No. 22-10560

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

STATE OF TEXAS; STATE OF MISSISSIPPI; STATE OF LOUISIANA,

Plaintiffs-Appellees,

v.

JANET YELLEN, in her official capacity as Secretary of the Treasury; RICHARD K. DELMAR, in his official capacity as Acting Inspector General of the Department of the Treasury; UNITED STATES DEPARTMENT OF THE TREASURY; UNITED STATES OF AMERICA,

Defendants-Appellants.

On Appeal from the United States District Court
for the Northern District of Texas, Case No. 2:21-cv-79
The Honorable Matthew Joseph Kacsmaryk

Brief of Amicus Curiae The Buckeye Institute in Support of the Appellees

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Certificate of Interested Persons

***State of Texas, et al. v. Yellen, et al.*, Case No. 22-10560**

Pursuant to Fifth Cir. R. 28.2.1, the undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this court may evaluate possible disqualifications or recusal.

Plaintiffs-Appellees: State of Texas, represented by Judd Edward Stone, II, Eric J. Hamilton, Ryan Daniel Walters, and Jeffrey Michael White (in the district court) of the Office of the Attorney General of Texas; State of Mississippi, represented by Justin Lee Matheny of the Office of the Attorney General for the State of Mississippi; and the State of Louisiana, represented by Elizabeth Baker Murrill of the Office of the Attorney General for the State of Louisiana.

Defendants-Appellants: Janet Yellen, in her official capacity as Secretary of the Treasury; Richard K. Delmar, in his official capacity as Acting Inspector General of the Department of the Treasury; United States Department of the Treasury; and United States of America, who are all represented by Daniel Winik, Alisa Beth Klein, and Michael Patrick Clendenen (in the district court) of the U.S. Department of Justice, Civil Division, Appellate Section.

Amicus Curiae: The Buckeye Institute, represented by Andrew M. Grossman and Kristin A. Shapiro of Baker & Hostetler LLP and Robert Alt of the Buckeye Institute; National Taxpayers Union Foundation, represented by Joseph Henchman; the Chamber of Commerce of the United States of America

and National Federation of Independent Business Small Business Legal Center, represented by Paul D. Clement (in the district court); Goldwater Institute, represented by Matthew R Miller of the Texas Public Policy Foundation (in the district court); and New Civil Liberties Alliance, represented by Margaret A. Little (in the district court).

Dated: October 31, 2022

/s/ Andrew M. Grossman
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Interest of Amicus Curiae[1]

The Buckeye Institute was founded in 1989 as an independent research and educational institution—a "think tank"—to formulate and promote free-market solutions for Ohio's most pressing public policy problems. Through its Legal Center, the Buckeye Institute engages in litigation in support of the principles of federalism enshrined in the U.S. Constitution. The Buckeye Institute is dedicated to upholding the balance of power between States and the federal government as prescribed by the U.S. Constitution. It is also dedicated to creating a pro-growth tax system that rewards work and encourages entrepreneurship. The "Tax Mandate" challenged in this case directly threatens Buckeye's policy priorities, including those related to federalism, clear lines of government accountability, and pro-growth tax policy.

[1] All parties have consented to the filing of this brief. No counsel for any party authored this brief in whole or in part, and no person or entity other than the *amicus curiae* or its counsel made a monetary contribution intended to fund the brief's preparation or submission.

Introduction and Summary of Argument

The American Rescue Plan Act of 2021 ("ARPA") conditions federal funding to States on a vague prohibition on using federal funds to "either directly or indirectly offset a reduction in the net tax revenue" through "a change in law, regulation, or administrative interpretation…that reduces any tax…or delays the imposition of any tax or tax increase." 42 U.S.C. § 802(c)(2)(A). What precisely this language proscribes is anyone's guess, as practically any action by a State may, intentionally or not, reduce tax revenues. But if Congress wishes to impose conditions on States' receipt of federal funds, it must do so "unambiguously," so as to enable a State to "ascertain what is expected of it" before deciding whether to accept funding. *Pennhurst State Sch. & Hosp. v. Halderman*, 451 U.S. 1, 17 (1981). "By insisting that Congress speak with a clear voice, we enable the States to exercise their choice knowingly, cognizant of the consequences of their participation." *Id.*

The Tax Mandate imposes no condition that can be lawfully enforced because it fails to draw any clear line distinguishing States' permissible exercise of their tax and police powers from that which is proscribed. Given force, the Tax Mandate threatens to bulldoze the Constitution's vertical separation of powers. Its fundamental vagueness mires States in uncertainty and chills the exercise of their core powers. And it potentially sets in stone State policy through 2026—the last day on which funds must be spent. Congress has never before used its Spending Clause power to affect such a broad intrusion on States' central policymaking authority.

The Secretary of the Treasury cannot cure Congress's failure to enact a clear condition by issuing implementing regulations. *See Coronavirus State and Local Recovery Funds*, 87 Fed. Reg. 4338 (Jan. 27, 2022). This Court has already explained that the "needed clarity" for federal funding conditions "must come directly from the statute" and cannot be provided "by regulations clarifying an ambiguous statute." *Texas Educ. Agency v. U.S. Dep't of Educ.*, 992 F.3d 350, 361 (5th Cir. 2021). This is so because "the ability to place conditions on federal grants ultimately comes from the Spending Clause, which empowers Congress, not the Executive, to spend for the general welfare." *Id.* at 362. It is therefore Congress's duty to take responsibility for exercising this power, and Congress cannot avoid accountability for such decisions by punting the hard questions to the discretion of the Executive Branch.

Moreover, "[r]elying on regulations to present the clear condition…is an acknowledgment that Congress's condition was not unambiguous." *Id.* at 361. The regulations here not only fail to clarify the fundamental vagueness of the Tax Mandate, but also they effectively appoint the Secretary as a virtual viceroy over the States, with authority to review practically every decision that might affect tax revenue (*i.e.*, potentially any exercise of tax and police powers) and discretion to approve or reject those decisions. In this role, the Secretary exercises greater discretion over what States may do than State governors.

If Congress wishes to exert control over the exercise of States' tax and police power, it must at a minimum do so with a clarity that the Tax Mandate lacks. The judgment of the district court should be affirmed.

Argument

I. The Tax Mandate Is Fundamentally Vague and Therefore Unenforceable

A. Congress May Impose Conditions on States' Receipt of Federal Funds Only If It Does So "Unambiguously"

"The legitimacy of Congress' power to legislate under the spending power…rests on whether the State voluntarily and knowingly accepts the terms of the 'contract.'" *Pennhurst*, 451 U.S. at 17. Accordingly, the Supreme Court has repeatedly emphasized that "if Congress desires to condition the States' receipt of federal funds, it 'must do so unambiguously..., enabl[ing] the States to exercise their choice knowingly, cognizant of the consequences of their participation.'" *South Dakota v. Dole*, 483 U.S. 203, 207 (1987) (quoting *Pennhurst*, 451 U.S. at 17); *see also Arlington Cent. Sch. Dist. Bd. of Educ. v. Murphy*, 548 U.S. 291, 296 (2006) (same). "In seeking to determine whether the language of a condition is sufficiently clear, courts must view the statute 'from the perspective of a state official who is engaged in the process of deciding whether the state should accept federal funds'…asking 'whether...a state official would clearly understand the nature of the condition.'" *Hurst v. Texas Dep't of Assistive & Rehab. Servs.*, 482 F.3d 809, 811 (5th Cir. 2007) (quoting *Arlington*, 548 U.S. at 296 (cleaned up)).

"There can, of course, be no knowing acceptance if a State is unaware of the conditions or is unable to ascertain what is expected of it." *Pennhurst*, 451 U.S. at 17. Congress therefore must provide "clear notice" of both the existence and the substance of the condition. *Arlington*, 548 U.S. at 296. Providing notice of just the existence of a condition, without clearly explaining what the

condition entails, is insufficient. *See Sossamon v. Lone Star State of Texas*, 560 F.3d 316, 330–31 (5th Cir. 2009) ("[A] textual waiver of immunity must extend unambiguously to such monetary claims." (quotation marks omitted)); *Com. of Va., Dep't of Educ. v. Riley*, 106 F.3d 559, 568 (4th Cir. 1997) (en banc) ("[A] clear statement is required not simply in determining whether a statute applies to the States, but also in determining whether the statute applies in the particular manner claimed.").[2]

As the Supreme Court recently explained, the limits on Congress's Spending Clause authority are "critical to ensuring that Spending Clause legislation does not undermine the status of the States as independent sovereigns in our federal system." *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 567 U.S. 519, 577 (2012); *see also Davis Next Friend LaShonda D. v. Monroe Cnty. Bd. of Educ.*, 526 U.S. 629, 655 (1999) ("A vital safeguard for the federal balance is the requirement that, when Congress imposes a condition on the States' receipt of federal funds, it must do so unambiguously." (quotation marks omitted)) (Kennedy, J., dissenting). "If the spending power is to be limited only by Congress' notion of the general welfare, the reality, given the vast financial resources of the Federal Government, is that the Spending Clause gives power to the Congress to tear down barriers, to invade the states' jurisdiction, and to become a parliament of the whole

[2] In reversing the panel opinion in *Riley*, the Fourth Circuit adopted the dissenting panel opinion of Judge Luttig. 106 F.3d at 561. Quotes from the opinion include those from Judge Luttig's original panel dissent, reproduced by the en banc court.

people, subject to no restrictions save such as are self-imposed." *Riley*, 106 F.3d at 571 (quotation marks omitted).

The requirement that federal funding conditions be unambiguous is one of several related "stringent clear-statement rule[s]" that preserve the vertical separation of powers. *Texas Educ. Agency*, 992 F.3d at 359 (quotation marks omitted); *see* Larry J. Obhof, *Federalism, I Presume? A Look at the Enforcement of Federalism Principles Through Presumptions and Clear Statements Rules*, 2004 Mich. St. L. Rev. 123, 132 (2004). Such rules "acknowledge[e] that the States retain substantial sovereign powers under our constitutional scheme, powers with which Congress does not readily interfere." *Gregory v. Ashcroft*, 501 U.S. 452, 461 (1991). Moreover, "[i]n traditionally sensitive areas, such as legislation affecting the federal balance, the requirement of clear statement assures that the legislature has in fact faced, and intended to bring into issue, the critical matters involved in the judicial decision.'" *United States v. Bass*, 404 U.S. 336, 349 (1971).

Consistent with these principles, "when the Federal Government takes over...local radiations in the vast network of our national economic enterprise and thereby radically readjusts the balance of state and national authority, those charged with the duty of legislating [must be] reasonably explicit.'" *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 544 (1994) (quotation marks omitted)). For example, *Fairfax's Devisee v. Hunter's Lesee*, 11 U.S. (7 Cranch) 603, 623 (1812), required statutory language that was "clear and explicit" to derogate from the common law.

The Supreme Court's Eleventh Amendment precedent is instructive. *See Will v. Mich. Dep't of State Police*, 491 U.S. 58, 65 (1989) ("*Atascadero* was an Eleventh Amendment case, but a similar approach is applied in other contexts."); *Texas Educ. Agency*, 992 F.3d at 359 ("Where th[e] constraints on Congress's spending power are met, the requirements for an effective [Eleventh Amendment] waiver are also satisfied."). For Congress to abrogate State sovereign immunity, it "must mak[e] its intention unmistakably clear in the language of a statute." *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 242 (1985); *see also, e.g.*, *Kimel v. Fla. Bd. of Regents*, 528 U.S. 62, 73 (2000) (same). This "simple but stringent test" helps "temper Congress' acknowledged powers of abrogation with due concern for the Eleventh Amendment's role as an essential component of our constitutional structure." *Dellmuth v. Muth*, 491 U.S. 223, 227–28 (1989).

"Although the States surrendered many of their powers to the new Federal Government, they retained 'a residuary and inviolable sovereignty.'" *Printz v. United States*, 521 U.S. 898, 918–19 (1997) (quoting The Federalist No. 39, at 245 (J. Madison)). State sovereignty is "one of the Constitution's structural protections of liberty" because "a healthy balance of power between the States and the Federal Government will reduce the risk of tyranny and abuse from either front." *Id.* at 921. Because the Constitution "has left primarily to the political process the protection of the States" from intrusion by Congress, strict adherence to the requirement that federal funding conditions be unambiguous assumes paramount importance. *Riley*, 106 F.3d at 567 (quoting *Gregory*, 501 U.S. at 464). "[T]o give the state-displacing weight of federal law to mere congressional

ambiguity would evade the very procedure for lawmaking on which [the Supreme Courts' federalism precedents have] relied to protect states' interests." *Id.* (quoting *Gregory*, 501 U.S. at 464).

B. The Tax Mandate's Unprecedented Vagueness Renders It Unconstitutional

The Tax Mandate fails to set out an unambiguous condition on the receipt of ARPA funds. In full, the Tax Mandate provides:

> A State or territory shall not use the funds provided under this section or transferred pursuant to section 803(c)(4) of this title to either directly or indirectly offset a reduction in the net tax revenue of such State or territory resulting from a change in law, regulation, or administrative interpretation during the covered period that reduces any tax (by providing for a reduction in a rate, a rebate, a deduction, a credit, or otherwise) or delays the imposition of any tax or tax increase.

42 U.S.C. § 802(c)(2).

What this language requires of States is anything but clear. Every exercise of a State's police power regulates human conduct, which in turn affects activity and taxation. After all, "taxation, in reality, is life."[3] Every policy may, depending on how things play out, "reduce[] any tax" and thereby run afoul of the Tax Mandate if funds received under ARPA are used to "indirectly" offset the loss, whatever that means. The Tax Mandate thus potentially intrudes on every area of state policymaking, limited only by the whims of the Secretary of the Treasury.

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[3] Jeffrey M. Birnbaum & Alan S. Murray, *Showdown at Gucci Gulch* 289 (1987) (quoting Sheldon Cohen).

Treasury contends (at 13–14) that "[t]he sole effect of the Offset Provision is that, when States determine how to balance the negative revenue effects of a tax cut on their budgets, they may not use the federal Fiscal Recovery Funds funds as part of that balancing process" (quotation marks omitted). But this description of the Tax Mandate glosses over several ambiguities in the provision.

As an initial matter, what does it mean to use ARPA funds to "directly or indirectly" offset a reduction in tax revenue? Even the Secretary of the Treasury admitted to Congress that this is a "thorny" issue, and "[g]iven the fungibility of money, it's a hard question to answer."[4] To this day, Treasury has never offered a definition of an "indirect offset," and the meaning of the term is entirely unclear. *See Ohio v. Yellen*, 547 F. Supp. 3d 713, 732 (S.D. Ohio 2021) ("Even armed with the Court's guidance as to the source of the ambiguity, the Secretary provides no workable definition of what an 'indirect offset' is."). Because "[m]oney is fungible," "any ARPA funds the Plaintiff States receive could be viewed as indirectly offsetting any reduction in net tax revenue from a change in state law or policy." *West Virginia v. U.S. Dep't of Treasury*, 571 F. Supp. 3d 1229, 1250 (N.D. Ala. 2021).

This ambiguity starkly contrasts with the maintenance-of-effort provision at issue in *Bennett v. Kentucky Department of Education*, 470 U.S. 656 (1985), which expressly required that federal funds be used only to "supplement" and not

[4] The Quarterly CARES Act Report to Congress: Hearing before the S. Comm. on Banking, Housing, and Urban Affairs, 117th Cong., at 1:11:47–1:13:30 (Mar. 24, 2021), *available at* https://www.banking.senate.gov/hearings/03/17/2021/the-quarterly-cares-act-report-to-congress (testimony of Secretary Yellen).

"supplant" preexisting spending on Title I, *id.* at 671. The maintenance-of-effort provision did not restrict tax cuts, and compliance with the provision could be evaluated by looking only at a State's Title I expenditures. Compliance with the Tax Mandate, by contrast, appears to require an assessment of every State action that could potentially affect tax revenue or spending. *See Texas v. Yellen*, No. 2:21-CV-079-Z, 2022 WL 1063088, at *6 (N.D. Tex. Apr. 8, 2022) ("Section 802(c)(2)(A)—by contrast—prohibits tax cuts altogether and does not require any maintenance of effort.").

The phrase "resulting from a change in law, regulation, or administrative interpretation…that reduces any tax" compounds the Tax Mandate's ambiguity. There are countless "changes" that this language would appear to describe, such as annual updates to property tax assessments or tax credits to developers for constructing affordable housing. Or consider an administrative decision that a tax credit for disabled individuals should extend to those with "long COVID." The decision would reduce the taxes for those with long COVID, but is it a "change" in law, regulation, or administrative interpretation? Does the answer depend on whether a Treasury bureaucrat thinks the decision is a straightforward application of existing law concerning the meaning of "disabled" or a novel extension of it?

Even the phrase "reduces any tax" lacks clarity. One could reasonably interpret the statute only to cover tax cuts and actions similar to tax cuts, such as rebates, deductions, and credits. Treasury, however, appears to take the position that any action that decreases tax *revenue* "reduces any tax" and is thereby

subject to the provision. *See* pp. 19–20, *infra*. As noted above, every exercise of a State's police power could potentially affect tax revenue. Updates to the building code, for example, may reduce new construction and thereby tax revenues. Prohibiting the sale of Cannabidiol products will come at the expense to the State of a reduction in sales-tax revenue. Requiring licensure of a profession may thin out the field, with a corresponding hit to tax collections. And requiring more electrical vehicle sales (as some States are trying to do) may reduce emissions, but it will also likely reduce gas-tax collections.

The phrase "reduction in net tax revenue" is similarly unclear. The Tax Mandate fails to answer basic, but significant, questions about the meaning of this phrase, such as the baseline for measuring a reduction in revenue, whether and how revenue should be adjusted for inflation, and whether a reduction should be measured by actual or expected revenue. *Ohio*, 547 F. Supp. 3d at 732 ("[T]he statutory language itself provides no mechanism for determining whether a State's net tax revenues are 'reduced' or not."). Nor does it address whether the reduction is measured each year of the covered years separately or cumulatively. These are no small questions, as the pandemic upended commerce and, consequently, tax collections, and States are currently confronted with historic inflation and a potential recession.

Texas, for example, has collected record-high tax revenues due to inflation and high gas prices, and many policymakers are suggesting that the legislature cut taxes in the upcoming January 2023 legislative session as a result. *See* Mitchell Ferman, The Texas Tribune, *Inflation, high energy prices mean the Texas*

Legislature will have unprecedented funds to allocate next year (July 14, 2022).[5] But doing so would reduce tax revenue compared to 2022, and therefore potentially run afoul of the Tax Mandate. Because of the uncertainty about how the provision applies in this situation, the Tax Mandate could deter Texas from reducing tax rates merely to prevent another historic and unneeded surplus.

Similarly, Louisiana legislators soon may be considering eliminating the State's income tax in favor of higher property taxes. *See* Will Sentell, The Advocate, *Louisiana likely to see budget surplus for second year, key budget leader says* (Sept. 20, 2022).[6] It is possible that—even if Louisiana intends the combined effect of the two tax changes to be revenue-neutral, and their long-term effect is revenue-neutral—a housing-market recession in 2023 could cause a temporary decrease in property tax collections. The Tax Mandate requires Louisiana legislators to consider these tax changes in the dark, without any certainty as to whether a recession will impact tax revenue or how the Tax Mandate would apply in such a situation.

Implicitly conceding the ambiguity of the Tax Mandate, Treasury contends (at 8–9) that the provision can be construed "narrowly" to avoid a constitutional infirmity. Because a threshold requirement for application of the canon

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[5] *Available at* https://www.texastribune.org/2022/07/14/texas-comptroller-revenue-estimate/; *see also* Bobby Harrison, Mississippi Today, *Mississippi in midst of historic times in terms of available state revenue* (July 24, 2022), *available at* https://mississippitoday.org/2022/07/24/mississippi-historic-state-revenue/.

[6] *Available at* https://www.theadvocate.com/baton_rouge/news/politics/article_af4feedc-6f61-5076-99f1-9d28ae96aea8.html.

of constitutional avoidance is an ambiguous statutory provision, the cannon cannot be relied upon to save an ambiguous federal funding condition. *See United States v. Palomar-Santiago*, 141 S. Ct. 1615, 1622 (2021) (the canon of constitutional avoidance "has no application in the absence of statutory ambiguity"). Any ambiguity in a federal funding condition is "contrary to the fundamental proposition that Congress, when exercising its spending power, can impose no burden upon the States unless it does so unambiguously." *Rowley v. Dep't of Educ.*, 458 U.S. 176, 190 n.11 (1982); *see also Dellmuth*, 491 U.S. at 230 ("If Congress' intention is 'unmistakably clear in the language of the statute,' recourse to legislative history will be unnecessary; if Congress' intention is not unmistakably clear, recourse to legislative history will be futile, because by definition the rule of *Atascadero* will not be met.").

Moreover, the prospect of a narrowing construction that may or may not be adopted by courts years after a program is enacted can hardly be of assistance to a "'state official who is engaged in the process of deciding whether the state should accept federal funds.'" *Hurst*, 482 F.3d at 811 (quoting *Arlington*, 548 U.S. at 296 (cleaned up)). And in light of the numerous ambiguities in the Tax Mandate described above, it is not even clear what narrowing construction would prevail or what obligations it might impose.

The ambiguity of the Tax Mandate is particularly troubling given the importance to the States of the tax power, which is "central to state sovereignty," *Dep't of Revenue of Oregon v. ACF Indus., Inc.*, 510 U.S. 332, 345 (1994), and "indispensable to their existence," *Gibbons v. Ogden*, 22 U.S. 1, 199 (1824). The

"power of self-government" in fact "cannot exist distinct from the power of taxation." *Providence Bank v. Billings*, 29 U.S. 514, 548 (1830). Because the scope of the Tax Mandate is not "plain to anyone reading the Act," *Gregory*, 501 U.S. at 467, a State has no way to predict with any certainty whether the provision permits any given exercise of its tax or police power. The result is that the Tax Mandate threatens to chill State decisionmaking and freeze in place State policy for years. It was incumbent upon Congress to make the Tax Mandate "unmistakably clear in the language of the statute." *Atascadero*, 473 U.S. at 242. Because Congress failed to do so, the Tax Mandate is facially invalid. *See Pennhurst*, 451 U.S. at 17.

II. Treasury Cannot and Did Not Cure the Tax Mandate's Constitutional Defect

A. The Executive Branch Cannot Make Up for Congress's Failure to Speak "Unambiguously"

This Court in *Texas Education Agency* held that the "needed clarity" to satisfy the Spending Clause cannot be provided by "regulations clarifying an ambiguous statute" but instead "must come directly from the statute." 992 F.3d at 361. Accordingly, Treasury's implementing regulations cannot cure the Tax Mandate's unconstitutional ambiguity. *See Yellen*, 2022 WL 989733, at *9 ("The Fifth Circuit has held regulations cannot provide the clarity required for a State's acceptance of a Spending Clause condition to be knowing." (quotation marks omitted)); *West Virginia*, 571 F. Supp. 3d 1254 ("Defendants appear to concede

that, assuming that the language of the Tax Mandate is itself unconstitutionally ambiguous, the Final Rule cannot cure that ambiguity.").

Texas Education Agency considered the Department of Education's argument that "the NDAA conditions the acceptance of any federal grant or contract on waiving immunity from whistleblower retaliation claims related to that grant or contract." 992 F.3d at 358. The Court first explained that the text of the NDAA was not "adequately clear for any such waiver to be effective." *Id.* at 359. The Court then proceeded to reject the Department's argument that "regulations clarify what the statute may have left ambiguous." *Id.* at 361. The Court held that the "needed clarity…must come directly from the statute, for two reasons." *Id.*

First is that "[r]egulations that interpret statutes are valid only if they either match Congress's unambiguous command or are clarifying a statutory ambiguity," and "[r]elying on regulations to present the clear condition, therefore, is an acknowledgment that Congress's condition was not unambiguous." *Id.* Second is that "the ability to place conditions on federal grants ultimately comes from the Spending Clause, which empowers Congress, not the Executive, to spend for the general welfare." *Id.* at 362. "Allowing the Executive to require states to waive immunity to receive federal funds would grant the Executive a power of the purse and thus would be inconsistent with the Constitution's meticulous separation of powers." *Id.*; *see also City of Chicago v. Barr*, 961 F.3d 882, 892 (7th Cir. 2020) (explaining that "the power to wield the purse to alter

behavior rests squarely with the legislative branch," which is constrained by "institutional checks" that are lacking in the executive branch).

This Court's holding in *Texas Education Agency* is consistent with Fourth Circuit's *en banc* decision in *Riley*, which rejected the argument that "in the event of ambiguity [in a funding condition]…we defer to a reasonable interpretation by the agency, as if we were interpreting a statute which has no implications for the balance of power between the Federal Government and the States." 106 F.3d at 567. The court explained that "[i]t is axiomatic that statutory ambiguity defeats altogether a claim by the Federal Government that Congress has unambiguously conditioned the States' receipt of federal monies in the manner asserted." *Id.*; *cf. Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 472–73 (2001) (rejecting the proposition that "an agency can cure an unlawful delegation of legislative power by adopting in its discretion a limiting construction of the statute").

Texas Education Agency also is consistent with the Supreme Court's Spending Clause precedents discussed above, which have consistently emphasized that it is *Congress's* duty to enact unambiguous conditions. *See, e.g.*, *Pennhurst*, 451 U.S. at 17 ("[I]f Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously."); *cf. Atascadero*, 473 U.S. at 243 ("Congress must express its intention to abrogate the Eleventh Amendment in unmistakable language in the statute itself."); *Dellmuth*, 491 U.S. at 230 ("Lest *Atascadero* be thought to contain any ambiguity, we reaffirm today that in this area of the law, evidence of congressional intent must be both unequivocal and textual."). Permitting Congress to rely on agencies to provide the necessary clarity

would defeat one purpose of the clear statement rule—ensuring "that *Congress* has…intentionally legislated on the matter." *Sossamon v. Texas*, 563 U.S. 277, 284–91 (2011) (emphasis added). Indeed, in *Rowley*, the Court rejected the claim that courts and hearing officers could "give content to the requirement of an 'appropriate education'" under IDEA, explaining that this position was "contrary to the fundamental proposition that Congress, when exercising its spending power, can impose no burden upon the States unless it does so unambiguously." 458 U.S. at 190 n.11.

Allowing agencies to provide the necessary clarity also would contradict the principle that, "[b]y insisting that Congress speak with a clear voice, we enable the States to exercise their choice knowingly." *Pennhurst*, 451 U.S. at 17. Implementing regulations are often issued *after* States have decided to participate in a federal program. *See, e.g.*, *Ohio*, 547 F. Supp. 3d at 739 ("Under ARPA as written, though, States were authorized to send in certifications immediately upon the effective date of the Act. That is strong evidence that Congress considered the terms of the deal to be complete as of that date."). Regulations also are subject to change with little or no notice. *See* 5 U.S.C. § 553(a) & (b) (listing exceptions to notice and comment). Indeed, Treasury claims that the Final Rule here was exempt from notice and comment as a "matter relating to agency…grants" and for "good cause." 87 Fed. Reg. at 4445 (quoting 5 U.S.C. § 553). In Treasury's apparent view, it may unilaterally rewrite States' obligations under the Tax Mandate at the drop of a hat. Whether or not that position is consistent with the Administrative Procedure Act, it underscores that agency

rulemaking cannot backfill Congress's failure to enact unambiguous and durable conditions on States' receipt of federal funds.

B. Treasury's Final Rule Only Reinforces the Tax Mandate's Fundamental Vagueness

Treasury's Final Rule only reinforces the ambiguity of the Tax Mandate and the broad scope of its unprecedented arrogation of State power. The Final Rule is 117 pages long and, among other things, codifies 31 C.F.R. § 35.8 in an attempt to clarify the Tax Mandate. Section 35.8 itself is a page, and the preamble to the Final Rule spends seven pages failing to explain it. Despite answering some questions at the margins, the Final Rule leaves crucial questions unanswered, and ultimately raises more questions than it answers.

By specifying several major components of the Tax Mandate, the Final Rule highlights the statute's fundamental vagueness. For example, the Final Rule provides a baseline for measuring a reduction in tax revenue. 31 C.F.R. § 35.3 ("Baseline means tax revenue of the recipient for its fiscal year ending in 2019, adjusted for inflation in each reporting year using the Bureau of Economic Analysis's Implicit Price Deflator for the gross domestic product of the United States."). The Final Rule also specifies that a reduction in net tax revenue should be based on actual, not expected, tax revenue, as measured at the end of the tax year. 31 C.F.R. § 35.8(b)(3). Of course, neither provision has any grounding in the statute, which is silent on these major issues.

Worse, the provisions' focus on *actual* revenue measured at the *end* of the tax year generates additional uncertainty. States must make tax and spending

decisions at the *beginning* of the fiscal year based on *estimated* revenue. Recognizing the problem, Treasury codified an atextual "de minimis" exception for a reduction in net tax revenue, calculated at 1 percent of the baseline. 31 C.F.R. § 35.8(b)(2). Treasury explained that the 1 percent level was chosen because it "reflects the historical reductions in revenue due to minor changes in state fiscal policies." 87 Fed. Reg. at 4427. But nobody knows, or even has a way of knowing, whether the de minimis exception will assist States facing historic inflation and a looming recession. Moreover, the need for this *ad hoc* exception to the Tax Mandate confirms the lack of clarity as to how States can actually comply with the Tax Mandate.

The Final Rule also raises additional questions about the scope of the Tax Mandate. For example, the Final Rule suggests that, but does not definitively resolve whether, the Tax Mandate's reference to "a change in law, regulation, or administrative interpretation" covers *any* change that reduces tax revenue—including exercises of the State's police power—and not just actions like tax cuts. *See, e.g.*, 87 Fed. Reg. at 4424 ("The offset provision is triggered by a reduction in net tax revenue resulting from 'a change in law, regulation, or administrative interpretation.'"); *id.* at 4423 ("[E]ach year, each recipient government will identify and value the changes in law, regulation, or interpretation that would result in a reduction in net tax revenue."); *but see id.* at 4424 ("[T]he offset provision prevents a recipient government from using SLFRF [*i.e.*, ARPA-provided] funds to offset a revenue reduction resulting from a tax cut."). The Final Rule also indicates that State governments may be responsible for such "covered changes"

adopted by local governments, without explaining the circumstances under which States might be liable for local changes, such as whether States would be liable only if they directed the change. *Id.* at 4425 ("[A] recipient government may make a covered change through its legislature or may delegate the authority to make a covered change including, but not limited to, to a sub-unit of government."). This suggests that the Tax Mandate, as construed in the Final Rule, would not only override federal–state relations but also State laws devolving authority to local governments. It would be difficult to contrive a greater intrusion on State sovereignty.

Treasury also refused in the Final Rule to clearly answer questions about "whether covered changes must be broad-based policies or whether administrative decisions applicable to individuals would be considered covered changes." 87 Fed. Reg. at 4425. Treasury's response suggests that an administrative decision applicable to *just one taxpayer* could constitute a covered change, but ultimately begs the question: "With respect to the question of whether covered changes could include administrative decisions applicable to individuals, as discussed above, a covered change includes a change in law, regulation, or administrative interpretation that reduces any tax. Such changes may apply to one or more individuals or entities, provided that—consistent with the statutory text—they result from a change in law, regulation, or administrative interpretation." *Id.* Treasury's response that an administrative decision applicable to one individual is a covered change if it "result[s] from a change in law, regulation, or

administrative interpretation" (*i.e.*, a covered change) is equivalent to saying that a decision is a covered change if it is a covered change.

Adding to the confusion, the Final Rule's preamble contains an exception to its definition of "covered change" that appears in neither the Tax Mandate nor the regulatory text. It states that Treasury will not treat changes in law, regulation, or administrative interpretation that "simply conform with recent changes in federal law, such as those to conform to recent changes in federal taxation of unemployment insurance benefits and taxation of loan forgiveness under the Paycheck Protection Program," as "covered changes." *Id.* at 4425.[7] These examples of "conforming" changes suggest that the exception broadly covers any response to a change in federal law, even if it is not *required* by federal law. The reason for this exception appears to be that Treasury does not want the Tax Mandate to deter States from adopting changes that Treasury approves of, as the Tax Mandate does to all other changes. Yet it is unclear how far this exception extends, such as whether it would include a State that enacts a tax cut for the Biden Administration's recent executive action on loan forgiveness. Conversely, it is unclear whether Treasury would view a State that decides to *tax* such loan forgiveness as having enacted a "conforming" change. And if that decision is a "conforming" change and not a "covered change," does that mean the expected increase in tax revenue cannot be used by the State to offset other

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[7] Treasury announced this exception in a press release in April 2021. U.S. Dep't of Treasury, Press Release, Statement on State Fiscal Recovery Funds and Tax Conformity (Apr. 7, 2021), *available at* https://home.treasury.gov/news/press-releases/jy0113. The Final Rule inexplicably fails to codify this exception.

tax decreases? *See* 31 C.F.R. § 31.8(b)(4)(i) (stating that reductions in tax revenue can be offset by "expected increases in tax revenue caused by one or more *covered changes*" (emphasis added)).

Unsurprisingly, the Final Rule also fails to offer any definition of a "direct" versus an "indirect" offset. *See West Virginia*, 571 F. Supp. 3d at 1255 ("[T]he Final Rule still fails to define how a State 'indirectly offsets' spending cuts with ARPA funds."). If anything, the Final Rule's focus on ascertaining compliance with the Tax Mandate through an objective, bean-counting process, *see* 31 C.F.R. § 35.8, threatens to expand the Tax Mandate beyond what anyone could have contemplated. For example, consider a Governor who campaigns and wins on the promise—regardless of ARPA—to reduce unemployment benefits and commensurately decrease taxes. Because this is something the State would have done regardless of ARPA, it would be difficult to say that the State is "using" ARPA funds to offset the tax cuts. But, unless this plan were set in stone prior to the beginning of the "covered period" (March 3, 2021), the Final Rule might prohibit it. *See* 31 C.F.R. § 35.3 ("A change in law includes any final legislative or regulatory action, a new or changed administrative interpretation, and the phase-in or taking effect of any statute or rule if the phase-in or taking effect was not prescribed prior to the start of the covered period.").

The Final Rule seems to artificially limit the ways in which States can "pay for" a covered change, such that they will not be considered to have impermissibly used ARPA funds to offset the change. Specifically, the Final Rule notes that "three sources of funds that may offset a reduction in net tax revenue

other than SLFRF funds: Organic revenue growth, increases in revenue due to policy changes (*e.g.*, an increase in a tax rate), and certain cuts in spending." 87 Fed. Reg. at 4423. This inexplicably excludes issuing debt or drawing on a rainy-day fund. Moreover, the Final Rule prohibits States from paying for a tax cut based on the "macroeconomic growth" that the tax cut might foster and resulting increase in tax revenue. 31 C.F.R. § 35.8(b)(1). But consider a State that enacts a tax cut based on a forecast that the cut will increase tax revenue and, in fact, achieves the projected economic and revenue growth. The Final Rule would nevertheless appear to count this as a "covered change" that reduced tax revenue.

Finally, the Final Rule generates additional uncertainty by prohibiting States from paying for a "covered change" by cutting spending in "areas" where ARPA funds are used. It specifies that, "[i]f the recipient government has not spent SLFRF funds in a department, agency, or authority, the full amount of the reduction in spending counts as a covered spending cut, up to the recipient government's net reduction in total spending." 87 Fed. Reg. at 4427. But "[i]f they have spent SLFRF funds in such department, agency, or authority, the SLFRF funds generally would be deemed to have replaced the amount of spending cut and only reductions in spending above the amount of SLFRF funds spent on the department, agency, or authority would count." *Id.* So what spending cuts count to offset tax reductions is gerrymandered based on whether a given State department or agency used ARPA funds in any of its programs. The Final Rule provides no definition of "authority"—whether it means an appropriation, budget

line item, statutory authority, program, or an entity akin to a department or agency is anyone's guess. Nor does the Final Rule specify whether the "or" in "department, agency, or authority" is disjunctive or conjunctive. For example, if a State appropriated ARPA funds to the State Department of Agriculture to vaccinate migrant farmworkers, it is unclear whether the Final Rule would prohibit reductions in spending only as to the migrant farmworker program or spending reductions in *any* program run by the department. This question is significant. Texas has appropriated ARPA funds to over *twenty* State departments and agencies, but it generally directs the funding to specific programs within each agency. *See* S.B. No. 8 (2021). Interpreting the Tax Mandate to prohibit reductions in spending within the entirety of each agency that receives ARPA funds effectively requires Texas to freeze its budget through 2026.[8] *See West Virginia*, 571 F. Supp. 3d at 1255 ("[D]ue to the breadth with which ARPA funds can be used, few 'areas' of State spending will be suitable candidates for spending cuts that could offset a decrease in revenue.").

Put simply, the Final Rule confirms the overwhelming sweep and ambiguity of the Tax Mandate. It establishes a proto-receivership under which State governments and their budget offices are mere functionaries reporting to their

[8] *See* 42 U.S.C. § 802(g) (defining "covered period" to begin on March 3, 2021, and end "on the last day of the fiscal year…in which all funds received by the State, territory, or Tribal government from a payment made under this section or a transfer made under section 803(c)(4) of this title have been expended or returned to, or recovered by, the Secretary"); 31 C.F.R. § 35.5(c) (providing that funds must be spent by December 31, 2026).

federal superintendent. It requires States to quantify every policy decision that they make, and then identify an offset for any decisions that reduce revenue to the satisfaction of the Treasury Department. And, despite all that, it indicates that the Treasury will be monitoring the States and—at its discretion—may determine that an unsuspecting State is evading the restrictions and seek recoupment of funds, notwithstanding compliance with the onerous procedures it has put in place.

Conclusion

The judgment of the district court should be affirmed.

Dated: October 31, 2022

/s/ Andrew M. Grossman

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Certificate of Compliance

I hereby certify that the foregoing complies with the length limitations of Fed. R. App. P. ("Rule") 32(a)(7)(B) because it is 6,473 words, excluding the parts that are exempted under Rule 32(f). It complies with the typeface and type-style requirements of Rule 32(a)(5) and Rule 32(a)(6) because it is printed in 14-point Calisto MT font, a proportionally spaced typeface with serifs.

Dated: October 31, 2022

/s/ Andrew M. Grossman
ANDREW M. GROSSMAN

Certificate of Service

I hereby certify that on October 31, 2022, a true and correct copy of the foregoing was filed via the Court's CM/ECF system and served via electronic filing upon all counsel of record in this case.

Dated: October 31, 2022

/s/ Andrew M. Grossman
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