

IN THE SUPREME COURT OF OHIO

08-2018

OHIO GROCERS ASSOCIATION, et al., : Case No. _____
: :
Plaintiffs-Appellees, : On Appeal from the
: Franklin County
v. : Court of Appeals,
: Tenth Appellate District
: :
WILLIAM W. WILKINS [RICHARD A. : Court of Appeals Case
LEVIN], in his official capacity as Ohio : No. 07AP-813
Tax Commissioner, :
: :
Defendant-Appellant. :

MEMORANDUM IN SUPPORT OF JURISDICTION
OF AMICUS CURIAE OHIO BUSINESS ROUNDTABLE

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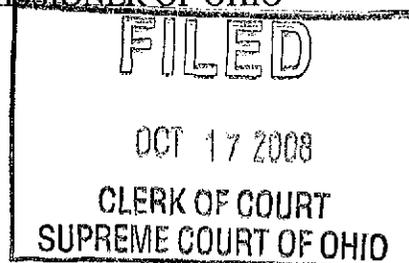
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Explanation of Why a Substantial Constitutional Question is Involved and Why This Case is of Public or Great General Interest

The Tenth District Court of Appeals below declared that the Ohio Commercial Activity Tax (“CAT”), levied by R.C. 5751.02 “on each person with taxable gross receipts for the privilege of doing business in this state[,]” is unconstitutional when applied to gross receipts from the wholesale sale of food and the retail sale of food for human consumption off the premises where sold. Specifically, the court held that the tax violates Sections 3(C) and 13 of Article XII of the Ohio Constitution, which prohibits excise taxes levied or collected upon such sales. This holding, if left standing, will have a severe impact on the CAT and on Ohio’s future economic development.

The CAT is the cornerstone of the major business tax reform enacted by the Ohio General Assembly in Am. Sub. H.B. No. 66 (“HB 66”) that became effective June 30, 2005. This tax reform resulted from a collaboration of the Governor, the General Assembly and the business community. Its goal was to modernize Ohio’s tax system to make it less onerous and more conducive to capital investment and entrepreneurial activity in Ohio, thereby fueling economic growth and reversing the state’s steady economic decline.

The new reforms achieved this goal by eliminating two taxes that had long imposed an unfair burden on Ohio businesses and discouraged capital investment in Ohio - the corporation franchise tax and the tangible personal property tax on property used in business. In their place, HB 66 adopted the CAT, a broad-based, low-rate tax. The CAT applies more evenly to a much broader range of business entities. Unlike the old system, the new business tax system does not discourage capital investment in Ohio because

businesses are no longer subjected to a heavy tax burden for making capital investments in the state. By eliminating that burden, the new tax system fosters new capital investment in Ohio by both existing businesses and new businesses looking for a tax climate that allows them to be competitive. The new business tax system substantially lowered the overall tax burden on business. The 2005 tax reform also significantly reduced personal income tax rates.

The CAT is an annual privilege tax imposed on Ohio businesses and is measured by taxable gross receipts from the annual tax period. The base includes gross receipts from a broad range of business activities. The inclusion of this range of activities in the measure is a critical element of the CAT; it ensures that the CAT is broadly based, which, in turn, allows the use of a very low tax rate. Any significant reduction of the base will necessarily require an increase in the tax rate, or a return to the previous, antiquated business tax scheme that had adversely impacted Ohio's ability to keep existing businesses and attract new investment.

In addition to threatening Ohio's economic development, the decision below is fundamentally flawed because it fails to follow a long line of decisions by this Court that have recognized the critical legal distinction between a tax imposed on receipts, income, or property, and a business privilege tax measured by receipts, income, or property. See, e.g., *East Ohio Gas Co. v. Limbach* (1986), 26 Ohio St.3d 63, 66-67 (holding that the public utilities excise tax, although measured by gross receipts, was not a tax on the daily transactions that generated the gross receipts; the "gross receipts are merely the measure of the tax on the privilege"). Like the utility in *East Ohio Gas*, the court of appeals mischaracterized the nature of a business privilege tax measured by gross receipts as a tax

on sales. It is this basic mischaracterization of the CAT that led the court of appeals to its erroneous conclusion that the CAT is imposed on sales of food at wholesale and at retail for off-premises consumption and therefore violates Sections 3(C) and 13 of Article XII of the Ohio Constitution.

In addition to its substantial constitutional implications, the decision below is also of public and great general interest because of its impact on Ohio's budget and on other critical tax questions currently working their way through Ohio's courts. By excluding taxable gross receipts from the sales of food at wholesale and at retail for off-premises consumption from the measure of the CAT, the court of appeals' decision will result in an annual estimated revenue loss of over \$180 million when the CAT is fully phased-in in 2010, as well as potential refund claims that could exceed \$300 million.

The fundamental mischaracterization of the CAT as a transactional tax on sales could have an even more devastating impact on the CAT. It would almost certainly generate commerce clause challenges to the CAT nexus standard in R.C. 5751.01(H), which applies a broad economic presence test rather than the physical presence test constitutionally required for sales tax purposes. It could also raise the specter of double taxation, because many sales that generate the taxable gross receipts included in the CAT measuring stick are subject to Ohio sales or use tax. This mischaracterization of the CAT would also have a direct impact on a pending challenge to the CAT asserting that under Section 5(A), Article XII of the Ohio Constitution CAT revenues based on gross receipts from sales of motor fuel cannot be used for general revenue fund purposes.

In sum, because the decision declares a critical portion of the CAT unconstitutional, based on a characterization of the CAT that is contrary to this Court's

long-standing jurisprudence, this case raises a substantial constitutional question. Because the decision severely impacts a crucial element of Ohio's historic business tax reform, and thus jeopardizes the significant economic benefits of that reform, this case is one of public or great general interest.

Statement of Interest of Amicus Curiae

The Ohio Business Roundtable ("BRT") is a nonprofit, nonpartisan organization comprised of the chief executive officers of Ohio's major business enterprises, representing a wide range of industries throughout Ohio. Its mission is to apply the knowledge and experience of its CEO members, in collaboration with public leaders, to address and solve complex problems affecting Ohio's social and economic vitality. BRT is highly selective in the issues it undertakes to solve; its CEO members focus on advocating public policies that will foster economic growth in Ohio and improve the standard of living for all Ohioans.

In 2004, concerned by Ohio's steady economic decline, BRT launched a major initiative to modernize Ohio's tax system. The initiative sought to create a new tax system that would foster capital investment and stimulate entrepreneurial activity in a broad-based, fair, equitable, and simple manner. The initiative - which entailed significant research, benchmarking, design work, and the development of models to evaluate the revenue and economic impact of various options - culminated in a comprehensive tax reform proposal that, among other things, would eliminate the tangible personal property tax and the corporation franchise tax, and replace those business taxes with the CAT, a broad-based, low-rate business privilege tax measured by

gross receipts. The reform proposal also reduced the rates of the state's personal income tax across the board by 21 percent.

The core components of this tax reform proposal were incorporated into the Governor's tax reform package included in HB 66. BRT led the business community's efforts in working with the Governor's administration and the General Assembly to assure the successful enactment of the tax reform package and its central innovation: the CAT.

Because of its substantial involvement in the creation and adoption of the tax reform proposal, BRT and its CEO members have a strong interest in seeing that all elements of the tax reform package remain intact. The entire reform package, including the significant reduction of the personal income tax, was a carefully-crafted balance that involved removing elements of the old system that discouraged economic growth in Ohio, reducing the tax burden on individuals, and adding a more equitable broad-based, low-rate business privilege tax to partially replace revenue losses from eliminating the tangible personal property and corporation franchise taxes and reducing personal income tax rates. The significant reduction of the CAT base that would result from the court of appeals' decision would substantially alter this delicate balance that is so critical to Ohio's future economic success.

Statement of the Case and Facts

BRT adopts the statement of the case and facts in appellant's memorandum in support of jurisdiction.

Argument

Proposition of Law:

The Ohio Commercial Activity Tax is an Excise Tax Imposed on Persons for the Privilege of Doing Business in the State, Measured by Gross Receipts for the Annual Period for Which the Privilege is Granted. It is not an Excise Tax Levied or Collected Upon the Sale or Purchase of Food for Human Consumption Off the Premises Where Sold or Upon the Wholesale Sale or Purchase of Food for Human Consumption. Therefore, the Inclusion of Gross Receipts From Sales of Food for Human Consumption in the Base by Which the Ohio Commercial Activity Tax is Measured does not Violate Sections 3(C) or 13 of Article XII of the Ohio Constitution.

R.C. 5751.02 states that the CAT is a tax levied “on each person with taxable gross receipts for the privilege of doing business in this state[.]” and is “an annual privilege tax for the calendar year[.]” Generally, persons with taxable gross receipts of \$150,000 or less are not subject to the CAT. R.C. 5751.01(E)(1). The CAT is measured by the taxpayer’s taxable gross receipts for the tax period, and there are two components to the measurement. R.C. 5751.03(B) provides that the tax on persons with taxable gross receipts of up to \$1 million is \$150. This is in the nature of a minimum tax, similar to the minimum franchise tax imposed by R.C. 5733.06. For taxpayers with taxable gross receipts of more than \$1 million, R.C. 5751.03(A) uses a second component: the privilege tax on these taxpayers is measured by applying the tax rate (.0026 when the CAT is fully phased in) to the taxpayer’s taxable gross receipts in excess of \$1 million for the tax period. The product of this calculation is then added to the minimum tax of \$150 to arrive at the taxpayer’s CAT liability for the tax period. Various credits are available to be applied against the CAT liability, including some unused franchise tax credits that can be converted to CAT credits. R.C. 5751.50 - 5751.53.

Notwithstanding the unambiguous language of R.C. 5751.02 and the established precedent of this Court recognizing the fundamental difference between an excise tax on the privilege of doing business in this state measured by sales, receipts, or income, and an excise tax imposed on sales, receipts, or income, the court of appeals held that the CAT is an excise tax levied or collected on sales and therefore implicates the proscriptions of Sections 3(C) and 13 of Article XII of the Ohio Constitution. That holding is based on several basic misconceptions of the operation of the CAT and flawed readings of this Court's decisions.

A. The Proscriptions of Sections 3(C) and 13 of Article XII of the Ohio Constitution Apply to Excise Taxes on Sales or Purchases; they do not Apply to Excise Taxes on the Privilege of Doing Business.

Section 3(C), Article XII of the Ohio Constitution prohibits the levy or collection of excise taxes "upon the sale or purchase of food for human consumption off the premises where sold." Section 13, Article XII of the Ohio Constitution provides in part that "[n]o sales or other excise tax shall be levied or collected (1) upon any wholesale sale or wholesale purchase of food for human consumption[.]" By the clear language of these provisions, the proscription is against only excise taxes **upon the sale of** food for human consumption off the premises where sold and **upon the wholesale sale of** food for human consumption. Just as clearly, neither of these constitutional provisions prohibit the levy of an excise tax on the privilege of doing business that is measured by gross receipts from such sales.

What Sections 3(C) and 13 of Article XII prohibit are transactional excise taxes on sales or purchases of food for human consumption. The history of the adoption of these provisions confirms this point. The predecessor to current Section 3(C) (former

Section 12, Article XII) was a reaction to the imposition of the then newly-enacted sales tax on the purchase of groceries.¹ Section 13 was a reaction to the enactment of the excise tax levied by former R.C. 5753.02 “on the sale of beverage in containers” and “on the sale of each container of post-mix syrup[.]”

Neither of these constitutional provisions contain any language even suggesting that excise taxes on the privilege of doing business – franchise taxes – could not include in the base by which the tax was measured receipts from sales of food for human consumption. Had that been the intent, it would have been easy to include language that stated as much. See *Bellemar Parts Industries, Inc. v. Tracy* (2000), 88 Ohio St. 3d 351, 355.

The fact that Section 3(C), Article XII authorizes the imposition of “excise and franchise taxes,” but the exception in that provision is limited to excise taxes upon the sale or purchase of food for human consumption off the premises, plainly establishes that the exception was not intended to prohibit franchise-type taxes from considering such sales in the measure of the tax. It also demonstrates that the drafters recognized the distinct nature of franchise taxes.

B. The CAT is not an Excise Tax on Sales or Purchases; it is an Excise Tax on the Privilege of Doing Business in Ohio.

R.C. 5751.02 does not levy an excise tax on sales or purchases of food; in fact, it does not levy an excise tax on any sales or purchases. It levies a tax on persons for the privilege of doing business in the state. This is a classic form of a business privilege tax, commonly referred to as a franchise tax. The ultimate flaw in the decision of the court of

¹ The only grocery items excepted from the sales tax at that time were produce purchased directly from farmers, and milk and loaf bread. Former G.C. 5546-2.

appeals was the failure to recognize the fundamental difference between an excise tax on transactions and an excise tax on the privilege of doing business in a state.

This failure is manifested by the focus in the court's decision on whether a franchise tax is an excise tax. Of course a franchise tax is an excise tax. But that is not the issue. The issue is whether the CAT is the type of excise tax that is proscribed by the Ohio Constitution. The type of excise taxes prohibited by Sections 3(C) and 13 are excise taxes on sales or purchases. Because a franchise tax is an excise tax on the privilege of doing business, not an excise tax on sales or purchases, it does not come within the proscription of those constitutional provisions. The CAT is a franchise tax because it is an excise tax on the privilege of doing business in Ohio. Therefore, the CAT is not the type of excise tax covered by Sections 3(C) and 13 of Article XII.

C. The Fact that the CAT is Measured by Gross Receipts from Sales (as Well as Other Business Activities) Does not Convert the CAT into a Tax on Sales.

The court of appeals concluded that by its operation the CAT is a transactional tax on sales of food. The court based this conclusion on the fact that, in its view, the CAT is measured solely by gross receipts, including those from sales of food. This conclusion reveals a basic failure to appreciate the critical distinction between the legal incidence of a tax and the measure of a tax. This failure is difficult to understand given the long line of decisions of this Court explaining and applying this distinction, beginning with *Express Co. v. State* (1896), 55 Ohio St. 69, and reaffirmed most recently in *Mut. Holding Co. v. Limbach* (1994), 71 Ohio St.3d 59.

Notably, *Express Co. v. State* involved an excise tax on the privilege of doing business, measured by gross receipts. In addressing the nature of the public utility excise tax, the Court succinctly explained this distinction: "The tax is not laid on the gross

receipts . . . but those receipts are taken as the standard by which to determine the amount of the tax to be paid for the privilege of doing business in the state” 55 Ohio St. at 81. Ninety years later, in *East Ohio Gas Co. v. Limbach*, this Court again rejected an attempt to mischaracterize the public utility excise tax as a tax on daily transactions. The Court explained the critical legal distinction that the utility ignored in its argument: the tax is not imposed on the transactions that generated the gross receipts; rather, “[a]nnual gross receipts are merely the measure of the tax on the privilege.” 26 Ohio St.3d at 67.

This Court has rejected this same attempted mischaracterization of excise taxes on the privilege of doing business in numerous decisions regarding the Ohio corporation franchise tax, the business privilege tax that the CAT replaced. In *Aluminum Co. of America v. Evatt* (1942), 140 Ohio St. 385, 394-395, this Court held that although the sales of goods manufactured in Ohio was used in the formula by which the franchise tax was measured, the tax was levied on the privilege of doing business in the state, not on the sales employed in the measure. Similarly, in *Rio Indal v. Lindley* (1980), 62 Ohio St.2d 283, 285, this Court again stated that “[t]he corporate franchise tax is a privilege tax. It is not a tax on corporate income, sales, or receipts, but rather is a tax on the privilege of doing business in Ohio.” The Court explained that a business privilege tax needs a measuring stick to assure that only the fair value of its business done in the state is taxed.

Mut. Holding Co. involved a claim that the company was exempt from the corporate franchise tax because its parent paid the franchise tax levied on domestic insurance companies by R.C. 5725.18 for the privilege of doing business as an insurance company in Ohio. That excise tax was measured by net worth or premium value. One of

the arguments made by the company was based on the characterization of the domestic insurance tax as a tax on property. Responding to that argument, the Court stated that measuring tax liability by net worth does not convert the tax to a property tax. The Court held that the tax “is a franchise tax measured by net worth, not a tax on net worth.” 71 Ohio St.3d at 60.

In *Fifth Third Union Trust Co. v. Peck* (1954), 161 Ohio St. 169, and *The Raymond Bag Co. v. Bowers* (1955), 163 Ohio St. 275, the taxpayers challenged the inclusion of federal securities in the franchise tax base. Specifically, the taxpayers contended that by such inclusion, the state was taxing those securities, which was prohibited by federal statute and thus violated the Supremacy Clause of the United States Constitution. The Court held that the tax was a franchise tax on the corporations based on the value of their capital stock, not a tax on the securities included in the value of the capital stock, and thus did not run afoul of the federal statute.

This Court rejected a similar challenge in *Bank One Dayton, N.A. v. Limbach* (1990), 50 Ohio St.3d 163. The banks contended that inclusion of federal obligations in the net worth base of the franchise tax on financial institutions violated a federal statute prohibiting state taxation of federal obligations and the Borrowing and Supremacy Clauses of the United States Constitution. This argument was based on the assertion that the tax was actually a property tax on those obligations. Focusing on the operation of the franchise tax, this Court held that the franchise tax was a tax levied on the exercise of the privilege of doing business and not on the property that comprised the yardstick by which the tax was measured.

Among the many cases upon which the *Bank One* Court relied was *Werner Machine Co. v. Dir. of Div. of Taxation* (1956), 350 U.S. 492, which rejected a similar challenge to the inclusion of federal obligations in the net worth base of New Jersey's franchise tax. The High Court noted that it has consistently upheld franchise taxes measured by a yardstick that includes tax-exempt income or property, even though a part of the economic impact of the tax may be said to bear indirectly upon such income or property.

The decision of the court of appeals either failed to understand or failed to follow these decisions that have uniformly rejected attempts to mischaracterize business privilege taxes that are measured by income, sales, receipts, or property as taxes on the income, sales, receipts, or property that comprised the measure. While the court did recognize a few of these decisions, it attempted to distinguish only two: *Bank One* and *Werner Machine*. This attempt is unavailing.

The court attempted to distinguish *Bank One* and *Werner Machine* by stating that in those cases the tax exempt property or income was not the only measure of the tax liability, whereas here a tax exempt transaction is not just a factor being considered, but is the only factor being used to determine tax liability. Dec. at ¶25. That is simply not correct. The measure of the CAT includes gross receipts from a broad spectrum of sales, not just sales of food. It also includes gross receipts from other business activity, such as the performance of various personal and professional services. This is consistent with the fundamental concept of the CAT as a broad-based tax. It is this broad base that allows the use of a low tax rate.

The fact that the CAT base is comprised solely of gross receipts is not a valid basis for distinguishing this Court's decisions. No such distinction has ever been recognized in this Court's precedents. In fact, the public utility excise tax at issue in *Express Co.* and *East Ohio Gas* was also based solely on gross receipts. Gross receipts are used as the measure of the CAT because the amount of gross receipts received by a business related to activities in the state is an accurate gauge of the fair value of business done in the state. This is in accord with the purpose of a tax on the privilege of doing business - to tax the fair value of the exercise of that privilege. *Rio Indal*, 62 Ohio St.2d at 285. If receipts from a significant portion of an entity's business are excluded from the measure, the fair value of that entity's exercise of its privilege of doing business in Ohio will not be taxed.

D. By its Operation, the CAT is a Tax on the Privilege of Doing Business, not a Transactional Tax on Sales.

In concluding that the CAT is in its operation a transactional tax on sales, the court of appeals relied solely on the fact that the measure of the tax included gross receipts from sales. The court failed to analyze the actual operation of the CAT. A review of the CAT demonstrates that it is in operation a business privilege tax, not a transactional tax.

The CAT replaced the corporation franchise tax as Ohio's tax on businesses for the privilege of doing business in the state. Because the CAT is a business privilege tax, entities that are subject to industry-specific business privilege taxes, such as public utilities, insurance companies, and financial institutions, are not subject to the CAT. R.C. 5751.01(E)(2), (3), and (9). The CAT is an annual tax on businesses measured by

taxable gross receipts from the tax year. R.C. 5751.02, 5751.03. Because it is an annual tax, the tax liability cannot be determined until the end of that annual period.

Generally, persons with taxable gross receipts of not more than \$150,000 in a tax year are not subject to the CAT. R.C. 5751.01(E)(1). Thus, the gross receipts from sales by those persons are not even included in the measure of the CAT; this precludes any suggestion that the CAT is a transactional tax on the sales that generate these gross receipts. The tax on persons with taxable gross receipts between \$150,001 and \$1 million is \$150. R.C. 5751.03(B). Thus, the tax on a person with taxable gross receipts of \$150,001 and a person with taxable gross receipts of \$1 million is the same. This rebuts the notion that the CAT is a transactional tax levied on sales.

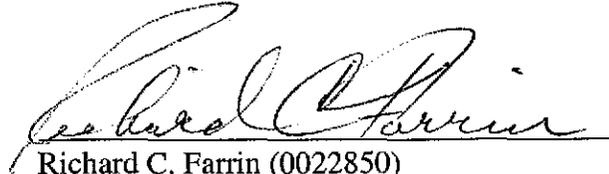
The existence of various credits that a taxpayer may apply against its CAT liability further demonstrates that the CAT is a business privilege tax, not a transactional tax on sales. The jobs retention credit, the credit for qualified research expenses, and the credit for a borrower's qualified research and development loan payments can be claimed against the taxpayer's annual CAT liability. R.C. 5751.50 – 5751.52. The credit that most clearly demonstrates that the CAT is a business privilege tax is the credit for unused franchise tax net operating loss deductions (“NOLs”). R.C. 5751.53. NOLs are uniquely franchise tax-type deductions. The deduction is based on the results of the business's operations over a full tax year. NOLs by their nature could not be applied to a transactional tax. The existence of this credit for NOLs also confirms that the CAT is a business privilege tax that replaced the corporation franchise tax.

The CAT has all of the attributes of a franchise tax. It is not just declared by the General Assembly to be an excise tax on the privilege of doing business. By its operation, that is plainly what the CAT is.

Conclusion

For the reasons discussed above, this case involves a substantial constitutional question and is a case of public or great general interest. Amicus BRT requests that this Court accept the appeal and order the case to be fully briefed and heard on the merits.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing MEMORANDUM IN SUPPORT OF JURISDICTION OF AMICUS CURIAE OHIO BUSINESS ROUNDTABLE was sent via regular U.S. Mail, postage prepaid, this 17th day of October, 2008, to Charles R. Saxbe, Donald C. Brey and Gerhardt A. Gosnell, Chester, Wilcox & Saxbe, Counsel for Appellees, at 65 East State Street, Suite 1000, Columbus, OH 43215; and to Benjamin C. Mizer, Solicitor General, Counsel of Record for Appellant, at 30 East Broad Street, 17th Floor, Columbus, OH 43215.


Richard C. Farrin