a cafeteria plan or flexible spending account to its retirees." However, if the Systems had simply followed Baker's method for cross-referencing and paid $175.50 to Plan Source – not FEBCO – the source of funding for Baker's FSA would not have been the Systems and the federal statute would not have been offended.

Initially, Baker and KTRS were unaware that the Systems was paying Plan Source only $70.42 toward Baker's premium. It was August 1996 before Plan Source finally informed Martin at KTRS that Baker's account was $735.66[6] in arrears for the months since January of that year.[7]

Martin attempted to solve the problem, at least for subsequent months. Without Baker's consent, she increased the amount KTRS paid toward the premium from $70.42 to $175.50 to cover the Systems' $105.08 payment shortfall. This fully paid the $245.92 premium. Unfortunately, this also meant that KTRS was paying nothing toward Baker's FSA. Martin, who admitted she was herself confused, informed Baker of these developments and what it meant for him.

Because funding of any federally-regulated FSA program is calculated on an annual basis, the balance of payments to fund Baker's FSA for the rest of 1996 had to be paid by someone. *See also*, KRS 18A.228(4)("Once an option [to fund a flexible spending account] is chosen, it shall not be changed until the end of the period for which election is made . . . ."). Consequently, to use Baker's language, he began "making an additional involuntary payment of $105.08 to FEBCO" from his pay for the five

[6] We rely on Baker's March 31, 1997, Corrected Answers to Interrogatories regarding these claimed damages amounts which are consistent with his testimony during the September 19, 1997, hearing. The figure calculated by the hearing officer ($839.04) appears to be incorrect due to minor errors in transcription and calculation. The actual figure would appear to us to be $735.56, being 7 months of delinquency at $105.08 per month.

[7] Plan Source never made demand on Baker to pay this arrearage and Baker, in fact, never paid it. Consequently, it is not an amount recoverable by Baker in damages.

remaining months of 1996 for a total of $525.40.[8] Baker failed to understand why this had happened. His search for an explanation was unavailing.

Baker wrote to the Systems on October 11, 1996, requesting "assistance in resolving a problem which has developed relating to the payment of my health insurance premium." The prompt response came by letter from the System's Deputy Commissioner of Operations who said, in pertinent part:

> The [Systems'] policy for cross-referencing medical insurance premiums is: "The employer contribution toward medical insurance premium shall be applied prior to determination of the amount to be paid by the [Systems'] Insurance Fund." . . .
>
> This is a final administrative decision concerning this matter. Accordingly, you are entitled to an administrative hearing, if you desire, in order to contest this decision pursuant to KRS 61.645(16)(a) and 13B.

After an unsuccessful second attempt to resolve the issue without invoking the adjudicatory power of the Systems, Baker did timely request an administrative hearing pursuant to KRS Chapter 13B, and the Systems' adjudicatory authority was engaged.

PROCEDURAL HISTORY

Baker's Petition alleged that the Systems had reduced his retirement benefits, specifically his health insurance premium benefits, contrary to plain legislative mandate that

[8] This is the only out-of-pocket expense Baker experienced as a result of the Systems' failure to follow his cross-referencing method and pay his premium "in full" within the meaning of KRS 61.702(3)(1995). Baker declined participation in the FSA for years subsequent to 1996.

> ***The premium*** required to provide hospital and medical benefits [to retiree-participants in the Kentucky Group Health Insurance Plan] ***shall be paid in full*** from the insurance fund[9] for all recipients of a retirement allowance from [the Kentucky Employees Retirement System] where such recipient . . . had two hundred and forty (240) months or more of service upon retirement [which included Baker].

KRS 61.702(3)(1995)(emphasis supplied), *recodified, using the same language, as* KRS 61.702(3)(a)5. Furthermore, Baker claimed that this right was part of an inviolable contract of which he was a beneficiary, then cited the Systems to the appropriate authority.

> It is hereby declared that in consideration of the contributions by the members [of the Kentucky Employees Retirement System] and in further consideration of benefits received by the state from the member's employment, ***KRS 61.510 to 61.705 shall***, except [for legislators and former legislators who commit felonies], ***constitute an inviolable contract*** of the Commonwealth, and the benefits provided therein ***shall . . . not be subject to reduction or impairment by alteration, amendment, or repeal***.

KRS 61.692(emphasis supplied); *see also Jones v. Board of Trustees of Kentucky Retirement Systems,* 910 S.W.2d 710, 713 (Ky.1995).

The Systems' Response to Baker's Petition denied his claim. The substance of the denial was that all agencies participating in the Kentucky Group Health Insurance Plan, including the Systems and KTRS, as well as their participating retirees and employees, are required to abide by the Personnel Cabinet's policies and procedures for administering the plan. According to the Systems, among these policies and procedures

[9] The Kentucky Retirement Systems' insurance fund was established for the purpose of funding the state contribution on behalf of retirees. KRS 61.701. The Systems and its Trustees who comprise the Board oversee the insurance fund in a fiduciary capacity and administer it "solely in the interest of the members and beneficiaries." KRS 61.650(1)(c)1.

was the Cabinet's unwritten policy requiring a double-dipper's employer to pay first toward his premium, thereby reducing the Systems' obligation to an amount equal to the remaining balance of the premium.

The Systems claimed that Baker's rights were also subject to the Systems' written policy. This policy was created on December 29, 1995, eleven days after the Systems' receipt of a copy of Baker's Employee Enrollment Application containing Martin's figures for allocating Baker's state contributions. It states in its entirety:

> KENTUCKY RETIREMENT SYSTEMS
> POLICY ON PAYMENT OF CROSS-REFERENCE INSURANCE
>
> The Kentucky Retirement Systems, by authority of KRS 61.645, established the following POLICY effective January 1, 1996, concerning amounts paid from the Insurance Fund on medical insurance cross-referenced with medical insurance obtained through a participating employer:
>
> (1) The employer contribution toward the medical insurance premium shall be applied prior to determination of the amount to be paid by the Insurance Fund.
>
> (2) The Insurance Fund shall pay the remainder of the premium not to exceed the amount that would be paid under KRS 61.702.
>
> Signed: Pamala S. Johnson Adopted: 12-29-95

After a fair period of discovery, a hearing was conducted on September 19, 1997, before Michael Head, an administrative hearing officer from the Office of the Kentucky Attorney General, Division of Administrative Hearings. The Systems was represented by legal counsel, as was Baker. The parties presented their cases in seven and one-half hours of testimony. Post-hearing briefs were filed by both parties.

On February 13, 1998, after nearly five months considering the record, the hearing officer issued a 23-page Findings of Fact, Conclusions of Law and Recommendation (Recommended Order) in favor of Baker. In summary, the hearing officer found that Baker's right to payment by the Systems of the full state contribution toward his health insurance premium was created by statute, KRS 61.702(3)(1995), and constituted an inviolable contract between Baker and the state. KRS 61.692. He also found that Baker did not waive that right, but gave timely notice to the Systems of his demand that the full contribution be paid in accordance with the statute. Finally, the hearing officer concluded as a matter of law that the Systems lacked the authority to affect Baker's right by internal policy, either written or unwritten, or otherwise.

As a remedy, the hearing officer recommended that the Systems pay into Baker's FSA an amount equal to that which it failed to pay for the years 1996 to 1998, and to award all future benefits to Baker without diminishment by the Systems' invalid cross-referencing policy.

The Systems transmitted the hearing officer's recommendation to Baker by unsigned letter dated the same day as the recommendation, February 13, 1998. The language of the letter is somewhat curious, stating that the "Board of Trustees . . . *has seen fit* to offer you fifteen (15) days *from your receipt* of this notice to file any exceptions." (emphasis added). We are not sure what the Systems believed the Board had seen fit to do for Baker. First, the Recommended Order was overwhelmingly in Baker's favor. Second, and more significantly, the legislature, not the Board, had already

granted Baker the right to file exceptions. KRS 13B.110(4). By this letter, the Systems only *mis*informed Baker as to his rights.

The statute actually measures the fifteen-day period, not from Baker's *receipt* of the notice, but "from the date the recommended order is *mailed*[.]" KRS 13B.110(4)(emphasis supplied). In other words, the Systems told Baker he had more time to file exceptions than the law allowed. This sounds generous at first blush, but "an administrative agency cannot enlarge statutorily prescribed time frames[.]" *Curtis v. Belden Electronic Wire and Cable, a Div. of Cooper Industries*, 760 S.W.2d 97, 99 (Ky.App. 1988). Furthermore, before being overruled in 2004 by *Rapier v. Philpot,* 130 S.W.3d 560 (Ky. 2004), missing the deadline for filing such exceptions could result in termination of the claim. *Swatzell v. Commonwealth of Kentucky Natural Resources and Environmental Protection Cabinet,* 962 S.W.2d 866, 869 (Ky. 1998)(Failure to file exceptions results in termination of claim), *overruled by Rapier* at 564. When the unnamed author at the Systems sent the letter to Baker, *Swatzell* was still good law. Therefore, if Baker had been lulled into inaction by the Systems' letter, he would have been precluded from seeking judicial review of any portion of the Board's final order that did not differ from the recommended order. *Id.*

As the procedural history goes, however, both parties timely filed exceptions. Baker merely took exception to the hearing officer's recommended method of remedy. Not surprisingly, the Systems took exception to the entire recommended order. The Systems' specific exceptions were few but amounted largely to its general demand that "the Board of Trustees of Kentucky Retirement Systems must reject in

whole as being clearly erroneous the Hearing Officer's Findings of Fact, Conclusions of Law and Recommendation."

On April 27, 1998, the Systems' Administrative Appeals Committee met to consider the exceptions filed in Baker's case and in two others. Only two members were present.[10] The meeting started at 9:11 AM and ended at 10:05 AM. First, the Committee approved the minutes of the previous meeting, then went into closed session during which it "studied the record of James Baker . . . in its entirety." At that time, the record in Baker's case consisted of nearly seven and one-half hours of videotaped testimony, nearly 400 pages of documents, lengthy post-hearing briefs filed by each party, the hearing officer's 23-page recommendation, and the parties' exceptions to that recommendation. The two men decided to reject the hearing officer's recommendation *in toto*.

At the same meeting, the Committee engaged in a "review of the record in its entirety" of two other hearings. In each of these, the hearing officer recommended denying the claims and the Committee of two voted to accept the recommendation. It is likely the Committee spent less time deliberating these cases, and understandably so.

All of this work was accomplished in the span of not quite one hour.

On May 12, 1998, the Systems sent an Order to Baker indicating that the Committee rejected the hearing officer's recommendation in its entirety. Ostensibly acting on behalf of the Board, the Committee Chairman signed, filed and served the

[10] Information regarding this meeting is taken from the Minutes of the Administrative Appeals Committee, April 27, 1998. Chairman Larry C. Conner and Bobby H. Henson were the members of the Administrative Appeals Committee in attendance.

decision in the form of a Final Order that the Chairman represented as the Committee's work. Examination of that Committee Order reveals that very little of it can be legitimately claimed as deriving from the Committee's *original* efforts.

The Committee's decision is captioned: "Board of Trustees Report and Order." The introductory paragraph of the Committee Order sets forth the same perfunctory information about the time, place and manner of the hearing as contained in the hearing officer's recommendation. Thereafter, the entire Committee Order is taken, word-for-word, from the Systems' Post-Hearing Brief.

The similarities between the Systems' brief and the Committee Order are not merely coincidental. Not only are the words the same, but the two documents share the identical font and format, paragraph structure, and typographical and grammatical errors.[11] In fairness, we do note that two and one-half sentences of the twenty-five page Committee Order are new, but those sentences are inconsequential to the decision.[12] The Committee Order's "Conclusions of Law" are even sequentially identical to the numbered

[11] For example, the word "forward" is misspelled in both documents as "froward." (Compare R.342 and R.449). The word "own" is misspelled "on" in both documents in the phrase "contrary to her on [sic] prior course of dealing". (Compare R.351 and R.457). The phrase "over come" is used in both documents where the word "overcome" is clearly intended. (Compare R.361 and R.466). Similarly, identical errors in grammar appear in both documents, as where the phrase "the coordination of Baker's insurance premiums were accomplished" is used. (Compare R.349 and R.456). As noted, *infra,* after this case was remanded on its first appeal to this Court, the Chairman of the Board of Trustees simply signed a reprinted copy of the Committee Order. Consequently, these identical typographical and grammatical errors can also be found at R.475, R.484, R.493 and R.482, respectively.

[12] Those sentences appear as the first sentence of paragraph 1, page 17 (R.463); the second half of the fourth sentence in paragraph 2, page 18 (R.464); and, the last sentence in paragraph 5, page 21 (R.467).

Arguments from the Systems' Post-Hearing Brief.[13] It takes no more than the most rudimentary knowledge of computer word processing to understand that the Systems' brief and the Committee Order share the same base document, created originally as an electronic file, on the same word processing system.

When Baker received the Committee Order, he appealed it to Franklin Circuit Court. In June 2000, that court affirmed the Committee's decision.

Baker then sought review for the first time in this Court. We issued an opinion vacating and remanding the case because the Board had delegated its power to enter a final order to a committee in violation of KRS 13B.030(1).[14] *See Baker v. Kentucky Retirement Systems,* 50 S.W.3d 770, 773 (Ky.App. 2001)(hereafter, *Baker I*). Having decided the case on that narrow issue, we expressed no opinion regarding the merits of the other issues Baker raised.

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[13] The Committee's Conclusions of Law directly correspond with the Systems' Arguments as follows:

Conclusion of Law 1 = Systems' Argument I (first part)
Conclusion of Law 2 = Systems' Argument I (second part)
Conclusion of Law 3 = Systems' Argument II
Conclusion of Law 4 = Systems' Argument III
Conclusion of Law 5 = Systems' Argument IV
Conclusion of Law 6 = Systems' Argument VI
Conclusion of Law 7 = Systems' Argument VII (paragraph 1)
Conclusion of Law 8 = Systems' Argument VII (paragraph 2)
Conclusion of Law 9 = Systems' Argument VII (paragraph 3)
Conclusion of Law 10 = Systems' Argument VII (paragraph 4)

[14] In pertinent part, KRS 13B.020(1) says that "[a]n agency head may not . . . delegate the power to issue a final order *unless specifically authorized by statute* . . . ." (emphasis supplied). In 2002, the Systems responded to *Baker I* by seeking such authorization. That year, the Kentucky legislature passed House Bill 309 amending KRS 61.645(16). The amendment authorized the Systems' Board of Trustees to create an appeals committee and to delegate to it the "authority to act upon the recommendations and reports of the hearing officer on behalf of the board" in cases such as Baker's. 2002 Kentucky Laws Ch. 52 (H.B. 309), § 11.

Nevertheless, we gave the Systems very clear instruction on remand. We pointed out that the "entire Board [of Trustees], collectively, is the agency head responsible for entry of a final order." *Id.* "[A]ll actions taken by the Board shall be taken by affirmative vote of a majority of the trustees present, subject to the requirement that those present constitute a quorum." *Id.* (Footnote citation omitted). We noted that "the final order of the Board need only be signed by the chairperson," but we made it clear that the chairperson's signature alone was sufficient only "so long as the signature reflects the decision of a majority of the Board." *Id.* We "remanded to the Franklin Circuit Court with directions to remand the matter to the Board for entry of a final order consistent with this opinion." *Baker I* became final on September 21, 2001. *Id.*

The record before us now gives virtually no indication that the nine-member Board followed our clear direction. More to the point, nothing in the record indicates "the entire Board, collectively," ever knew about this case. There is simply a three-and-one-half year recordless gap between the Systems' notification to Baker of the Committee Order he appealed in *Baker I,* and the Order signed only by Board of Trustees Chairman, Randy J. Overstreet, on November 15, 2001 (Board Order). There are no indicia in the Board Order or the record suggesting that the Board of Trustees actually participated in its issuance. The Chairman's signature does not indicate that he signed it at the direction of the Board or after Board action by majority vote. There are no minutes of the Board of Trustees indicating a vote on this order. Nor does this order indicate anywhere in its body that it is the decision of the Board of Trustees. We shall presume however, despite the absence of typical hallmarks indicating Board action, that the Board

Order was issued with Board approval. *Hutson v. Commonwealth*, 215 S.W.3d 708, 716 (Ky.App. 2006)(courts presume public officers perform the duties entrusted to them by law in good faith). If we are mistaken in that presumption, that is a matter to be determined and addressed by the Board of Trustees itself.

The Board Order is captioned identically to the Committee Order reviewed in *Baker I*, that is, "Board of Trustees Report and Order." With the exception of the signature line, it is identical to the Committee Order, which, as we indicated *supra*, is in its body, identical to the Systems' Post-Hearing Brief. The Board order is clearly another spawn of that original electronic word processing file that gave birth likewise to its kindred, the Systems' Post-Hearing Brief and the Committee Order.

Just as he had appealed the Committee Order, Baker appealed this identical Board Order to the Franklin Circuit Court. Again, the circuit court affirmed this order, holding that: (1) the Board's Order complied with the statutory requirements of KRS 13B.120; (2) the Board's decision was supported by substantial evidence and was not arbitrary; and (3) the Systems' policy did not violate KRS Chapter 13A nor did it exceed its authority or impair any benefits to which Baker was entitled.

Baker appeals to this Court for a second time. We have grouped his arguments in the following three categories.

- The Board Order is not supported by substantial evidence and its rejection of the hearing officer's findings of fact, conclusions of law and recommendation was arbitrary;[15]

[15] Appellant's Brief, Arguments III and IV, pp. 12-14.

- By adopting the Systems' Post-Hearing Brief as its Final Order, the Board failed to comply with KRS 13B.120(1) and undermined the purpose of KRS Chapter 13B;[16]

- The Systems' cross-referencing policy is void because it was an internal policy, was not promulgated as a regulation as required by Chapter 13A, and completely lacked statutory or regulatory authority for its issuance.[17]

Only the first of these arguments challenges the weight of the evidence or disputes any facts.

STANDARD OF REVIEW

Substantial Evidence

The Systems urges that we focus our attention on the Board's fact-finding, stating that "Baker's case is subject to the substantial evidence standard of review." (Appellee's Brief, p.12 fn.16). In general terms, this standard holds that if there is any evidence of substance to support the agency action, the reviewing court must defer to the agency decision because such action could not be arbitrary. *Borkowski v. Commonwealth,* 139 S.W.3d 531, 533 (Ky.App. 2004)("If there is any substantial evidence to support the decision of the administrative agency, it cannot be found to be arbitrary and will be sustained." Internal quotation marks omitted.).

This standard is a powerful weapon in any administrative agency's arsenal since it puts review of an agency's decision at least on a par with appellate review of a jury verdict. *Compare, Lewis v. Bledsoe Surface Min. Co.,* 798 S.W.2d 459, 461 (Ky. 1990)(reversal not justified unless jury verdict is "palpably or flagrantly against the

[16] Appellant's Brief, Argument V, p. 15.

[17] Appellant's Brief, Argument I and II, pp. 8-12.

evidence." Internal quotation marks omitted), *with McManus v. Kentucky Retirement Systems,* 124 S.W.3d 454, 458 (Ky.App. 2003)(reversal not justified unless evidence is "so compelling that no reasonable person could have failed to be persuaded by it."); *see also, Kentucky State Racing Commission v. Fuller,* 481 S.W.2d 298, 308-09 (Ky. 1972)(comparing role of administrative fact-finder to that of jury; the case should be read with the *caveat* that the members of the State Racing Commission actually sat as the tribunal in this administrative adjudication and did not delegate the fact-finding, including the opportunity to assess witness demeanor, to a hearing officer.).

However, "[s]ubstantial evidence is only important when the award of the board is attacked as being insufficiently grounded upon evidence." *Stovall v. Collett*, 671 S.W.2d 256, 257 (Ky.App. 1984). As noted, only one of Baker's arguments challenges the sufficiency of any evidence. And the only finding of fact rejected by the Board was whether the Systems received notice as to how Baker intended to cross-reference the two state contributions. Consequently, we will review that single finding to see if it is supported by substantial evidence.

For Baker's remaining legal arguments, the Systems predictably turns to *American Beauty Homes Corp. v. Louisville and Jefferson County Planning and Zoning Commission,* 379 S.W.2d 450 (Ky. 1964) as its touchstone. However, in view of the Supreme Court's decision in *Hilltop Basic Resources, Inc. v. County of Boone,* 180 S.W.3d 464 (Ky. 2005), and given that KRS Chapter 13B applies to this case, we believe it is time to review and clarify the applicability of the "extraordinarily powerful case" of *American Beauty Homes*. *Kuprion v. Fitzgerald,* 888 S.W.2d 679, 689 (Ky. 1994).

American Beauty Homes

American Beauty Homes was a zoning case that has had impact far beyond its original limited scope. The "*root of the trouble*" in *American Beauty Homes* was whether the Legislature could "*impose on the court a nonjudicial administrative function*" by means of KRS 100.057, a statute captioned "Appeal to courts from decision of commission on question of approving adjustments." *American Beauty Homes,* 379 S.W.2d at 453 (emphasis in original). The case was decided at a time when our administrative law was a mass of "uncorrelated legislative attempts to designate specific considerations controlling the scope of judicial review[.]" *Id.* at 457. Some would say that is still the state of affairs in Kentucky administrative law.

The general standard of review drawn from *American Beauty Homes* has become an axiom: "In the final analysis all of these issues may be reduced to the ultimate question of whether the action taken by the administrative agency was arbitrary." *Id.* This self-evident general rule is so all-encompassing that it applies to appellate review of all manner of administrative action, whether it be a review of a zoning determination as in *American Beauty Homes* itself, a worker's compensation claim, a Board of Claims award, or any other appeal from any administrative agency. Nothing in this opinion changes that general rule. However, when attention is given to the specific language of *American Beauty Homes*, we see how limited the case is, in fact.

The court in *American Beauty Homes* clearly and narrowly stated that the decision "concerns the scope of review *under KRS 100.057* [and of] appeals taken *under KRS 100.085*." *Id.* at 456, 458 (emphasis supplied). The court focused on the fact that

these statutes represent the legislature's delegation of its own legislative power. *American Beauty Homes*, then, establishes the principle that the separation of powers doctrine will not allow any "court to substitute its independent judgment on the facts for that of an administrative agency" which the legislature has "designated to carry out a *legislative* policy by the exercise of *discretionary* judgment in a specialized field [thereby] performing a *nonjudicial* function." *Id.* at 458-59, 458 (emphasis supplied). The case is thus perfectly suited to serve as the standard for reviewing the exercise of "a delegation of *legislative* power to an administrative agency[,] exercised in conformity with a *legislative policy* and in a *discretionary manner in the light of prevailing local conditions*." *Id.* at 455 (emphasis supplied). That is, to zoning matters. Some of its principles certainly will apply to many agency actions. Yet we must guard against relying on *American Beauty Homes* out of habit or convenience.

We do not present the circumscribed nature of *American Beauty Homes* as a new concept. Almost immediately after the case was rendered, we were warned to resist the judicial reflex of "relying on *American Beauty Homes* without reference to the subsequent opinions by th[e Commonwealth's highest] court that have eroded the holding in *American Beauty Homes*." *Brady v. Pettit,* 586 S.W.2d 29, 31 (Ky. 1979). "The first indication that this court was not wholly committed to *American Beauty Homes* . . . came in *Kilburn v. Colwell,* Ky., 396 S.W.2d 803 (1965)," in which the court reviewed a city's termination of a police officer's employment. *Id.* Two years after *Kilburn*, the Supreme Court made it clear that "*American Beauty Homes* is limited to zoning and other administrative acts and held not to be applicable to" an agency's *adjudication* of a public

employee's contract of employment. *Brady* at 31, *citing Osborne v. Bullitt County Bd. of Ed.,* 415 S.W.2d 607, 610 (Ky. 1967)("We no longer think that the principles enunciated in *American Beauty Homes* should be extended to the problems herein involved."). By 1979, it was inarguable that "*American Beauty Homes* now applies only to zoning matters and matters of like nature." *Brady* at 31.

Then, if resort to *American Beauty Homes* is not the first proper step in our review of an agency's actions, what is? The answer is that before we can apply any standard of review to an any act of any administrative agency, we must decide what function the agency is performing.

"A Mixed Bag of Legislative, Executive, and Judicial Functions"

Just as with the circumscribed nature of *American Beauty Homes*, it is neither a new, nor should it be a surprising, concept that we must first determine the function being performed by an administrative agency before applying a standard of review. In *Bourbon County Bd. of Adjustment v. Currans,* 873 S.W.2d 836 (Ky.App. 1994), we indicated that what might be arbitrary action in one context might not be so in another, even within the same agency. This is because Kentucky's various administrative bodies "perform a mixed bag of legislative, executive, and judicial functions[,]" *id.* at 838, and for that reason

> it is most helpful to determine the function performed by the body in order to determine the appropriate standard of review; that is to say, one should look not only at the nature of the body, [footnote omitted] but more particularly to the act performed by it. Was it a legislative, executive, or judicial act? Ultimately, it is the act or function performed and not the nature of the body which dictates the standard of review.

Id.

This first step in the review process is not merely perfunctory. At least three substantive characteristics distinguish a review of an agency's adjudicative acts from a review of its non-adjudicative acts. Each significantly impacts the standard of review.

Distinguishing Review of an Agency's Non-Adjudicative or Legislative Acts from Review of an Agency's Adjudicative Acts

The first distinguishing characteristic is the focus of appellate inquiry. Review of an agency's *non-adjudicative* or *legislative* acts is "concerned primarily with the *product* and not with the motive or method which produced it." *National-Southwire Aluminum Co. v. Big Rivers Elec. Corp.,* 785 S.W.2d 503, 515 (Ky.App. 1990)(emphasis supplied), *quoted with approval in Hilltop Basic Resources, Inc. v. County of Boone,* 180 S.W.3d 464, 469 (Ky. 2005). The "product" of such non-adjudicative acts is simply the agency's manifestation of its legislative prerogative in deciding "[g]eneral policy-based controversies[.]" *Hilltop* at 470; *see also City of Louisville v. McDonald,* 470 S.W.2d 173, 177-78 (Ky. 1971)("when the local legislative body undertakes . . . to enact a generally applicable zoning regulation, the facts to be considered *do not relate as such to a particular individual*[.]" Emphasis supplied.). Therefore, when an agency exercises its *legislative* authority, "[t]he 'right to an impartial tribunal' is nowhere to be found[,]" *Hilltop* at 469, and "the concept of what is 'arbitrary' is much more narrowly constricted[.]" *Trimble Fiscal Court v. Snyder,* 866 S.W.2d 124, 125 (Ky.App. 1993).

Admittedly then, our review of an agency's non-adjudicative or legislative act is oriented to the result of the act and not to the process.

By contrast, when an agency enters a final order adjudicating an individual's rights, we most certainly do focus on "the motive and method which produced it." *National-Southwire, supra*, at 515. Our Supreme Court recently held that all of Kentucky's "adjudications, whether judicial *or administrative*," are protected by due process guarantees "whereby Kentucky citizens may be assured of fundamentally fair and unbiased *procedures*." *Commonwealth Natural Resources and Environmental Protection Cabinet v. Kentec Coal Co., Inc.*, 177 S.W.3d 718, 724 (Ky. 2005)(emphasis supplied). Kentucky thus embraces the concept long ago enunciated by the United States Supreme Court that, in the exercise of its adjudicative authority, an administrative agency is not excused from adhering to the same basic principles of due process we expect of any court.

> The maintenance of proper standards on the part of administrative agencies in the performance of their quasi-judicial functions is of the highest importance and in no way cripples or embarrasses the exercise of their appropriate authority. On the contrary, it is in their manifest interest. For, as we said at the outset, if these multiplying agencies deemed to be necessary in our complex society are to serve the purposes for which they are created and endowed with vast powers, *they must accredit themselves by acting in accordance with the cherished* ***judicial tradition*** *embodying the basic concepts of fair play.*

Morgan v. U.S., 304 U.S. 1, 22, 58 S.Ct. 773, 778 (1938)(all emphasis supplied), *cited in Osborne v. Bullitt County Bd. of Ed.,* 415 S.W.2d 607, 611 (Ky. 1967). And so, it is essential to distinguish an agency's non-adjudicative acts from its adjudicative acts so that

we properly direct our *focus*. The focus of our review of an agency's adjudicative acts is on the *process*.

The second distinguishing characteristic is that, in its exercise of adjudicatory authority, an agency often functions in dual capacities – as an advocate and as the adjudicator. Expressed another way, the agency judges the merits of its own lawyer's case against the other party. This causes concern among many that the agency head cannot engage in the detached and independent adjudication which is expected in our understanding of due process.

A biased decision-maker is constitutionally unacceptable, and our system of justice "has always endeavored to prevent even the probability of unfairness." *Withrow v. Larkin*, 421 U.S. 35, 47, 95 S.Ct. 1456 (1975)(citation and internal quotation marks omitted). In terms of probability, the odds for bias are greater when the adjudicator heads the agency appearing as a party before it than when that is not the case. *See, e.g., Morongo Band of Mission Indians v. State Water Resources Control Bd.*, 153 Cal.App.4th 202, 214, 62 Cal.Rptr.3d 492, 500 (2007)("Human nature being what it is, the temptation is simply too great for the . . . Board members, consciously or unconsciously, to give greater weight to [the Board's attorney's] arguments by virtue of the fact she also acted as their legal advisor[.]").

While Kentucky is among the jurisdictions holding that concepts of due process are flexible enough to countenance the dual roles, *Commonwealth, Cabinet for Human Resources, Dept. of Health Services v. Kanter*, 898 S.W.2d 508, 512-13 (Ky.App. 1995), our highest court also long ago recognized that these dual roles do increase the

risk of bias. The Court specifically cautioned that the dual nature of an agency's functions demands that reviewing courts guard against a deteriorating vigilance.

> The anomaly in procedure which permits . . . an administrative body, to serve in the [mult]iple capacity of [party] and judge makes it vitally necessary that in reviewing administrative decisions courts zealously examine the record with the view to protecting the fundamental rights of the parties, lest the rule against arbitrariness and oppressiveness become a mere shibboleth. [Review] must not be permitted to degenerate into a mock ceremony. The least that the courts can do is to hold high the torch of "fair play" which the highest court of our land has made the guiding light of administrative justice.

Osborne v. Bullitt County Bd. of Ed., 415 S.W.2d 607, 611 (Ky. 1967), *citing Morgan v. U.S.*, 304 U.S. 1, 22, 58 S.Ct. 773 (1938).

While we are vigilant, we are also mindful of "a presumption of honesty and integrity in those serving as adjudicators[,]" *Withrow* at 47, and so we reject the notion "that the combination of . . . functions *necessarily* creates an unconstitutional risk of bias in administrative adjudication[.]" *Id.* at 46-47 (emphasis supplied), *cited in Board of Ed. of Pulaski County v. Burkett,* 525 S.W.2d 747, 747 (Ky. 1975). We tolerate the increased risk of bias as a matter of policy and because *administrative* adjudication expedites resolution of certain controversies. "But neither wisdom of policy nor demands of expediency, nor both, should be allowed to lead the courts away from basic constitutional processes, or sound judicial construction of statutory authority" to which the agency is also bound. *Bloemer v. Turner*, 281 Ky. 832, 137 S.W.2d 387, 390 (1939). Thus, we have rightfully refused to abdicate our responsibility to remain "alert to the possibilities of bias that may lurk in the way particular procedures actually work in

practice." *Withrow* at 54; *see also LaGrange City Council v. Hall Bros. Co. of Oldham County, Inc.,* 3 S.W.3d 765, 770-71 (Ky.App. 1999). Although, we must admit that there was a time when our judiciary appeared overwhelmed by the power of administrative agencies.

During World War II, after a "trend of . . . two or three decades [that] raised serious and difficult questions of delegation of governmental power to administrative agencies[,]" our former Court of Appeals lamented that "[t]he assertion, 'Ours is a government of laws and not of men' became hackneyed in the early days of the Republic, and . . . is no longer accepted by all as a truism[.]" *Goodpaster v. Foster,* 296 Ky. 614, 178 S.W.2d 29, 31 (1944). Three decades later, a Kentucky law school professor was still motivated to write:

> As any lawyer who has practiced before an administrative agency knows, however, ours has become, to a significant degree, "a government of men and not of laws." [footnote omitted] The "men" referred to are those nameless bureaucrats at every level of government whose discretionary domain now includes practically every aspect of American life.

Edward H. Ziegler, Jr., *Legitimizing the Administrative State: The Judicial Development of the Nondelegation Doctrine in Kentucky*, 4 N. KY. L. REV. 87, 90 (1977), *citing generally* C. Horsky, The Washington Lawyer (1952).

Fortunately, we have outgrown that pessimism. "Ours is a government of laws and not of men" remains our credo. We no longer defend this statement as a mere "assertion" embraced only by some as truth. It is the irrefutable foundation upon which our government is set. And we must not consider it otherwise, for "there is danger in a

departure from th[is] fundamental doctrine[.]" *Id.* It "is not a fair-weather or timid assurance[,]" but represents "a profound attitude of fairness between man and man, and more particularly between the individual and government[.]" *Joint Anti-Fascist Refugee Committee v. McGrath*, 341 U.S. 123, 162, 71 S.Ct. 624, 643 (1951)(Frankfurter, J., concurring). And so, it is essential, when an agency adjudicates the merits of its own case, that we ensure every decision rests upon the firm foundation of the law, and not upon the conscious or unconscious bias of men and women.

The third characteristic distinguishing review of an agency's adjudicative acts from that of its non-adjudicative acts involves the comparative influence of specific constitutional considerations. *Hilltop* recognized that when a court reviews a decision by an administrative agency in its exercise of a *legislative* function, it must

> balance[] the need to ensure fair and nonarbitrary treatment . . . with the equally compelling need to avoid undue infringement upon the legislative or nonjudicial aspects of the process or function of such bodies.

Hilltop at 469-70. In constitutional terms, the Court was balancing Kentucky Constitution § 2, prohibiting government exercise of arbitrary power, with Kentucky Constitution § 28, prohibiting the judiciary from exercising power belonging to the legislative branch. *See also Raney v. Stovall*, 361 S.W.2d 518, 522 (Ky. 1962)("[W]hile the courts will jealously guard its [sic] powers and jurisdictions, they will be careful not to infringe upon the powers, prerogatives and jurisdictions of the legislative department." Quotation marks and citation omitted).

Fortunately, "[t]he concept of constitutional due process in administrative hearings is flexible." *Danville-Boyle County Planning and Zoning Com'n v. Prall,* 840 S.W.2d 205, 207 (Ky. 1992). This flexibility leaves reviewing courts free to grant only "such procedural protections as the particular situation may demand." *Hilltop* at 568-69, *quoting Kentucky Cent. Life Ins. Co. v. Stephens*, 897 S.W.2d 583, 590 (Ky.1995). Due process flexibility, combined with principles of comity, allowed the Court in *Hilltop* to tip the scales against Ky. Const. § 2, and in favor of Ky. Const. § 28, resulting in the ruling that "[t]he 'right to an impartial tribunal' . . . , as it is commonly conceived within the *judicial* context, cannot be guaranteed (nor need it be) in the administrative or *legislative* setting." *Hilltop* at 469 (emphasis supplied).

We should not be surprised that the court in *Hilltop* weighed constitutional considerations in favor of Section 28 which, together with Section 27, embodies the "cardinal principle of our republican form of government and one that is among the most emphatically cherished and guarded principles in our Constitution." *Prater v. Com.,* 82 S.W.3d 898, 901 (Ky. 2002)(citations and internal quotation marks omitted).

> Perhaps no state . . . has a Constitution whose language more emphatically separates and perpetuates what might be termed the American tripod form of government than does our Constitution, which history tells us came from the pen of the great . . . Thomas Jefferson[.]

Sibert v. Garrett, 197 Ky. 17, 246 S.W. 455, 457 (1922).

In essence and summary, constitutional considerations require that judicial review of an exercise of legislative authority *delegated* by our General Assembly is substantially the same as our review of an exercise of legislative authority *retained* by our

General Assembly. Conversely, appellate review of an agency's exercise of *adjudicative* authority is far less concerned – perhaps not concerned at all – with the "need to avoid undue infringement upon the legislative" branch. *Id.* at 469-70.

In fact, to the extent consideration of the separation of powers doctrine is implicated, the violator – if there is one – is the legislative branch. When the legislature enacts a law directing that a particular claim against the Commonwealth be adjudicated before a particular state agency, it does so under claim of authority found in Ky. Const. § 231. But that constitutional provision only allows the legislature to direct "in what *courts* suits may be brought against the Commonwealth." Ky. Const. § 231 (emphasis supplied); *see also* Ky. Const. § 14 (captioned, "Right of *judicial remedy* for injury . . . "; emphasis supplied). It is only by the doctrine of comity that the judicial branch accepts and even embraces such legislation.[18] Consequently, a court reviewing an agency's exercise of

[18] Governance effected through a proliferation of federal and state agencies has been referred to as "the modern administrative state." *See Massachusetts v. E.P.A.*, ___ U.S. ___, 127 S.Ct. 1438, 1454 (2007). In Kentucky, we have referred to agencies as the "fourth branch of government." *American Beauty Homes*, 379 S.W.2d at 454 fn.4 ("An administrative agency has been realistically characterized as a *fourth* branch of government." Emphasis in original); *Kentucky Commission on Human Rights v. Fraser*, 625 S.W.2d 852, 857 (Ky. 1981)("[T]here has developed in our government a fourth branch known as administrative proceedings[.]"); *see also Legislative Research Com'n By and Through Prather v. Brown,* 664 S.W.2d 907, 916 (Ky. 1984)("[T]here are *three* branches of government[. T]he net effect of the words 'independent agency of state government' [in legislation creating the Legislative Research Commission] was to create a fourth branch of government." Emphasis in original); *see also Federal Trade Commission v. Ruberoid Co.,* 343 U.S. 470, 487, 72 S.Ct. 800, 810 (1952)(Administrative agencies "have become a veritable fourth branch of the Government, which has deranged our three-branch legal theories much as the concept of a fourth dimension unsettles our three-dimensional thinking." Jackson, J., dissenting). Whatever its label, it should be clear that it exists because the judiciary has permitted it to exist.

> It is not clear from the Constitution that this transference of governmental power to the agencies is constitutional. Indeed, the text may suggest just the opposite. . . . The most fundamental challenge to the administrative state focused on whether this delegation of power is permissible. The [United States Supreme]

adjudicatory authority need not be concerned that it will run afoul of the separation of powers doctrine. *See City of Greenup v. Public Service Com'n,* 182 S.W.3d 535, 539 (Ky.App. 2005)("[I]t is a judicial function finally to decide the limits of the statutory power of an administrative agency.").

Therefore, our review of administrative adjudications properly involves only one side of the scales balanced in *Hilltop*; that is, the side holding Ky. Const. § 2 and "the need to ensure fair and nonarbitrary treatment" of the parties. *Hilltop* at 469.

Hilltop, by the clarity with which it defined the parameters of due process in a legislative context, has returned *American Beauty Homes* to *its* proper context. Both cases review "zoning determinations [which] are purely the responsibility and function of the legislative branch of government[.]" *Hilltop,* 180 S.W.3d at 467. *Hilltop* makes it entirely clear that the process due a party affected by an agency's exercise of an administrative[19] or legislative function is very different from the process she is due when

> Court's affirmative answer to this question represents one of the most important developments in constitutional history.
> . . . .
> The Court's role in the administrative state has been that of both facilitator and skeptic. . . . Having allowed the establishment of the administrative state, the Court has assumed a role in supervising the agencies. In this role the Court tends to avoid unduly interfering [but, a]s in virtually every other area of the law, the Court tends to equate judicial review with the very idea of the rule of law.

Kermit L. Hall, ed., The Oxford Companion To The Supreme Court of the United States 11, 16 (1992). Administrative agencies and the function they perform have become so entrenched in the makeup of our federal and state governments that to strictly apply constitutional principles to do away with them would place burdens on the three traditional branches of government that they could not feasibly bear.

[19] Characterizing non-judicial functions as "administrative" in *Hilltop* is not as "ill-advised" as the use of "quasi-judicial" to describe the same function, *see, Hilltop* at 468 n.1, since an agency's "administrative functions or acts are distinguished from such as are judicial." *Black's*

the agency is performing a judicial function. *Id., passim,* at 468-70. Therefore, while *Hilltop* and *American Beauty Homes* are perfectly appropriate as measures of the standard for reviewing zoning determinations, neither case is the best guide to appellate review of an agency's exercise of a judicial function. For that, we have sufficient case law, but equally important with regard to the case before us, we have KRS Chapter 13B.

Review of Administrative Adjudications under KRS Chapter 13B

The concern for fundamentally fair and impartial administrative adjudications was addressed by our legislature just more than a decade ago. The Albert Jones Act of 1994 (codified as KRS Chapter 13B and effective in 1996) created comprehensive and uniform procedural safeguards for "any type of formal adjudicatory proceeding conducted by an agency as required or permitted by statute or regulation to adjudicate the legal rights, duties, privileges, or immunities of a named person." KRS 13B.010(2); *see also* KRS 13B.020(1)("This chapter creates only procedural rights[.]"). The Act is not applicable to all state agencies, but provides for a fair number of exemptions including the conduct of legislative proceedings of the type addressed in *American Beauty Homes* and *Hilltop*. KRS 13B.020(2)(f). None of the exemptions are applicable to this case. Therefore, this statutory standard of review applies.

The Act codified much of Kentucky administrative common law. While our state agencies and even our courts have often foregone citation to the Act and opted instead for reference to case law, and particularly to *American Beauty Homes*, it is most proper to apply KRS 13B.150.

Law Dictionary 42 (5th ed. 1979).

> The court shall not substitute its judgment for that of the agency as to the weight of the evidence on questions of fact. The court may affirm the final order or it may reverse the final order, in whole or in part, and remand the case for further proceedings if it finds the agency's final order is:
>
> (a) In violation of constitutional or statutory provisions;
>
> (b) In excess of the statutory authority of the agency;
>
> (c) Without support of substantial evidence on the whole record;
>
> (d) Arbitrary, capricious, or characterized by abuse of discretion;
>
> (e) Based on an ex parte communication which substantially prejudiced the rights of any party and likely affected the outcome of the hearing;
>
> (f) Prejudiced by a failure of the person conducting a proceeding to be disqualified pursuant to KRS 13B.040(2); or
>
> (g) Deficient as otherwise provided by law.

KRS 13B.150(2).

Applying the proper standard of review requires our reflection on this statute, and the judicial interpretations of Chapter 13B, along with the administrative common law that preceded it. We now apply that standard to Baker's arguments.

LACK OF SUBSTANTIAL EVIDENTIARY SUPPORT

Baker first argues that the Board "made factual determinations contrary to the trier of fact" that are not supported by substantial evidence. As noted, there is only one factual issue that the Board resolved in a manner contradictory to the hearing officer. That fact is whether Baker gave notice to the Systems of his expectation that the Systems

would comply with KRS 61.702(3)(1995) and coordinate the cross-referencing allocations of his state contributions that he requested. The hearing officer found as fact that he did. The Board found that he did not. We believe the Board's finding to that effect is not supported by substantial evidence.

The Significance of Baker's Notice to the Systems

As is evident from an exchange at the beginning of the hearing, both the Systems and Baker believed this fact to be crucial to their respective cases. Baker's counsel began the hearing by explaining to the hearing officer that, during the discovery phase, he requested that the Systems produce a copy of the "Employee Enrollment Application" it received from KTRS Payroll Officer Martin. The Systems responded by producing a copy that strangely did not contain Martin's figures in the margin. At the hearing, Baker's counsel requested that the System's counsel produce the original from which that copy was made.

Hearing Officer:	Are you saying that is pertinent to this issue?
Baker's Counsel:	Yes, sir.
Hearing Officer:	Do you have something that has the original markings on it?
Baker's Counsel:	Yes, sir.
Hearing Officer:	Okay.
Systems' Counsel:	Well, the issue is that that is what we received from [KTRS] with illegible scratchings in the lower right hand corner. That is the notice we received that they were

> going to take some different action on Mr. Baker's cross-referencing.

The Systems claims Baker's failure to notify it of the manner in which he desired to coordinate his benefits is a complete defense to any alleged right Baker may have to the Systems' payment of the full contribution rate. By his prior course of dealing, claims the Systems, Baker waived the right to an allocation of the state contribution different from that to which he previously acquiesced. To the extent this defense is valid, it is necessary that we determine Baker's prior cross-referencing practices, and then determine whether substantial evidence supports the Board's finding that Baker did not give notice to the Systems.

Baker's Course of Dealing Prior to 1996

We begin by identifying an irrefutable fact of this case: Baker is the beneficiary of an inviolable right to have the Systems insurance fund pay his insurance premium in full. KRS 61.692; KRS 61.701(2); KRS 61.702(3)(1995); *see also, Jones v. Board of Trustees of Kentucky Retirement Systems*, 910 S.W.2d 710, 712 (Ky. 1995). From 1991 to 1996, the Systems disregarded this mandate and paid only the balance remaining after Baker's employer, KTRS, paid its full state contribution rate toward the premium. Baker never raised an objection to the System's failure to obey this statute since his goal of combining his contributions to pay his entire premium was being met. For years prior to 1996, he effectively waived the right to compel the Systems to pay his premium in full. At least that is one of the Systems' arguments, and we have no reason to question it.

However, when the state adopted an FSA plan for its employees, Baker became eligible to divert a portion of the KTRS contribution to his FSA. The Systems' obligation to pay Baker's premium "in full" thereby became more significant to Baker. If the Systems complied with the statute and paid his premium in full[20], Baker could direct a portion of the KTRS contribution to his FSA.

But Baker had established a certain "course of dealing" – to use the Systems' language – in previously failing to object to the Systems' payment of only part of the state contribution. To effectuate a change, so the argument goes, he needed to notify the Systems. The only notification Baker gave was the allocation figures written by Martin on the "Employee Enrollment Application" sent to the Systems. The hearing officer considered this document sufficient notice.

The Hearing Officer's Finding of Evidence Tampering

When the hearing officer examined the original application produced at Baker's counsel's urging during the hearing, the hearing officer himself introduced this version of the form into the record as Exhibit 22. The reason is obvious. It is irrefutable, and in fact the Board does not attempt to refute, that someone created this version of the form by cutting and taping together copies of a previous generation of the form, or forms, resulting in a copy on which Martin's figures could not be read. That spliced and taped, and partially unreadable, version of the form was then copied and produced to Baker's counsel during discovery.

[20] Baker does not claim entitlement to any more than the applicable state contribution rate.

The hearing officer made the following findings of fact regarding this document, based on his examination of the evidence and his observation of the witnesses, including their demeanor.

> 37. The hearing officer introduced into the record at the hearing the original copy of the Employee Form sent by Martin to the Systems which was retained in the Systems' file for Baker. [Hearing Exhibit, "HE", 22]
>
> 38. Martin's hand-written figures regarding allocation of premium payments between KTRS and the System[s] (KERS) do not appear at the bottom margin of the copy in the Systems' files. However, the bottom section of Baker's form is taped on. This taped-on bottom section has barely discernible marks in the margin where Martin's hand-writing appeared.
>
> 39. Martin said she would never send a copy of Baker's Employee Form to the Systems in this condition. She said she had the ability to make a reduced copy of the legal size form, or to make a full-sized copy, and it would be too much trouble to cut and paste a form together. In fact, Martin brought with her to the hearing Baker's KTRS file which contained a full-sized photocopy of Baker's Employee Form. [Hearing Exhibit] 21. On this photocopy, Martin's figures in the margin are clearly legible.
>
> 40. The hearing officer finds that the photocopy of Baker's Employee Form in the Systems' files (HE 22) which was received December 18, 1995, *was altered by someone within the Systems to remove any indication of the payment allocation figures hand-written by Martin.*

Recommended Order, Record (R.) 394-95 (footnotes and citations to the record omitted; emphasis supplied).

In the process of finding as fact that this document "was altered by someone within the Systems," the hearing officer was required to assess the credibility of

two witnesses whose testimony directly contradicted one another. One was Martin, whose testimony the hearing officer summarized and we have set forth, *supra*.

The other was the Systems' employee, Lela Hatter. Hatter was allowed to testify first, out of traditional order, because she was not feeling well at the time of the hearing and wanted to go home as soon as she could. Observation of her videotape testimony shows that, in contrast to Martin's relaxed testimony, Hatter appears nervous, uncomfortable and uncertain, particularly when testifying about how she received the form, changing her testimony, then changing it back again.[21]

Hatter testified that she never received any communication from Martin regarding Baker's cross-referencing and that she received the "Employee Enrollment Application" in the spliced and taped and partially unreadable condition in which it was presented at the hearing.

The hearing officer obviously believed that someone at the Systems, if not Hatter, did receive the form in the fully readable condition in which Martin testified she sent it. Relying in part upon the witnesses' demeanors, he found as fact that "the Systems

[21] On appellate review, we must look at "the whole record[,]" KRS 13B.150(2)(c); *see also* KRS 13B.130(1)-(10), just as we should expect the Board did. 105 KAR 1:215 Section 8 ("final order of the board shall be based on substantial evidence appearing in the record as a whole[.]"). This would include at least viewing the videotaped testimony of these two witnesses. Appellate courts often view videotape to observe a person's demeanor where such demeanor has a bearing on the review. *See, e.g., Gabow v. Commonwealth,* 34 S.W.3d 63, 79 (Ky. 2000)(Appellate court's viewing of videotape determined defendant's demeanor during confession to be "calm" and not "under the influence of alcohol or drugs."); *Transit Authority of River City (TARC) v. Montgomery,* 836 S.W.2d 413, 416 (Ky. 1992)(On claim of judicial misconduct, Appellate court's viewing of videotape determined trial judge's "'body language' [and] plain physical attitude and tone of voice do not [appear] vituperative[.]"); *Price v. Commonwealth,* 734 S.W.2d 491, 494 (Ky.App. 1987)(Appellate court viewing of videotape revealed defendant's demeanor of "despair and shame."). By doing so, we are not substituting our judgment of demeanor for that of the hearing officer or the Board. We observe the videotape only to gain insight into whether the decision under review meets the standard of that review.

received a copy of Baker's Employee Form with figures showing Baker intended the Systems to pay first." He then concluded as a matter of law that "[t]his is sufficient notice from KTRS, even if not intended as such by Martin, that Baker and KTRS intended the Systems to pay first."

The Board's Finding that Baker Failed to Give the Systems Notice

If the Board had adopted the hearing officer's finding that Baker gave notice to the Systems, it would have been acknowledging that someone under its authority had tampered with the evidence.[22] Notably, the Board did not contradict the hearing officer's finding of evidence tampering itself and, in fact, ignored it. The Board simply stated that Hatter had received Exhibit 22, the tampered document, "with the cut and attached bottom" just as it was presented at the hearing. Then the Board criticized Martin's conduct.

> Martin's conduct was contrary to established Personnel Cabinet cross-reference procedures and contrary to her on [sic] prior course of dealing in the administration of payment of Baker's health insurance premiums. . . . Ms. Martin had a duty to place Baker on notice that the action he proposed was contrary to cross-reference procedures. Ms. Martin never gave notice to [the Systems] that she was deviating from established cross-reference procedures, nor that she was altering her course of dealing with [the Systems].

(R. 456-57). The Board then concluded that "Baker never gave notice to [the Systems] that he was changing his course of dealing." (R.491).

[22] We do not suggest that any particular Systems employee, including the employees who testified, was necessarily responsible for the tampered condition of the document. We take no more specific position than that the hearing officer determined "someone within the Systems" did so. If the Board chooses to investigate or ignore the conduct of its employees, it is free to do so.

The Board did not explain why it found Hatter's testimony more credible than Martin's, nor did it give any other reason for rejecting the hearing officer's conclusions on this issue. The Systems apparently believes no explanation is necessary, simply urging this Court to find that the substantial evidence standard is satisfied because the Board Order and Hatter's testimony are consistent on this point.

If we were to simply review the final order and, upon finding some measure of evidentiary support in the record, affirm on the basis of substantial evidence, we would be failing in our duty. Such a sciolistic approach would suffice only if the rule were that where there is *any* evidence to support a finding, that finding cannot be challenged. This is not the rule and we will not make it so. *Com., Revenue Cabinet v. South Hopkins Coal Co.*, 734 S.W.2d 476, 479 (Ky.App. 1987)("'Substantial evidence' is not simply some evidence or even a great deal of evidence[.]"); *see also Young v. L. A. Davidson, Inc.,* 463 S.W.2d 924, 926 (Ky. 1971)("[M]isuse of the fact-finding power by the board arrogates to that administrative body a policy-making function which it should not have[.]").

Appellate Review of Agency Head's Rejection of Hearing Officer's Recommendation

For his part, Baker urges adoption of a more sophisticated rule of review that he believes applies when the agency head deviates from the recommendation of the hearing officer. *Citizens Bank of Marshfield, Missouri v. FDIC,* 718 F.2d 1440, 1444 (8th Cir. 1983)("a slightly different rule applies when the administrative agency *rejects* the findings" of the hearing officer; emphasis supplied); *see also*, *Brock v. L.E.Myers Co.,* 818 F.2d 1270, 1277 (6th Cir. 1987)(administrative agency must explain grounds for rejection of hearing officer's recommendation).

Baker advances the argument that the Board cannot reject a hearing officer's recommendation, including his fact-finding, without first articulating non-arbitrary reasons for doing so. We find merit in this argument.

We believe our statutes and case law require us to recognize that an agency head's failure to articulate its rationale for rejecting the hearing officer's recommendation is a factor in our review. *See, e.g., Kentucky Bd. of Nursing v. Ward,* 890 S.W.2d 641, 643 (Ky.App. 1994)("In determining whether the evidence is substantial, the court must take into account whatever in the record fairly detracts from its weight." Internal quotation marks omitted).

Section (1) of KRS 13B.120 requires the Board to "consider the record *including the recommended order*[.]" (Emphasis supplied). Consistent with the chapter, the Board has even adopted a regulation requiring that any "final order of the board shall be based on substantial evidence appearing in *the record as a whole*[.]" 105 KAR 1:215 Section 8. Consequently, the Board is not free to review only the evidence presented and reach its own independent result, utterly disregarding the reasoning, observations and opinions of the hearing officer.

When an agency head adopts the hearing officer's recommendation, it is self-evident that the recommendation received appropriate consideration.

However, when an agency head rejects the hearing officer's recommendation, there is no way for a reviewing court to know whether due consideration was given to reasons and factors supporting that rejection. We believe it is necessary for the agency head to add to the record by articulating non-arbitrary reasons

for such rejection. This specific directive is implicit in the language of KRS 13B.120(3), as interpreted by our Supreme Court.

If the Board exercises its lawful prerogative of rejecting the hearing officer's findings of fact, KRS 13B.120(3) explicitly requires the agency head to "include separate statements of findings of fact and conclusions of law." Our Supreme Court interpreted this to mean more than simply identifying what testimony the Board believes conflicted with the hearing officer's fact-finding.

In *Herndon v. Herndon,* 139 S.W.3d 822 (Ky. 2004) a unanimous court "took pains to point out that '[i]f the agency head deviates from the recommended order, it must make separate findings of fact and conclusions of law *for any deviation* from the recommended order.'" *Id.* at 825 (emphasis supplied), *quoting Rapier v. Philpot*, 130 S.W.3d 560, 563 (Ky. 2004*), citing* KRS 13B.120(3).

Lest the "pains"-taking of our Supreme Court be misinterpreted as a mere repetition of the statutory requirements, the court emphasized a "difference between KRS 13B cases and cases governed by the civil rules." *Id.* That difference is "the breadth of discretion possessed respectively by the agency head [acting on the recommendation of a hearing officer under KRS 13B.030] or the trial judge [acting on the recommendation of a commissioner under CR 53.06]." *Id.* The Supreme Court indicated there are strictures on an agency head's discretion where, "[*b*]*y contrast,* a trial judge acting on a Commissioner's report pursuant to CR 53.06 has *the broadest possible discretion* with respect to the action that may be taken." *Id.* (emphasis supplied).

The contrasting degree of discretion is not readily revealed by simply comparing the respective rules and statutes. Both CR 53.06 and KRS 13B.120(2) give the respective final decision-maker the power to accept, reject or remand the recommendation. Both CR 52.01 and KRS 13B.120(3) say that the final decision-maker must render written findings of fact and conclusions of law. Yet *Herndon* unmistakably intended to identify a degree of deference owed by an agency head to the hearing officer that does not exist between a trial judge and a commissioner. Such a rule of deference has been adopted in other jurisdictions, primarily to recognize the superior ability of the hearing officer to determine demeanor-based facts. *See, e.g., McEwen v. Tennessee Dept. of Safety,* 173 S.W.3d 815, 824 (Tenn.Ct.App. 2005); *Brock v. L.E. Myers Co., High Voltage Div.,* 818 F.2d 1270, 1277 (6th Cir. 1987); *see also, Community Clinic, Inc. v. Department of Health and Mental Hygiene,* 922 A.2d 607, 619 (Md.App. 2007).

We believe the basis for the deference alluded to in *Herndon* is the agency head's lack of *adjudicatory* experience and expertise relative to that of the hearing officer. A further comparison of the two systems is illustrative.

When we undertake appellate review of a circuit judge's decision that has been aided by a commissioner's report, we appropriately presume that the adjudicatory experience and expertise of the circuit judge is at least equal to that of the commissioner. On the other hand, when we examine the statutes and regulations governing the conduct of administrative hearings, we are struck by the fact that it is the hearing officer, and not the agency head, who is possessed of superior adjudicatory experience and expertise.

While "[c]ourts often advert to the expertness, special competence, specialized knowledge, or experience of the administrative agency" when engaged in a legislative function, *Graybeal v. McNevin*, 439 S.W.2d 323, 326 (Ky. 1969)(citation omitted), it is the hearing officer and not the agency head who is the expert in the kind of fact-finding necessary to an agency adjudication. Hearing officers develop this expertise through training and experience that is rarely, if ever, possessed by agency board members. In fact, the legislature specifically exempts board members from the requirement of obtaining any education in adjudicating controversies that come before them. KRS 13B.030(3).

On the other hand, since 1994 the legislature has required that Kentucky's Office of the Attorney General, Division of Administrative Hearings, be responsible for hearing officer training and for "maintaining a pool of hearing officers for assignment to the individual agencies at their request, for the conduct of administrative hearings." KRS 15.111(2)(a), (c). Legislatively mandated training includes both initial training (a minimum of 18 classroom hours) and continuing education (a minimum of 6 classroom hours annually) in a variety of disciplines focusing on administrative law and procedure. KRS 13B.030(3), (4); 40 Kentucky Administrative Regulations (KAR) 5:010. Training includes everything from the substantive statutory law of specific agencies to enhancing the hearing officer's ability to determine witness credibility. On the latter topic alone, courses cover "judging demeanor and forthrightness of witnesses, appearance and body language; [s]exual, racial and cultural bias, and prejudice; and [j]udging common sense of answers, consistency, context and flow." 40 KAR 5:010 Section 3(1)(c).

No doubt the legislature's intent in requiring this level of qualification was to better serve the agency head and the public, but ultimately it was to best serve justice. Without question, it is the hearing officer who provides the agency head with the adjudicatory experience and expertise it would otherwise lack. This is undoubtedly the reason more than sixty (60) government agencies and boards[23] "delegate the fact-finding role to a hearing officer[.]" *Herndon v. Herndon,* 139 S.W.3d 822, 826 (Ky. 2004).

We do not intend to suggest that this Board, or any agency head, is prohibited from rejecting a hearing officer's recommendation, including his fact-finding. Upon due consideration of the entire record, an agency head enjoys the prerogative of making factual findings independent of, and even contrary to, those of the hearing officer. KRS 13B.120(2). Despite the politicization of the appointment process, the individuals comprising the various agency heads are appointed to serve ostensibly because of their particular personal expertise in the field regulated by the agency. The agency head certainly may, and should when appropriate, draw upon that expertise to articulate legitimate bases upon which to reject a hearing officer's recommendation.[24] We simply

[23] The number of state agencies and boards using hearing officers comes from the official website of the Commonwealth of Kentucky, Office of the Attorney General, Division of Administrative Hearings. http://ag.ky.gov/hearings.htm This information is current as of October 10, 2006.

[24] The deference reviewing courts have always given an agency's final order is derivative of this expertise. *See, e.g., Our Lady of the Woods, Inc. v. Com., Kentucky Health Facilities and Health Services Certificate of Need and Licensure Board,* 655 S.W.2d 14, 17 (Ky.App. 1982).

> Deference is accorded [an agency's] factual conclusions for a different reason – [the agency is] presumed to have broad experience and expertise in [the area]. . . . Further, it is the [agency] to which [the legislature] has delegated administration of the [statute]. The [agency], therefore, is viewed as particularly capable of drawing inferences from the facts. . . . Accordingly, . . . a [reviewing court] must abide by the [agency's] derivative

deem it appropriate and necessary to require the agency head to offer an explanation when it does so.

However, "on matters which the [hearing officer], having heard the evidence and seen the witnesses, is best qualified to decide, the agency should be reluctant to disturb his findings unless error is clearly shown." *Universal Camera Corp. v. N.L.R.B.*, 340 U.S. 474, 494 (1951). Where the agency overcomes that reluctance and "rejects the fact-finding of a [hearing officer], on appellate review, courts are entitled to expect, at a minimum, that the agency will provide a rational exposition of how other facts or circumstances justify its course of action." 2 Am. Jur. 2d *Administrative Law* § 365.

Upon appellate review, we are required to look at "the whole record," KRS 13B.150(2)(c); *see also* KRS 13B.130(1)-(10). For purposes of our review under Chapter 13B, the hearing officer's recommendation (including his findings of fact) is as much a part of the record as the evidence put before the hearing officer, and we must consider his views in deciding whether the Board Order is supported by substantial evidence. *Universal Camera Corp. v. N.L.R.B.*, 340 U.S. 474, 493 (1951)("[A]n examiner's [hearing officer's] report is as much a part of the record as the complaint or the

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> inferences, if drawn from not discredited testimony, unless those inferences are "irrational," . . . "tenuous" or "unwarranted." . . . As already noted, however, the [agency], as a reviewing body, has little or no basis for disputing a [hearing officer]'s testimonial inferences.

Department of Health and Mental Hygiene v. Shrieves, 641 A.2d 899, 907 (Md.App. 1994), *quoting Penasquitos Village, Inc. v. National Labor Relations Bd.*, 565 F.2d 1074, 1078-79 (9th Cir.1977)(internal citations omitted).

testimony."). Similarly, the agency head's rationale for rejecting the hearing officer's recommendation, if one is given, is also part of that whole record we must consider. If no non-arbitrary rationale is given, that too is a factor we must consider.

Expecting the agency head to articulate its rationale for departing from the recommendation does not erode the substantial evidence rule of review. Because we are already required to give due regard to the hearing officer's recommendation, KRS 13B.150(2)(c); KRS 13B.130(7), the agency head's explanation for any departure from it, if not arbitrary, will only serve to strengthen the validity of the final order. To give both the recommendation and the rationale for its rejection "this significance does not seem to us materially more difficult than to heed the other factors which in sum determine whether evidence is 'substantial.'" *Universal Camera, supra,* at 496-97.

The need for the agency head to articulate its rationale for rejecting demeanor-based findings, such as the one we address here, is especially keen. Other courts have called "the problem of ignoring the 'credibility' findings of the initial hearing officer[,]" *Scarborough v. Cherokee Enterprises,* 816 S.W.2d 876, 877 (Ark. 1991), "a special problem of administrative review."*Slusher v. NLRB,* 432 F.3d 715, 727 (7th Cir. 2005).

We have concluded that when an agency head rejects any finding or recommendation of a hearing officer pursuant to KRS 13B.120(2), and fails to make its non-arbitrary rationale for such rejection a part of the final order, as in the case *sub judice*, it risks a determination both that the final order is not supported by substantial evidence and that it is arbitrary.

The Board's Finding that Baker Failed to Give Appropriate Notice to the Systems is Not Supported by Substantial Evidence

We have previously said that "[i]n determining whether the evidence is substantial, the court must take into account whatever in the record fairly detracts from its weight." *Kentucky Bd. of Nursing v. Ward,* 890 S.W.2d 641, 643 (Ky.App. 1994)(internal quotation marks omitted), *quoting Willbanks v. Secretary of Health & Human Services,* 847 F.2d 301 (6th Cir. 1988), *quoting Universal Camera* at 488. In this case, there are at least three factors that detract from the substantiality of the evidence upon which the Board relies in finding that the Systems never received Baker's notification.

First, unlike the hearing officer, the Board was not in a position to observe the demeanor of the witnesses and assess their credibility. Of course, this is always the case when an agency head delegates its fact-finding duty. Consequently, we would expect this to be a factor only in cases in which a demeanor-based finding plays an important role, such as the one before us. As the United States Supreme Court put it, "evidence supporting a conclusion may be less substantial when an impartial, experienced examiner [in our case, the hearing officer,] who has observed the witnesses and lived with the case has drawn conclusions different from the Board's than when he has reached the same conclusion." *Universal Camera* at 469.

The prevailing view on an agency head's deference to demeanor-based fact-finding by a hearing officer has been articulated often and variously, but in general conformity with *Ward v. N. L. R. B.,* 462 F.2d 8 (5th Cir. 1972).

> The preeminence of the [hearing officer's] conclusions regarding testimonial probity does not amount to an inflexible

> rule that either the Board or a reviewing court must invariably defer to his decision, thereby effectively nullifying either administrative or judicial review. But when the Board second-guesses the [hearing officer] and gives credence to testimony which he has found – either expressly or by implication – to be inherently untrustworthy, the substantiality of that evidence is tenuous at best.

Ward at 12, *citing N.L.R.B. v. Walton Mnfg. Co.*, 369 U.S. 404, 408, 82 S.Ct. 853, 855, 7 L.Ed.2d 829, 832 (1962); *see also Brock v. L.E. Myers Co., High Voltage Div.,* 818 F.2d 1270, 1277 (6th Cir. 1987); *McEwen v. Tennessee Dept. of Safety,* 173 S.W.3d 815, 824 (Tenn.Ct.App. 2005)(Where "credibility plays a pivotal role, then the hearing officer's . . . credibility determinations are entitled to substantial deference."); *Department of Health and Mental Hygiene v. Shrieves,* 641 A.2d 899, 908-09 (Md.App. 1994)(Hearing officer's "findings based on the demeanor of witnesses are entitled to substantial deference and can be rejected by the agency only if it gives strong reasons for doing so[.]"); *Ritland v. Arizona State Bd. Of Medical Examiners,* 140 P.3d 970, 974 (Ariz.App. 2006)("Board's decision must reflect its factual support for rejecting [hearing officer's] credibility findings."). This is an appropriate and necessary consideration when any agency head decides to reject findings of fact of the same hearing officer to whom the agency head entrusted its delegation of responsibility for determining facts.

While the first factor focuses on the witnesses' believability, the second focuses on the witnesses' relationship to the Board. To reach the finding of fact at issue in this case – that Baker never sent the Systems proper notice – the Board had to totally discount the apparently disinterested testimony of Martin that the form she sent on Baker's behalf to the Systems was not the tampered document produced during discovery

and at the hearing. Further, the Board had to reject the notion that anyone at the agency it headed, and specifically Ms. Hatter, tampered with the document. It had to vest in the testimony of its own agency's employee the entire weight of the issue. In the absence of the Board's rationale for doing so, such obvious cherry-picking of the evidence, contrary to the disinterested finding of the hearing officer, based on the testimony of a disinterested witness, has the strong appearance of arbitrariness. Such an appearance is brought into sharper resolution by the fact that the Board's substituted finding on this point was a literal parroting of this witness's employer's brief.

The third factor has to do with motivation. The Board's finding that it never received notice requires acceptance of the inference that a person other than "someone within the Systems" had a reason to tamper with Baker's form. Martin had no reason to tamper with the form. To do so would have served neither her nor her employer any purpose. In fact, sending a form illegible in any way would have been contrary to her purpose, possibly necessitating that she repeat her effort. We can conceive of no other motivation for any person or entity to tamper with the form than that provided by the hearing officer. More importantly, the Board offers no alternative explanation, rational or otherwise.

We have fully considered the record as a whole and conclude that the Board's finding that Baker did not give notice to the Systems of his allocation of state contributions, to which he was lawfully entitled, is not supported by substantial evidence and is arbitrary.

Nevertheless, Baker's notice to the Systems of his desired coordination of benefits is irrelevant if the Systems' policy is sustainable under KRS Chapter 13A as a matter of law. Before addressing that issue, however, we must turn to Baker's second argument and determine whether the Board's adoption of the System's Brief as its final order was proper under KRS Chapter 13B.

ADOPTION OF THE SYSTEMS' BRIEF AS THE BOARD ORDER

Baker's second argument opens upon an erroneous premise. He claims that Chapter 13B includes "an administrative hearing procedure that removes total control of in house decision making by a state agency and vests that responsibility in an independent professionally managed quasi judicial authority[.]" While this statement is more accurate with regard to some administrative adjudications than others, Chapter 13B most certainly is not designed to do this. *See, e.g.,* KRS 13B.030(1)("An agency head may not . . . delegate the power to issue a final order[.]").

We have noted in the past, with varying degrees of emphasis, as well as in this opinion, that administrative adjudications vary widely in their process. That variety was specifically addressed with regard to the subject of Baker's second argument – an agency head's duty of independent fact-finding – in *Burch v. Taylor Drug Store, Inc.,* 965 S.W.2d 830 (Ky.App. 1998).

> [I]n many administrative agencies, there is a single finder of fact who hears and weighs evidence, makes factual findings and applies the facts to the law. . . . For example, workers' compensation procedure (at least prior to 1996) functions much in the same manner as the courts. . . . [A]n Administrative Law Judge (ALJ) conducts a hearing, makes findings of fact, conclusions of law and determines the

> amount of the award, if any. On appeal, the Workers' Compensation Board sits as a true appellate body. *The Board cannot* consider additional evidence, or *second-guess the findings made by the ALJ*. . . .
>
> However, the approach to fact-finding in unemployment insurance cases is substantially different. . . . The referee conducts a hearing, receiving testimony from witnesses and reviewing documentary evidence. The referee then issues findings of fact, conclusions of law and final order[. A]n aggrieved party may appeal to the full Commission.
>
> [A]ll appeals to the Commission may be heard upon . . . the evidence and exhibits introduced before the referee. Thus, while *the Commission* generally does not hear evidence directly from witnesses, it *has the authority to enter independent findings of fact*. Necessarily, such authority allows the Commission to judge the weight of the evidence and the credibility of witnesses and to disagree with the conclusion reached by the referee.

Burch at 833-34 (emphasis supplied; internal quotation marks and citations omitted). While both workers' compensation and unemployment compensation claims are exempted from Chapter 13B, KRS 13B.020(3)(e)1.a., (3)(i)1.a., the fact-finding determination under that chapter very closely reflects the method prescribed for unemployment claims. KRS 13B.120(2), (3) ("agency head may accept . . . or it may reject or modify . . . the recommended order [and] include separate statements of findings of fact and conclusions of law.").

Baker nevertheless correctly makes the point that KRS 13B.120 places the duty squarely on the agency head to prepare a final order. *See also* KRS 13B.030(1). He argues that the Board breached this duty because "the Board's counsel became the

decision maker" when the "Board of Trustees essentially adopted the [Systems'] Post-Hearing Brief as its Report and Order." (Appellants Brief, pp. 14, 16).

We cannot imagine a more complete appropriation of the intellectual work product of another than occurred here when the Board adopted the Systems' brief as its final order. But for the fact that the Systems obviously agreed to have the Board appropriate its work, this case would represent the essence of plagiarism. But does it constitute reversible error? Ultimately, we think not.

The question fairly stated is, "To what extent may an agency head incorporate the work of others, and more particularly, the work of the parties before it, as its final order in a Chapter 13B adjudication?"

Undoubtedly, claimants whose personal rights are being adjudicated by a state agency are entitled to a decision that is the product of independent, deliberative consideration by the members of the agency head. Yet even before adoption of Chapter 13B, we "held that agency decisions may be based on the work of hearing officers." *Robinson v. Kentucky Health Facilities,* 600 S.W.2d 491, 492 (Ky.App. 1980). Clearly, the entire concept of utilizing hearing officers under KRS 13B.030(1) anticipates that the agency head conducting independent deliberations and fact-finding will rely on, and routinely appropriate, the work product of another, namely the hearing officer.

Does it make a difference when the work being appropriated was offered by a party to the administrative proceeding? While this aspect of the question is one of first impression in Kentucky, we believe that an agency head's fact-finding under Chapter 13B

is sufficiently comparable to the fact-finding of a trial court under CR 52.01 to justify application of the principles developed in the latter context.

An early consideration of the question in a judicial context is found in *Callahan v. Callahan,* 579 S.W.2d 385 (Ky.App. 1979), where we once claimed "[t]he appellate courts of this state have universally condemned the practice of adopting findings of fact prepared by [a party's] counsel . . . because of the problems such findings present upon appellate review." *Id.* at 387. However, a few years later, the Supreme Court corrected us.

> We do not condemn this practice (of permitting attorneys to draft findings of fact and conclusions of law) in instances where the court is utilizing the services of the attorney only in order to complete the physical task of drafting the record. However, . . . [*o*]*ur concern . . . is that the trial court does not abdicate its fact-finding and decision-making responsibility*[.]

Bingham v. Bingham, 628 S.W.2d 628, 629 (Ky. 1982)(emphasis supplied); *see also Mansfield v. Voedisch,* 672 S.W.2d 678, 681 (Ky.App. 1984). In *Bingham*, the Supreme Court engaged in a "[c]areful scrutiny of the record" and determined that "the court was thoroughly familiar with the proceedings and facts[,] prudently examined the proposed findings and conclusions and made several additions and corrections *to reflect his decision* in the case." *Id.* (emphasis supplied). Consequently, the Supreme Court determined the trial court had not abdicated its role in the case before it.

But *Bingham* did seem to establish a bright line rule for distinguishing between the trial court's impermissible abdication of its fact-finding responsibility and its permissible adoption of persuasive language. Distinguishing *U.S. v. Forness,* 125 F.2d

928 (2nd Cir. 1942) from the case before it, the Supreme Court in *Bingham* pointed to the fact that in *Forness* there was a "verbatim or mechanical adoption of proposed findings of fact[.]" *Bingham* at 629. The *Forness* court thus concluded that the trial court did abdicate such responsibility. *See Forness* at 942 ("[W]e lose the benefit of the judge's own consideration [when] the findings proposed by the defendants [a]re mechanically adopted[.]").

Emphasizing the importance of independent fact-finding, *Forness* itself addressed the analogous roles of a trial court and an administrator as fact-finder.

> We stress this matter because of the grave importance of fact-finding. The correct finding . . . of the facts . . . is fully as important as the application of the correct legal rules to the facts as found. An impeccably "right" legal rule applied to the "wrong" facts yields a decision which is as faulty as one which results from the application of the "wrong" legal rule to the "right" facts. The latter type of error, indeed, can be corrected on appeal. But the former is not subject to such correction unless the appellant overcomes the heavy burden of showing that the findings of fact are "clearly erroneous". Chief Justice Hughes once remarked, "An unscrupulous administrator might be tempted to say 'Let me find the facts for the people of my country, and I care little who lays down the general principles.'" [citation omitted]. That comment should be extended to include facts found without due care as well as unscrupulous fact-finding; for such lack of due care is less likely to reveal itself than lack of scruples, which, we trust, seldom exists. And Chief Justice Hughes' comment is just as applicable to the careless fact-finding of a judge as to that of an administrative officer. The judiciary properly holds administrative officers to high standards in the discharge of the fact-finding function. The judiciary should at least measure up to the same standards.

Forness at 942 (citations omitted).[25]

[25] Chief Justice Hughes' quotation is taken from his Address before the Federal Bar Association in 1931, quoted in N.Y. Times, February 13, 1931, page 18. *See* James Landis, The

Very quickly taking our cue from *Bingham's* interpretation of *Forness*, this Court decided *Stafford v. Board of Educ. of Casey County,* 642 S.W.2d 596 (Ky.App. 1982). In *Stafford,* the trial court had both parties prepare findings of fact "and then adopted verbatim the set of findings and conclusions which more closely reflected his thoughts[.]" We said,

> Such a practice is not proper, as the trial court should have either made an oral statement as to his findings and conclusions for the benefit of counsel in completing the physical task of drafting the finding of fact and conclusion of law or in some other manner *retained control of the decision making process*. (See, for example, *Bingham v. Bingham*, Ky., 628 S.W.2d 628 (1982) . . . .

Stafford at 598 (emphasis supplied). In *Prater v. Cabinet for Human Resources, Com. of Ky.,* 954 S.W.2d 954 (Ky. 1997), the Supreme Court again disabused us of an erroneous belief. This time it was our erroneous belief that *Bingham* had given us a bright line rule.

In *Prater,* the appellant counted on the existence of the ostensible bright line rule. He claimed "the trial court failed to make independent findings of fact[.]" *Prater* at 956. As proof he demonstrated that "the trial court adopted the Cabinet's proposed findings of fact without correction or change." *Id.* While the Supreme Court agreed the adoption was verbatim, it did not agree that this is proof of the trial judge's abdication of his fact-finding responsibility, specifically holding that it "is not error for the trial court to adopt findings of fact which were merely drafted by someone else." *Id.*

Given our review of the case law, we believe Kentucky stands with the United States Supreme Court on this issue. Even where a party's work is "adopted

Administrative Process (1938) 135, 136. *Cf.* Bell, *Let Me Find the Facts*, 26 A.B.A.J. 552 (1940).

verbatim[, t]hose findings, though not the product of the workings of the [trial] judge's mind, are formally his; they are not to be rejected out-of-hand[.]" *U. S. v. El Paso Natural Gas Co.,* 376 U.S. 651, 656, 84 S.Ct. 1044, 12 L.Ed.2d 12 (1964), *quoted in Brunson v. Brunson,* 569 S.W.2d 173, 175 (Ky.App. 1978); *see Bingham* at 630 ("[I]n the absence of a showing that the trial judge clearly abused his discretion and delegated his decision-making responsibility[, his findings] are not to be easily rejected."). And so it is also with the fact-finding of an agency head.

Findings of fact "drawn with the insight of a disinterested mind *are*, however, more helpful to the appellate court." *Id.* (emphasis supplied). And, of course, it is just as much in the interest of the agency head, with the assistance of the hearing officer to whom it lawfully delegated fact-finding authority, KRS 13B.030(1), to draw its own findings of fact.

And yet, an agency head, in the lawful exercise of its own wisdom and discretion, remains free to jettison the hearing officer's recommendation, and the training and experience in fact-finding that goes with it. KRS 13B.120(2); KRS 13B.030(3), (4). The agency head is also free to replace that recommendation with language from a brief designed for an entirely different purpose, *see Bingham* at 630, and written by an advocate who likely lacks the specialized training required of the hearing officer. *See* 40 KAR 5:010 Section 3(1)(h)(Required hearing officer training in "Decision writing"); 40 KAR 5:010 Section 3(2)(g)("Findings and evidence"); 40 KAR 5:010 Section 3(2)(h)1.("The recommended order and writing for judicial review"; "The nature, scope

and function of findings and conclusions under KRS 13B.110"). Determining what or whose work to appropriate is a decision left to the agency head.

Unlike plagiarism though, where the main risk is being discovered, the greater gamble in appropriating the legal work of another is the potential for embracing inferior work and claiming it as one's own. Determining whether the work appropriated by an agency head is inferior as a matter of law is a decision left to the reviewing judiciary.

Having thus warned even ourselves about the risks of appropriating the work of others, we pass on the following bit of advice to trial judges and agency heads alike. We have offered this advice before, *Brunson, supra,* at 175 fn.1, having borrowed the words, with attribution, from the United States Supreme Court in *United States v. El Paso Natural Gas Co., supra*, which credited the quote to Judge J. Skelly Wright of the Court of Appeals for the District of Columbia.

> [We] suggest to you strongly that you avoid as far as you possibly can simply signing what some lawyer puts under your nose. These lawyers, and properly so, in their zeal and advocacy and their enthusiasm are going to state the case for their side in these findings as strongly as they possibly can. When these findings get to the courts of appeals they won't be worth the paper they are written on as far as assisting the court of appeals in determining why the judge decided the case.

Brunson at 175 fn.1 (internal quotations and citations omitted).

In summary, we hold that the Board's adoption of substantial portions of the Systems' brief does not, in itself, establish that the agency head abdicated its fact-finding

responsibility. Therefore, Baker's argument that the Board committed reversible error by failing to make its own findings of fact in violation of KRS 13B.120(1) must fail.

THE ILLEGALITY OF THE SYSTEM'S CROSS-REFERENCING POLICY

Even though we found that Baker gave sufficient notice to the Systems, he will not prevail on appeal unless the Systems' cross-referencing policy is unenforceable. Baker's final argument is that this policy lacks underlying authority and violates various provisions of Chapter 13A. To properly address this argument and apply Chapter 13A, we must identify the circumstances about which there is no controversy.

Baker's rights as a retiree were established by the General Assembly in KRS 61.510, *et seq*. and are contractual and inviolable. KRS 61.692; *see also Jones v. Board of Trustees of Kentucky Retirement Systems,* 910 S.W.2d 710, 713 (Ky.1995). Those rights included the Systems' obligation to pay Baker's monthly health insurance premium for 1996 in full, not to exceed the monthly state contribution rate for that year of $175.50. *See* KRS 61.702(3)(1995). The legislature provided that such right shall "not be subject to reduction or impairment by alteration, amendment, or repeal." KRS 61.692.

Equally clear is the fact that the Systems' policy – a policy applicable to all retirees – reduced or impaired Baker's right by withholding $105.08 of its $175.50 monthly state contribution obligation. The Systems claims it was authorized to do so by: (1) an unwritten Personnel Cabinet policy dating back at least as far as 1981; (2) a written Systems policy issued December 29, 1995; and (3) the policy-making authority delegated by the legislature pursuant to KRS 61.645(9)(a), (b), and (g) to the Systems' General Manager, Pamala Johnson.

Because the proper role of an administrative agency is to regulate, the first question we must answer is whether the Systems' policy is an "administrative regulation," and, if it is not, does it qualify as a exception, as defined by KRS 13A.010(2). For the purpose of answering this question, we focus on the Systems' December 29, 1995, written policy.

The Systems' Policy is an Administrative Regulation

Whether administrative action constitutes a "regulation" does not depend on the label the agency attaches to it, such as policy or procedure, but whether it fits the definition of KRS 13A.010(2). KRS 13A.010(2) defines "administrative regulation"[26] expansively as

> ***each statement of general applicability*** promulgated by an administrative body ***that implements, interprets, or prescribes law or policy***, or describes the organization, procedure, or practice requirements of any administrative body.

KRS 13A.010(2).[27] An administrative regulation is effective only after it is "adopted." KRS 13A.010(3). *See GTE v. Revenue Cabinet, Com. of Ky.,* 889 S.W.2d 788, 792 (Ky.

[26] Kentucky did not adopt either the 1961 or 1981 version of the Model State Administrative Procedures Act (MSAPA). *See* Model State Admin. Proc. Act, Refs. & Annos., Table of Jurisdictions Where Adopted (1961); Model State Admin. Proc. Act, Refs. & Annos., Table of Jurisdictions Where Adopted (1981). However, the definition of "administrative regulation" contained in KRS 13A.010(2), which is identical to the definition of "regulation" contained in its predecessor statute, KRS 13.080(3)(repealed 1984), is worded nearly identically to the definition for "rule" contained in Section 1(7) of the 1961 MSAPA.

[27] The verb "promulgated" in this definition should be distinguished from the technical term "adopted" defined in KRS 13A.010(3)("'Adopted' means that an administrative regulation has become effective in accordance with the provisions of this chapter[.]"). "Promulgated" should be given its its "common and everyday meaning[,]" KRS 446.015, which is simply to announce or make known publicly. However, the legislature uses the terms interchangeably in other statutes in the chapter. *See, e.g.,* KRS 13A.100(1) and KRS 13A.120(1). We therefore treat them as synonymous.

1994)(Agency actions not excepted from the definition of "administrative regulation" and not adopted "constitute a technical violation of KRS 13A.010(2)."). If an administrative regulation is not adopted, it does not have the effect of law. *Commonwealth, Bd. of Examiners of Psychology v. Funk,* 84 S.W.3d 92, 98 (Ky.App. 2002)("An administrative agency may promulgate administrative regulations, and such regulations, *if 'duly adopted* and properly filed have the full effect of law.'"; emphasis supplied), *quoting United Sign, Ltd. v. Commonwealth*, 44 S.W.3d 794, 798 (Ky.App. 2000).

The legislature, in its wisdom, understood that an administrative agency would be hamstrung if it could only act by promulgating *and adopting* an administrative regulation for every action it needed to take.[28] So that an agency could operate internally, the legislature carved out five specific categories of agency action and excepted them from the definition of administrative regulation. KRS 13A.010(2)(a)-(e). Such agency

[28] UCLA School of Law Professor Emeritus Michael Asimow tells us that the trend among the majority of states is to follow federal law and allow agencies to adopt informal statements of policy, referred to as "guidance documents," without the pre-adoption notice-and-comment required of administrative rulemaking. Michael Asimow, *Guidance Documents in the States: Toward a Safe Harbor*, 54 ADMIN. L. REV. 631, 632, 644 (2002). However, "eight states have gone in precisely the opposite direction: their statutes and case law explicitly prohibit the adoption of guidance documents except by complying with [their respective state's] rulemaking procedures. California is the most prominent of these states[,]"*Id.* at 644, but Kentucky is also among them. *Id.* at 651 (citing KRS 13A.010(2) and KRS 13A.130). In those eight states, the agencies recognize that

> [u]sing notice and comment to adopt every piece of paper that interprets law or constrains discretion would be prohibitively expensive in terms of scarce staff resources [and] consume precious months. . . . Instead, agencies generally adopt these documents, pejoratively known as 'underground regulations,' and hope that nobody will notice (or at least nobody will challenge) them.

Id. at 635.

actions need not be adopted to be effective. Because the last two exceptions have no possible applicability to this case, we will describe only the first three. They are

- "Statements concerning only the internal management of an administrative body and not affecting private rights or procedures available to the public" KRS 13A.010(2)(a)
- "Intradepartmental memoranda not in conflict with KRS 13A.130" KRS 13A.010(2)(c)
- "Declaratory rulings" KRS 13A.010(2)(b)

The Systems' policy does not fall within the first exception for two reasons: (1) it is *not* a "[s]tatement concerning only the internal management of [the] administrative body" and (2) it *did* "affect[] private rights" of Baker and all retirees similarly situated. KRS 13A.010(1)(a). A proper example of this category of exception would be a policy stating whether a Systems' employee could listen to music at his or her workstation.

We also conclude that the policy does not fall within the next exception listed: an "[i]ntradepartmental memoranda not in conflict with KRS 13A.130." KRS 13A.010(2)(c). We need go no further than to say that the Systems' policy was intended to apply to all persons who retired from employment with Kentucky state government. By definition, these persons were not "intradepartmental" personnel. Even if the policy applied only intradepartmentally, the policy does not satisfy the second part of the exception (not conflicting with KRS 13A.130(1)) because it modifies or limits a statute – KRS 61.702(3)(1995), now KRS 61.702(3)(a)5. A proper example of this category of

exception would be the health benefits plan available intradepartmentally to all Systems employees.

The third listed exception, declaratory rulings, requires closer examination. However, we conclude that the Systems' policy was not a "[d]eclaratory ruling." KRS 13A.010(2)(b).[29]

Declaratory rulings, *per se*, have been authorized by the legislature to only one Kentucky agency – the Board of Nursing. KRS 314.105. While Chapter 13A does not provide a definition for the term, the meaning ascribed to it by the legislature in KRS 314.105 is consistent with our understanding of how that term is to be interpreted in KRS 13A.010(2)(b). A "declaratory ruling" is an interpretation by an administrative agency of "the applicability to any person, property, or state of facts of a statute, administrative regulation, decision, order, or other written statement of law or policy within the jurisdiction of the board." KRS 314.105(1); *see also*, *Baltimore City Bd. of School Com'rs v. City Neighbors,* 929 A.2d 113, 136 (Md. 2007)("[T]he declaratory ruling procedure was meant to enable persons concerned with a more narrowly focused issue to obtain binding advice about their particular situation.").

[29] As noted in footnote 24, *supra*, KRS 13A.010(2) is taken from the definition for "rule" contained in § 1(7) of the 1961 version of the MSAPA, which includes these very same exceptions verbatim. However, the legislature apparently chose not to adopt § 8, the section of the MSAPA that would have authorized all state agencies to issue declaratory rulings. It reads as follows:

> Each agency shall provide by rule [administrative regulation] for the filing and prompt disposition of petitions for declaratory rulings as to the applicability of any statutory provision or of any rule or order of the agency. Rulings disposing of petitions have the same status as agency decisions or orders in contested cases.

On the other hand, the legislature has authorized Kentucky agencies other than the Board of Nursing to render "advisory opinions" which we perceive to be synonymous with "declaratory rulings." *See, e.g.,* KRS 6.666(4)(Legislative Ethics Commission); KRS 11A.110 (Executive Branch Ethics Commission); KRS 121.120(1)(f)(Kentucky Registry of Election Finance); KRS 216B.040(3)(e)(Cabinet for Health and Family Services); KRS 224.20-515(1)(Small Business Stationary Source Compliance Advisory Panel of the Environmental and Public Protection Cabinet); KRS 311A.040 (Kentucky Board of Emergency Medical Services).

Despite the fact that the legislature has declined to specifically grant the Systems the authority to issue either declaratory rulings or advisory opinions, the Systems claims the policy was authorized by KRS 61.645(9). A description of that authority is appropriate.

A search of Kentucky statutes will not reveal a grant of agency authority more broadly worded than that contained in KRS 61.645(9)(g). The legislature empowered the Board to "*do all things, take all actions*, and promulgate all administrative regulations, *not inconsistent with* the provisions of KRS 61.515 to 61.705." KRS 61.645(9)(g)(emphasis supplied). A strict and literal interpretation of this statute would authorize the Systems to exercise every power that did not undermine its mission. That is different from granting it only so much authority as is necessary to carry out its mission. However, such a strict and literal interpretation would not promote the legislative purpose, and we do not believe the legislature's choice of the double-negative phrase, "not inconsistent with," was intended to grant more power than would have been

granted if the more appropriate phrase, "consistent with," had been used. Therefore, for purposes of statutory interpretation, we ascribe the same, more restrictive, meaning to both of these phrases.

Yet the Systems also claims, and its Board held, that the legislature has granted broad policy-making authority to its general manager under KRS 61.645(9)(a) and (b).

> As chief administrative officer of the Board, Ms. [Pamala] Johnson is in a policy making position as authorized by statute and she is not prohibited from issuing an opinion or administrative decision on behalf of the Board.

(Board Order, Conclusions of Law ¶ 4). The specific provisions the Board relies upon state:

> The board of trustees shall appoint or contract for the services of an executive director [who] shall be the chief administrative officer of the board [who is] deemed to be in a policy-making position[.]

KRS 61.645(9)(a) and (b).

The Systems and its Board misunderstand the statute's primary purpose in designating Ms. Johnson's position a "policy-making" position. KRS 61.645(9)(a) and (b) do not constitute a blanket grant to Ms. Johnson of boundless authority to set policy. Designation of Ms. Johnson as a policymaker has more to do with her compensation and liability than with any grant of authority. *See* KRS 61.645(9)(b) and KRS 18A.175; *see, e.g., Cabinet for Families and Children v. Cummings,* 163 S.W.3d 425, 431, 435 (Ky. 2005)("Legislature did not intend for policy makers and managers to be individually liable under the [Whistleblower] Act. . . . Commonwealth or its agencies are per se liable

for the acts of a policy maker or manager in violation of the statute."); *compare Heggen v. Lee*, 284 F.3d 675, 683 (6th Cir. 2002)(To some degree, even "a 'football coach' is a policymaker"; applying Kentucky law).

"[W]hether a particular official has 'final policymaking authority' is a question of state law[,]" *City of St. Louis v. Praprotnik,* 485 U.S. 112, 123, 108 S.Ct. 915, 924 (1988)(emphasis removed), *citing Pembaur v. City of Cincinnati*, 475 U.S. 469, 483, 106 S.Ct. 1292, 1300 (1986), and this Court is responsible for answering that question. We do not doubt that Ms. Johnson has certain authority. Her "office has all the indicia of a 'policy-making,' government position which vests its holder with discretionary power, considerable responsibility, confidence and supervisory authority." *Garrard County Fiscal Court v. Layton,* 840 S.W.2d 208, 210 (Ky.App. 1992). What it does not do, is exempt the office or officeholder from the safeguards we have established to protect citizens such as Baker from the arbitrary exercise of that policy-making authority.

However broad Ms. Johnson's or the Board's power may appear, it is always subject to "Kentucky's strong stance against vague delegations" of power referred to as the "nondelegation doctrine." *Board of Trustees of Judicial Form Retirement System v. Attorney General of the Commonwealth of Kentucky*, 132 S.W.3d 770, 781-82, 784 (Ky. 2003)(describing at length the "nondelegation doctrine" in Kentucky). This doctrine compels us to strictly limit an agency's authority to that clearly delegated and no more.

Our common law has long adhered to the doctrine that the powers of administrative agencies "are limited to those conferred expressly by statute or which exist by necessary and fair implication. . . . But these implications are never extended beyond fair and reasonable inferences." *Blue Boar Cafeteria Co. v. Hackett*, 312 Ky. 288, 227 S.W.2d 199, 201 (Ky. 1950). "Powers not conferred are just as plainly prohibited as those which are expressly forbidden[.]" *Louisville and Jefferson County Planning Commission v. Schmidt,* 83 S.W.3d 449, 460 fn.14 (Ky. 2001), *quoting Allen v. Hollingsworth*, 246 Ky. 812, 56 S.W.2d 530, 532 (1933). Because the legislature did not delegate to the Systems the authority to render declaratory rulings or advisory opinions, it is prohibited from doing so, either through the Board or pursuant to any authority presumed by Ms. Johnson as the Board's chief administrative officer.

Furthermore, the Board has not treated the policy it promulgated as a declaratory ruling or advisory opinion. One important feature of either is that its validity is not to be challenged in a Chapter 13B hearing, but is immediately subject to judicial review. *See* KRS 314.105(5), *supra*, ("A declaratory ruling of the board may be appealed to the Circuit Court[.]"); *and* KRS § 311A.040(5), *supra*, ("An advisory opinion of the board may be appealed to the Circuit Court[.]"). Inconsistent with immediate judicial review, the Systems required Baker to challenge the policy in a Chapter 13B hearing.

We therefore conclude that the Systems' policy was not a declaratory ruling as that term is used in KRS 13A.010(2)(b).

There is but one conclusion. The Systems' policy constituted an administrative regulation, never adopted, and therefore ineffective. *Vincent v. Conn*, 593

S.W.2d 99, 100, 101 (Ky.App. 1979)("[P]olicy of the Bureau for Social Insurance . . . amounts to a regulation[, but] was not promulgated as required by KRS 13.085 [now KRS 13A.100], has no effect, KRS 13.085(1) [now KRS 13A.100(2)], and therefore cannot be used as an independent basis for denying benefits."). The question remains whether the policy, now determined to be an unadopted administrative regulation, is enforceable as law nonetheless.

Administrative Agency Action Subject to Safeguards Against Abuse

Kentucky embraces the concept that the legislature's delegation of power is valid only to the extent it does not run counter to established "safeguards against abuse and injustice." *Butler v. United Cerebral Palsy of Northern Ky., Inc.*, 352 S.W.2d 203, 208 (Ky. 1961)(Adopting the "safeguards" approach and rejecting the "standards" approach as "mumbo-jumbo."); *see also, Kentucky Commission on Human Rights v. Barbour*, 587 S.W.2d 849, 850-51 (Ky.App. 1979)(*Butler* "placed Kentucky in the forefront of states adopting the 'safeguards' test[.]"). Since *Butler*, our courts have applied the safeguards analysis after the fact to remedy abuses of agency authority.

In 1984, the legislature wisely enacted Chapter 13A to establish *preventive* safeguards[30]. Three statutes in that chapter are of particular relevance here. They are KRS 13A.100, KRS 13A.120 and KRS 13A.130. These statutes, indeed all of the statutes of KRS Chapter 13A, were designed to prevent administrative agencies from

[30] KRS Chapter 13A is the successor chapter to KRS Chapter 13. Chapter 13 was originally enacted in 1952, substantially revised beginning in 1972 to reflect developments in administrative law, and repealed in 1984 when replaced by Chapter 13A.

abusing their authority. Should any agency fail to abide by these preventive safeguards, it is the judiciary's role to remedy the failure.

KRS 13A.100, KRS 13A.120 and KRS 13A.130, read together and in the context of the definition of "administrative regulation" contained in KRS 13A.010(2), require the adoption of a regulation every time an agency desires to give legal effect to its issuance of any "statement of general applicability" or any "other form of action" that the agency intends to impact any group of individuals other than that agency's own personnel. Any agency's attempt to modify or vitiate, limit or expand, any statute or administrative regulation, or to expand or limit a right guaranteed by any regulation, statute, or the state or federal Constitution using an internal policy such as is before this Court, is void. KRS 13A.100; KRS 13A.120; KRS 13A.130.

The Systems' Policy is Void

The Systems' policy on cross-referencing violates all three of these provisions and "is null, void, and unenforceable." KRS 13A.130(2). *Franklin v. Natural Resources and Environmental Protection Cabinet*, 799 S.W.2d 1, 3 (Ky. 1990)(Agency action "modifies and vitiates the statute, rendering the regulation 'null, void and unenforceable' as set out in KRS 13A.120(2)."). Because the Systems failed to adopt this policy as a regulation, it is already suspect. *White v. Checkholders, Inc.*, 996 S.W.2d 496, 498 (Ky. 1999)("Court limits the deference shown to informal agency interpretations that have been arrived at without rulemaking or an adversarial proceeding."). However, because it essentially creates new law and usurps the authority of the legislature by limiting KRS 61.702(3)(1995), it is entirely invalid. *Hagan v. Farris,* 807 S.W.2d 488,

490 (Ky. 1991)("KRS 13A.130 prohibits an administrative body from modifying an administrative regulation by internal policy or another form of action."); *see also Linkous v. Darch*, 323 S.W.2d 850, 852 (Ky. 1959)(Agency "may not by rule or regulation . . . limit the terms of a legislative enactment."); *Revenue Cabinet v. Humana, Inc.,* 998 S.W.2d 494, 495-96 (Ky.App. 1998)(KRS Chapter 13A "sets limits upon the discretionary interpretive powers of agencies by forbidding certain actions by internal policy or memorandum.").

Not giving up however, the Systems' asserts that the voiding of its policy does not affect the fact that Baker failed to satisfy his burden of proving "the propriety of his scheme for cross-referencing." We believe the language of KRS 61.702(3)(1995) sufficiently does exactly that by requiring the Systems to pay its state contribution "in full." If we doubted that Baker's interpretation was correct and the Systems' wrong, our review of the *legislative* history of "cross-referencing" put that doubt to rest.

Prior to 1998, no mention is made in statute or regulation to cross-referencing. But in that year, the legislature amended a portion of KRS 61.702 to implement the Systems' policy with regard to a retiree who cross-references with his spouse. The amended statute states that where there is:

> cross-referencing of insurance premiums, the employer's contribution for the working member or spouse shall be applied toward the premium, and the Kentucky Retirement Systems insurance fund shall pay the balance, not to exceed the monthly contribution

1998 Ky. Acts ch. 105 (H.B. 234) § 20, *codified as* KRS 61.702(3)(a)4.

In 2002, the legislature solved this problem of "benefits double-dipping" in a completely different way by adding the following language to KRS 18A.225:

> Any employee who is eligible for and elects to participate in the state health insurance program as a retiree, . . . shall not be eligible to receive the state health insurance contribution toward health care coverage as a result of any other employment for which there is a public employer contribution.

2002 Kentucky Laws Ch. 352 (H.B. 846) § 1, *codified as* KRS 18A.255(13), *and recodified as* KRS 18A.225(12). This eliminated the problem that the Systems' internal policy sought to address.

In 2004, Kentucky's legislature amended KRS 61.702 again. This time the legislation affected members of the retirement system whose participation began after July 1, 2003. Among other things, it deprives participants of the inviolable nature of the retirees' health insurance benefits.

> The benefits of this subsection provided to a member whose participation begins on or after July 1, 2003, shall not be considered as benefits protected by the inviolable contract provisions of KRS 61.692, 16.652, and 78.852. The General Assembly reserves the right to suspend or reduce the benefits conferred in this subsection if in its judgment the welfare of the Commonwealth so demands.

2004 Ky. Acts ch. 33 (H.B. 290) § 5, *codified as* KRS 61.702(8)(d).

The Legislature's incorporation into law of the essence of the Systems' cross-referencing policy, subsequent to the relevant time-period, has no retroactive effect on Baker. KRS 446.080(3)("No statute shall be construed to be retroactive, unless expressly so declared."). It does, however, indicate that the Systems' policy was

inconsistent with the law prior to 1998 for "whenever a statute is amended, courts must presume that the Legislature intended to effect a change in the law." *Brown v. Sammons,* 743 S.W.2d 23, 24 (Ky. 1988); *see also Butler v. Groce,* 880 S.W.2d 547, 550 (Ky. 1994)(Lambert, C.J., dissenting)("courts must presume that the amendment of a statute was intended to change the law."), *citing Whitley County Bd. of Ed. v. Meadors,* 444 S.W.2d 890, 891 (Ky. 1969)("the presumption is that the legislature, by the amendment, intended to change the law.") *and Blackburn v. Maxwell Co.,* 305 S.W.2d 112, 115 (Ky. 1957)("We are compelled to assume that the Legislature had a purpose in mind in specifically changing the statute as it did-that the changes were intentional and not fortuitous."). That change in the law reflected a shift in the law from Baker's correct, pre-1998, interpretation to the Systems' then erroneous view of the law as embodied in its void policy. But the change in the law occurred too late to affect Baker's rights in 1995 and 1996.

We summarize the Systems' attempt to implement law by internal policy as follows. First, the Systems lacked statutory authority in 1995 to limit Baker's inviolable contract rights expressed in KRS 61.702(3)(1995). Second, the policy the Systems promulgated is invalid because it was never "adopted" as an "administrative regulation" as required by KRS 13A.100, and as those terms are defined in KRS 13A.010(2) and (3). If the policy had been adopted, it would have violated KRS 13A.120(2)(i) because it sought to "modify or vitiate a statute [KRS 61.702(3)(1995)] or its intent." Finally, the cross-referencing policy is an "internal policy, memorandum or other form of action" that attempts to modify or limit KRS 61.702(3)(1995), in violation of KRS 13A.130.

DAMAGES

Baker was entitled to the Systems' payment of the state contribution toward his health insurance premium "in full." The Systems failed to make that payment. This led to a shortfall in the payment of Baker's health insurance premium. If KTRS had not unilaterally chosen to stop funding Baker's FSA in order to pay the balance of his premium, Baker would have had to do so. Because KTRS stopped paying into the FSA in order to pay the balance of the premium the Systems failed to pay, Baker was forced to reach into his own pocket to fund the FSA for the remainder of 1996 in the amount of $525.40.

The Systems' counsel described Baker's claim for damages as follows: "Baker is requesting KRS to give him a dollar for dollar reimbursement for money he contributed into a flexible spending account." (R.366). We believe this is a correct assessment of Baker's claim and a correct statement of Baker's measure of damages. We will order the Systems to pay to Baker the sum of $525.40, a sum more representative of principle than of principal.

Baker is not entitled to recover the sum of $735.56 claimed as an arrearage accruing during the first seven months of 1996 when the Systems paid only $70.42 per month toward his premium. According to the record, that sum was never demanded of Baker and he never paid it.

Nor is Baker entitled to be paid anything as compensation for years after 1996. He elected not to participate in the FSA program. Therefore, he cannot be said to have been damaged by having to pay it. Effectively, he waives this claim.

Inapplicability of the Rule of De Minimus Non Curat Lex

The small sum of money in controversy in this case could quite easily have camouflaged its significance. And so we deem it necessary to address the rule of *de minimus non curat lex*.

The rule translates from the Latin as "The law does not concern itself with trifles." BLACK'S LAW DICTIONARY (8th ed. 2004), *de minimis non curat lex* (Westlaw through September 2007). But the "trifles" to which the rule refers are not the dollars involved in a case. That understanding of the rule ignores the proper role of the judiciary. The courts are not redistributors of wealth. The courts address injustice and enforce rights, or at least strive to do so. The movement of dollars from party to party is merely a by-product of the judiciary's work. In our application of the rule of *de minimus non curat lex*, the sum of money has never been the primary consideration.

Our review of the rule in Kentucky shows that cases with sums in controversy as paltry as $6.00 have been addressed and reversed. *Wagers v. Sizemore*, 222 Ky. 306, 300 S.W. 918, 919 (1927)($69.59 in today's dollars). Where the rule has not been applied, it is because a legal principle or substantial right was at stake, making the issue anything but "trifling." The only cases with which the law in Kentucky will not concern itself are those where both the amount of money at stake *and* the legal principle involved, if any, are trifling.

In *Clark v. Mason*, 264 Ky 793, 117 S.W.2d 993, 997 (1938), the sum of $16 was at stake on appeal; that would be about $241 dollars today. The case illustrates the correct interpretation of the doctrine in Kentucky.

> This general "de minimis" rule is thus announced [that]:
>
> Where the ***only impropriety*** in the judgment or decree ***is a trifling error in the amount of the recovery*** which might have been corrected in the court below, the appellate court will usually apply the maxim, "de minimis non curat lex," and refuse to reverse the judgment or decree on that account.
> . . . .
> The question is necessarily governed by the discretion of the court, and where equity and justice demand it, a judgment will be reversed, even though the amount in controversy is insignificant.

Clark, 117 S.W.2d at 296(emphasis supplied).

Kentucky courts have uniformly refused to apply the rule in cases such as *Wagers, supra,* where substantial rights are at stake. In such cases, "because of their involvement of matters other than that of merely a small amount erroneously adjudged, the *application of the rule is held to be improper* because of its working material prejudice to such substantial rights involved." *Id.* at 297.

In the case *sub judice*, the rights of a former public servant, a retiree from state employment, are at stake. In "consideration of benefits received by the state from" that public servant, no lesser institution than the General Assembly of the Commonwealth of Kentucky granted and guaranteed those rights by statute in the form of an inviolable contract, never to be reduced or impaired. KRS 61.692. Applying the rule of *de minimus non curat lex* would not only disparage that right, it would dishonor the commitment of a co-equal branch of our government. And so it would be improper to apply the rule in this case.

The significance of this case is reflected in the stubbornness with which each party strived to prevail. There was never more money at stake than a few hundred, perhaps a few thousand, dollars. What then would cause Baker, a lawyer, to hire another lawyer to pursue his case for more than a decade? What would cause the Systems, an agency of state government that manages total assets exceeding $15,000,000,000,[31] to utilize such substantial resources resisting Baker's claim to such a small amount of money? A cynic would call it trite, but the answer is obvious. This is a case about rights and principles, power and authority.

We are, in fact, grateful that the sum of money in controversy is minimal, for the issue at stake is great. Our system of government is premised upon the concept that all authority originates with our citizens. When the proper exercise of that authority is displaced by the abuse of power, it is the judiciary's duty to remedy it, no matter how few dollars are involved, for the abuse of power feeds upon itself and will inevitably do greater harm if left unchecked. The rule of *de minimus non curat lex* has its proper place in our jurisprudence. But actual injustice is never a trifling matter, and this is particularly so when the injustice comes at the hands of the government.

CONCLUSION

The Kentucky Retirement Systems, by means of a void internal policy that never had the effect of law, wrongfully reduced James Baker's inviolable contractual right to have the Systems pay the full state contribution rate toward his health insurance

[31] This figure is taken from the Systems' "Comprehensive Financial Report for Fiscal Year Ended June 30, 2006," p. 28, http://www.kyret.com/cafr/cafr2006.pdf. The actual figure is $15,051,061,000.

resulting in Baker's suffering monetary damages in the amount of $525.40. The Board's rejection of the hearing officer's Recommended Order was not supported by substantial evidence, was arbitrary and was contrary to law. For these reasons, we REVERSE.

IT IS HEREBY ORDERED:

1. That the Order of the Franklin Circuit Court affirming the Board of Trustees' Report and Order is REVERSED and REMANDED with instructions to order the Board to reinstate the Recommended Order of the hearing officer with modifications consistent with this opinion.
2. That the Systems pay to James M. Baker the sum of $525.40.

VANMETER, JUDGE; KNOPF, SENIOR JUDGE, CONCUR IN RESULT ONLY.

ENTERED: October 19, 2007

/s/ Glenn E. Acree
JUDGE, COURT OF APPEALS

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