**IN THE SUPREME COURT OF MISSOURI**

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**No. SC95181**

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**KRISPY KREME DOUGHNUT CORPORATION,**
***Appellant,***

**v.**

**DIRECTOR OF REVENUE,**
***Respondent.***

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**ON PETITION FOR REVIEW**
**FROM THE MISSOURI ADMINISTRATIVE HEARING COMMISSION,**
**THE HONORABLE KAREN A. WINN, COMMISSIONER**
**No. 06-1044 RS**

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# APPELLANT'S REPLY BRIEF

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## I

**THE COMMISSION ERRED IN REJECTING KRISPY KREME'S REFUND CLAIM BECAUSE, UNDER SECTION 621.193, ITS DECISION IS CONTRARY TO THE ONLY EVIDENCE IN THE RECORD IN THAT THE ONLY EVIDENCE IN THE RECORD IS COMPELLING THAT THE 2012 SURVEY OF CUSTOMERS IS REFLECTIVE OF CUSTOMER BEHAVIOR FROM 2003-2005 BECAUSE NO ASPECT OF KRISPY KREME'S BUSINESS OR ITS CUSTOMERS' CONSUMPTION HABITS HAD CHANGED IN ANY SIGNIFICANT WAY.**

### Introduction

Section 621.193 provides that the Court should reverse any decision of the Commission that is not "authorized by law and supported by competent and substantial evidence," or contrary to the reasonable expectations of the General Assembly, among other grounds. Krispy Kreme Doughnut Corporation ("Krispy Kreme") addresses the "supported by competent and substantial evidence" here. The "authorized by law" and "reasonable expectations" grounds are addressed in Point II.

The only party to present evidence to the Commission during the remand hearing was Krispy Kreme. That evidence consisted of: (1) testimony and exhibits regarding the results of an on-line customer survey from 2012 written and directed by an eminently qualified and experienced expert in such matters; (2) undisputed accounting evidence from a CPA incorporating the results of that survey; and (3) testimony and exhibits

sponsored by Alison Holder, Krispy Kreme's VP of Brand Development in the Marketing Department, and Mike Parker, the manager of the four Missouri stores at issue.

Based upon the customer survey and the accounting and survey architect's testimony, the Commission found that Krispy Kreme established that it met the 80/20 test for the periods that it surveyed its customers in 2012. L.F. 27. ("Thus, if we assume the evidence in this case is sufficient to establish the consumption habits of the four stores' customers during the tax periods – in other words, that customers' consumption patterns in 2012 reflect their consumption patterns during the tax periods – Krispy Kreme has proved that less than 80% of its products were sold for immediate consumption on or off the premises of the establishment"). In fact, Krispy Kreme met that standard by an almost 2 to 1 margin—nearly 40% of the retail sales were things other than food prepared for immediate consumption. Ex. 2, pp. 22-26.

But the tax periods at issue here are 2003-2005. Krispy Kreme presented the testimony and exhibits of Holder and Parker, each very qualified in their own way, to establish that the 2012 survey results were applicable to those periods.

Holder has worked at Krispy Kreme's headquarters since 2000. Tr. 115. She stated that the 2012 survey was representative of prior years, including 2003 through 2005, because, among other things, the customer demographics did not change, the focus of the marketing message did not change, the products did not change, the motivation to buy doughnuts did not change, and the relative pricing of doughnuts (pricing to upsell dozens) did not change. Tr. 146-148. Holder also identified other documents and surveys

for prior periods to bolster her opinion. Exs. 8-10. Additionally, she noted that Krispy Kreme tracked, from 2007 forward, the average number of doughnuts purchased at the four Missouri stores. That number was between 10 and 12 doughnuts, corresponding closely with the 10.3 average found in the 2012 survey. Exs. 12-13; Tr. 148. She stated under oath that she knew of no reason why the 2012 survey would not be representative of the tax periods. Tr. 148.

Parker worked at the four Missouri stores at issue as an employee, manager, or owner, during the tax periods at issue through the date of hearing. Tr. 170-172. He was intimately familiar with the four stores at issue. Tr. 172. Those stores had not changed in any relevant way since 2003. Tr. 177. He knew his customers' consumption habits, which did not change in since 2003. Tr. 180. Nor did the products change. Tr. 181. Store promotions did not change other than adjusting variety on non-glazed and limited time doughnuts. Tr. 181-182. The stores' competitors did not change. Tr. 185-186. The dozen discount percentage had not changed. Tr. 186-187. The stores' customer demographics had not changed. Tr. 188. The marketing message of the stores had not changed. Tr. 189. Parker knew of nothing that would cause him to believe that the results of the 2012 survey would not apply equally to the relevant tax periods. Tr. 192.

In spite of that evidence, the Commission decided to grant the survey little weight. The Commission made no finding or observation that either witness was not credible. The Commission merely noted that each was "obviously interested in the results of the case." L.F. 22. But that is true of any witness in a tax case and most other cases as well.

**"Supported By Competent and Substantial Evidence" Standard**

The Missouri constitution, article V, section 18 provides for judicial review of the final decision of any "administrative officer or body existing under the constitution or by law" to determine whether the decision is "supported by competent and substantial evidence upon the whole record." Section 18's constitutional "minimum standard" is identical to the statutory standard of review applicable here, § 621.193. *Wood v. Wagner Elec. Corp.*, 197 S.W.2d 647 (Mo. 1946); Mo. Rev. Stat. § 621.193 (providing that the Commission's decision must be upheld when "supported by competent and substantial evidence upon the whole record"). Under these identical standards, "[a] court must examine the whole record to determine if it contains sufficient competent and substantial evidence to support the award, i.e., whether the award is contrary to the overwhelming weight of the evidence." *Hampton v. Big Boy Steel Erection*, 121 S.W.3d 220, 222-23 (Mo. 2003)

In its responsive brief, the Director incorrectly argues that decisions about "the weight to give evidence are uniquely within the province of the Commission." Dir. Br. 12. Not so. In fact, however "[w]hether the award is supported by competent and substantial evidence is judged by examining the evidence in the context of the whole record." *Hampton*, 121 S.W.3d at 223. "An award that is contrary to the overwhelming weight of the evidence is, in context, not supported by competent and substantial evidence." *Id.* Put differently, under article V, § 18 of the Missouri constitution, "[a] reviewing court is . . . authorized to conduct an independent review of the whole record to

determine for itself whether the Commission's award, although supported by some evidence, is nevertheless clearly against the overwhelming weight of the evidence contained in the whole record." *Davis v. Research Med. Ctr.*, 903 S.W.2d 557, 564 (Mo. App. W.D. 1995) *overruled on other grounds by Hampton*, 121 S.W.3d 220.[1]

In its initial brief, Krispy Kreme noted that it could find no Missouri case applying section 621.193's "supported by competent and substantial evidence" standard where, as here, the prevailing party presented no evidence. Under this Court's precedent, however, it is clear that this standard is not met "when the award is contrary to the overwhelming weight of the evidence." *Hampton*, 121 S.W.3d at 223. Accordingly, an against the weight of the evidence standard applies. Under that standard, this Court must reverse if, based upon the evidence, it has a firm belief that the decision is wrong. *Ivie v. Smith*, 439 S.W.3d 189, 206 (Mo. banc 2014). As explained in Krispy Kreme's opening brief, this Court should reverse under that standard. The Director makes no argument that

[1] Krispy Kreme admits that *Hampton* and *Davis* were workers' compensation appeals. However, their reasoning applies equally here. *Hampton* and *Davis* interpret the standard of review of agency decisions under article V, § 18 of the Missouri constitution. Notably, this provision applies to appeals from *all* agency administrative bodies, including the Commission here. As a result, *Hampton* and *Davis* control the standard of review for this case. *See Holm v. Director of Revenue*, 148 S.W.3d 313, 314 n.2 (Mo. 2004) (citing *Hampton*); *Five Delta Alpha, LLC v. Director of Revenue*, 458 S.W.3d 818, 819 (Mo. 2015) (citing Mo. Const. art. V, § 18).

the Commission's decision can be sustained under that standard. Rather, the Director combines the "competent and substantial evidence" standard with the "arbitrary and capricious" standard, claiming that the issue is whether the Commission was arbitrary or capricious in granting little weight to the only evidence in the record that the results of the 2012 survey were representative of the tax periods at issue. Dir. Br. 13. As discussed above, an against-the-weight-of-the-evidence standard applies.[2]

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[2] Krispy Kreme believes that the Court should evaluate whether the Commission's decision was against the weight of the evidence. In the event the Court adopts the Director's "arbitrary and capricious" standard, however, Krispy Kreme directs the Court to the Wyoming Supreme Court's decision in *Dale v. S & S Builders, LLC*, 188 P.3d 554, 559 (Wyo. 2008). In that case, the Wyoming Supreme Court held that the tribunal should explain why it is disregarding evidence so that the reviewing court can determine whether the tribunal "could reasonably conclude as it did based upon all of the evidence before it:"

> If the hearing examiner determines that the burdened party failed to meet his burden of proof, we will decide whether there is substantial evidence to support the agency's decision to reject the evidence offered by the burdened party by considering whether that conclusion was contrary to the overwhelming weight of the evidence in the record as a whole. *See*, *Wyo. Consumer Group v. Public Serv. Comm'n of Wyo.*, 882 P.2d 858, 860-61 (Wyo. 1994); *Spiegel*, 549 P.2d at 1178 (discussing the definition of substantial evidence as "contrary to the overwhelming weight of the

evidence"). If, in the course of its decision making process, the agency disregards certain evidence and explains its reasons for doing so based upon determinations of credibility or other factors contained in the record, its decision will be sustainable under the substantial evidence test. Importantly, our review of any particular decision turns not on whether we agree with the outcome, but on whether the agency could reasonably conclude as it did, based on all the evidence before it.

Emphasis added.

In a sense, this standard is not all that different from the Director's offered "arbitrary and capricious" standard:

> Whether an action is arbitrary focuses on whether an agency had a rational basis for its decision. Capriciousness concerns whether the agency's action was whimsical, impulsive, or unpredictable. To meet basic standards of due process and to avoid being arbitrary, unreasonable, or capricious, an agency's decision must be made using some kind of objective data rather than mere surmise, guesswork, or "gut feeling." An agency must not act in a totally subjective manner without any guidelines or criteria.

*Missouri Nat. Educ. Ass'n v. Missouri State Bd. of Educ.*, 34 S.W.3d 266, 281 (Mo. App. W.D. 2000).

Next, the Director argues that the Commission is the "sole judge" of witness credibility. *Id.* at 13. Again, this undersells this Court's constitutional role in reviewing administrative decisions under article V, § 18 of the Missouri constitution. Krispy Kreme admits that this Court "gives due deference to the Commission's ability to assess the credibility of witnesses." *Laciny Bros. v. Director of Revenue*, 869 S.W.2d 761, 762 (Mo. 1994). But this Court has never said the Commission's credibility findings are conclusive. Indeed, "[d]ue deference to the findings of the triers of the facts does not mean . . . that the reviewing tribunal should fail to perform its own proper function of reaching its own conclusions on the whole evidence." *Douglas v. St. Joseph Lead Co.*, 231 S.W.2d 258, 263 (Mo. Ct. App. 1950). "To give the principle of due deference any such meaning or application as is contended for by employer herein [i.e., courts *must* defer] would render all reviews futile and an unnecessary expense." *Id.*

In sum, this Court must determine "whether, considering the whole record, there is sufficient competent and substantial evidence to support the award." *Hampton*, 121 S.W.3d at 223. This standard is not met when the decision is "contrary to the overwhelming weight of the evidence." *Id.* In *Hampton*, this Court noted that it is a "rare case" when the award is contrary to the weight of the evidence. *Id.* However, as Judge Price more recently pointed out, "reported cases show that reversal on [an against-the-weight-of-the-evidence] ground occurs regularly." *Pearson v. Koster*, 367 S.W.3d 36, 76 (Mo. 2012). He continued: "More to the point, the frequency of reversals is irrelevant to the outcome of any particular case, because a court's decision to reverse or affirm

necessarily depends on a careful and detailed examination of the facts of each case." *Id.* at 77-78.

Under the applicable standard and the facts of this particular case, the decision was not supported by competent and substantial evidence because the reasons that the Commission gave for discounting the evidence were insufficient to find that the decision was reasonable or rational.

The Commission discussed the weight it would give the survey for the tax periods at issue on pages 20-22 of its decision. L.F. 22-24. Its reasons for granting the survey little weight in the face of Holder's and Parker's testimony and other supporting exhibits were: (1) that Holder and Parker were interested in the outcome (L.F. 22); (2) that their testimony and documentary evidence did not directly show when and where customers consumed their doughnuts during the tax periods even though Holder and Parker stated that nothing had changed to indicate that the "where and when" would have been different for the survey period (L.F. 22); (3) the other surveys, from 2003 and 2010, do not hurt or help Krispy Kreme (L.F. 23); (4) that there was a difference in the "I wanted a doughnut" reason for visiting a Krispy Kreme store from 2001 (49%) through 2003 (59%) (L.F. 23); and (5) that the evidence showing a stable average number of doughnuts purchased per transaction from 2007 through 2014 did not also show that metric for the tax periods (L.F. 23-24).

The 2012 survey showed that Krispy Kreme comfortably (by about double) met the 80/20 test for the period of that survey. The reasons given for assigning little weight to

the survey are distilled to three points: (1) Holder and Parker were interested; (2) there was no direct evidence of where and when the doughnuts were consumed during the tax periods; and (3) one thing measured in the 2001 and 2003 surveys, the percentage of customers who visited a store because they "wanted a doughnut," changed somewhat from 49% to 59%.

Both Holder and Parker were credible witnesses and the Commission did not, and reasonably could not, find them other than credible. If the Court believes that could be a basis for the Commission decision, then this Court should remand for the Commission to make findings on credibility. The Commission rendered only the below findings of fact regarding Holder and Parker, and neither relates to credibility:

> 28. Alison Holder, vice president of brand development within Krispy's Kreme's marketing department, has been employed by Krispy Kreme since 2000. She is familiar with Krispy Kreme's customer demographics, marketing, pricing, and competition, and customer motivation and purchasing habits. She believes these factors stayed relatively constant from the tax periods through the survey period. Thus, although the survey took place in 2012, she believes it reflects the sales that took place during the tax periods.
>
> 29. Mike Parker worked in the stores as a manager and other positions from 2002 through the date of the hearing, including all periods when the stores were open during the tax periods and during the survey

> period, and between the two. It was his opinion that the stores' customers' purchasing habits, the products, the top selling product, the competitors, the relative pricing of the products, the customer demographics, the "dozens discount," and the marketing of Krispy Kreme's products did not change in any meaningful respect from the tax periods through the survey period.

L.F. 9-10. Far from discounting their testimony as not credible, the Commission actually found facts entirely consistent with their testimony. *See, e.g.*, L.F. 21 ("These surveys tend to show that motivations for visiting Krispy Kreme stores and buying doughnuts have remained similar from 2003 through 2012."). Credibility was not, and is not, any basis for finding little weight to the 2012 survey. To be sure, Holder and Parker were interested, but so is just about any witness in a tax case.

It is true that there was no direct evidence showing where and when customers consumed doughnuts during the tax periods. This Court did not set the 80/20 standard until well after the tax periods and Krispy Kreme did not happen to survey for that metric for any other reason. The circumstantial evidence was competent and substantial. As indicated above, both Holder and Parker testified at length that no meaningful change occurred between the tax periods and the survey period and that they fully expected and believe that the 2012 survey is representative of the tax periods. But Krispy Kreme produced some supporting surveys from both the tax periods and other periods. While the 2012 survey showed the percentage of retail sales of doughnuts <u>consumed at home</u> as 45.4% (Ex. 2, p. 14), the 2001 and 2003 surveys (Ex. 10, p. 53) showed that 49% of

customers were going home after visiting a Krispy Kreme. Holder testified that the metric measured in 2001 and 2003 "gets us as close as we can" to the "where are doughnuts consumed" question. Tr. 136. Significantly, the percentages are very close. Holder also introduced Exhibit 8, a survey from 2005, and Exhibit 9, another survey from 2012, to show that motivations for buying Krispy Kreme doughnuts had remained consistent. Tr. 138-139. And this circumstantial evidence support a survey showing that Krispy Kreme met the 80/20 test by a substantial margin.

Last, the Commission noted that on page 57 of Exhibit 10 the 2001 and 2003 surveys measured the response to the question "What factors prompt customer to visit Krispy Kreme[?]" In 2003, 59% of respondents stated the reason as "I wanted a doughnut." In 2001, that percentage was 49%. The Commission cited this "as slightly undermin[ing] Krispy Kreme's contention that consumption and buying patterns have not changed from 2003 through 2012." L.F. 23. But that percentage difference, while not significant by itself, is hardly any basis for discounting the testimony of Holder and Parker that nothing significant had changed since the tax periods to cause them to believe that the 2012 survey results would not be representative of the tax periods. And the Commission recognized that one metric measured, average number of doughnuts per purchase, seemed relevant and had remained stable since 2007, when the metric was first introduced. L.F. 24.

In summary, the decision to give no weight to the 2012 survey was not rational given the testimony in the record and particularly given that the Commission neither

found that testimony not credible nor gave any meaningful justification for rejecting it. Thus, the Commission's decision to afford the 2012 survey no weight does not satisfy the "against the weight of the evidence standard." Likewise, that decision was arbitrary in that it was not rational, was subjective, and applied no reasonable criteria. Last, were this Court to apply the test from *Dale v. S & S Builders, LLC, supra*, it would reverse because "the [Commission] could [not] reasonably conclude as it did, based on all the evidence before it."

**Director's Arguments That Were Not Advanced By the Commission**

The Director argues that the 2012 survey results should be discounted because the response rate was "low." Dir. Br. 14-15. The survey's author, Professor Ratneshwar, did not know whether the response rate was "low" since he had never surveyed doughnut purchasers before. But on this point he was clear that the response rate does not matter because what matters is the "representativeness" of the respondents surveyed. He stated that the survey respondents were representative. Tr. 68, 83. By way of example, he noted that for presidential approval surveys the sample size could be as low as 500 people even though there are over 300 million in this country. His was the only testimony on this point. The Commission did not seem to think that the response rate was of concern or it would have mentioned that in its decision

The Director claims that the "selection of the respondents was haphazard and untrustworthy." Dir. Br. 15. Unlike the Director's other criticisms, this one was addressed by the Commission. It concluded that "we do not find the selection of the

respondents was haphazard – everyone who purchased a doughnut at the stores during the survey period was invited to take the survey, and steps were taken to ensure the transaction were a representative sample [sic]." L.F. 21-22. And that conclusion was based upon the testimony of Professor Ratneshwar. Tr. 68, 83.

Although the Commission rendered a specific finding apparently accepting the testimony of Parker, Finding 29, L.F. 9-10, the Director claims that Parker should not have been believed because of two things he said on cross-examination, two things that the Commission never addressed, and for good reason. In each case, the Director misunderstands or greatly exaggerates, the facts. First, Parker stated on direct that Springfield Shop 199 tends to "suck in the communities of Ozark and Nixa and Battlefield as they're driving into work in Springfield." Tr. 187-188. On cross, the Director paraphrased that as "in south Springfield you get a lot of people buying doughnuts on the way to work?" The Director then compares that ("a lot of people") to the results of the 2012 survey where 11.3 percent of the dollars spent on doughnuts were spent on doughnuts consumed at work. Ex. 2, p. 14; tr. 193. First, the metrics are not the same. One is purchasers on the way to work and the other is percent of doughnut sales receipts for doughnuts consumed at work. Second, Parker stated that 11.3 percent is "a lot" in any event. Nothing about this testimony calls Parker's credibility into question. Certainly, the Commission did not think so or it would have mentioned it.

The Director next challenges Parker for his discussion, on direct, of the Branson store. Parker stated that "it's 75 percent tourist. The tourism in Branson hasn't changed."

Tr. 188. Then on cross, the Director noted that only 16 percent of the Branson stores gross receipts from the sale of doughnuts were for doughnuts consumed at "some other place" rather than in the store, at home, in the car/on the go, at work, at school, or "don't remember where." Ex. 2, p. 14. Parker explained the 75 percent figure as an approximation and further explained that the metrics are different. He noted that while the customers are tourists, they can still eat doughnuts in the store, or take them home. Likewise, they could also eat them in the car/on the go or not remember where they consumed the doughnuts. Tr. 193-194. His answers did not conflict at all with the survey results. Certainly, the Commission did not think so or it would have mentioned it.

**The Results of the 2012 Survey Were Properly Admitted**

The Director devotes nine pages of her brief to attacking the Commission's decision to admit the survey results and related documents. Dir. Br. 18-27. The bulk of these arguments were made to, and rejected by, the Commission. L.F. 16-21. The survey was properly admitted under the general rules of evidence, but also under the Administrative Procedure Act, which at section 536.070(11) provides:

> The results of … surveys, involving interviews with many persons, or examination of many records, or of long or complicated accounts, or of a large number of figures, or involving the ascertainment of many related facts, shall be admissible as evidence of such results, if it shall appear that such … survey was made by or under the supervision of a witness, who is present at the hearing, who testifies to the accuracy of such results, and who

> is subject to cross-examination, and if it shall further appear by evidence adduced that the witness making or under whose supervision such examination, study, audit, compilation of figures, or survey was made was basically qualified to make it. All the circumstances relating to the making of such an examination, study, audit, compilation of figures or survey, including the nature and extent of the qualifications of the maker, may be shown to affect the weight of such evidence but such showing shall not affect its admissibility[.]

Dr. Ratneshwar testified at the hearing, was subject to cross, and was eminently qualified to design and administer the survey. The survey was clearly admissible as the Commission found. The Commission found that "the survey questions were straightforward and the answers were self-explanatory, calling for no real evaluation other than statistical analysis." L.F. 20. The Director argues that section 536.070(11) limits a witness to an analysis of competent evidence and that the survey responses were hearsay and thus not competent. Dir. Br. 26. There are many exceptions to the hearsay rule. Those exceptions treat the evidence as competent. *Cach LLC v. Askew*, 358 S.W.3d 58, 63 (Mo. 2012) (meeting business records exception to hearsay rule renders evidence competent). Section 536.070(11) provides a legislative exception for surveys, studies and the Director's favorite, audit reports. The survey results are properly admitted competent evidence.

The Director cites two authorities that she claims stand for the proposition that surveys must be of a subject matter that is competent evidence. Neither authority supports that claim. Dir Br. 26-27. But each authority holds that the results are competent evidence because they fall within section 536.070(11)'s exception to the hearsay rule. In *Savage v. State Tax Commission*, 722 S.W.2d 72, 76-77 (Mo. 1986), this Court affirmed the receipt of ratio studies for property tax purposes. This Court merely affirmed admission of the studies by noting that the requisite foundation under section 536.070(11) had been made. Nothing in the opinion states or implies that the individual assessments forming the basis of the studies were not hearsay. In *Big River Tel. Co, LLC v. Southwestern Bell Tel., L.P*, 440 S.W.3d 503 (Mo. App. W.D. 2014), the Court of Appeals affirmed the admission of a spreadsheet that consisted of a summary of numerous sources of hearsay:

> Exhibit 33 was a compilation of figures billed by ATT to Big River for the traffic at issue in the dispute and created either by Greenlaw or under his authority. Greenlaw acknowledged that he had consulted with many people to compile the figures of Exhibit 33 and had reviewed Big River's testimony, public documents, documents filed with the Commission, and the ICA. Greenlaw was obviously present at the hearing and available for cross-examination.

The 2012 survey is at least as admissible as the Spreadsheet in *Big River*. At least here the survey results were prepared by the testifying witness.

While section 536.070(11) is sufficient alone for admission of the survey at issue, even in its absence the survey would have been admissible, just as the Commission found. The Commission relied on *Liberty Financial Management Corporation v. Beneficial Data Processing Corporation*, 670 S.W.2d 40 (Mo. App. E.D. 1984). L.F. 20. There, a plaintiff hired Arthur Anderson to survey the plaintiff's employees to determine how much of their time was wasted due to a defective computer system. The survey was properly received because it met the fundamental requirements of necessity and trustworthiness. The court noted that "[r]esults of properly conducted surveys have gained judicial acceptance." Id at 53-54.

## II

**THE COMMISSION ERRED IN REJECTING KRISPY KREME'S REFUND CLAIM BECAUSE, UNDER SECTION 621.193, ITS DECISION IS CONTRARY TO THE REASONABLE EXPECTATIONS OF THE GENERAL ASSEMBLY AND CONFLICTS WITH THE REASONABLE INTERPRETATION OF SECTION 144.014.2 IN THAT THE PLAIN MEANING OF "FOOD PREPARED … FOR IMMEDIATE CONSUMPTION" REQUIRES CONSIDERATION OF THE LENGTH OF TIME BETWEEN PREPARATION OF FOOD AND CONSUMPTION OF FOOD.**

**Food Prepared For Immediate Consumption Should Be Determined Without The Need to Quiz Customers After They Make Their Purchases**

The words under consideration hereunder for the 80/20 test are "food prepared by such establishment for immediate consumption." Section 144.014.2. If sales of other than "food prepared by such establishment for immediate consumption" exceed twenty percent of retail sales, the establishment is eligible to sell at the low food tax rate. The record shows that the Krispy Kreme establishments sell some food that is clearly prepared for immediate consumption (hot coffee drinks) as well as some food that the establishments do not prepare at all (bags of ground coffee beans, bottles of water and juice, cartons of milk). Then there are doughnuts, some of which are prepared to be eaten right away, and some of which are prepared to be stored and sold throughout the day for

consumption much later. All of its food sales (except ground coffee beans) can be consumed either on or off the premises.

This Court in *Krispy Kreme Doughnut Corporation v. Director of Revenue*, 358 S.W.3d 48 (Mo. banc 2011)(*Krispy Kreme I*), rejected the Director's offered construction of the subject language (food capable of consumption without further preparation by the purchaser) and Krispy Kreme's offered constructions as well. *Id.*, 358 S.W.3d at 52-53. It adopted a standard that was not offered, nor briefed, by either party:

> Accordingly, "food prepared … for immediate consumption on or off the premises" means all food that is eaten at the place of preparation and purchase, or while traveling to, or immediately upon arrival at another location without any further preparation.

Contrary to the Director's claim, Dir. Br. 27, Krispy Kreme's arguments here do present "something new." This appeal is taxpayers' first chance to brief the standard that this Court set in *Krispy Kreme I*. As explained in Krispy Kreme's opening brief, App. Br. 40-43, that standard could not have been the reasonable expectation of the General Assembly. Section 621.193. That is because the standard requires the taxpayer to quiz its customers to determine where and when they have consumed their food purchases after the purchases have been made and the rate of sales tax figured. This can be done only by the expensive and time-consuming process of surveying customers after they make their purchases. As the Commission observed in this case, "we do not believe that our legislature intended that retailers quiz or survey their customers as to when they plan to

eat the food they buy." Commission decision of December 23, 2010, p. 15. The Director's brief fails to even address this argument about legislative expectations.

Moreover, the standard this Court set places no emphasis on the "prepared … for" language modifying "immediate consumption" and renders those words surplussage. Retailers know when they are preparing something for consumption right away or immediately. Certainly they are when they prepare a hot beverage, a Big Mac, or a t-bone steak. They know this without surveying their customers. They also can know this because certain of their food products have a "shelf life" before they are even purchased, much less consumed. Bread (which the Director concedes is not prepared for immediate consumption, Dir. Br. 9), bagels and doughnuts fall into this category. Each of those food items requires no further preparation to be consumed but a significant portion of these food items sit on the retailers' shelves before sold and thus consumed. Those are foods that are prepared for consumption after some delay. Krispy Kreme knows that more than twenty percent of its doughnuts and other food are prepared for other than immediate consumption because they will not be sold right away. Rather, that food will be sold, and thus consumed, at least an hour after preparation. Those doughnuts could be consumed in the store or off premises, but they still would not have been prepared to be consumed right after preparation. This construction of "food prepared by such establishment for immediate consumption" gives meaning to all the words of the statute, including "prepared … for," and does not require vendors to quiz their customers after the sales are made. Moreover, this construction is consistent with the dictionary definitions of

"prepare," "immediate," and "consumption" cited on page 38 of Krispy Kreme's opening brief and page 31 of the Director's brief.

The Director argues that Krispy Kreme's offered standard is a "made to order" standard. Dir. Br. 32. That is not true. Made to order food is obviously prepared to be consumed right away because only the customer ordering it wants it in that form. But other food prepared in advance of any customer ordering it can be prepared to be consumed right away, like McDonald's French fries or hot apple pies. Likewise, not all food prepared in advance of a customer ordering it is prepared to be consumed right away, or without delay. The Director acknowledges that bread falls into that category. Not all doughnuts prepared by Krispy Kreme fall into that category, but lots of them do. Doughnuts are freshly produced twice a day, once early in the morning and again in the evening, but available for sale throughout the day from a store's display cases. Knowing that the doughnuts are sold throughout the day but only prepared early and late in the day, we know that many of those doughnuts are not prepared to be consumed right away. Krispy Kreme proved that it met this standard by a comfortable margin. *See* December 23, 2010 Commission Decision, p. 3, ¶5, App. A110.

The Director's brief appears to grossly misunderstand Krispy Kreme's position. On page 30 of her brief, the Director asserts that "Krispy Kreme concedes that a great majority of its retail sales of doughnuts are not only prepared for immediate consumption, but are actually immediately consumed." That assertion is false. Under either the standard the Court set in *Krispy Kreme I*, or the standard sought in this appeal, Krispy

Kreme made no such concession. Indeed, a significant part of Krispy Kreme's doughnuts are prepared to sit on a shelf for some time waiting to be sold, so they are not prepared for immediate consumption. *See* December 23, 2010 Commission Decision, p. 3, ¶5, App. A110. And, as shown in Exhibit 2, over forty percent of Krispy Kreme's sales are taken somewhere else and not even immediately consumed there. The Director then claims that "Krispy Kreme also does not argue that most doughnuts purchased at its drive-throughs are not prepared for immediate consumption." Again, that statement is incorrect. Whether doughnuts are sold at the drive thru or at the counter has no bearing on whether they were prepared for immediate consumption or whether they were immediately consumed, for the reasons set forth above. And while the Director makes much of the "HOT DOUGHNUTS NOW" sign, her arguments there are misplaced as well. If someone buys a doughnut while the sign is on, there is a better chance that the doughnut was recently produced, but not all doughnuts are sold while that light is on. Many are produced earlier and even doughnuts purchased while the sign is illuminated may be taken somewhere else and not consumed until after some significant delay.

**The Court Should Reconsider This Construction Issue**

The Director argues that this Court is bound by *stare decisis* and should not reconsider its construction. Dir. Br. 27-28. But the Court should reconsider any construction that is "clearly erroneous and manifestly wrong," such as the construction in *Krispy Kreme I*. *See Templemire v. W&M Welding, Inc.*, 433 S.W.3d 371, 379 (Mo. banc 2014). There, this Court overruled a 1984 construction of the Worker's Compensation

Law that allows employees to sue for discrimination if they are discriminated against or discharged for exercising their rights under the Act. Section 287.780. In 1984, this Court read an exclusivity standard into the statute such that employees had to prove "an exclusive causal relationship between" the exercise of their rights and the discharge or discrimination against the employee. *Id.*, 433 S.W.3d at 377-378. Since that exclusivity requirement was nowhere to be found in the statute, this Court determined in 2014 to overrule the 1984 decision.

As shown above, the decision in *Krispy Kreme I* ignores the words "prepared for" in section 144.014.2 and leads to a standard that could not have been the reasonable expectation of the General Assembly, namely a requirement that vendors interview customers after their purchases have been made about when and where they consumed food. This is particularly apt in this case since neither the Director nor Krispy Kreme argued for, nor briefed, the standard that this Court set in *Krispy Kreme I*.

Krispy Kreme's opening brief cited *Wilson's Total Fitness Center, Inc. v. Director of Revenue*, 38 S.W.3d 424 (Mo. banc 2001) as an example of this Court's reconsideration, and rejection at the Director's suggestion, of a sales tax statute's construction that favored taxpayers but proved to be unworkable. Not surprisingly, the Director fails to cite or discuss this decision. Apparently, in the Director's view, *stare decisis* works only to the Director's benefit.

**Section 144.014 Should Be Strictly Construed In Favor Of Krispy Kreme**

The Director argues that section 144.014 should be strictly construed against Krispy Kreme because the statute is, in effect, a tax exemption. But the Director acknowledges that a tax imposition statute is strictly construed in favor of the taxpayer. *Am. Healthcare Mgmt., Inc. v. Director of Revenue*, 984 S.W.2d 496, 498 (Mo. 1999). This issue was briefed in *Krispy Kreme I,* but the Court did not resolve the issue. *See Krispy Kreme I*, 358 S.W.3d at 53-54, n. 6. The word "exempt" or "exemption" appears nowhere in section 144.014, unlike the statutes imposing sales tax exemptions. *See* sections 144.030, 144.054, and 144.615. Section 144.014 certainly reads like a tax imposition statute, albeit as an alternative to section 144.020: "the tax levied and imposed [under this chapter] … shall be at a rate of one percent." While the words of the statute are clear, any doubt on their meaning should be resolved in favor of Krispy Kreme.

**Krispy Kreme's Construction Furthers the Purpose Of Section 144.014**

Surprisingly, the Director takes issue with the obvious purpose of section 144.014. Dir. Br. 33. As noted in Krispy Kreme's opening brief, a lower sales tax rate on food purchases benefits consumers. And that is exactly what section 144.014 was designed to do. Setting a standard that is expensive and difficult to prove simply means that the Director, in her almost unfettered discretion, determines which retailers may sell at the lower rate and which may not. As the collector of revenue, the Director can be expected to side with higher tax collections, at the expense of consumers. Section 144.014 does

not "benefit" any retailer. The retailer collects the tax from its customers and remits the tax to the Director. Sections 144.060 and 144.080.

The Director also confuses the taxability of food purchased with food stamps with food purchased under section 144.014. Dir. Br. 33. The Director argues that section 144.014 was not intended to allow Krispy Kreme to sell at the low rate because its establishments are not places that food stamps may be redeemed. But food purchased with food stamps has been exempt from all sales tax since before the passage of section 144.014 in 1997. *See* Section 144.037, enacted in 1986. So it matters not whether Krispy Kreme stores may accept food stamps. And the Director admits that doughnuts are food stamp eligible food, meaning that they are "food" for purposes of section 144.014. Dir Br. 33. Clearly section 144.014 was intended to benefit purchasers of food who purchased the same without benefit of food stamps. Dir. Br. 33. The Krispy Kreme establishments at issue "meet" the 80/20 test so the General Assembly intended for them to sell food at the lower food tax rate for the benefit of their customers.

## CONCLUSION

For the above-mentioned reasons, this Court should reverse the Commission's erroneous conclusion that Krispy Kreme's establishments do not meet section 144.014's 80/20 rule.

Respectfully submitted,

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## RULE 84.06(c) CERTIFICATION

The undersigned counsel certifies that this brief includes the information required by Rule 55.03, complies with the limitations provided for in Rule 84.06(b) and contains 7,220 words.

*/s/ Edward F. Downey*

## CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and accurate copy of the foregoing was served by the court's electronic filing system on all counsel of record on this 18th of February, 2016:

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