UNITED STATES DISTRICT COURT

DISTRICT OF SOUTH DAKOTA

SOUTHERN DIVISION

FLANDREAU SANTEE SIOUX TRIBE, a Federally recognized Indian Tribe, Plaintiff, v. ANDY GERLACH, Secretary of the State of South Dakota Department of Revenue; and DENNIS DAUGAARD, Governor of the State of South Dakota, Defendants.	Civ. No. 14-4171 DEFENDANTS' REPLY BRIEF TO PLAINTIFF'S BRIEF IN OPPOSITION TO DEFENDANTS' MOTION FOR JUDGMENT ON THE PLEADINGS

The Defendants, Andy Gerlach and Dennis Daugaard (the State) in their official capacities, by and through their counsel, Matt Naasz, Stacy R. Hegge, and Kirsten E. Jasper, submit this brief in reply to the Plaintiff's Brief in Opposition to Defendant's Motion for Judgment on the Pleadings (the Tribe's Opposition), Doc. 42.

The Tribe's Opposition presents no legal authority to refute the State's motion for judgment on the pleadings. For the reasons set forth in the State's initial brief and the reasons set forth below, this Court should, as a matter of law, enter an order of dismissal or a judgment on the pleadings.

ARGUMENT

I. Jurisdiction.

Res judicata and *Younger* abstention support a decision by this Court to not exercise jurisdiction over the Tribe's claims.

a. Res judicata.

As the United States Supreme Court said, federal courts are required "to give preclusive effect to state-court judgments whenever the courts of the State from which the judgments emerged would do so." *Allen v. McCurry*, 449 U.S. 90, 96, 101 S.Ct. 411, 66 L.Ed.2d 308 (1980) (citations omitted). *See also* 28 U.S.C. § 1738. The Tribe's Opposition neglects to address when South Dakota courts give "preclusive effect to state-court judgments." *Id.* The South Dakota Supreme Court has stated "the rationale for the doctrine of res judicata is equally applicable to contested administrative hearings as it is to judicial proceedings." *Schmidt v. Zellmer*, 298 NW2d 178, 180 (S.D. 1980)(citing *Gottschalk v. S. D. State Real Estate Com'n*, 264 N.W.2d 905 (S.D. 1978). South Dakota courts have made it clear that "failure to appeal an adverse administrative ruling pursuant to SDCL ch 1-26 constitutes a failure to exhaust administrative remedies." *Small v. State*, 659 N.W.2d 15, 16 (S.D. 2003)(citing *Jansen v. Lemmon Federal Credit Union*, 562 N.W.2d 122 (S.D. 1997). *See also Farmer v. S.D. Dept. of Revenue & Regulation*, 781 N.W.2d 655 (S.D. 2010); *Beals v. Wagner*, 688 N.W.2d 415 (S.D. 2004); *Schmidt v. Zellmer*, 298 N.W.2d 178 (S.D. 1980).

Also, the *Small* court stated that "exhaustion of administrative remedies is a well-settled component of the Administrative Procedures Act" citing SDCL 1-26-30. *Small* 659 N.W.2d at 19. The facts in *Small* are similar to the facts presented here: the plaintiffs received an adverse decision from an administrative hearing officer and did not appeal the decision, but instead later filed a declaratory judgment action in the circuit court. *Small*, 659 N.W.2d at 15. *Schmidt v. Zellmer* is also similar in that the plaintiffs did not appeal an adverse administrative decision and filed an original action in circuit court. 298 N.W.2d 178 (S.D. 1980). The later filed claims in both cases were dismissed based on res judicata.

The Tribe's contentions that the hearing officer could not resolve the constitutional claims raised was also addressed in *Small*. The South Dakota Supreme Court held "their constitutional concerns and concerns regarding [the administrative rule] should have been raised by direct appeal pursuant to SDCL 1-26-30 and considered by the circuit court vested with the authority to determine if their substantial rights have been violated by an administrative decision in violation of constitutional or statutory authority or in excess of the agency's statutory authority." *Small* 659 N.W.2d at 19 (citing SDCL 1-26-36(1), (2)).

Along those same lines, the South Dakota Supreme Court has also explained that "for a claim to be barred by res judicata, the claim need not have been actually litigated at an earlier time. Rather, the parties only need to have been provided 'a fair opportunity to place their claims in the prior

litigation." *Farmer*, 781 N.W.2d at 659 (citations omitted). *See also Allen v. McCurry*, 449 U.S. 90, 94 (1980)(stating res judicata precludes "relitigating issues that were or could have been raised in" the previous action)(citing *Cromwell v. County of Sac*, 94 U.S. 351, 352 (1876)). The Tribe had the opportunity and did in fact raise the same substantive issues to the hearing officer, was provided an administrative hearing, and had the opportunity to appeal the decision to the circuit court and the South Dakota Supreme Court. The Tribe opted not to pursue its full and fair opportunity to have the circuit court and state supreme court consider its constitutional issues. These state courts have the ability and authority to adjudicate constitutional challenges and the Tribe has not, and cannot, allege that the administrative review process was inadequate, especially considering the Tribe chose not to pursue the full array of the administrative review process.

The Tribe's Opposition summarily dismisses the factors associated with South Dakota's application of res judicata. *See Farmer*, 781 N.W.2d 655. The Tribe failed to cite to any binding authority or law which would allow it to collaterally attack an adverse administrative decision when it chose not to pursue the adequate remedy of appealing to state circuit court. "When an administrative agency is acting in a judicial capacity and … the parties have had an adequate opportunity to litigate, the courts have not hesitated to apply res judicata to enforce repose." *United States v. Utah Constr. & Mining Co.*, 384 U.S. 394, 422 (1966). "Such repose is justified on the sound and obvious principle of judicial policy that a losing litigant deserves no rematch after a

defeat fairly suffered, in adversarial proceedings, on an issue identical in substance to the one he subsequently seeks to raise." *Astoria Federal Savings and Loan Ass'n v. Solimino*, 501 U.S. 104, 107 (1991). As the substance of the Tribe's claims in the Complaint replicate the claims raised before the hearing officer and the Tribe failed to exhaust its administrative remedies, this Court should not hesitate to apply res judicata.

b. *Younger* abstention.

Nothing in the Tribe's Opposition alters the *Younger* analysis provided by the State in its opening brief on this issue. The state administrative proceedings were part of a unitary process, involving a civil enforcement proceeding akin to a criminal proceeding, that could have included state court review of the hearing officer's decision. However, Plaintiff now attempts to circumvent the state process by filing this action in federal court.

The Tribe argues that the absence of "ongoing state judicial proceedings" prevent application of Younger in the present context. But the Tribe does not dispute that it could have appealed the hearing officer's decision to state circuit court, or that the circuit court could have addressed the constitutionality of the relevant statutes. State proceedings, through appellate review, are a "unitary process" for *Younger* purposes. "For *Younger* purposes, the State's trial-and-appeals process is treated as a unitary system, and for a federal court to disrupt its integrity by intervening in mid-process would demonstrate a lack of respect for the State as sovereign." *New Orleans Public Service, Inc. v. Council of City of New Orleans*, 491 U.S. 350, 369 (1989). Here, the Tribe is requesting

this Court intervene in mid-process, by trading the adequate state remedy of appealing the hearing officer's decision to the state circuit court for this federal action.

That the state action commenced as an administrative proceeding does not bar application of *Younger*. As addressed in the State's initial brief, the Supreme Court has "assum[ed] without deciding, . . . that an administrative adjudication and the subsequent state court's review of it count as a 'unitary process' for *Younger* purposes." *Sprint Communications, Inc. v. Jacobs*, 134 S.Ct. 584, 592 (2013). The State administrative proceeding, which included state judicial review via appeal to the circuit court, was part of a unitary system, and the Tribe was required to exhaust its state appellate remedies. *See*, *New Orleans Public Service,* 491 U.S. at 369 ("A necessary concomitant of *Younger* is that a party wishing to contest in federal court the judgment of a state judicial tribunal must exhaust his state appellate remedies before seeking relief in the District Court.")(citations and brackets omitted).

The Tribe also argues that the state action implicates no important state interest. But the State's interest is in the regulation of alcohol within its borders – an interest recognized by the United States Supreme Court. "The State has an unquestionable interest in the liquor traffic that occurs within its borders, and this interest is independent of the authority conferred on the States by the Twenty-first Amendment." *Rice v. Rehner*, 463 U.S. 713, 724 (1983).

This action falls within the scope of *Younger*, and this Court should abstain from exercising jurisdiction over this matter out of respect for the State as sovereign.

II. Judgment on the Pleadings.

Even if the Court chooses to exercise its jurisdiction over this case, the State should be granted judgment on the pleadings. Judgment on the pleadings is appropriate "where no material issue of fact remains to be resolved and the movant is entitled to judgment as a matter of law." *Clemons v. Crawford*, 585 F.3d 1119, 1124 (8th Cir. 2009)(citation omitted).

The Tribe's arguments that the Department could apply the use tax to the profits from the actual class III gaming activities are irrelevant. The State does not seek to impose use tax on nonmember patrons' actual gaming profits. Rather, the State denied reissuance of the alcoholic beverage licenses because the Tribe has failed to collect and remit use tax on *any* purchases from nonmember patrons, including purchases of food, beverages, gift shop items, cigarettes, etc. at the Royal River Casino, Royal River Family Entertainment Center, and First American Mart. *See* Doc. 32, ¶¶ 48, 54-55, 60 (factual assertions within the Tribe's Complaint admitting that nonmembers have purchased alcoholic beverages, tangible personal property, and services at the three locations and that no use tax has been remitted).

a. Indian Gaming Regulatory Act.

Contrary to the Tribe's assertions, IGRA is inapplicable to this case. The Tribe's Opposition neglects to address or even consider the plain meaning of

the text of IGRA. *State of Rhode Island v. Narragansett Indian Tribe*, 19 F.3d 685, 697-698 (1st Cir. 1994); *Barona Group of Capitan Grande Band of Mission Indians v. American Management & Amusement, Inc.*, 840 F.3d 1394, 1404 (1987). The plain language of IGRA does not preempt, nonetheless mention, alcohol, the taxation of tangible personal property or services, or operation of a hotel, restaurant, bowling center, gift shop, convenience store, or entertainment activity.

The Tribe's assertion that the State's use tax *could* apply to the class III gaming activities is irrelevant. The Tribe and the State have been involved in this dispute since the 1990s and the State has not once asserted the use tax was to be imposed on the class III gaming activities. Additionally, the Tribe has recognized that state law provides an exemption of the use tax from gaming activities. SDCL 10-46-52; Doc. 42 at 11; *see also* Doc. 32-3 at 7 (section 4.1 of the gaming compact). Further, the State has always recognized IGRA's plain language providing that "nothing in this section shall be interpreted as conferring upon a State…authority to impose any tax, fee, charge, or other assessment upon an Indian tribe or upon any other person or entity authorized by an Indian tribe to engage in a class III activity." 25 U.S.C. § 2710(d)(4). Pursuant to this plain language, the State cannot tax a "class III activity."[1] Interestingly, the Tribe did admit that "class III gaming" "primarily includes slot machines, horse racing, and certain card games." Doc. 41 at 12, n. 7 (citing *Michigan v. Bay Mills Indian Community*, 134 S. Ct. 2024, 2028 (2014)). Note,

[1] The application of 25 U.S.C. § 2710(d)(4) is IGRA's only application to the claims raised in the Tribe's Complaint.

however, that the Tribe did not include a hotel, restaurant, bowling center, gift shop, convenience store, or entertainment center within this recognized definition.

The Tribe continually cites to matters that establish what is permissible to include in a gaming compact, but not what is required. However, this argument neglects the law on preemption and statutory interpretation. IGRA does not specifically require the State and Tribe to compact regarding taxation of non-class III gaming activities or the regulation of alcohol. The Tribe asserts that as other states have incorporated alcoholic beverage regulations within the State-Tribal gaming compacts and those compacts are approved by the Department of the Interior, this approval creates authority supporting the Tribe's argument that IGRA requires the State's alcoholic beverage regulations be included in the gaming compact in order to be enforced. This assertion is not supported by the plain language of IGRA. Merely because the Department of the Interior approves other gaming compacts with provisions addressing the application of alcoholic beverage regulations, this approval does not equate that such provisions are required in all negotiations. The mere fact that alcohol may legally be consumed while one is gaming, does not make one a necessity to the other.

The Ninth Circuit, when faced by a similar argument asserted by a tribe, stated:

> Often, the Secretary simply permits compacts with [questionable] provisions to go into effect 'only to the extent they are consistent with IGRA,' thus leaving open the precise question at issue. The State therefore could not reasonably have relied on the Department

> of Interior's approval of certain other compacts as proof that its demands…were lawful.

Rincon Band of Luiseno Mission Indians of the Rincon Reservation v. Schwarzenegger, 602 F.3d 1019,1041-1042 (9th Cir. 2010).

To this point, the Tribe has not presented any case law or binding authority asserting that a State *must* include such provisions in a gaming compact or that those types of provisions are subject to IGRA. Allowing such provisions to be discussed and included is one matter, requiring such provisions is another. The Tribe's arguments to the contrary result in a strained and implausible reading of IGRA.

Notably, the Tribe's Opposition does not assert that IGRA, the State's alcohol regulation, and the State's taxation of nonmember patrons' non-class III gaming activities are incompatible. *See Cabazon Band of Mission Indians v. Wilson*, 37 F.3d 430, 433 (9th Cir. 1994); *Gaming Corp. of America v. Dorsey & Whitney*, 88 F.3d 536, 543 (8th 1996). Here, there is no conflict between IGRA and the State's taxation of non-class III gaming, the requirement to collect and remit the use tax, and the alcoholic beverage licensing laws. The requirements do not interfere with the Tribe's "gaming operations" or the purpose or operation of IGRA.

As it is clear IGRA does not apply to the facts asserted by the Tribe, this Court should enter judgment in the State's favor on the Tribe's First, Second and Sixth Claims for Relief.

b. *Mescalero*.

As stated in the State's initial brief on this matter, determination of the appropriate test turns on the location of the challenged regulation – on or off reservation. Here, the Tribe challenges the on-reservation regulation. Therefore, as the Supreme Court has made clear, the appropriate test is found in *Bracker*.

In response to the State's argument to dismiss the Tribe's Fourth Claim for Relief, the Tribe argues that discriminatory state laws are not allowed on or off the reservation. But the State's argument in favor of dismissing this lawsuit is that the proper test for determining the validity of on-reservation conduct is different than that articulated by the Tribe in its Fourth Claim for Relief. The State's tax credit scheme is not discriminatory. For purposes of the State's motion, the relevant question is only what test will this Court apply to determine the validity of the challenged tax. Supreme Court precedent makes clear that the test to be applied when the challenged regulation occurs on-reservation is the *Bracker* interest-balancing test. *Wagnon v. Prairie Band of Potawatomi Nation*, 546 U.S. 95, 110 (2005). The *Bracker* balancing test forms the basis of the Tribe's Third Claim for Relief. Therefore, the Tribe's Fourth Claim for Relief, relying on an inapplicable test, should be dismissed.

The Tribe's reliance on *Prairie Band Potawatomi Nation v. Wagnon*, 476 F.3d 818 (10th Cir. 2007) (*Prairie Band*), is misplaced. The history of that action shows that the United States Supreme Court remanded the lower courts' decisions for reconsideration given their recent clarification of the *Bracker*

balancing test. "The Supreme Court began its decision in *Prairie Band III* by clarifying that 'the *Bracker* interest-balancing test applies only where "a State asserts authority over the conduct of non-Indians engaging in activity on the reservation."'" *Id.* at 823 (10th Cir. 2007) (quoting *Wagnon v. Prairie Band Potawatomi Nation*, 546 U.S. 95, 126 S. Ct. 676, 680 (2005)(quoting *Bracker*, 448 U.S. at 144, 100 S. Ct. 2578)). As noted by the Tenth Circuit, the determination of the appropriate test turns on the location of the challenged regulation. The Tenth Circuit went on to explicitly distinguish that case from a tax case:

> The fact that the Supreme Court, in *Prairie Band III*, found that the Nation was not similarly situated to other sovereigns in relation to motor fuel taxation is of no moment. First, this is not a tax case where, "[w]hen two sovereigns have legitimate authority to tax the same transaction, exercise of that authority by one sovereign does not oust the jurisdiction of the other." *Colville*, 447 U.S. at 184 n. 9, 100 S. Ct. 2069 (Rehnquist, J., concurring in part, concurring in result, and dissenting in part). As we have detailed, the two regulations at issue here cannot coexist[.]

Id. at 827. Here, the State's tax and the Tribe's tax can coexist. See, e.g., *Colville*, 447 U.S. at 184 n.9 ("When two sovereigns have legitimate authority to tax the same transaction, exercise of that authority by one sovereign does not oust the jurisdiction of the other." (Rehnquist, J., concurring in part, concurring in result in part, and dissenting in part)).

The challenged tax occurs on the reservation. The proper test to apply is *Bracker*. The Plaintiff's Third Claim for Relief relies on *Bracker*. Therefore the Tribe's Fourth Claim for Relief, relying on the test articulated in *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 148-49 (1973), should be dismissed.

c. Ripeness.

The Tribe argues that the Fifth Claim for Relief is ripe because the mechanism for collecting the State use tax already exists. But the Tribe's Fifth Claim for relief "is primarily directed at 'the small proportion of transactions that may give rise to activity within this State's taxing authority,' if in fact there are any such transactions[.]" Doc. 42 at 36. Should this Court determine that some, but not all, of the State's use tax is invalid, the parties will then be left to develop record-keeping requirements aimed at ascertaining which transactions are subject to the validly imposed tax. It is these record-keeping requirements the Court addressed in *Colville*. *See, Washington v. Confederated Tribes of Colville Indian Reservation*, 447 U.S. 134, 160 (1980).

The burdens analyzed in *Moe* and *Colville* were "burdens on Indian businesses to aid in collecting and enforcing" a valid tax. *Colville*, 447 U.S. at 159, 160. *See Colville*, 447 U.S. at 159-60 ("The state sales tax scheme requires smokeshop operators to keep detailed records of both taxable and nontaxable transactions. The operator must record the number and dollar volume of taxable sales to nonmembers of the Tribe. With respect to taxable sales, the operator must record and retain for state inspection the names of all Indian purchasers, their tribal affiliations, the Indian reservations within which sales are made, and the dollar amount and dates of sales. In addition, unless the Indian purchaser is personally known to the operator he must present a tribal identification card. . . . [W]e hold that the Tribes have failed to demonstrate that the State's recordkeeping requirements for exempt sales are

not reasonably necessary as a means of preventing fraudulent transactions."). The Tribe's theory appears to assert that any record-keeping requirements would be overly burdensome, but this question has already been addressed by *Colville*. *See id.*

To the extent that this claim for relief is limited to additional burdens possibly imposed if a portion of the State use tax is found invalid, this claim for relief is not ripe. Doc. 42 at 36. No court has yet determined that any transactions involving nonmembers do not give rise to activity within the State's taxing authority. Should that event occur, record-keeping requirements may be implemented to differentiate between those transactions that do, and those transactions that do not, give rise to activity within the State's taxing authority. The burdens the Tribe associates with this claim for relief are speculative, as evidenced by the Tribe's consistent use of the word "would" in the paragraph discussing potential burdens. Doc. 42 at 39. Should this Court determine that there is a "small proportion of transactions that may give rise to activity within this State's taxing authority," and should the State then attempt to impose record-keeping requirements on the Tribe in order to facilitate appropriate collection and remittance of that tax, there will be burdens to evaluate at that time.

Also, *Virginia v. American Booksellers Ass'n, Inc.*, 484 U.S. 383 (1988), is inapposite. In that case the Supreme Court was faced with different possible interpretations of a challenged statute. *Id.* at 395. Rather than determine the constitutionality of the statute, the Court certified two questions to the Virginia

Supreme Court. *Id.* at 397. This hardly supports the proposition that this Court is in a position to declare that any potential record-keeping requirements, used to determine which transactions are subject to a valid tax, are overly burdensome.

The Tribe's Fifth Claim for Relief rests on contingent future events that may not occur as anticipated, or at all. Therefore, this claim is not ripe and should be dismissed. *See Parrish v. Dayton*, 761 F.3d 873, 875-76 (8th Cir. 2014).

d. The Tribe Consented to the State's Licensing Authority.

In response to the State's motion regarding the Tribe's Eighth Claim, the Tribe argues that this claim for relief does not presume the validity of the State's use tax. The State has never taken the position that the Tribe's submission to the State's alcoholic beverage licensing scheme prevents the Tribe from challenging the validity of the use tax. Nor could the State take the position that reissuance of an alcoholic beverage license could lawfully be denied based on a failure to remit an invalid tax. Should this Court, or any court, determine that any portion of the State's use tax is not validly imposed on certain transactions, the State would not condition alcoholic beverage license reissuance on remittance of the invalid portion of the tax. The State's position is that any lawfully imposed tax must be remitted to the State prior to reissuance of an alcoholic beverage license – as required by SDCL 35-2-24.

Obviously, the State believes that its use tax is validly imposed on on-reservation transactions (other than on class III gaming activity) involving non-

members. That has been the State's position for years, and is well-supported by United States Supreme Court precedent. See, e.g., *Moe v. Confederated Salish & Kootenai Tribes*, 425 U.S. 463, 96 S.Ct. 1634, 48 L.Ed.2d 96 (1976). Should a court of competent jurisdiction determine otherwise, and should that decision be upheld on appeal and become final, the State would not condition reissuance of an alcoholic beverage license on remittance of that portion of the use tax found to be invalid. The Tribe argues, vehemently, that the State has never limited application of SDCL 35-2-24 to only require remittance of lawfully imposed taxes. But no court has ever determined that the State was attempting to collect invalid taxes.

The State's argument regarding the Tribe's Eighth Claim for Relief is that by choosing to obtain a State issued alcoholic beverage license (as the Tribe is required to do in order to sell alcoholic beverages on its reservation), the Tribe consented to the State's alcoholic beverage licensing regulations. Those regulations include remittance of lawfully imposed taxes before an alcoholic beverage license will be reissued. *See* SDCL 35-2-24. This is not a concession that any portion of the State tax identified by the State as requiring collection and remittance is unlawful. Rather the State's argument, supported by *Rice v. Rehner*, 463 U.S. 713 (1983) and 18 U.S.C. § 1161, is that by choosing to sell alcohol on its reservation, the Tribe consented to the State's alcoholic beverage licensing scheme, which includes collection and remittance of validly imposed taxes prior to reissuance of an alcoholic beverage license. The Tribe's Eighth Claim for Relief should be dismissed because the Tribe consented to the State's

regulations when it applied for issuance and reissuance of the alcoholic beverage licenses. This regulatory scheme includes the requirement that reissuance will not occur when all validly incurred taxes have not been remitted.

CONCLUSION

This Court should not exercise jurisdiction over the Tribe's attempt to obtain federal court intervention in a state licensure and taxation matter and further, the Tribe's claims fail as a matter of law. The State respectfully requests entry of an order of dismissal or in the alternative, a judgment on the pleadings as to the claims raised in the Complaint.

Dated this 4th day of May 2015.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 4th day of May, 2015, I electronically filed the foregoing with the Clerk of the Court for the United States District Court for the Southern Division by using the CM/ECF system. Participants in the case who are registered CM/ECF users will be served by the CM/ECF system.

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