

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEBRASKA**

**HCI DISTRIBUTION, INC.; and ROCK
RIVER MANUFACTURING, INC.,**

Plaintiff,

v.

**DOUGLAS PETERSON, Nebraska
Attorney General; and TONY FULTON,
Nebraska Tax Commissioner,**

Defendants.

Case No. 8:18-CV-173

**DEFENDANTS' REPLY BRIEF IN
SUPPORT OF MOTION TO DISMISS**

INTRODUCTION

Defendants Peterson and Fulton (collectively, "Defendants") submit this Reply Brief in Support of Defendants' Motion to Dismiss Plaintiffs' Complaint pursuant to Fed. R. Civ. P. 12(b)(1) and (6).

ARGUMENT

I. Plaintiffs failed to state a claim upon which relief can be granted for their Supremacy Clause and Equal Protection claims.

A. The Supremacy Clause does not create a cause of action.

In their initial brief, Defendants showed how the Supremacy Clause does not create a cause of action and Plaintiffs' claims of a violation of the Supremacy Clause cannot serve as the basis for judicial remedy. Filing 28 at 26 – 27. Plaintiffs' Brief in Opposition fails to address or dispute this assertion. Plaintiffs have failed to state a Supremacy Clause claim upon which relief can be granted and this Court should dismiss this claim.

B. Plaintiffs have not made the claim of dissimilar treatment of similarly situated parties necessary for an Equal Protection claim.

Plaintiffs have failed to state a claim for a violation of the Equal Protection Clause. The Complaint predicates the Equal Protection cause of action specifically on the Term Sheet: "The State of Nebraska, by the Term Sheet, has specifically targeted Indian tribes and reservation Indians for increased scrutiny and increased legal burdens under its MSA laws." Complaint ¶ 68. But, Plaintiffs claim in their Brief in Opposition they are not challenging the Term Sheet at all. Filing 29 at 20, n. 12. Under either theory, Plaintiffs have failed to sufficiently plead a violation of the Equal Protection Clause.

Equal Protection prohibits most dissimilar treatment of similarly situated parties. *See*, Filing 28 at 27; *In re Kemp*, 894 F.3d 900 (8th Cir. 2018). However, "[d]issimilar treatment of dissimilarly situated persons does not violate equal protection." *Id.* Plaintiffs' response fails to address the same glaring deficiencies exposed in their Complaint, they have not alleged treatment

“of tribally-affiliated NPMs any differently than other NPMs, and have not alleged differential treatment of NPMs versus PMs.” Filing 28 at 28. Plaintiffs have provided no substantive refutation of this fact in their Brief in Opposition. This Court should dismiss the Equal Protection claim.

II. Plaintiffs’ allegations continue to fail to surmount important gateway restrictions.

A. Plaintiffs cannot challenge state regulation of an Indian tribe without alleging the regulation is “unreasonable and unrelated” to state authority.

Plaintiffs’ Complaint failed to allege Nebraska’s escrow and directory laws are unreasonable and unrelated to its regulatory authority. Filing 28 at 13 – 14. Plaintiffs’ Brief in Opposition also fails to address whether Nebraska’s escrow and directory laws are unreasonable and/or unrelated to its regulatory authority.¹ Without alleging this, Plaintiffs cannot challenge state regulation of an Indian tribe. *See, White Earth Band of Chippewa Indians v. Alexander*, 683 F.2d 1129, 1138 (8th Cir. 1982); *Colville*, 447 U.S. at 160. Plaintiffs’ challenge of state regulation of an Indian tribe, to the extent that such a challenge has been made, must be dismissed.

B. Plaintiffs’ allegations do not satisfy the *Ex Parte Young* exception and the Eleventh Amendment bars their claims.

Plaintiffs acknowledge that the Declaratory Judgment Act is not a waiver of Eleventh Amendment immunity; and so, Plaintiffs rely entirely upon *Ex Parte Young*. Filing 29 at 4. However, Plaintiffs have only alleged past actions, and not an ongoing violation, or threat to violate, federal law and thus cannot avail themselves of the *Ex Parte Young* exception to Eleventh Amendment immunity. Filing 28 at 12. Plaintiffs say this Court may only conduct a straightforward inquiry into “whether the complaint alleges an ongoing violation of federal law.”

¹ Neither the Complaint, nor the Brief in Opposition even contain the words “unreasonable” or “unrelated.”

Filing 29 at 6 (emphasis removed). But, Plaintiffs have only alleged a series of past actions that cannot serve as the basis for an *Ex Parte Young* exception to Eleventh Amendment immunity. This Court must dismiss these aspects of the complaint.

Plaintiffs assert that the threat of an illegal policy is sufficient basis for an *Ex Parte Young* exception to Eleventh Amendment immunity. Filing 29 at 6 (citing *McDaniel v. Precythe*, 897 F.3d 946 (8th Cir. 2018)). Plaintiffs cite to their allegations regarding compact negotiations with third parties, and conversations between previous staff members of the Nebraska Attorney General's Office and third parties as proof of such an illegal policy. *Id.*

However, the *McDaniel* case is actually about how “[t]he Department of Corrections has no policy governing how the director decides whom to invite as witnesses,” which is fundamentally problematic for Plaintiffs’ intended purpose of citing to the case as a holding regarding existing illegal policies. The Court in *McDaniel* recognized allegations of “unbridled discretion” in selecting witnesses to executions that allows for “discrimination based on viewpoint” through witness application questions regarding “an applicant’s association with groups that support or oppose the death penalty.” 897 F.3d at 951. “These allegations and reasonable inferences made from them support a plausible claim that an applicant’s viewpoint is a factor used by the Director when considering whom to invite as a witness.” *Id.* In other words, substantial allegations related directly to a pattern of behavior can support reasonable inferences for a plausible claim that an informal, illegal policy might exist when otherwise no formal policy actually exists. Plaintiffs cannot simply rely on *McDaniel* for their proposition that they can just basely allege the existence of an illegal policy.

Moreover, Plaintiffs’ Complaint does not actually contain allegations related to the existence or lack of a formal “policy,” which is fundamentally problematic for Plaintiffs’ intended

purpose of arguing their Complaint properly alleged the existence of an illegal formal policy. Compact negotiations that statutorily cannot be conducted with the Plaintiffs, since they are not the tribe,² are a far cry from establishment or communication of a formal policy, and conversations between state officials and third-parties about the drafting of legislation are not even close to formal policy. This Court can hardly be expected to draw reasonable inferences from allegations related substantially to third parties on isolated, non-patterned behavior to support a plausible claim that an informal, illegal policy might exist when otherwise no formal policy has been alleged.³ Therefore, Plaintiffs have not alleged existence of an illegal formal policy such that it might serve as the basis for an *Ex Parte Young* exception to Eleventh Amendment immunity.

C. Plaintiffs lack standing and their challenge is not ripe for judicial review.

Plaintiffs have attempted to reframe the present suit as a “pre-enforcement” challenge. Filing 29 at 16 – 17. Plaintiffs’ Complaint simply does not allege “pre-enforcement;” rather, Plaintiffs have only alleged an “as-applied” enforcement challenge. Filing 28 at 31. Plaintiffs’ Complaint only alleges “tax assessments” against third-party retailers, compact negotiations with third-party tribal governments, and an uncertain business climate created as a result of State law enforcement against third-parties. *See*, Filing 28 at 32 – 36; Complaint ¶¶ 44 – 50. Plaintiffs have not pled a pre-enforcement challenge, Plaintiffs have not responded to Defendants’ assertions regarding the “as-applied” enforcement challenge, and Plaintiffs cannot meet the requirements for standing and ripeness. Accordingly, they have no standing and their challenge is not ripe.

² *See*, Filing 28 at 7; Neb. Rev. Stat. § 77-2602.06(1).

³ To be clear, Defendants do believe that the escrow and directory laws apply as written.

III. Plaintiffs incorrectly use “Indian country” and “value added” in this case.

A. Plaintiffs’ incorrect usage of “Indian country.”

Plaintiffs are incorrect in their usage if they intend for “Indian country” to mean, in this case, all Indian country nationwide, collectively. The long-standing focus of analyzing federal prohibition on state regulation of tribal conduct regards solely the particular Indian country on which the tribe is located in relation to activities with members of the tribe. *Washington v. Confederated Tribes of the Colville Indian Reservation*, 447 U.S. 134, 160 – 61 (1980). “Absent express federal law to the contrary, Indians going beyond reservation boundaries have generally been held subject to non-discriminatory state law otherwise applicable to all citizens of the State.” *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 148–49 (1973). The law is clear. The analysis of state regulation of tribal conduct in Indian country only considers the relevant tribe’s own Indian country. To the extent Plaintiffs claim to be the Winnebago Tribe and such a claim substantiates certain rights,⁴ then this Court’s inquiry into state regulation of tribal conduct in Indian country is restricted to two playing fields: the Winnebago reservation, and everywhere else. Upon the Winnebago reservation, Plaintiffs may have a certain set of rights depending on the sufficiency of their claims and this Court’s analysis of the relevant facts and law.⁵ For everywhere else, Plaintiffs are no more special or unique a party than any other citizen of the United States.

⁴ As a reminder, Defendants asserted Plaintiffs cannot rely on 28 U.S.C. § 1362 for jurisdiction because Plaintiffs are not an Indian tribe or band. Filing 28 at 44 – 45. Plaintiffs have not refuted this assertion in their response. This is because Plaintiffs are not the Winnebago Tribe.

⁵ To be clear, Defendants do not believe any of these potential rights would negatively impact the efficacy of the escrow and directory laws because the statutory scheme already accounts for those potential rights and clearly affords them to the relevant parties.

B. *Cabazon* has been superseded by statute.

Plaintiffs have asserted that their tobacco enterprise implicates the *Cabazon* principles of “value added.” Filing 29 at 14 (citing *California v. Cabazon Band of Mission Indians*, 480 U.S. 202 (1987) (whether California can regulate tribally-run unlicensed gambling enterprises on Indian country within the State that would otherwise be illegal elsewhere in the State)). Unfortunately for Plaintiffs, Congress adopted the Indian Gaming Regulatory Act, 25 U.S.C. § 2701 et seq., (“IGRA”) in response to the Court’s ruling in *Cabazon* “which held that States lacked any regulatory authority over gaming on Indian lands [but] left fully intact a State’s regulatory power over tribal gaming outside Indian territory.” *Michigan v. Bay Mills Indian Community*, 134 S.Ct. 2024, 2034 (2014). In other words, Congress enacted IGRA to fix the problem of “*Cabazon*’s ouster of state authority” and the holding from *Cabazon* is now superseded by statute. *Id.* This presents clear Congressional disapproval of the Court’s use of “value added” to prevent State regulation of tribal conduct in Indian country, and Plaintiffs’ attempted reliance on this principle is misplaced.

IV. This is not a case of first impression, decades of Indian law precedent are applicable, and Nebraska law does not work the way Plaintiffs claim it does.

A. Nebraska’s escrow and directory statutes can regulate tribal conduct in Indian country when that conduct is the sale of cigarettes to nonmembers.

Defendants appreciate Plaintiffs’ attempt to clarify the scope of the present suit, and Defendants agree with Plaintiffs’ essential framing of the question before this Court: “whether the [S]tate may regulate tribal conduct in Indian [c]ountry.” Filing 29 at 7. However, Plaintiffs assert “[n]ot a single U.S. Supreme Court case cited by the Defendants answers the question before this Court.” Filing 29 at 7. This statement is simply not true. Tribes and tribal members are not being

regulated. For example, cigarettes sold on the Winnebago reservation to Winnebago tribal members are not subject to Nebraska tax or escrow; cigarettes sold on the Winnebago reservation to nonmembers of the Winnebago tribe are subject to Nebraska tax and escrow.

Defendants cited to several United States Supreme Court cases that explicitly address the question of whether a state may regulate tribal conduct in Indian country with respect to cigarettes. These cases include *Colville*, 447 U.S. 134, 154 – 61 (The State of Washington is explicitly allowed to regulate cigarette sales to nonmembers in smokeshops on reservations located within the State, and the State can impose regulatory recordkeeping and collection burdens on those Indian businesses participating in sales to nonmembers on the reservations); *Moe v. Confederated Salish and Kootenai Tribes of Flathead Reservation*, 425 U.S. 463, 483 (1976) (The State of Montana can regulate cigarette sales from Indian tribal retailers to non-Indian consumers taking place on reservations); and *Department of Taxation and Finance of New York v. Milhelm Attea & Bros., Inc.*, 512 U.S. 61, 75 (1994) (“Indian traders are not wholly immune from state regulation that is reasonably necessary to the assessment or collection of lawful state taxes.”).

Defendants also cited to *Rice v. Rehner*, 463 U.S. 713 (1983) (Whether California’s liquor license laws apply to a federally licensed Indian trader located on a reservation selling liquor for off-premises consumption.); *McClanahan v. State Tax Commission of Arizona*, 411 U.S. 164 (1973) (Whether Arizona’s individual income tax on reservation Navajo Indians for income derived wholly from reservation sources was lawful.); *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136 (1980) (Whether Arizona taxes on Indian tribe and logging company were preempted by federal law.); *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163 (1989) (Whether New Mexico could tax on-reservation production of oil and gas by a non-Indian company that was also subject to the reservation tribe's own tax.); *Nevada v. Hicks*, 533 U.S. 353 (2001) (Involving

questions of Nevada and tribal jurisdictional law surrounding search warrant on allotted land within reservation for evidence of off-reservation poaching crime.); *Mescalero*, 411 U.S. 145 (Whether New Mexico may impose a tax on a ski resort operated by a Tribe on off-reservation land); *Oklahoma Tax Commission v. Chickasaw Nation*, 515 U.S. 450 (1995) (Whether Oklahoma could tax fuels sold by tribe in Indian country or income of both Indians and non-Indians residing in state outside Indian country.).

This is not a comprehensive list, but it certainly rebuts Plaintiffs' claim that this would be a case of first impression for this Court. State regulation of tribal conduct in Indian country is a fact-specific inquiry incorporating overarching legal principles. Whether dealing with licensing or taxes for alcohol, cigarettes, fuel, gambling, oil, gas, hunting, fishing, income, or any other property or moneyed interest the Court has focused on the facts of the case in order to appropriately apply the legal principles.

Perhaps Plaintiffs simply meant Defendants did not cite to a United States Supreme Court case that has dealt with the issue of state cigarette escrow and directory laws. Such an assertion would be true because the United States Supreme Court has issued no opinion on state cigarette escrow and directory laws. However, Defendants did cite to opinions from federal circuit and district courts, and state court, that have taken the above-cited Supreme Court cases, and others, related to state regulation of tribal conduct in Indian country and applied them to the factual and legal context of state escrow and directory laws.

Defendants cited to *Muscogee (Creek) Nation v. Pruitt*, 669 F.3d 1159 (10th Cir. 2012) (Whether, among other things, Oklahoma's escrow and directory laws are non-discriminatory state laws of general application that do not specifically pertain to Indian tribes, tribal members, or Indian country.); *King Mountain Tobacco Co., Inc. v. McKenna*, 768 F.3d 989 (9th Circuit 2014)

(Whether Washington’s escrow law is preempted by federal law.); *Omaha Tribe of Nebraska v. Miller*, 311 F.Supp.2d 816 (S.D. Iowa, 2004) (Whether Iowa’s escrow law is preempted or unconstitutional.); *State ex rel. Edmondson v. Native Wholesale Supply*, 237 P.3d 199 (Okla. 2010) (Whether Oklahoma’s directory law is preempted or unconstitutional.).

Although the facts of these particular cases are not identical to this case, the legal reasoning is entirely applicable to this matter. As such, Nebraska’s escrow and directory laws are non-discriminatory state laws of general application that are not preempted or unconstitutional and can be used to regulate certain types of tribal conduct in Indian country.

Plaintiffs propose a categorical ban on enforcement of Nebraska’s escrow and directory laws against Plaintiffs because the Supreme Court has prohibited direct taxation “on an Indian tribe or its members inside Indian country.” Filing 29 at 8 (quoting *Oklahoma Tax Commission v. Chickasaw Nation*, 515 U.S. 450, 458 (1995)).⁶ As Defendants already explained in their Brief in Support of their Motion to Dismiss, Nebraska’s cigarette excise tax law explicitly does not tax an Indian tribe or its members inside Indian country.⁷ This is important because the fundamental basis for determining whether the escrow and directory laws apply to any company in Nebraska is whether or not cigarettes sold in the state count as “units sold.”⁸ A “unit sold” is a cigarette sold in the State in a pack “required to bear a stamp pursuant to section 77-2603 or 77-2603.01...” Neb. Rev. Stat. § 69-2702(14). As stated in Defendants’ Brief in Support, packs sold “on an Indian tribe’s Indian country to its tribal members where state taxation is precluded by federal law” are

⁶ Plaintiffs follow their citation to this case with this statement: “Although this matter is not a challenge to a tax, the principle applies.” Filing 29 at 8. Plaintiffs do not attempt to resolve the inherent conflict between this statement and their earlier protestations to Defendants’ use of “a line of cases that address imposition of state taxes in various different circumstances.” Filing 29 at 7. Indeed, the *Muscogee*, *McKenna*, *Miller*, and *Native Wholesale Supply* cases offer guidance as to what to do. See, respectively 669 F.3d 1159, 768 F.3d 989, 311 F.Supp.2d 816, and 237 P.3d 199.

⁷ See, Filing 28, Background, § I.C., page 7 (“Under Nebraska law, cigarette sales within a certain tribe’s Indian country to a member of that tribe are not a taxable event.”)

⁸ See, Filing 28, Background, § I.A., page 4; see also, Neb. Rev. Stat. § 69-2703(1), (2)(a), & 69-2702(14)

exempt from the requirements of taxation and escrow.⁹ Plaintiffs' request for a categorical ban on Nebraska's escrow and directory laws in Indian country is nonsensical. Tribes and tribal members are not being taxed or regulated.

The Court in *Miller* appreciated this distinction by identifying that the nature of the transaction to be regulated informs the applicability of the regulation. 311 F.Supp.2d at 825. Iowa's escrow law does not regulate sales of cigarettes on the Omaha reservation to Omaha tribal members, Iowa's escrow law only regulates sales of cigarettes in Iowa that Iowa is entitled to tax and regulate. *Id.* Under Nebraska law, cigarettes sold in Indian country to nonmembers are subject to tax, therefore the stamp is required and escrow is triggered; cigarettes sold in Indian country to its tribal members are not subject to tax, therefore the stamp is not required and the escrow requirement is not triggered. Put more specifically, cigarettes sold on the Winnebago reservation to Winnebago tribal members are not subject to Nebraska tax or escrow; cigarettes sold on the Winnebago reservation to nonmembers of the Winnebago tribe are subject to Nebraska tax and escrow. Nebraska's escrow and directory laws therefore do not purport to regulate tribal conduct in Indian country. Nebraska's escrow and directory laws simply regulate the full scope of units sold within the State, including those cigarettes sold in Indian country to nonmembers.

With a full understanding of how Nebraska's escrow and directory laws work, Plaintiffs request makes no sense. Plaintiffs are apparently asking for an order prohibiting an action that Nebraska law does not provide for anyway, and they have alleged no evidence of attempts to improperly enforce the escrow and directory laws in ways other than as written.

⁹ See, Filing 28, Background, § I.C., page 7

B. Nebraska's escrow functions on the incidence of the State's cigarette taxes.

Plaintiffs urge this Court to adopt their position on the “legal incidence” of escrow based on the holding in *Oklahoma Tax Commission v. Chickasaw Nation*, 515 U.S. 450 (1995), a case involving the legal incidence of taxation for sales of motor fuels. Filing 29 at 9. As recited above, Nebraska law does not tax the sale of cigarettes in Indian country contrary to what is allowed under federal law. Nebraska escrow functions on the incidence of Nebraska taxes and therefore escrow is not required contrary to the limitations of federal tax law. Even the Court in *Miller* identified that Iowa's escrow law does not regulate tribal conduct in Indian country impermissibly because the sales to be regulated fall squarely within the regulatory authority of the State. 311 F.Supp.2d at 825. This Court should favor the ruling in *Miller* because it actually applies to a state's cigarette escrow law, and Plaintiffs' attempt to defeat State regulation here should be rejected.

V. Based on Plaintiffs' concession, Defendants no longer assert the matter related to an alternative basis for federal jurisdiction.

Defendants asserted that in the event the other federal constitutional claims were dismissed, Plaintiffs cannot rely on tribal sovereign immunity to establish federal jurisdiction in this matter. Filing 28 at 45 – 46. Defendants did so out of an abundance of caution and to make sure Plaintiffs could not fall back on any particular misconstruction of arguments due to their belief in the plenary powers of tribal sovereign immunity. Plaintiffs and Defendants both agree that tribal sovereign immunity cannot be used as sword to create federal jurisdiction and can only be used as a shield for defense to a lawsuit. See, Filing 28 at 45 – 46; #29 at 26 – 27. Plaintiffs and Defendants agree there is no remaining dispute on this point.

CONCLUSION

For the foregoing reasons, the Court should grant Defendants' Motion to Dismiss and dismiss HCID and RR's claims.

Submitted September 12, 2018.

**DOUGLAS PETERSON, Nebraska Attorney General;
and TONY FULTON, Nebraska Tax Commissioner,
Defendants.**

By: DOUGLAS J. PETERSON
Attorney General of Nebraska

By: s/ Daniel J. Muelleman
Daniel J. Muelleman, NE #25806
Joshua E. Dethlefsen, NE #24667
Assistants Attorney General

OFFICE OF THE ATTORNEY GENERAL
2115 State Capitol
Lincoln, Nebraska 68509
(402) 471-2682
daniel.muelleman@nebraska.gov
joshua.dethlefsen@nebraska.gov
Attorneys for Defendants.

CERTIFICATE OF SERVICE

I hereby certify that on September 12, 2018, I electronically filed the foregoing document with the Clerk of the United States District Court for the District of Nebraska, using the CM/ECF system, causing notice of such filing to be served upon all parties' counsel of record.

By: s/ Daniel J. Muelleman