UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF MICHIGAN
NORTHERN DIVISION

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

Plaintiff,

v

NICK A. KHOURI, Treasurer of the State of Michigan; WALTER FRATZKE, Native American Affairs Specialist of the Michigan Department of Treasury; RUTH JOHNSON, Secretary of State of Michigan; and CHRISTOPHER CROLEY, Detective/Sergeant of the Michigan State Police; DANIEL C. GRANO, Assistant Attorney General for the State of Michigan; and, TIMOTHY SPROULL, Detective of the Michigan State Police,

Defendants.

No. 2:16-cv-00121

HON. PAUL L. MALONEY

ORAL ARGUMENT REQUESTED

REPLY BRIEF IN SUPPORT OF DEFENDANTS' SECOND MOTION FOR JUDGMENT ON THE PLEADINGS OF THE TOBACCO CLAIMS

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I. *Sunnen* does not prevent this Court from granting judgment on the pleadings based on res judicata.

The Community's official-capacity tobacco claims cannot survive a challenge under res judicata because they each "were or could have been raised" in *Keweenaw Bay Indian Cmty. v. Rising*, 477 F.3d 881 (6th Cir. 2007) (*Rising I*). *Federated Dep't Stores, Inc. v. Moitie*, 452 U.S. 394, 398 (1981). The Community asserts that *Commissioner v. Sunnen*, 333 U.S. 591 (1948), prevents Defendants from asserting res judicata because the cigarette seizures in this case occurred in a different tax period from the seizures in *Rising I*. But the Community is wrong.

Federal Indian tax cases are different from ordinary tax cases, which determine whether or how much tax is due. Rather, this type of case asks far more fundamental questions concerning whether and how states and tribes exercise their competing or overlapping sovereignty and jurisdiction. Federal Indian law principles, not simply tax law, resolve these disputes. Thus, the Community misdirects this Court when it cites *Sunnen* and other similar cases to argue res judicata does not apply.

A. Res judicata and collateral estoppel under *Sunnen*.

Sunnen, 333 U.S. at 597, considered whether a decision concerning an annual federal tax liability has res judicata effect in later years for the same tax. The Supreme Court held that, when parties have previously litigated a tax liability, **res judicata** bars re-litigating claims for the ***same annual tax*** in the ***same tax year***. But, for an annual tax, "[e]ach year is the origin of a new liability and of a separate cause of action." *Id*. at 598; *see also Westwood Chem. Co. v. Kulick*, 656 F.2d 1224, 1227 (6th Cir. 1981) (res judicata requires an identity of the cause of action). Parties in a subsequent case litigating the ***same annual tax*** in a ***different tax year*** must rely on **collateral estoppel** because it does not require the same cause of action in both suits like res

judicata. *Sunnen*, 313 U.S. at 598-99. Additionally, to prevent discriminatory treatment of taxpayers, neither preclusive doctrine applies if the "significant facts" or "controlling legal principles" change, making the earlier decision "obsolete or erroneous[.]" *Id*. at 599.

B. The Community is not a taxpayer under the TPTA.

The Community cannot rely on *Sunnen* because it is not a taxpayer. Treasury requires any person not licensed under the Michigan Tobacco Products Tax Act (TPTA), Mich. Comp. Laws § 205.421 *et seq*., (including the Community) to purchase taxed, stamped cigarettes to assist it in collecting the tobacco tax from liable consumers. *Rising I*, 477 F.3d at 887-90. The consumer is the taxpayer under the TPTA. *Id*. The Community never bears the legal incidence of the tax and the tax pre-collection process is not a tax on the Community because it typically obtains a refund from Treasury or recoups the cost of the tax from the consumer. *Id*. at 890-892. The Community does not face an assessment because it is a taxpayer, but because it willfully refuses to assist Treasury in pre-collecting the tax for sales to liable consumers so that it has a "discount" it can use to attract business.

C. This case does not involve determining the amount of an annual tax liability.

The Community cannot rely on *Sunnen* because the TPTA does not impose an annual tax liability. *See, generally, Batchelor-Robjohns v. United States*, 788 F.3d 1280, 1288 (11th Cir. 2015) (*Sunnen* relied on "annual accounting"). The TPTA levies the tobacco tax on "sales" and "upon the importation or acquisition" of tobacco products. *See* Mich. Comp. Laws § 205.427(1), (6); Letter Ruling 2015-4, available at https://tinyurl.com/lum3td9. *Sunnen* did not address an excise tax, like the $0.10-per-cigarette tax levied under the TPTA.

Even if the type of tax at issue were not significant to whether res judicata applies, *Sunnen* involved tax assessment proceedings to decide the *amount* of tax that is due under a statute. There is no such claim in the third amended complaint because Treasury is "responsible for the collection of taxes," Mich. Comp. Laws § 205.1(1), and issues the assessments for unpaid taxes. (PageID.819, ¶ 101.) Treasury is not a defendant here because state agencies are immune from suit under the Eleventh Amendment. Further, the Community cannot sue Defendants over an amount of tax due because that claim would arise under the TPTA and federal courts lack pendent jurisdiction over state law claims against state officials sued in their official capacity. *See Pennhurst State Sch. & Hosp. v. Halderman*, 465 U.S. 89, 100-01, 120-21 (1984). Thus, this case is not the type of tax liability case where *Sunnen* limits res judicata.

D. The cases the Community cites do not bar res judicata here.

The Community cites cases in which res judicata did not bar a subsequent suit, but they are inapplicable here. For instance, *New York v Mountain Tobacco Co.*, __ F. Supp. 3d __ (E.D.N.Y. July 16, 2016), available at 2016 WL 3962992, addresses when New York's res judicata doctrine applies to a claim under New York law. *Mountain* does not clarify when the federal res judicata doctrine applies to federal claims.

The other tax cases the Community cites each involve an uncomplicated application of *Sunnen* to decide whether res judicata or collateral estoppel bars a taxpayer challenge to the amount of an annual tax liability for the same tax and in the same tax year,[1] different taxes,[2] or

[1] *See Golden v. C.I.R.*, 548 F.3d 487, 494 (6th Cir. 2008) (res judicata barred taxpayers from raising statute of limitations defense in income tax dispute).

[2] *See Batchelor-Robjohns*, 788 F.3d at 1286 (res judicata did not apply because cases involved different federal taxes on the same assets or transaction related to corporate income tax liability).

the same tax in a different tax period after a significant change in law.[3] This case does not present any of those scenarios. Notably, the Community does not contend that the Supreme Court has changed the legal framework for its claims or that the Department of Interior has adopted relevant regulations since *Rising I*.[4] Thus, this case does not implicate *Sunnen's* central concern with preventing "discriminatory distinctions in tax liability" that parties in annual tax proceedings would face if the law changed, but tax liabilities remained fixed. *Id*.

The Community also cites cases involving recurring acts or multiple events under a non-tax statutory scheme in which each violation or transaction was a separate cause of action.[5] The best analogy to those cases are the state judicial and administrative proceedings that the TPTA, Mich. Comp. Laws § 205.429(3)-(4), provides for every tobacco products seizure and the Revenue Act, Mich. Comp. Laws § 205.20 – § 205.30, provides for every tax assessment under the TPTA. In those proceedings against Treasury, each seizure and tax assessment arising out of different facts is a different cause of action. Though Defendants contend that *Rising I* is binding

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[3] *See Limbach v. Hooven & Allison Co.*, 466 U.S. 353, 362-63 (1984) (collateral estoppel did not bar Ohio from imposing ad valorem personal property tax after Supreme Court changed interpretation of Import-Export Clause); *Burlington N. Santa Fe R. Co. v. Assiniboine & Sioux Tribes of Fort Peck Reservation*, 323 F.3d 767, 770-71 (9th Cir. 2003) (collateral estoppel did not bar challenge to annual tribal ad valorem tax after Supreme Court changed interpretation of status of lands on reservation).

[4] *See Agua Caliente Band of Cahuilla Indians v. Riverside Cty*., 181 F. Supp. 3d 725, 746 (C.D. Cal. 2016) (preclusive doctrines did not bar tribe's challenge to possessory interest tax on leased lands within a reservation more than forty years after other cases upheld same/similar taxes because Supreme Court had changed legal framework for deciding Indian tax cases and the Dept. of Interior had adopted new regulations on leasing since then).

[5] *Lawlor v. Nat'l Screen Serv. Corp.*, 349 U.S. 322, 327-28 (1955) (res judicata did not bar claims for new federal anti-trust violations that occurred after first suit); *Storey v. Cello Holdings, L.L.C.*, 347 F.3d 370, 383-84 (2d Cir. 2003) (res judicata did not preclude lawsuit under federal anti-cyberquatting statute based on letter offering domain name registration sent after first action had been dismissed); *Cellar Door Prods., Inc. of Michigan v. Kay*, 897 F.2d 1375, 1378 (6th Cir. 1990) (res judicata did not bar subsequent antitrust claim that arose each time the plaintiff was prevented from making a competitive bid for an event).

precedent in those proceedings, they do not argue that res judicata precludes the Community from litigating the facts of each assessment and each seizure in those cases.

Had the Community prevailed in *Rising I*, it would surely argue that Defendants could not continue to seize its contraband cigarette shipments outside of Indian country on the theory that each seizure was a new case where they could re-litigate the same federal Indian law claims their predecessors had lost. After all, the federal Indian law principles that may preempt a state law do not change with every shipment. Defendants are equally entitled to finality here.

II. Collateral estoppel would bar all official-capacity tobacco claims except Count XII.

The Community also argues that collateral estoppel is the only preclusive doctrine available to Defendants and that, if the court looks only at the second amended complaint in *Rising I*, that doctrine does not bar the official-capacity tobacco claims in this case. Collateral estoppel "bars relitigation of issues actually litigated and determined in an earlier action and necessary to the judgment." *Kane v. Magna Mixer Co.*, 71 F.3d 555, 561 (6th Cir. 1995). But the Community never provides any authority to support changing the legal doctrine underlying this motion. Nor does the Community explain why this Court is obligated to ignore the full record in *Rising I*. Even if the court were inclined to consider collateral estoppel here,[6] it would bar five of the six official-capacity tobacco claims in the third amended complaint, leaving only the Interstate Commerce Clause claim in Count XII.

The Community would have the court believe that it voluntarily withdrew a number of its tobacco claims from *Rising I*, allowing them to be re-pleaded here. But this Court's first opinion granting partial summary judgment of claims in the first amended complaint in *Rising I* disposed

[6] If this Court denies this motion, Defendants ask to be allowed to brief the collateral estoppel issue fully and reserve the right to challenge the claims on their merits and assert other defenses.

of at least three of the six official-capacity tobacco claims in this case:

***Rising I* First Amended Complaint**	**Claim**	***Khouri* Third Amended Complaint**
Count I	Legal incidence of the tobacco tax falls on the Community.	
Count II	Legal incidence of the tobacco tax falls on the person selling tobacco to the Community and Indian trader statutes apply.	
Count III	Legal incidence of the tobacco tax falls on the consumer, the tax is preempted in the Community's Indian country and the land ceded in the 1842 Treaty because the Community's members do not have a method of purchasing tobacco products that avoids paying the tax.	
Count IV	Federal and tribal interests outweigh state interests in imposing the tobacco tax in the Community's Indian country and the land ceded in the 1842 Treaty (*Bracker* balancing).	**Count IX**
Count V	Imposing the tobacco tax infringes on tribal self-government and violates the Community's sovereignty.	**Count X**
Count VI	Imposing the tobacco tax and its other requirements violates the Indian Commerce Clause.	**Count XI**

These claims were meritless under the Supreme Court cases that "repeatedly denied tribal businesses any right to market a tax exemption to nonmembers, and repeatedly upheld state cigarette taxes imposed on nonmembers even when the sales take place from tribal or tribal member sellers within the sellers' Indian country." (2:03-cv-00111 PageID.876.)

The court in *Rising I* then clarified that its holding that the legal incidence of the tax under the TPTA fell on consumers rejected these six claims in the first amended complaint. As the court explained, "Both sides agree that the question of where the legal incidence falls is a legal question that is controlling, and that it ***effectively disposes of significant portions of this case, namely, the first 6 counts*** of Plaintiff's 12 count [first amended] complaint." (2:03-cv-00111 PageID.1147 (emphasis added).) These claims were actually and necessarily decided,

which is why the Community did not re-plead them in the second amended complaint in *Rising I*. Thus, collateral estoppel bars the Community from re-litigating its *Bracker*, self-government and sovereignty, and Indian Commerce Clause claims in Counts IX through XI in this case.

This court's final opinion granting summary judgment on the second amended complaint in *Rising I* disposes of two additional counts in this case:

***Rising I* Second Amended Complaint**	**Claim**	***Khouri* Third Amended Complaint**
Count V	Article II of the 1842 Treaty bars enforcing the TPTA in the lands ceded in the 1842 Treaty, which includes seizing the Community's untaxed, unstamped cigarettes.	**Count XIII**
Count VIII	Sovereign immunity bars seizing the Community's property.	**Count XIV**

This court rejected both of these counts in *Rising I*. (2:03-cv-00111 PageID.6618-6620, 6629-6631.) *See Rising I*, 477 F.3d at 893, 894-95 (1842 Treaty does not preempt TPTA and seizures do not violate sovereignty); *see also Keweenaw Bay Indian Cmty. v. Rising*, 569 F.3d 589, 594 (6th Cir. 2009) (*Rising I* "rejected" the argument that the 1842 Treaty "creates an independent barrier to state taxation of transactions with Indians in the ceded area . . . ."). Thus, if the doctrine at issue in this motion were collateral estoppel, Count XII concerning the Interstate Commerce Clause claim would be the only claim to survive this motion.

III. *Rising I* applies as binding precedent.

Even if this Court decided that neither res judicata nor collateral estoppel applies, Defendants are still entitled to judgment on the pleadings based on *Rising I*. *See United States v. United Techs. Corp.*, 782 F.3d 718, 725 (6th Cir. 2015) (if *stare decisis* applies to disputes involving different parties, then courts should apply decisions in prior cases between the same

parties). When res judicata and collateral estoppel do not bar a lawsuit, a "court is free in the second proceeding to make an independent examination of the legal matters at issue. It may then reach a different result or, if consistency in decision is considered just and desirable, reliance may be placed upon the ordinary rule of stare decisis." *Sunnen*, 333 U.S. at 601. Judgment on the pleadings based on *Rising I* is just and desirable here because that opinion and its underlying Supreme Court precedent remain good law. The Supreme Court has also continued to affirm a state's right to take a wide variety of civil and criminal actions to enforce nondiscriminatory state laws outside of Indian country to prevent unlawful conduct by tribes with sovereign immunity. *See Michigan v. Bay Mills Indian Cmty*., 134 S. Ct. 2024, 2035 (2014).

IV. Qualified immunity protects Defendants from litigating the individual capacity tobacco claims.

The Community argues that qualified immunity cannot be asserted as a defense to the individual-capacity tobacco claims under 42 U.S.C. § 1983 because Defendants relied solely on *Rising I* to support their conduct. But Defendants focused their arguments in this motion on *Rising I* for efficiency, not because they lack other meritorious defenses. Conducting a lawful traffic stop outside of the Community's reservation and trust lands and seizing contraband cigarettes falls squarely within the conduct *Rising I* permits.

The Community's position in this case that *Rising I* did not already reject its claims that federal law preempts the TPTA directly undercuts its argument that its rights were clearly established at the time of the seizures. If the Community has new, undecided claims that require this Court to recognize its right to sell untaxed tobacco products to consumers liable for the tax without a risk of seizure or other consequence, then those rights were not clearly established at the time of these seizures. The interstate commerce and state investigation allegations in the third amended complaint do not distinguish this case from *Rising I*, where the Michigan State

Police had been investigating the Community and intercepting tobacco products in transit from other states.

The Community also argues that it has a clearly established right not to be subject to state investigation. But the cases it cites relate to executing state search warrants on Indian lands within a reservation and arresting Indians within a reservation, [7] neither of which happened in this case. [8] Contrary to the Community's suggestion, federal law does not bar states from entering a reservation to investigate off-reservation crimes under all circumstances. *See Nevada v. Hicks*, 533 U.S. 353, 361-65 (2001) (reservation "ordinarily" considered part of state territory and in case holding tribal court lacked jurisdiction over state officers who executed state warrant on reservation to investigate off-reservation crime); *State v. Clark (En Banc)*, 308 P.3d 590, 594-97 (Wash. 2013) (state did not violate tribal sovereignty by issuing and executing warrant to search Indian's home on trust land where tribe lacked process for issuing a tribal warrant to investigate crime). There are more examples of cases where state investigations are not barred. At best, the state authority to investigate inside Indian country is unsettled. See *Saginaw Chippewa Indian Tribe of Michigan v. Granholm*, 2011 WL 1884196, at *3 (E.D. Mich. May 18, 2011) (state police authority inside reservation may not be a settled issue). But an unsettled question does not create a clearly established right.

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[7] *See United States v Peltier*, 344 F. Supp. 2d 539, 547-48 (E.D. Mich. 2004) (warrant to search Indian's home not valid on reservation); *State v Cummings*, 679 N.W.2d 484, 487-88 (S.D. 2004) (sheriff could not pursue Indian onto reservation to make warrantless arrest); *Moses v Dep't. of Corrections*, 736 N.W.2d 269, 279-80 (Mich. Ct. App. 2007) (general discussion of federal statutes concerning jurisdiction to prosecute crimes committed in Indian country).

[8] The Community attaches an excerpt from a preliminary examination transcript in the criminal cases against its members for transporting the contraband cigarettes seized off-reservation in December 2015. That transcript provides the entirely unremarkable revelation that Defendant Croley and another officer were driving from Houghton to Marquette on US-41, a public road that passes through the L'Anse Reservation, when they saw trucks they suspected of transporting contraband tobacco. Those facts hardly raise § 1983 concerns.

Finally, the Community's desire for discovery does not prevent the court from granting this motion. "The purpose of a qualified immunity defense is not only protection from civil damages but protection from the rigors of litigation itself, including the potential disruptiveness of discovery." *Summers v. Leis*, 368 F.3d 881, 886 (6th Cir. 2004). Courts should not defer a ruling on qualified immunity, even when discovery is not complete. See *Skousen v. Brighton High Sch.*, 305 F.3d 520, 527 (6th Cir. 2002) (violation of clearly established law is a threshold issue). Thus, Defendants are entitled to judgment on these claims now.

CONCLUSION AND RELIEF REQUESTED

Defendants respectfully request that this Court grant them judgment on the pleadings of all the tobacco claims in this case. The Community's *Sunnen* argument is effectively an announcement that it will continue to smuggle untaxed, unstamped cigarettes into and through Michigan for resale because it views every seizure as a new opportunity to re-litigate its federal claims. That position underscores the need for the specific relief Defendants have requested.

Respectfully submitted,

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