IN THE SUPREME COURT OF MISSOURI

UNION ELECTRIC CO. D/B/A AMEREN MISSOURI, Appellant (Petitioner below), v. DIRECTOR OF REVENUE, Respondent.	)	Case No. SC93083

APPELLANT/PETITIONER UNION ELECTRIC CO. D/B/A AMEREN MISSOURI'S OPENING BRIEF

On Petition for Review from the Administrative Hearing Commission
Hon. Sreenivasa Rao Dandamudi, Commissioner

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INTRODUCTION AND SUMMARY

The key issue in this sales tax dispute is whether the Department of Revenue is required to provide a refund to a taxpayer in accordance with a Department regulation. The Administrative Hearing Commission correctly concluded that Appellant/Petitioner Union Electric Co. d/b/a Ameren Missouri ("Ameren") fell within the scope of a regulation that would have exempted energy sales for bakeries from tax, but the Commission erred in concluding that this Court implicitly nullified the regulation in another case that did not mention the regulation.

The regulation in question interprets a 2007 Missouri statute that exempts the energy used in "processing" from the tax on sales of electricity or other energy sources. Mo. Rev. Stat. § 144.054.2. The Department of Revenue adopted a regulation setting forth examples of what would and would not constitute "processing" under this statute. The portion of the regulation at issue exempts from tax the energy used for creating baked goods at a retail location: "A bakery creates baked goods for sale directly to the public or through retailers. The energy sources, chemicals, machinery, equipment, and materials used by the bakery are exempt from state sales and use tax and local use tax, but not local sales tax." 12 CSR 10-110.621(4)(O) ("Bakery Regulation"). (App. at A19.)

This litigation began when Ameren sought a refund for sales tax it paid to the State on energy Ameren sold to Schnuck Markets, Inc. ("Schnucks") for use in Schnucks' in-store bakeries, where baked goods are prepared in production areas behind the retail counters. The Department denied the refund request without claiming or explaining how

Schnucks' bakeries fell or could have fallen outside the Bakery Regulation. Ameren appealed to the Administrative Hearing Commission.

The Commission agreed with Ameren that Schnucks' bakeries were within the scope of the Bakery Regulation, but concluded that the Department of Revenue was not required to follow its own exemption regulation. The Commission opined that the Bakery Regulation conflicted with this Court's statement in a different case not involving a bakery that "the preparation of food for retail consumption is not 'processing.'" *Aquila Foreign Qualifications Corp. v. Dir. of Revenue*, 362 S.W.3d 1, 2-3, 6 (Mo. banc 2012) (holding that "processing" did not occur in Casey's convenience stores, where the activities claimed to be processing were "minimal" food preparation activities, such as heating pre-cooked items, adding water, or freezing water to make ice).

Even assuming that *Aquila*'s "for retail consumption" language is inconsistent with the Department of Revenue's Bakery Regulation, and that this Court intended to address the validity of the Bakery Regulation in a case in which the Bakery Regulation was neither applicable nor mentioned by this Court, the Commission still should have applied the Bakery Regulation and ruled for Ameren for at least four reasons:

1. The Department of Revenue cannot avoid its obligation to adhere to its own regulation by claiming that its regulation is inconsistent with the authorizing statute: the Department must follow the Missouri Administrative Procedure Act if it wants to stop following one of its own regulations. *Greenbriar Hills Country Club v. Dir. of Revenue*, 47 S.W.3d 346, 357 (Mo. banc 2001).

2. Agency regulations are presumptively valid and can be overturned only if "plainly inconsistent" with a statute, which cannot be the case here because *Aquila* held that the statutory definition of processing is ambiguous.

3. The cases cited by the Commission for the statute-trumps-regulation proposition are inapplicable because they merely hold that regulatory agencies cannot interfere with property or other rights of the public without statutory authorization.

4. The public should be able to rely on the government's promise, made in the form of a tax-exemption regulation, to refrain from claiming a right to a taxpayer's property.

Because of the erroneous legal analysis of the Commission, the Commission's decision should be reversed and the case remanded with directions to apply the Bakery Regulation to this case.

JURISDICTIONAL STATEMENT

This is an appeal of a final decision of the Administrative Hearing Commission, which decisions are subject to review in the Supreme Court where constitutionally required. Mo. Rev. Stat. § 621.189. This appeal involves the construction of Mo. Rev. Stat. § 144.054, a revenue law of the State of Missouri. Therefore, this Court has exclusive jurisdiction over this matter pursuant to Article V, § 3 of the Missouri Constitution.

STATEMENT OF FACTS

Ameren seeks a refund of state sales tax paid on energy (primarily electricity and some natural gas) sold to Schnucks for the production of baked goods in 40 Schnucks stores in Missouri (the "Bakery Stores"). (AHC Op., App. at A1-2, LF 504-505.) Ameren is the entity legally required to remit the tax to the State on the sale of electricity or natural gas, and therefore Ameren has standing to bring this refund claim based on electricity and natural gas Ameren sold to Schnucks. Mo. Rev. Stat. §§ 144.010.1(7), (8) (12); 144.020-144.021; 144.060; 144.190. Thus, Ameren seeks the refund of taxes paid by Ameren to the State based on amounts Schnucks paid to Ameren. (AHC Op., App. at A2-3, LF 505-506.)

This case is centered on an exemption to the tax otherwise authorized by Section 144.020.1(3) on the sale of electricity or natural gas to domestic, commercial or industrial consumers. The exemption, enacted in 2007, exempts energy sales for "processing":

> **In addition to all other exemptions granted under this chapter**, there is hereby specifically exempted . . . from the computation of the tax levied, assessed, or payable under sections 144.010 to 144.525 . . . , **electrical energy and gas**, whether natural, artificial, or propane, water, coal, and energy sources, chemicals, machinery, equipment, and materials **used or consumed in the** manufacturing, **processing**, compounding, mining, **or producing of any product** . . .

Mo. Rev. Stat. § 144.054.2 (emphasis added); L. 2007 S.B. 30 (App. at A16.) The statute goes on to define "processing" as "any mode of treatment, act, or series of acts performed upon materials to transform or reduce them to a different state or thing, including treatment necessary to maintain or preserve such processing by the producer at the production facility." Mo. Rev. Stat. § 144.054.1(1).

In 2008, the Department of Revenue promulgated a regulation that provided numerous examples of what the Department would and would not consider "processing" under the new statute. One example specifically dealt with bakeries:

> A bakery creates baked goods for sale directly to the public or through retailers. The energy sources, chemicals, machinery, equipment, and materials used by the bakery are exempt from state sales and use tax and local use tax, but not local sales tax.

12 CSR 10-110.621(4)(O) ("Bakery Regulation"). (App. at A19.)

An energy management consultant for Schnucks brought the Bakery Regulation to the attention of Schnucks during an audit. (Tr., Vol. 1, at 79:6-7, 80:9-19, 81:19-83:5.) After reading the regulation and knowing that Schnucks had areas in its stores that "create[] baked goods for sale directly to the public," Schnucks asked that Ameren request refunds on Schnucks' behalf related to energy used in bakery operations at 52 of Schnucks' Missouri stores. (Tr., Vol. 1, at 83:14-84:11, 86:10-18.) Schnucks differs from its competitors in preparing baked goods in its stores rather than preparing them at a remote location and shipping them to the grocery stores. (Tr., Vol. 1, at 62:14-63:8.)

Ameren applied to the Department of Revenue for refunds on Schnucks' behalf in May 2009 (for electric purchases) and July 2009 (for natural gas purchases at its Cape Girardeau store). (AHC Op., App. at A2-3, LF 505-506.) During the refund application process, Ameren and Schnucks later reduced the number of stores at issue from 52 to 40 based on adjustments requested by the Department of Revenue, and clearly limited the scope of the request to the back-room (non-retail) preparation areas where freezers, ovens, retarders, mixers, preparation tables, and other equipment is located. (Tr., Vol. 1, at 109:22-113:7, 121:14-122:22; Exs. 9, 11, 13, 15, 19, 21.)

The refund amounts sought were based on the percentage of square footage attributable to the production of baked goods in Schnucks' in-store bakeries. (Tr., Vol. 1, at 143:12-152:9; Exs. 22, 24, 25.) This method is authorized by Department of Revenue regulations. 12 C.S.R. 10-110.601(4)(A).

During the refund application process, a Department of Revenue official told a Schnucks representative that the Department was not challenging the merit of Ameren's right to a refund, but was merely trying to determine the applicable square footage. (Tr., Vol. 1, at 124:1-9.)

The Department of Revenue denied the two refund requests in January 2011, which was about 18 months after the applications were made. (AHC Op., App. at A2-3, LF 505-506; Exs. 7, 17-18, 20.) The "Explanation" portion of both denial decisions stated in their entirety: "This refund/credit request is being denied because the customer does not qualify under 144.054 Mo. Rev. Stat." (Exs. 7, 17-18, 20.) The denials did not refer to the Bakery Regulation. (Exs. 7, 17-18, 20.)

Ameren timely appealed the Department's decisions to the Administrative Hearing Commission on March 10, 2011. The hearing began on July 27, 2011, and resumed and concluded on August 4, 2011. (AHC Op., App. at A2, LF 505.)

At the hearing, Schnucks described the bakery process through testimony, photographs, product samples, and other exhibits. (Tr., Vol. 1, at 24:6-72:8; Exs. 1-2, 4-5.) Schnucks' bakery departments produce a variety of baked goods, including cookies, donuts, bagels, rolls, stollens, coffee cakes, breads, and cakes. (Tr., Vol. 1, at 24:20-21; Ex. 1.) Most of the baked goods produced by Schnucks begin as hard, frozen chunks of raw dough that clank when they hit a table. (Tr., Vol. 1, at 27:16-29, 28:12-14, 32:19-33:14, 43:25-44:7, 49:19-50:2, 52:23-53:4, 55:23-56:3, 58:12-17, 60:25-61:5.) This frozen dough is not safe to eat and is not sold at retail. (Tr., Vol. 1, at 28:22-29:3, 29:4-5, 29:6-8, 50:10-16, 50:17-19, 50:20-22, 53:10-17, 53:18-19, 53:20-22, 56:6-12, 56:13-14, 56:15-17, 58:22-23, 58:24-25, 59:1-3, 61:11-15, 61:16-18, 61:19-21.)

During Schnucks' preparation of baked goods, these frozen dough products visibly change in shape, increase in size, and convert from inedible raw materials into finished, cooked items that are consumable by the public. (Tr., Vol. 1, at 29:9-14, 30:8-12, 27:3-28:8, 35:6-9, 45:14-22, 47:16-18, 50:7-9, 53:23-54:6, 55:11-13, 59:4-8, 61:22-23; Exs. 1, 2, 4, 5.)

Generally, raw, frozen dough is put in retarders to thaw, sometimes put in proofers, then baked in ovens, fried, and/or topped or injected with creams, icing, or other ingredients before being packaged for sale in Schnucks' stores. (Tr., Vol. 1, at 27:3-28:8,

30:13-42:24, 42:25-48:13, 51:16-52:7, 52:23-53:4, 54:22-55:22, 55:23-56:3, 57:15-58:11, 58:16-17, 59:24-60:24, 61:4-5, 63:9-25, 65:16-69:19; Exs. 1, 2, 4, 5.)

Photographs showing some of the "before" and "after" pictures of baked goods produced by Schnucks are found in the Appendix at A20 and 21. (*See* Exs. 2 and 4.) The donut-making process, which includes the use of a retarder, a frying screen (two different times), a proofer, a fryer, a glazing cradle, a bakery bench, a filler, and the human hand, is shown in a set of 39 photographs. (Ex. 2.) This set of photographs was not created for this case but for the purpose of educating staff members about the products sold in Schnucks' stores. (Tr., Vol. 1, at 30:20-31:6.)

The conversion from raw, frozen products into finished baked goods uses a variety of electric-powered machinery, including ovens, proofers, retarders, mixers, fryers, and freezers. (Tr., Vol. 1, at 24:1-72:8; Ex. 1.)[1] Some of the machinery contained in Schnucks' bakery production area is constantly running. (Tr., Vol. 1, at 70:20-23.) In addition, there are no windows in the production portion of Schnucks' bakery departments, necessitating the use of electric lights. (Tr., Vol. 1, at 70:24-71:3.) Further, the equipment used to produce baked goods generates heat necessitating the use of electric air conditioning in those areas. (Tr., Vol. 1, at 139:8-16.) Many of Schnucks'

[1] Retarders are refrigerated units typically set from 36 to 38 degrees that are used to slowly take certain products from frozen to thawed states. (Tr., Vol. 1, at 32:24-34:4.) Proofers are pieces of equipment that use heat and humidity to active the yeast in certain products, causing these products to rise. (Tr., Vol. 1, at 34:19-25, 49:11-15.)

bakery production areas have separate air conditioning units dedicated just for the bakery production areas due to the heat generated by the equipment. (Tr., Vol. 1, at 139:13-16.)

The baked goods produced by Schnucks are not prepared for immediate consumption. (Tr., Vol. 1, at 29:25-30:7, 51:8-11, 54:14-17, 57:4-7, 59:17-19, 62:7-9, 65:9-11, 69:23-70:1.)

Much of the evidence presented by the Department of Revenue at the hearing focused on how much of the space within Schnucks' bakery departments constituted production square footage. (AHC Op., App. at A15, LF 518). The Department's witness in that regard was an auditor who visited three of the 40 bakery departments in the Bakery Stores. (Tr., Vol. 2, at 172:1-5, 219:5-7.) He had never audited a bakery before. (Tr., Vol. 2, at 236:13-16.) Schnucks presented charts and testimony as to the square-footage attributable to its back-room bakery production areas at all 40 stores at issue. (Tr., Vol. 1, at 143:12-153:3; Exs. 22, 23, 24, 25.)

The Department did not assert at the hearing or in the post-trial briefs that the Bakery Regulation was invalid or not authorized by the processing exemption statute.

While the case was under submission, on March 6, 2012, this Court decided *Aquila*. The parties submitted supplemental briefs on *Aquila* in April 2012. The Commission issued its decision on December 19, 2012. The Commission found that Schnucks bakeries were bakeries under the Bakery Regulation and held that the Bakery Regulation was inconsistent with *Aquila* and denied the refund. (AHC Op., App. at A15, LF 518.)

This appeal followed.

POINT RELIED ON

The Commission erred in holding that Ameren is not entitled to a sales tax refund for electricity and gas used in Schnucks' bakeries because the Commission's decision is not authorized by law in that: (1) there is a regulation authorizing a sales tax exemption for retail bakeries to which the Department of Revenue is bound; (2) the Commission correctly found that the regulation applied to Schnucks' bakeries; and (3) the regulation was not and should not be deemed invalidated by this Court.

Mo. Rev. Stat. § 144.054

12 CSR 10-110.621(4)(O)

Greenbriar Hills Country Club v. Dir. of Revenue, 47 S.W.3d 346 (Mo. banc 2001)

State ex rel. Mo. Pub. Def. Comm'n v. Waters, 370 S.W.3d 592 (Mo. banc 2012)

Utility Serv. Co. v. Dep't of Labor & Indus. Rels., 331 S.W.3d 654 (Mo. banc 2011)

Foremost-McKesson, Inc. v. Davis, 488 S.W.2d 193 (Mo. banc 1972)

STANDARD OF REVIEW

As statutory interpretation is a question of law, the Supreme Court reviews the Administrative Hearing Commission's interpretation of § 144.054.2 *de novo.* *Concord Publishing House, Inc. v. Dir. of Revenue*, 916 S.W.2d 186, 189 (Mo. banc 1996). The Commission's factual determinations "are upheld if supported by substantial evidence upon the whole record." *Id.* (internal quotations omitted). The Commission's decision shall only be affirmed if: (1) it is authorized by law; (2) it is supported by competent and substantial evidence on the whole record; (3) mandatory procedural safeguards are not violated; and (4) it is not clearly contrary to the reasonable expectations of the General Assembly. Mo. Rev. Stat. § 621.193.

ARGUMENT

I. The Commission erred in holding that Ameren is not entitled to a sales tax refund for electricity and gas used in Schnucks' bakeries because the Commission's decision is not authorized by law in that: (1) there is a regulation authorizing a sales tax exemption for retail bakeries to which the Department of Revenue is bound; (2) the Commission correctly found that the regulation applied to Schnucks' bakeries; and (3) the regulation was not and should not be deemed invalidated by this Court.

The issue in this case is a question of law: Should this Court require the State to comply with a regulation that construes a statute in a way that provides a refund to a taxpayer? This Court should hold that the Commission must apply the Department of Revenue's own regulation authorizing tax refunds and reject the Commission's conclusion that *Aquila* intended to effectively nullify the Bakery Regulation without discussing the Bakery Regulation. The cases on which the Commission relied for the general proposition that a statute prevails over a regulation actually stand for the narrow proposition that an agency cannot rely on a regulation to restrict rights or seize property of the public when doing so is plainly inconsistent with a statute. Those cases do not apply here because the Bakery Regulation instead limits government power and applies in interpreting an ambiguous statute. No Missouri courts have effectively nullified a regulation the way the Commission did here, so this Court should reverse the Commission's decision.

A. The Bakery Regulation Applies to Schnucks' Bakeries.

1. The Department of Revenue Promulgated a Regulation Authorizing an Exemption From Tax on Energy Used by Retail Bakeries to Create Baked Goods.

In 2007, the Missouri General Assembly chose to expand sales tax exemptions by exempting energy purchased for "processing" from sales tax:

> In addition to all other exemptions granted under this chapter, there is hereby specifically exempted . . . electrical energy and gas . . . used or consumed in the manufacturing, processing, compounding, mining, or producing of any product . . . .

Mo. Rev. Stat. § 144.054.2; L. 2007 S.B. 30.

That same statute defined "processing" as "**any** mode of treatment, act, or series of acts performed upon materials to **transform or reduce them to a different state or thing**, including treatment necessary to maintain or preserve such processing by the producer at the production facility." Mo. Rev. Stat. § 144.054.1(1) (emphasis added).

The following year, the Department of Revenue issued a regulation that provided examples of what was or was not exempt to aid the public in understanding the exemption. The portion dealing with bakeries states:

> A bakery creates baked goods for sale directly to the public or through retailers. The energy sources, chemicals, machinery,

> equipment, and materials used by the bakery are exempt from state sales and use tax and local use tax, but not local sales tax.

12 CSR 10-110.621(4)(O) ("Bakery Regulation").

2. The Commission Correctly Found that the Bakery Regulation Applied to Schnucks' Bakeries.

The Commission found that the Bakery Regulation applied to Schnucks' bakeries, stating that the Schnucks' bakeries "were bakeries, whether for the purposes of 12 CSR 10-1110.621(4)(O) or any other statute or regulation." (AHC Op., App. at A15, LF 518.) The Department of Revenue argued that Schnucks' bakeries were not within the scope of the Bakery Regulation. But after a two-day hearing and hundreds of pages of exhibits on the operations of Schnucks' bakeries, the Commission rejected the Department's argument. (AHC Op., App. at A8 n.22, A15, LF 511, LF 518.)

The Commission's finding on this point was supported by overwhelming evidence that, within its in-store bakery production areas, Schnucks uses machinery powered by electricity to convert raw, frozen, inedible products into finished baked goods that can be sold to the public. Some of that evidence is described above in the Statement of Facts. In fact, the Commission observed that most of the hearing was devoted to this issue. (AHC Op., App. at 11, LF 514.) Given both the evidence and the deferential standard of review on fact questions, the Commission's finding is unassailable.

B. The Commission Erred in Assuming that *Aquila* and the Bakery Regulation Cannot be Reconciled.

Given the fact that Commission found that Schnucks' bakeries fell within the scope of the regulation that treated its bakery energy purchases as exempt, one would have ordinarily expected a refund would be ordered. That should be the end of the story.

But the Commission held that the Bakery Regulation was inconsistent with and essentially trumped by this Court's opinion in *Aquila*. The Commission relied on this Court's statement in *Aquila* that **"the preparation of food for retail consumption is not 'processing.'"** (AHC Op., App. at A6, LF 509 (citing *Aquila*, 362 S.W.3d at 6).) The Commission treated food preparation by Schnucks as being "for retail consumption." (AHC Op., App. at A3, LF 506.) Having found *Aquila* inconsistent with the Bakery Regulation, the Commission concluded that *Aquila* prevailed over what the Commission called an inconsistent regulation. (AHC Op., App. at A8, LF 511.) In effect, the Commission held that *Aquila* invalidated the Department's regulation.

Interestingly, neither party agreed with the Commission's analysis. The Commission acknowledged that the Department of Revenue was merely arguing that Schnucks' bakeries did not fall within the scope of the Bakery Regulation, rather than contending that it was invalid or that the Department was free to ignore it. (AHC Op., App. at A8, LF 511.) It is not surprising that a state agency (here, the Department of Revenue) did not argue that it had promulgated an illegal regulation and took no steps to modify it pursuant to the Missouri Administrative Procedure Act.

The premise of the Commission's decision is that *Aquila* **intended** to rule on an issue not before the Court: how the "processing" statute should be interpreted when there is a regulation on-point. That is an issue the Court now confronts here, and it should not be assumed to have been addressed silently in *Aquila*.

Moreover, the Commission assumed there was a conflict without even addressing the meaning of the phrase "for retail consumption." The Commission apparently interpreted the phrase to mean "for retail sale" rather than, for instance, retail sale for immediate consumption or consumption at the retailer's location, such as at a restaurant. If the Commission's legal assumption as to the meaning of "for retail consumption" is **not** correct, then *Aquila* is consistent with the Bakery Regulation, and the Commission erred in not applying the Bakery Regulation.

This Court should hold that the phrase "for retail consumption" does not apply broadly to all retail sales and would not apply to a grocery store where the uncontroverted testimony was that food is not ordinarily purchased for immediate consumption. (Tr., Vol. 1, at 29:25-30:7, 51:8-11, 54:14-17, 57:4-7, 59:17-19, 62:7-9, 65:9-11, 69:23-70:1.) It is now appropriate to clarify or even modify *Aquila* in light of the applicability of the Bakery Regulation.

Also, the Commission should have considered indicators that *Aquila* was focusing on food prepared for restaurant-type sales, which are specifically **not exempt** under the same regulation of which the Bakery Regulation is a part: "A restaurant preparing food for immediate consumption is not exempt [under section 144.054]." *Aquila*, 362 S.W.3d at 5 (quoting 12 C.S.R. 10-110.621(5)(A)). *Aquila* noted that Casey's General Stores

were **restaurants** insofar as they prepare and serve food to customers. *Aquila*, 362 S.W.3d at 5 n.9 (quoting 12 C.S.R. 10-110.621(5)(A)). *Aquila* relied heavily on a case involving a restaurant conglomerate: *Brinker Mo. Inc. v. Dir. Of Revenue*, 319 S.W.3d 433 (Mo. banc 2010) (quoted in *Aquila*, 362 S.W.3d at 4-5). Here, there is no contention or evidence that Schnucks' bakeries are restaurants.

Moreover, the Commission erred in assuming that this Court intended the phrase "for retail consumption" to be so broad as to be in direct conflict with the Department's regulation without ever mentioning the Bakery Regulation.

Thus, if this Court holds that the "for retail consumption" phrase in *Aquila* is not so broad as to contradict the Bakery Regulation, the Commission erred, and this case should be remanded to the Commission for application of the Bakery Regulation to the facts of this case. The analysis below would not have to be reached, other than that analysis shows the problems associated with concluding that this Court implicitly invalidated an agency regulation.

C. Assuming that *Aquila* Intended to Exclude Retail Food Sales from the Processing Exemption, the Duly Promulgated Regulation Should Control.

Even if *Aquila* is read as being in direct conflict with the Bakery Regulation, the Bakery Regulation should control. The Commission adopted a statute-trumps-regulation analysis incorrectly and in a way that does not apply to this case. (AHC Op., App. at A8-9, LF 511-512.) While the law is clear that members of the public can challenge a state regulation that deprives citizens of liberty or property when that regulation lacks statutory

authority, the opposite happened here: the Commission allowed the Department of Revenue to avoid compliance with its own regulation. The Commission would allow an agency to break its promise to the public as to the standards by which the agency would behave.

No matter how broadly *Aquila* is read, this Court should reiterate in this case that a regulation controls over case law interpreting an ambiguous statute.

1. This Court's *Greenbriar* Decision Requires the Department of Revenue to Follow its Own Regulation.

This Court has previously held that the Department of Revenue should follow its own regulations and that if the Department does not want to follow its own regulations, it can validly change its position only by going through "the more stringent and lengthy process of rulemaking as required under section 536.021." *Greenbriar Hills Country Club v. Dir. of Revenue*, 47 S.W.3d 346, 357 (Mo. banc 2001). In *Greenbriar*, the Department of Revenue contended that its failure to follow its regulation was "substantially justified" because it was inconsistent with the statute as it tried to avoid paying attorney's fees on a case it lost. *Id*. at 354. The Supreme Court conceded that the regulation at issue was "arguably inconsistent with section 144.020.1(2)," but still concluded that the Department had to follow the regulation. *Id*. at 356. The Department was not even "substantially justified" in failing to follow the regulation and had to pay the attorney's fees of the taxpayer. *Id*. at 358.

Greenbriar requires the Department to follow its own regulations granting exemptions to taxpayers. If the Department wants to change the retail bakery exemption

regulation, the Department should not ask the Administrative Hearing Commission or the courts to do so. Instead, the Department must follow the Missouri Administrative Procedure Act. Mo. Rev. Stat. § 536.021. Even if the Department were to initiate a rule change, the change may not take effect: the Missouri General Assembly can disapprove of a change in the Bakery Regulation, just as it could have, but did not, disapprove of the Bakery Regulation when enacted. Mo. Rev. Stat. § 536.021.1.[2]

If the goal is to ascertain the legislative intent behind the processing statute, it is appropriate to rely on a regulation that first went through the General Assembly where it could have been blocked. Likewise, if there is an effort to change the regulation, whether that change would make it through the General Assembly would also be an indicator, one way or the other, of legislative intent.

Aquila did not discuss *Greenbriar*, presumably because the taxpayer there did not claim that it was covered by a Department of Revenue regulation. But it is squarely before the Court now, and the Commission erred in not relying on *Greenbriar*. The

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[2] "If the joint committee on administrative rules disapproves any proposed order of rulemaking, final order of rulemaking or portion thereof, the committee shall report its finding to the house of representatives and the senate. No proposed order of rulemaking, final order of rulemaking or portion thereof shall take effect, or be published by the secretary of state, so long as the general assembly shall disapprove such by concurrent resolution pursuant to article IV, section 8 within thirty legislative days occurring during the same regular session of the general assembly." Mo. Rev. Stat. § 536.021.1.

Greenbriar opinion is also important in that it appears to be the only published case in which an agency asked the Courts to relieve the agency of the duty to follow its own regulations. It is not surprising that taking such a position is so rare. If an agency thinks its own rule is incorrect, the agency can go through the steps to change the rule.

The Commission tried to distinguish *Greenbriar* by saying that it was this Court that nullified the Bakery Regulation, rather than the Department of Revenue. (AHC Op., App. at A8, LF 811.) But *Aquila* cannot be said to have nullified a regulation it did not discuss. Regardless, if the Department of Revenue seeks affirmance on the basis of a perceived nullification of the Bakery Regulation, it is the Department of Revenue that would be taking advantage of that nullification. The Commission's distinction is one without a difference.

If this Court were to affirm the Commission here, it would in effect repeal the Bakery Regulation. Instead, this Court should require that changes in regulations interpreting an ambiguous statute providing a taxpayer relief retain their validity unless administratively changed or challenged in a declaratory judgment action or other proper method applying a deferential standard as described below.

2. This Court Should Defer to an Agency's Regulation Interpreting an Ambiguous Statute.

When the Commission discussed resolving the conflict it found between *Aquila* and the Bakery Regulation, the Commission did not discuss the rules requiring deference to an agency's regulation. But Missouri courts have addressed the issue, including in a case decided after the Commission rendered its decision here.

First, when "state agencies promulgate a rule addressing an issue within the scope of their authority, the rule must be followed unless it has been held invalid or inapplicable." *State ex rel. Mo. Pub. Def. Comm'n v. Waters*, 370 S.W.3d 592, 597 (Mo. banc 2012) (citing *Foremost-McKesson, Inc. v. Davis*, 488 S.W.2d 193, 197 (Mo. banc 1972)). It is undisputed that the Department acted within the scope of its authority when it promulgated the Bakery Regulation. No court has held that the Bakery Regulation is invalid.

The Commission appears to have concluded that this Court implicitly held that the Bakery Regulation was invalid based on *Aquila*. But that is incorrect: as stated above, *Aquila* did not even mention the Bakery Regulation. The Commission held that Schnucks qualified as a bakery under the Bakery Regulation. The Commission should have followed the Bakery Regulation and ordered a refund here.

Like the circuit court in *Mo. Pub. Def. Comm'n*, the Commission here overstepped its authority in effectively invalidating the Bakery Regulation. The Commission should have considered the standards calling for deference to agency regulations.

Pursuant to *Mo. Pub. Def. Comm'n*, "a rule promulgated by an administrative agency [is] entitled to a presumption of validity and may 'not be overruled except for weighty reasons.'" *Mo. Pub. Def. Comm'n*, 370 S.W.2d at 602 (citing *Foremost-McKesson*, 488 S.W. 2d at 197, and quoting *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512 (1994) (federal courts must give "substantial deference to an agency's interpretation of its own regulations")). Rules and regulations are valid "'unless unreasonable and plainly inconsistent' with the statute under which the regulation was

promulgated." *Mo. Pub. Def. Comm'n*, 370 S.W.3d at 602 (citing *Linton v. Mo. Vet. Med. Bd.*, 988 S.W. 2d 513, 517 (Mo. banc 1999), *Foremost-McKesson*, 488 S.W. 2d at 197). Here, the Bakery Regulation is not "plainly inconsistent" with the statute: *Aquila* held that the statute was ambiguous. *Aquila*, 362 S.W.2d at 3.[3]

When a statute is ambiguous, a regulation defining the ambiguous phrase is not "plainly inconsistent" with the statute where it does not "arbitrarily or unreasonably expand the phrase." *Long v. Interstate Ready-Mix, LLC*, 83 S.W.3d 571, 579 (Mo. Ct. App. W.D. 2002). Also, agency regulations "should not be judicially invalidated except for weighty reasons and are to be sustained unless unreasonable and plainly inconsistent with the [statutes]." *Utility Serv. Co. v. Dep't of Labor & Indus. Rels.*, 331 S.W. 3d 654, 658-59 (Mo. 2011); *See also Mercy Hosps. E. Cmtys. v. Mo. Health Facilities Review Comm.*, 362 S.W. 3d 415, 417 (Mo. 2012)("Administrative rules and regulations are valid unless they are unreasonable and plainly inconsistent with the authorizing statute.")

Moreover, *Mo. Pub. Def. Comm'n* observed that the "burden is upon those challenging the rule[ ] to show that [it] bear[s] no reasonable relationship to the legislative objective." *Mo. Pub. Def. Comm'n*, 370 S.W.3d at 603 (citing *Foremost-McKesson*, 488 S.W. 2d at 197). In the absence of such a showing, a rule must be followed until properly and successfully challenged. Here, in an act without precedent, the Commission effectively invalidated the Bakery Regulation even while noting that

[3] The dissent stated that the "processing" definition was broad, but unambiguous. *Aquila*, 362 S.W.3d at 6 (Price, J., and Teitelman, C.J., dissenting.)

Department of Revenue was not asking it do so. (AHC Op., App. at A8, LF 511.) Thus, the Commission did not put the extraordinary burden on anyone.

Mo. Pub. Def. Comm'n also noted that the "usual mechanism by which to challenge the validity or application of an administrative agency's rule is a suit for declaratory judgment." *Mo. Pub. Def. Comm'n*, 370 S.W.3d at 603. Here, that did not happen because (1) agencies don't bring declaratory judgment actions against their own rules; and (2) the Commission effectively invalidated the Bakery Regulation.

Thus, the Court should reverse the Commission's ruling for failure to follow the Department of Revenue's own regulation.

3. The Commission's Cases are Irrelevant.

The Commission cited three cases for its conclusion that *Aquila* "prevails" over the Bakery Regulation. (AHC Op., App. at A8, LF 511.) The Commission misconstrued the general rule that where there is a "direct conflict or inconsistency" between a statute and a regulation, the statute must prevail. (AHC Op., App. at A8, LF 811, citing *Parmley v. Missouri Dental Bd*., 719 S.W.2d 745, 755 (Mo. banc 1986).) But in *Parmley*, there was a "direct" conflict: the regulation prohibited dentists from advertising that their practice was "limited to" a certain specialty, and the statute expressly allowed such a statement. *Parmley*, 719 S.W.2d at 755. The regulation directly conflicted with the underlying statute by restricting speech of members of the public without statutory authorization to do so.

The second case the Commission cited for the "statute prevails" proposition is even more limited: an agency can issue regulations only on the subject matters on which

it is authorized to issue regulations. In *Gasconade County Counseling Servs., Inc. v. Mo. Dep't of Health*, 314 S.W.3d 368 (Mo. Ct. App. E.D. 2010), the court of appeals held that the Department of Mental Health was not authorized to issue regulations restricting "with whom" a county health board could contract (only non-profits, per the regulation), when the statute merely allowed the Department to issue regulations on "standards of construction, staffing, operations, and services." *Gasconade County*, 314 S.W.3d at 377-78. The court of appeals held that the regulation that barred for-profit entities from receiving contracts was not a subject matter that the Department of Mental Health could regulate.

Here, there is no dispute that the Department of Revenue was authorized to issue regulations that clarified the term "processing," as used in Section 144.054. Mo. Rev. Stat. § 144.270 ("For the purpose of more efficiently securing the payment of and accounting for the tax imposed by this chapter, the director of revenue shall make, promulgate and enforce reasonable rules and regulations for the administration and enforcement of the provisions of [chapter 144].") This is especially true given the fact that *Aquila* held that the meaning of the "processing" statute is ambiguous. *Aquila*, 361 S.W.3d at 3.

The Commission also cited *Gasconade County* for the proposition the Court's interpretation of the statute has the same "prevailing" effect over a regulation as the statute itself. But the *Gasconade County* court's "interpretation" was its interpretation of "a plain reading" of the statutory language that a county board could contract with for-profit entities. *Gasconade County*, 314 S.W.3d at 376. It did not involve a court's

interpretation of an ambiguous statute. Moreover, the regulation restricted a citizen's rights by disqualifying the for-profit from participating in the government contract.

The last case cited by the Commission for the statute-prevails proposition is *Gulf C. & S.F.R. Co. v. Moser*, 275 U.S. 133, 136 (1927) (finding court's interpretation becomes integral part of the statute). (AHC Op., App. at A9 n.26, LF 512.) But that case did not even involve a regulation. The court was merely describing the principle that it should follow its precedent in determining how to calculate damages under the Federal Employers' Liability Act. *Moser*, 275 U.S. at 133, 136. That proposition has no relevance to the situation currently before the Court.

Thus, the Commission's cases merely limit what a government agency can do **to** the public. None of the cases cited by the Commission support the proposition that a taxing regulation (or any other regulation) is invalid if it does not capture the fullest potential reach to take property or limit the rights of the public, especially when the statute is ambiguous in the first place. The Commission misinterpreted the law on the interplay between a statute and a regulation limiting the reach of government.

4. Taxpayers Should be Able to Rely on the Department of Revenue's Regulations.

As a matter of fundamental fairness, the public should be able to believe and rely on what the government tells the citizenry that the government will not take from the public. Schnucks only began this process because Schnucks' employees and agents read the Bakery Regulation and saw that its plain language applied to Schnucks. (Tr., Vol. 1, at 79:6-7, 80:9-19, 81:19-83:3, 83:14-84:11, 86:10-18.) Schnucks invested time, effort,

and money to obtain what the Department of Revenue has said Schnucks was entitled to obtain. A Department of Revenue official advised Schnucks that the only issue for the Department of Revenue was the amount, not entitlement to a refund. (Tr., Vol. 1, at 124:1-9.) But then the Department rejected Schnucks' applications, giving no explanation other than "[t]his refund/credit request is being denied because the customer does not qualify under 144.054 Mo. Rev. Stat." (Exs. 7, 17-18, 20.)

The idea that Schnucks was not a bakery under the Bakery Regulation came up only after the appeal to the Administrative Hearing Commission, and the Commission rejected that argument. (AHC Op., App. at A14-15, LF 517-518.) Now Schnucks has been confronted with the argument that the Bakery Regulation was illegal all along. This, as explained above, is contrary to law and fundamentally unfair to taxpayers like Ameren and Schnucks.

CONCLUSION

The Commission decision is not authorized by law because the Commission erroneously failed to apply the Bakery Regulation exemption. This Court should reverse the Commission's decision and remand this case to the Commission to apply the Bakery Regulation to the record in this case.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE AND SERVICE

This brief complies with Rule 55.03 and the requirements of Rule 84.06(b), and contains 6,925 words (excluding the cover, signature block and this certificate); has been prepared in proportionally spaced typeface using the software application for Microsoft Word 2010 in 13 point Times New Roman font.

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