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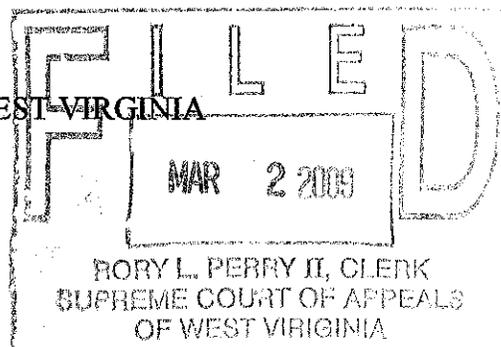
IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

CHARLESTON

CHARLESTON AREA MEDICAL CENTER, INC.  
Appellant,

v.

STATE TAX DEPARTMENT OF WEST VIRGINIA  
Appellee.



**BRIEF OF APPELLANT, CHARLESTON AREA MEDICAL CENTER, INC.**

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## I. KIND OF PROCEEDING AND NATURE OF RULING BELOW

This case began as an administrative appeal of an assessment of additional West Virginia health care provider taxes against CAMC, which at the time otherwise remitted between \$9 and \$9.5 million in provider tax annually (now annual remittances of that tax by CAMC are \$14.5 million). The West Virginia State Tax Department's assessment asserted that an accounting entry tracking self-insurance benefits to covered employees constituted *gross receipts* of CAMC for provider tax purposes. The Tax Department's subsequent administrative decision ultimately sustained the assessment for the period January 1, 1996 through June 30, 1997, asserting that CAMC is liable for additional provider tax of \$198,269 plus interest of \$56,904.92.

CAMC paid the total asserted liability under protest and appealed the administrative decision to the circuit court. In an Order entered more than five years after final briefs were submitted, the circuit court affirmed the administrative decision. The Order misstates the key facts determined by the State Tax Department in the administrative decision and otherwise erroneously applies the provider tax law by imputing gross receipts to CAMC that are never *received or receivable*. In addition, the circuit court without discussion ruled that the State Tax Department's delay did not deprive the Appellant of its right to a timely administrative decision granted by W.Va. Code § 11-10-9 [2000].

## II. STATEMENT OF FACTS

The State Tax Department itself made the following findings of fact in the Administrative Decision:

During the assessment period at issue, CAMC operated a self-insurance program for its approximately 4,500 employees. CAMC employees contribute to the self-insurance programs. The payroll withholdings made on account of those contributions are deposited in the fund. The fund, with built in deductions, pays all of the costs incurred by the CAMC employees when they receive health care services provided by the facilities or physicians, other than CAMC. However, the

self-insurance program does not cover or pay for the charges for health care services provided to the employee's at CAMC's own facilities.

In connection with its self insurance program, CAMC maintained accounting entries, which tracked self-insurance benefits provided to its employees. For instance, when a covered employee of CAMC was treated at its facilities, CAMC's billing system would record and track the treatment activities from the date of admission to the date of discharge and the charges associated with such treatment. While its in-house accounting system maintained and accumulated these entries for its employees-patients covered under the self-insurance program, CAMC did not generate any paper, or electronic invoices, to third-party payors (insurers) requesting payments relating to these accounting entries. In other words, CAMC did not bill to or receive any payments from its patients/employees or third-parties in connection with these accounting entries.<sup>1</sup>

For federal income tax purposes, CAMC is required to file a Form 990. In CAMC's final Forms 990 covering returns for the subject assessment period, CAMC did not reflect the above-mentioned accounting entries associated with the self-insurance benefits provided to its employees as being part of the "gross receipts" of CAMC. In its "gross receipts," CAMC included the amounts of contributions made by its employees attributed to its self-insurance program.

The assessment in question treats the above-mentioned accounting entries as being properly subject to the health care provider tax.

### **III. ASSIGNMENTS OF ERROR**

- A. The circuit court erred in overruling an administrative agency's key fact determination without addressing why the facts found by the agency are clearly erroneous.**
- B. The circuit court erred in determining that the accounting entry tracking an employee benefit constitutes gross receipts of the employer for West Virginia health care provider tax purposes.**
- C. The circuit court erred in finding that 15 months from hearing until issuance of an Administrative Decision is a "reasonable time".**

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<sup>1</sup> Employees, through deductibles and co-pays, did remit amounts to CAMC, and these amounts were included within CAMC's reported "gross receipts" for which provider tax was remitted. This case involves the amount of the accounting entries in excess of employee contributions.

#### IV. ARGUMENT

- A. **The Order fails to address why or how the Administrative Decision's fact finding (that the *accounting entry* is not an *account receivable*) is clearly erroneous or an abuse of discretion.**

After a full record in an administrative matter is developed by the administrative agency (in this case, the State Tax Department), a circuit court reviews the findings of fact and conclusions of law under a clearly erroneous and abuse of discretion standard with respect to factual determinations and reviews legal questions *de novo*. *Frymier-Halloran v. Paige*, 193 W.Va. 687, 458 S.E.2d 780 (1995). The Order properly cites this standard but fails to apply it to a key finding of fact in the Administrative Decision.

The Order states as a fact: "Charges for the services received by participants in the self-insurance program are recorded by CAMC as accounts receivable. After the charges are recorded as an account receivable, CAMC then makes an adjusting entry to remove the receivable from its books." Order at p. 3, ¶¶ 6 and 7.

The circuit court's statements contradict the findings in the Administrative Decision in the administrative record which establishes the contrary. The State Tax Department in its own administrative decision NEVER found that the accounting entry tracking self insurance benefits to be "charges" that constitute "accounts receivable." The State Tax Department found as a fact after the administrative hearing (at which the State Tax Department did nothing other than offer the assessment which itself DID NOT find that the accounting entry was an *account receivable*):

... In connection with its self insurance program, CAMC maintained accounting entries, which tracked self-insurance benefits provided to its employees. For instance, when a covered employee of CAMC was treated at its facilities, CAMC's billing system would record and track the treatment activities from the date of admission to the date of discharge and the charges associated with such treatment. While its in-house accounting system maintained and accumulated these entries for its employees-patients covered under the self-insurance program, CAMC did not generate any paper, or electronic invoices, to third-party payors (insurers) requesting payments relating to these accounting entries. In other

words, CAMC did not bill to or receive any payments from its patients/employees or third-parties in connection with these accounting entries.<sup>2</sup>

For federal income tax purposes, CAMC is required to file a Form 990. In CAMC's final Forms 990 covering returns for the subject assessment period, CAMC did not reflect the above-mentioned accounting entries associated with the self-insurance benefits provided to its employees as being part of the "gross receipts" of CAMC. In its "gross receipts," CAMC included the amounts of contributions made by its employees attributed to its self-insurance program.

The circuit court fails to explain why the facts found by the State Tax Department as set forth in the Administrative Decision (which does not find that accounting entries are *accounts receivable*) are clearly erroneous or an abuse of discretion. The key mistaken "fact" in the Order—that an accounting entry tracking an employee benefit is an *account receivable*—is central to this case. The only evidence in the record (presented solely by CAMC, as the State Tax Department offered no witnesses or relevant documents to defend or support its assessment) contradicts the Order's factual error.

**B. The provider tax does not apply to an employer's economic benefit from reduced employee costs realized by an optional employee fringe benefit.**

*1. Provider tax statutory background.*

West Virginia imposes a series of health care provider taxes under Article 27, Chapter 11 of the West Virginia Code, known as the "West Virginia Health Care Provider Tax Act of 1993." Sixteen separate sections (West Virginia Code §§ 11-27-4 through -19) impose taxes at varying rates on gross receipts derived by providers engaged in the business of providing certain enumerated health care services. The rates are determined based upon the type of health care services identified, ranging from ambulatory surgical centers to therapists' services. Taxpayers must compute tax based upon the specific type of services rendered so that one taxpayer may be

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<sup>2</sup> See footnote 1.

reporting and paying provider tax under several different rate classifications.<sup>3</sup> The State Tax Department has failed to promulgate legislative or interpretive rules to assist taxpayers in complying with the 15-year-old provider tax.

Taxes on various health care services are imposed by separate Code sections. For purposes of this assessment, the relevant provider tax classifications have common features (e.g., each of the taxes is imposed on “gross receipts” and the phrase “gross receipts” is defined consistently for each of the relevant classifications). However, several key Code sections provisions apply generally to all of the various provider tax classifications, including West Virginia Code § 11-27-3 (definitions), § 11-27-22 (accounting periods and methods of accounting) and § 11-27-29 (incorporating the West Virginia Tax Procedure and Administration Act).

Three key provisions in the provider tax statute are particularly relevant to this case. First, W.Va. Code § 11-27-3(b)(1) defines the term *business* in the context of employee services for purposes of the provider tax:

... ‘business’ does not include services rendered by an employee within the scope of his or her contract of employment. Employee services, services by a partner on behalf of his or her partnership, and services by a member of any other business entity on behalf of that entity, are the business of the employer, or partnership, or other business entity, as the case may be, and reportable as such for purposes of the [Provider Tax].

Second, the phrase *gross receipts* is defined for provider tax purposes in a number of separate Code sections<sup>4</sup> as follows:

‘Gross receipts’ means the amount received or receivable, whether in cash or in kind, from patients, third-party payor and others for [particular health] services

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<sup>3</sup> For instance, during the assessment period, CAMC reported and paid health care provider taxes in five separate service categories, including ambulatory surgical centers, emergency ambulance services, inpatient hospitals, physicians and therapists. See Administrative Record; State’s Exhibit No. 3.

<sup>4</sup> W.Va. Code §§ 11-27-4 through -19.

furnished by the provider, including retroactive adjustments under reimbursement agreements with third-party payors, without any deduction for any expenses of any kind: Provided, That accrual basis providers shall be allowed to reduce gross receipts by their contractual allowances, to the extent such allowances are included therein, and by bad debts, to the extent the amount of such bad debts was previously included in gross receipts upon which the tax imposed by this section was paid.

Third, West Virginia Code § 11-27-22(c) provides direction on how a taxpayer is to complete and file provider tax returns:

A taxpayer's method of accounting under this article shall be the same as taxpayer's method of accounting for federal income tax purposes.

2. *The transaction at issue—an employer's promise of coverage without a measurable difference in services received from participating employees—is not an in-kind account receivable to the employer offering the coverage.*

After making the error of assuming as a fact that an accounting entry tracking benefits under the employee health plan is an *account receivable* (which it is not), the Order makes the following conclusion of law:

CAMC receives the services of its employees in exchange for the payments otherwise due on account of the health services provided to them. Therefore, CAMC is receiving economic value in exchange for the provision of healthcare benefits under the self-insurance plan. This economic value *can be considered*<sup>5</sup> in kind services. Order p. 5, ¶ 6 (emphasis supplied).

The Order fails to cite (and research does not disclose) any authority whatsoever supporting the inclusion in an employer's gross receipts for tax purposes of an "in kind" economic benefit to an employer arising from offering an optional benefit to employees (who of

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<sup>5</sup> Just because one might argue that economic value in all sorts of context "can be considered" in kind services, that does not mean it must be for tax purposes. In *Coordinating Council for Independent Living, Inc. v. Palmer*, 209 W.Va. 274, 546 S.E.2d 454 (2001), this Court rejected the State Tax Department's attempt to broadly interpret an undefined term in the health care provider *privilege* tax (adopted as a companion to the health care provider taxes at issue herein) and stated:

Where, however, the statute to be interpreted concerns taxation, we usually construe the tax law in a manner that is favorable to the subject taxpayer. "Laws imposing a license or tax are strictly constructed and when there is doubt as to the meaning of such laws that are construed in favor of the taxpayer and against the state." 209 W.Va. at 281, 546 S.E.2d at 461 (citation omitted).

course are otherwise paid wages and salaries and receive other cash and non-cash benefits). The State Tax Department offered no evidence on the record does to support the proposition that participating employees provide specific, quantifiable “in-kind” services to CAMC in exchange for “in-kind” services rendered to participating employees.

What is “exchanged” in-kind or otherwise in this regard? First, with respect to CAMC’s self-insured employee benefit, each employee must elect to participate in the plan and many employees do not. Nonparticipating employees do not receive a bigger paycheck than participating employees. Nonparticipating employees do not receive a dispensation or reduction of duties. The extent or value of services “received” by CAMC from nonparticipating employees is not reduced or curtailed.

Moreover, CAMC offers to provide “coverage” both to a participating employee who never needs a particular service but elects to “co-pay” for the coverage and also to a participating employee who receives significantly greater value of services (both from CAMC and other providers) than provided by that employee to CAMC. If anything, these indirect, non-incremental employee-services are “exchanged” for *coverage*, not for taxable health care services. The value of the services rendered by a particular employee *as received by CAMC* is not directly affected by whether or not the employee elects to be covered by CAMC’s self-insurance program.

The health care provider tax statute does not purport to quantify the receipt of generalized “economic values” exchanged among employers and employees. Nor does the law purport to impose a tax on health-insurance coverage whether or not the coverage is provided through an insurer or a provider. The Order’s failure to evaluate the transaction at issue leads to an erroneous conclusion.

3. *The Order ignores key provider tax statutory provisions dealing expressly with employee services and accounting methods.*

The Order fails to cite or address two key statutes quoted above. First, West Virginia Code § 11-27-3(b)(1) states that employee services are deemed services of the employer for Provider Tax purposes. Applying this statute to the exchange identified by the State Tax Department and applied by the circuit court, CAMC received the services of *itself* and must therefore report its own services *to itself* as gross receipts! When read in *pari materia*, the governing statutes **do not** contemplate that an employer will derive gross receipts from “in kind” services rendered to or by its own employees because employees are treated as part and parcel of the employer. The statute, read as a whole, does not require or permit this sort of unprecedented overreaching to identify an economic benefit that may increase tax receipts by the State.

Second, West Virginia Code § 11-27-22(c) requires accounting consistency. CAMC did not report the accounting entry tracking services rendered pursuant to the self-insurance program as “gross receipts” for federal income tax purposes in filing its Form 990. The Legislature mandates accounting method consistency (keeping one set of gross receipts books) in W.Va. Code § 11-27-22(c) to ease the burdens to taxpayers and to avoid taxpayers taking inconsistent positions.<sup>6</sup> The accounting method consistency requirement is not some mechanical afterthought. If this section is ignored, as it is by the State Tax Department in this case, the complexity of compliance increases significantly by mandating that all health care providers maintain multiple sets of tax books. The gross receipts definition and the accounting method requirements can be reconciled by a common sense reading of in-kind exchanges to apply to third party health care providers (who are not employees) that have a bartering arrangement with other

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<sup>6</sup> In Administrative Notice 97-20 (Exhibit 1 to Appellant’s Circuit Court Brief) and Administrative Decision 96-155 ME (Exhibit 2 to Appellant’s Circuit Court Brief) the State Tax Department addressed taxpayers’ attempts to deviate from consistency in reporting gross receipts contrary to the taxpayer’s federal income tax accounting method.

providers which (unlike an employee benefit) would be gross receipts for GAAP and tax purposes.

Moreover, this is not truly an issue of first impression in West Virginia gross receipts tax law. The State Tax Department, for 65 years (1922 to 1987), collected a gross receipts-based State business and occupation tax ("B&O Tax"). W.Va. Code §§ 11-13-1 *et seq.* [as of June 30, 1987]. The B&O Tax applied to gross receipts from sales, exchanges and in-kind transactions:

If services or property are paid for other than in money, the fair market value of the property or service taken in payment must be included in gross income [for State B&O Tax purposes]. 110-13 C.S.R. § 1a(g)(1) [filed May 13, 1987].

In administering the State B&O Tax, the State Tax Department found that transactions between employers and employees constituted *business* for B&O Tax purposes (which it expressly is not for Provider Tax purposes) and closely scrutinized fringe benefit transactions. The State Tax Department, however, *never* sought to extend the reach of the gross receipts tax to an employer for un-reimbursed employee fringe benefits. The final regulations under the now-repealed State B&O Tax provided the following specific examples of employee fringe benefits (110-13 C.S.R. § 1a [filed May 13, 1987]):

(m) The business and occupation tax act imposes taxes upon persons engaged in business. The term "Business" shall include all activities engaged in or caused to be engaged in with the object of gain or economic benefit, either direct or indirect . . . .

(1) In determining whether a business is engaged in for "Direct or Indirect Economic Gain or Benefit", the lack of profit suffered in said activity is not relevant; nor is it material that the business was engaged in without profit as the primary motivation. In order to farther clarify this situation, two (2) examples are presented below.

(A) The D E Company provides, for employee use, a cafeteria in the basement of its office building. The cost of operating the cafeteria, for a year, is one hundred ten thousand dollars (\$110,000) and the gross income derived

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Both Administrative Notice 97-20 and Administrative Decision 96-155 ME require the taxpayer to prepare Provider Tax consistently with that taxpayer's federal income tax filings in determining what constitutes gross receipts.

therefrom is nine-three [sic] thousand dollars (\$93,000). Even though the cafeteria operation reflected a loss for the taxable year, the gross amount of income derived therefrom is subject, under the retail classification, to business and occupation tax; for the cafeteria business was engaged in for indirect economic benefit or gain. By providing a direct benefit to its employees, the company has incurred an indirect benefit which places the operation within the definition of "Business" for the purpose of this tax .

(B) The D E Company decides to provide safety equipment to its industrial employees. It decides to provide said equipment at below cost prices to its employees; therefore, said activity is engaged in without profit motivation. The gross amount received from the sale of such equipment is subject to business and occupation tax; for the company receives an indirect economic benefit by providing its employees with such equipment. It can be expected that employees who take advantage of the safety equipment will be safer, have less loss of time accidents and will perform better than previously.

Accordingly, in administering a gross receipts tax, the State Tax Department recognized that employers derive economic benefits from providing employee fringe benefits. Nevertheless, the State Tax Department did not require the employer to report and pay tax upon a theoretical in-kind receipt associated with un-reimbursed costs (loss) of employee fringe benefit programs.

CAMC in this case reported as gross receipts (and paid Provider Tax on) employee premiums and co-pays actually paid by the employee as part of the self-insured employee benefit, just as would be expected from the State B&O tax regulation example set forth above. However, CAMC did not report the unreimbursed cost or loss from the self-insured employee benefit.

The policy pursued by the State Tax Department requires an employer to identify and quantify in-kind economic benefits from imputed exchanges with employees. While this policy is not reflected in any published rule,<sup>7</sup> it would still presumably be the generally applicable policy of the State in connection with provider taxes at least. So this requirement would apply not only

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<sup>7</sup> As it should have been. Pursuant to W.Va. Code § 11-27-29 (incorporating the West Virginia Tax Procedure and Administration Act) and W.Va. Code § 11-10-5 (broad rulemaking authority), the State Tax Department has ample rulemaking authority in the provider tax arena. Of course, W.Va. Code §29A-1-2 would classify the State Tax Department's policy of requiring an employer to include an employee benefits "gross receipts" of the employer as a legislative rule. The State Tax Department chooses to pursue this expansive policy through the assessment route.

to a large, integrated health care organization like CAMC, but also to other health care provider taxpayers, like a small dental practice. The provider tax is required by law<sup>8</sup> to be “broad-based” and cannot (to achieve its aims) be applied solely against large regional hospitals. The tax applies to many hundreds of providers, most of whom are small, cash-based firms that do not dedicate accounting resources to track imputed in-kind benefits that may be provided to employees. This policy creates an unanticipated and unnecessary burden.

If the State Tax Department were seriously going down this “imputed income” road, the cost of every employee benefit not directly mandated by an employment law (from lunchroom snacks to “free” parking) would become “gross receipts” of the employer!<sup>9</sup> That is an absurd proposition without precedent in gross receipts tax or income tax law, and given the discussion above, a proposition that is not consistent with the provider tax law, viewed in its entirety.

**C. The 15-month delay in issuing the Administrative Decision after the hearing is not reasonable.**

West Virginia Code § 11-10-9 requires that the Tax Commissioner to provide notice in writing of an administrative decision in a contested assessment, like the assessment against CAMC, within a “reasonable time” after the hearing. The administrative decision in this case was issued more than *two and a half years* after the hearing. The delay in this case was unreasonable and the remedy is reversal of the administrative decision and the dismissal of the assessment against CAMC.

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<sup>8</sup> See W.Va. Code § 11-27-1 (e), (f), and (g) and § -3(b)(2) (“broad-based health care related tax” means a broad based health care related tax as defined in Section 1903 of the Social Security Act).

<sup>9</sup> Other gross receipts taxes are implicated. If West Virginia gross receipts tax administrators are required to subdivide the employment arrangement into (1) wage and (2) in-kind “exchanges” for privilege tax purposes, employers will face unprecedented burdens in “marking up” their gross receipts to include amounts not ever billed or collected or derived from third parties. For instance municipal business and occupation tax administrators (like town finance managers) would mark-up imputed gross income of an employer any time “extra” benefits (over and above wages are provided) to an employee.

First, on its face, 15 months to render a decision is an unreasonable amount of time. In two recent cases, circuit courts in West Virginia have found that delays in issuing an administrative decision by the State Tax Commissioner are unreasonable resulting in reversals. See *C&O Motors, Inc. v. Tax Commissioner*, Civil Action No. 98-AA-159 (Circuit Court Kanawha County) May 4, 1999 (Exhibit 3 to Appellant's Circuit Court Brief); *Hess v. Tax Commissioner*, Civil Action No. 98-C-535 (Circuit Court of Berkeley County) September 29, 2000 (Exhibit 4 to Appellant's Circuit Court Brief). In *C&O Motors*, the Circuit Court of Kanawha County reversed the administrative decision due to a one-year delay. In *Hess*, the Circuit Court of Berkeley County reversed the administrative decision due to a four-year delay. Despite petitions for appeal by the State Tax Department urging review of both of these decisions, the West Virginia Supreme Court of Appeals allowed the final orders of the circuit courts—reversing administrative decisions because of delay—to stand.

Second, the administrative decision itself makes the following concession:

Pursuant to the provisions of W.Va. Code § 11-10-7b(a)(2), the interest on the tax assessment should be and is hereby abated for the period of October 1, 2000 through the date of this Administrative Decision.

In turn, W.Va. Code § 11-10-7b(a)(2) provides in relevant part:

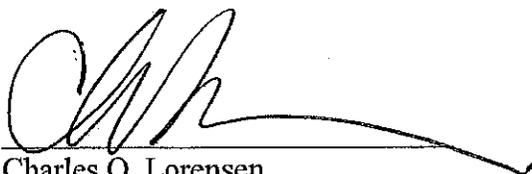
In this case of any interest due on...any payment of tax (or fee) assessed...to the extent that any...delay in such payment is determined by the tax commissioner to be attributable to an officer or employee of the tax division (acting in his or her official capacity) being...dilatory in performing a ministerial act, the tax commissioner may abate all or any part of such interest for any period.

The determination set forth in the Administrative Decision is based on this Code section and hence the State Tax Department admits that the delay in rendering a decision was attributable to an officer being "dilatory." Given that an officer was dilatory, the decision was not rendered within a reasonable time.

## V. CONCLUSION

For the above stated reasons, Appellant respectfully requests that the West Virginia Supreme Court of Appeals reverse the Order of the circuit court, declare that an employer who provides an optional benefit through a self-insurance arrangement does not derive imputed gross receipts for provider tax purposes and order that amounts paid under protest by CAMC after the administrative decision below be refunded with interest.

Respectfully Submitted,  
CHARLESTON AREA MEDICAL CENTER, INC.  
By Counsel



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**CERTIFICATE OF SERVICE**

I, Charles O. Lorensen, do hereby certify that service of the attached APPELLANT BRIEF was made upon the parties by mailing a true and exact copy thereof in the United States mail, postage prepaid, on this 2<sup>nd</sup> day of March, 2009 to the individual named below:

Katherine A. Schultz, Esq.  
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