UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

KEWEENAW BAY INDIAN COMMUNITY, a federally-recognized Indian tribe, on its own behalf and as *parens patriae* for its members,

Plaintiff,

v.

ROBERT J. KLEINE, Treasurer of the State of Michigan; JAY RISING, former Treasurer of the State of Michigan; MICHAEL REYNOLDS, Administrator of the Collection Division of the Michigan Department of Treasury; WALTER A. FRATZKE, Native American Affairs Specialist of the Michigan Department of Treasury; and TERRI LYNN LAND, Secretary of State of Michigan,

Defendants.

Hon. Gordon J. Quist

Civil Action No. 2:05-CV-0224

PLAINTIFF'S REPLY MEMORANDUM IN SUPPORT OF SECOND MOTION FOR PARTIAL SUMMARY JUDGMENT

I. THE 1993-94 SALES AND USE TAXES VIOLATED FEDERAL LAW.

In their opposition brief, Defendants concede that "a Native American tribe is generally immune from the legal incidence of a state tax for conduct within its own Indian Country unless Congress grants the state the authority to impose the tax." Def. Opp. Br. 5. Defendants now contend, however, that the Community waived its federal sales and use tax immunities by entering into the 1977 Tax Agreement, Dakota Affidavit, Dkt. 117, Ex. A ("Tax Agreement" or "TA"). This contention, which Defendants neglected even to raise in their initial waiver argument, lacks any merit.

The sales and use tax section of the Tax Agreement addressed only the tax obligations and immunities of Community *members*, and did not speak to the Community's supposed

obligations with respect to nonmember sales. The Tax Agreement established a formula by which the State could calculate and pay "[a] refund of sales tax paid by tribal *members*" each year. TA 1 (emphasis added). The Tax Agreement also created an express exemption for "enrolled *members*" for sales and use taxes on large purchases such as cars, trucks, boats and aircraft and telephone service. TA 3, 8 (emphasis added). The stated purpose of the Tax Agreement, which Defendants quote but then misinterpret, was to carry out "a fair and workable policy" to uphold and implement "those rights possessed by *members* of the . . . Community to be exempt from the assessment of certain state taxes pursuant to treaty and other federal rights." TA 35 (emphasis added).[1] The Tax Agreement does not even mention, much less specifically identify, the *Community's* sales and use tax obligations with respect to nonmember sales.

Defendants also argue that the agreement of the Community's K-BIT-C store to obtain a sales and use tax license somehow obligated the Community "to abide by all of the provisions of" the Michigan Sales and Use Tax Acts at K-BIT-C and all future businesses. Def. Opp. Br. 7. Defendants' novel "licensure implication argument" is meritless. Defendants admit, as they must, that any waiver of tribal tax immunity must be "express and unequivocal," id., such that the immunity is "surrendered in unmistakable terms." Id. (quoting Merrion v. Jicarilla Apache Tribe, 455 U.S. 130, 148 (1982)). Under this standard, a mere agreement to obtain a sales and use tax license cannot possibly be viewed as an "express and unequivocal" agreement of the Community to surrender its tax immunities and subject itself to the default provisions of the Michigan Sales and Use Tax Acts.[2]

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[1] The Tribal Council resolution adopting the Tax Agreement reflects this understanding, specifying that the agreement concerned taxes imposed on "*Indian persons*" and refunds "due to various *members*" of the Community. LaFernier Affidavit Ex. A, Dkt. 115-2.

[2] Moreover, Fred Dakota's testimony contradicts Defendants' argument and confirms the plain language of the Tax Agreement. Dakota Affidavit ¶ 11.

Defendants' argument also is inconsistent with those sections of the Tax Agreement dealing with other taxes, which explicitly identified each instance where the Community was obligated to keep records and pay taxes to the Michigan Department of Treasury (the "Department"). The cigarette tax section, for instance, provided that the Community's K-BIT-C store would purchase cigarettes tax-free from a licensed wholesaler and make tax-free sales to tribal members. TA 12. The section expressly provided that the Community would calculate and remit cigarette tax directly to the Department on an annual basis for specifically described cigarette sales at K-BIT-C. TA 13; see also TA 18-19 (expressly discussing Community obligations regarding gasoline tax). As these sections indicate, the State was perfectly capable of expressly specifying in the Tax Agreement those instances in which the Community was obligated to pay, collect and remit state taxes to the State, and the State made no such specifications regarding the Community's sales and use tax obligations for nonmember sales.[3]

As the Community has demonstrated, Defendants' *initial* waiver argument, based on certain purported statements of tribal officials, lacks any legal basis because only a Tribal Council resolution could waive the Community's sales and use tax immunities and the Tribal Council made no such resolution. Pl. Resp. Br. 10-12. Accordingly, the "essential facts" outlined by Defendants regarding these purported statements, Def. Opp. Br. 4, were *insufficient as a matter of law* to waive the Community's tax immunities.[4]

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[3] Defendants' citation of the "pre-payment and refund system . . . imposed on the Community" at issue in Keweenaw Bay Indian Community v. Rising, No. 2:03-CV-111, 2005 WL 2207224, at *7-10 (W.D. Mich. Sept. 12, 2005), Def. Opp. Br. 7 n. 2, is puzzling, because no such scheme appears anywhere in the sales and use tax section of the Tax Agreement.

[4] Defendants have ignored the testimony of the Community's former Tribal Attorney that he was thwarted from appearing at the Department's informal hearing as a result of technological problems. DePetro Affidavit, Dkt. 118, ¶ 3. More importantly, an Indian tribe has no obligation to vindicate its federal tax immunities through state procedural channels, see Pl. Resp. Br. 6-7, and thus the Community's failure to do so cannot, as a matter of law, constitute a waiver of these immunities.

II. THE 2005 OFFSETS OF THE COMMUNITY'S FEDERAL PROGRAM FUNDS VIOLATED FEDERAL LAW.

A. The Community Properly Pleaded its Claim in Count V.

Defendants first claim that the Community failed to properly plead its claim in Count V and for this reason, Defendants did not have sufficient notice of those claims. Def. Opp. Br. 11-13. Defendants' argument is meritless. Rule 8 requires only "a short and plain statement of the claim showing that the pleader is entitled to relief," and specifies that "[n]o technical form is required," and that "[p]leadings must be construed so as to do justice." Fed. R. Civ. P. 8(a)(2),(d)(1), (e). Here, the Community more than satisfied the notice pleading requirement. In Count V, the Community alleged that Defendants, through the 2005 Offsets, "violate[d] the terms and purposes of the federal statutes and regulations to which the federal program funds relate and violate[d] general federal law restrictions on federal appropriations." Second Amended Complaint, Dkt. 30, ¶ 81. The Community also specifically identified the four federal program funds at issue. Id. ¶ 42.

Defendants ask the Court to dismiss Count V because the statutes relied upon in the Community's motion are not specifically cited in the Complaint. Defendants' argument has been widely rejected by federal courts. As one federal appeals court explained:

> A complaint under Rule 8 limns the claim; details of both fact and law come later, in other documents. Instead of asking whether the complaint points to the appropriate statute, a court should ask whether relief is possible under any set of facts that could be established consistent with the allegations. . . . [T]he complaint need not identify a legal theory, and specifying an incorrect theory is not fatal.

Bartholet v. Reishauer, 953 F. 2d 1073, 1078 (7th Cir. 1992). The Sixth Circuit concurs with this approach. E.g., Smith v. City of Salem, 378 F.3d 566, 577 (6th Cir. 2004) (reversing dismissal of Section 1983 claims for failure to cite constitutional provision); Black v. City of

Memphis, No. 98-6508, 2000 WL 687683 at *5 (6th Cir. 2000) (reversing dismissal of claims for failure to cite applicable statute in complaint).[5] Moreover, as noted above, the Community identified in the Complaint all of the federal program funds at issue.

The Community also gave notice of its claims in the August 9, 2005, letter from the Deputy Tribal Attorney to Defendant Fratzke, which identified all of the federal program funds and cited *both* the Purpose Statute, 31 U.S.C. § 1301(a), *and* the Debt Collection Improvement Act, 31 U.S.C. § 3716. Durocher Aff., Dkt. 121, ¶ 27, Ex. N. Thus, Defendants indisputably received notice of the legal basis for the Community's claims from as early as August 2005. Defendants also had notice from Michigan's own Community Health Department, which raised similar concerns about Defendants' offset of federal funds. Durocher Aff. ¶ 22, Ex. C, 46-50, 126-28.[6]

B. The Purpose Statute Applies to Defendants.

Defendants make the astonishing argument that the Purpose Statute, 31 U.S.C. § 1301(a), binds only the federal government, with no application to the states, and that after funds are disbursed by federal agencies, there are no constraints on what state officials do with respect to those federal funds. See Def. Opp. Br. 13-15. To the contrary, in each of the federal programs at issue, Congress *enlisted the states as partners* with the federal government in administering the

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[5] Lillard v. Shelby County Board of Education did not hold that the plaintiff's claims must be dismissed for failure to cite the specific statute as Defendants suggest, see Def. Br. 11, but instead affirmed dismissal because the alleged constitutional violation did not include sufficient "*specific factual allegations*" to state a claim. 76 F.3d 716, 726 (6th Cir. 1996). Morgan v. Church's Fried Chicken, 829 F.2d 10, 12 (6th Cir. 1987), is also irrelevant; the dismissal for failure to state a claim had nothing to do with any failure by plaintiff to cite a statute in its complaint.

[6] Even if the Court concluded - and it should not - that Defendants did not have proper notice of the Community's legal basis for its claim in Count V, Defendants have failed to demonstrate any prejudice as a result of their supposed lack of notice. They have not identified any additional factual inquiry that they would have performed, and they have had ample opportunity to brief the legal issues.

program and *appropriated federal funds to the states* to accomplish the program purposes. If a state chooses to participate in these programs, it must comply with the federal statutes governing the use of program funds. See, e.g., Lapeer County Med. Care Facility v. Michigan, 765 F. Supp. 1291, 1294 (W.D. Mich. 1991) (Medicaid program). As discussed below, for each category of federal funds at issue, the statute governing the relevant program expressly prohibits the use of congressional appropriations for unauthorized purposes, consistent with the Purpose Statute.[7]

Medicaid: Federal appropriations pursuant to the Medicaid statute are made "[f]or the purpose of enabling each State . . . to furnish (1) medical assistance on behalf of families with dependent children and of aged, blind, or disabled individuals, whose income and resources are insufficient to meet the costs of necessary medical services, and (2) rehabilitation and other services to help such individuals and families . . . ." 42 U.S.C. § 1396. In order to receive such appropriations, the State must "have submitted, and had approved by the Secretary, [a] State pla[n] for medical assistance," id., satisfying each of 65 congressionally mandated requirements, none of which permits any use of the federal funds to pay a health care provider's debts owed to the State. 42 U.S.C. § 1396a. The amount payable to each State is computed with reference to expenditures by the State for medical assistance, with no exception permitted allowing States to collect debts. 42 U.S.C. § 1396b(a). Each State must comply with the State plan or risk loss of federal funding and other sanctions. 42 U.S.C. § 1396c.

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[7] Defendants continue to press their qualified immunity defense to the Community's Section 1983 claim for damages, asserted in Count VI. Def. Opp. Br. 12 n. 4. It is well established, however, that a state official's violation of rights created under federal benefit program statutes are actionable under Section 1983. E.g., Wilder v. Virginia Hosp. Ass'n, 496 U.S. 498, 509-10(1990); Westside Mothers v. Olszewski, 454 F.3d 532, 539-41, 543-44 (6th Cir. 2006) (both holding that provisions of Medicaid statute created rights enforceable under Section 1983).

Child Care: Federal appropriations for child care are made for the purpose of each State "providing child care assistance . . . ." 42 U.S.C. § 618(a)(1). "Amounts received by a State under this section shall only be used to provide child care assistance." 42 U.S.C. § 618(b)(1). The federal appropriations are subject to the additional condition that they be integrated by the State into its programs established pursuant to the Child Care and Development Block Grant Act of 1990, 42 U.S.C. § 9858 et seq. (the "CCDBG Act"), and "be subject to requirements and limitations of such Act." The CCDBG Act conditions eligibility for federal funds on providing "an assurance that the State will comply with the requirements of this subchapter" and "a State plan that meets the requirements of subsection (c) of this section." 42 U.S.C. § 9858c(a). The CCDBG Act further provides that "[t]he State plan shall provide that the State will use the amounts provided . . . under this subchapter" for specified types of child care and related services and for limited administrative costs. 42 U.S.C. § 9858c(c)(3). Each State must comply with the State plan or risk loss of federal funding and other sanctions. 42 U.S.C. §§ 9858g(b)(2)(A) & (B).

Women, Infants & Children ("WIC"): Federal WIC appropriations are made "to provide, up to the authorization levels set forth in subsection (g) . . . supplemental foods and nutrition education" for the benefit of "pregnant, postpartum, and breastfeeding women, infants, and young children from families with inadequate income . . . ." 42 U.S.C. § 1786(a). "[T]he Secretary shall make cash grants to State agencies . . . and . . . any State agency approved eligible local agency . . . shall immediately be provided with the necessary funds to carry out the program." 42 U.S.C. § 1786(c)(2).[8] The WIC statute conditions a State's eligibility for federal

[8] The State of Michigan has approved the Community as an "eligible local agency" to receive federal WIC funds. http://www.michigan.gov/mdch/0,1607,7-132-2942_4910_4920---,00.html (last visited Jan. 28, 2008).

funds on federal approval of a State plan that meets specified statutory requirements. 42 U.S.C. § 1786(f). Subsection (g)(1) "authorize[s] to be appropriated to carry out this section such sums as are necessary" for specified fiscal years, followed by detailed provisions governing the use of appropriated funds. See, e.g., 42 U.S.C. § 1786(g)(4). Each State must comply with the statute and the State plan or risk loss of federal funding. 42 U.S.C. § 1786(f)(10).

Promoting Safe and Stable Families: Federal Safe and Stable Families appropriations are made "to enable States to develop and establish, or expand, and to operate coordinated programs of community-based family support services, family preservation services, time-limited family reunification services, and adoption promotion and support services . . . ." 42 U.S.C. § 629(b). The statute conditions a State's eligibility for federal funds on establishing a State plan, which must include "assurances that . . . expenditures shall be for programs of family preservation services, community-based family support services, time-limited family reunification services, and adoption promotion and support services, with significant portions of such expenditures for each such program . . ." and related administrative costs. 42 U.S.C. § 629b(a)(4); see also 42 U.S.C. §§ 629f(a), 629g, 629h(a), 629i(a)(2).

C. Defendants Mischaracterize the Community's DCIA Argument.

Defendants fundamentally mischaracterize the Community's argument with respect to the Debt Collection Improvement Act ("DCIA"), 31 U.S.C. § 3716. The Community argues that pursuant to the federal scheme of the DCIA, the federal government itself could not have offset the federal program funds at issue, and that Defendants likewise were precluded under the Supremacy Clause from offsetting the funds pursuant to state common law. The Supremacy Clause, central to the legal structure establishing relations between the federal government and the states, operates to preempt state law where it conflicts with federal legislation. E.g., Felder v. Casey, 487 U.S. 131, 138 (1988).

Defendants rely heavily on Section 3716(d), which states that "[n]othing in this section is intended to prohibit the use of any other administrative offset authority existing under statute or common law." 31 U.S.C. § 3716(d). This section, however, is referring to *federal* administrative offset authority existing under *federal* law, not *state* administrative offset authority under *state* law. Furthermore, the federal program statutes described above and Section 3701(d)(2) provide additional evidence of congressional intent against state offsets of these Social Security Act and WIC program funds.[9]

Defendants also contend that the offset program authorized by Section 3716 only applies to "nontax debts," and the debts Defendants claim the Community owes to the State were not "nontax debts." To the contrary, for purposes of Section 3716, the debts at issue *were* "nontax debts," because Section 3701(a)(8) defines "nontax" for the purpose of the DCIA as "any debt or claim other than a debt or claim under the [federal] Internal Revenue Code of 1986." 31 U.S.C. § 3701(a)(8). Defendants are simply wrong in contending that "the DCIA would never apply to this type of debt."

V. DEFENDANTS' JURISDICTIONAL ARGUMENTS ARE MERITLESS.

Defendants contend for the first time that because the disputed taxes have all been collected by the 1996 and 2005 Offsets, the Community's request for declaratory and injunctive relief directed to preventing similar offsets in the future is moot. Def. Opp. Br. 3. This argument is meritless. "[A] well-established exception to the mootness doctrine permits the adjudication of an otherwise moot controversy which is capable of repetition yet evading review." Grider v.

[9] Section 3701(d)(2) of Title 31 provides that the DCIA "do[es] not apply to a claim or debt under, or to an amount payable under . . . the Social Security Act . . ., except to the extent provided under . . . section 3716(c). . . ." Section 3716(c) provides for offsets of payments due to *individuals* under the Social Security Act, such as retirement and survivors' benefits, subject to a $9,000 annual exemption. No such payments to individuals are involved here.

Abramson, 180 F.3d 739, 746 (6th Cir. 1999) (quotation omitted). The Community and the Department have had frequent disputes about the State's taxing authority over the Community, and Defendants on more than one occasion have sought to collect taxes from the Community by imposing offsets pursuant to state law. Indeed, Defendants have contended in their own motion that "it is critically important for the State to offset funds before they are disbursed because the Community has sovereign immunity and cannot be sued without its consent. Dkt. 99-2, 25. Defendants offset the Community's federal funds to collect taxes in 2002 and again in 2005 and can be expected to do so in the future, given that the Community receives substantial federal funds through the State each year to cover its costs of administering various health and welfare programs benefiting Native Americans. The questions relating to the propriety of Defendants' offsets clearly are "capable of repetition yet evading review."

Defendants' remaining jurisdictional arguments, based on the Eleventh Amendment, see Def. Opp. Br. 2-4, merely rehash earlier arguments to which the Community has responded. Dkt. 67, 7-14.

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