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UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA

State of Arizona,

Plaintiff,

v.

Janet Yellen, in her official capacity as Secretary of the Treasury, *et al.*,

Defendants.

Case No. 2:21-cv-00514-DJH

Related case: 2:22-cv-00112-SPL

MOTION TO TRANSFER

Defendants Janet Yellen (in her official capacity Secretary of the Treasury), Richard K. Delmar (in his official capacity as Acting Inspector General of the Department of Treasury), and the U.S. Department of Treasury respectfully request the Court enter an order transferring *Ducey v. Yellen*, 2:22-cv-00112, to the Honorable Diane J. Humetewa under Local Rule 42.1 because it is related to a previously filed case (*Arizona v. Yellen*, 2:21-cv-00514-DJH) also arising under the American Rescue Plan Act ("Rescue Plan" or "Act").

On March 11, 2021, Congress enacted the Rescue Plan. *See* Pub. L. No. 117-2, § 9901(a) (codified at 42 U.S.C. §§ 802–805). The Act establishes a "Coronavirus State Fiscal Recovery Fund," allocating nearly $200 billion for the States and the District of Columbia to "mitigate the fiscal effects" of the pandemic. 42 U.S.C. § 802(a)(1); *id.* § 802(b)(3)(A). Congress gave States considerable flexibility to use these new federal funds, which may be directed to a broad variety of state efforts to respond to the pandemic and to its economic effects, including by funding state-level government services and by providing assistance to households, small businesses, and industries. *Id.* § 802(c). To ensure that the new federal funds would be used for the broad categories of state expenditures it identified, Congress specified that States cannot use the federal funds to offset a reduction in net tax revenue resulting from changes in state law. *Id.* § 802(c)(2)(A) (the "offset provision").

Both *Ducey v. Yellen* and *Arizona v. Yellen* should be related and *Ducey v. Yellen* should be transferred to Judge Humetewa under Local Rule 42.1. That rule provides for case transfer when two or more cases "(1) arise from substantially the same transaction or event"; "(2) involve substantially the same parties or property"; "(3) involve the same patent, trademark, or copyright"; "(4) call for determination of substantially the same questions of law"; or "(5) for any other reason would entail substantial duplication of labor if heard by different Judges." LRCiv 42.1(a). Here, both cases involve substantially the same parties, arise from

the Rescue Plan, call for a determination of similar legal issues, and would advance judicial economy if they were related.

For starters, both *Ducey v. Yellen* and *Arizona v. Yellen* "involve substantially the same parties." LRCiv 42.1(a). The defendants in both cases—the Secretary of the Treasury, the Acting Inspector General of the Treasury Department, and the Treasury Department itself—are identical. *See* Ex. 1, Arizona Compl. ¶¶ 15–17; Ex. 2, Ducey Compl. ¶¶ 12–14. And while the plaintiff in both cases is not identical—the State of Arizona and the Governor of Arizona—they both represent Arizona in an official and sovereign capacity. *See Grand Canyon Skywalk Dev., LLC v. Sa Nyu Wa, Inc.*, 2012 WL 6101901, at *3 (D. Ariz. Nov. 21, 2012) (finding substantially the same parties, despite an additional twelve Tribal Council defendants in one case, because "the pleadings largely treat the council members as surrogates for the Tribe or Tribal Council"). So the two cases "involve substantially the same parties" and should be related for that reason alone.[1]

But the overlap does not stop there. Both cases stem from the Rescue Plan and involve similar legal issues, so they both "arise from substantially the same transaction or event" and "call for determination of substantially the same questions of law." LRCiv 42.1(a). The previously filed case, *Arizona v. Yellen*, asked the Court to interpret the Rescue Plan's permissible and impermissible uses in 42 U.S.C. § 802(c) and determine whether (a) Arizona had standing to raise a challenge to that section, and (b) if so, whether the offset provision violated the Spending Clause. *See Arizona v. Yellen*, --- F. Supp. 3d ---, 2021 WL 3089103 (D.

[1] Because the triggering conditions in Local Rule 42.1(a) are enumerated in a list where the last condition is preceded by an "or," the conditions are considered disjunctive and the satisfaction of any one condition would be enough to relate two cases. *See United States v. Woods*, 571 U.S. 31, 45 (2013) (explaining that when "the operative terms are connected by the conjunction 'or,'" as in Local Rule 42.1, "its ordinary use is almost always disjunctive"); *cf. Rose v. U.S. Postal Service*, 774 F.2d 1355, 1360–61 n. 14 (9th Cir. 1984) (finding disjunctive a statute containing a list of offenses whose last two items are separated by an "or").

Ariz. July 22, 2021). Similarly, *Ducey v. Yellen* asks the Court to interpret the Rescue Plan's permissible and impermissible uses in 42 U.S.C. § 802(c) and determine whether (a) the Governor has standing to raise a challenge under that section, and (b) if so, whether Treasury had the authority to issue, and potentially enforce, regulations about those uses, including under the Spending Clause. *See* Ex. 2, Ducey Compl. ¶¶ 72–105. So both cases "arise from substantially the same . . . event"—the Rescue Plan—and "call for determination of substantially the same questions of law." LRCiv 42.1(a).

With such a substantial overlap in parties and legal issues, there can be little doubt that relating these two cases under *Arizona v. Yellen* will advance judicial economy. Judge Humetewa is intimately familiar with the Rescue Plan, Treasury's authority under that statutory scheme, and attendant standing and Spending Clause issues in this context. *See, e.g.*, *Arizona v. Yellen*, 2021 WL 3089103, at *2–6; *id.* at *4 (analyzing whether "it is within the Secretary's power, under ARPA, to request that Arizona identify funds used to offset tax changes, which is one of ARPA's conditions"). There is no reason for Judge Logan to engage in a "duplication of labor" to do the same. LRCiv 42.1(a)(5); *Garcia v. Army*, 2015 WL 5646640, at *2 (D. Ariz. Sept. 25, 2015) (granting motion to transfer where the judge "ha[d] developed familiarity with the issues involved in the cases"). Nor is there any reason to risk inconsistent rulings between the two cases. *See Caron v. Caesars Ent. Corp.*, 2020 WL 1323105, at *2 (D. Ariz. Mar. 20, 2020) (granting motion to transfer where "transfer and consolidation will avoid the potential of inconsistent outcomes"). Defendants therefore respectfully request that *Ducey v. Yellen* be transferred to Judge Humetewa as a related case to *Arizona v. Yellen*.

DATED: February 1, 2022

Respectfully submitted,

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Exhibit 1

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UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA

STATE OF ARIZONA, Plaintiff, 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 Treasury; and U.S. DEPARTMENT OF THE TREASURY; Defendants.	No. **COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF**

INTRODUCTION

1. This is a constitutional challenge to a provision in the American Rescue Plan Act of 2021 (the "Act"). Specifically, a component of Section 9901 of the Act (hereinafter, the "Tax Mandate") forbids States from using COVID-19 relief funds to "directly or indirectly offset a reduction in … net tax revenue" resulting from state laws or regulations that reduce tax burdens—whether by cutting rates or by giving rebates, deductions, credits, "or otherwise." This Tax Mandate is plainly unconstitutional, either because: (1) it is too ambiguous to satisfy the constitutional requirements for Congress placing conditions on the States under the Spending Clause or (2) it represents an unprecedented and unconstitutional intrusion on the separate sovereignty of the States through federal usurpation of one half of the State's fiscal ledgers—control of their revenues.

2. The actual effect of the Tax Mandate remarkably appears to depend on who is asked. The principal proponent of the provision, Senator Manchin—who insisted upon its inclusion as a condition for his support and provided the decisive vote without which the Act would not have passed—intended (and believed) that the Tax Mandate enacts a blanket prohibition forbidding States from cutting taxes in any manner whatsoever through 2024. The New York Times, for example, reports that Senator Manchin "argue[s] that states should not be cutting taxes at a time when they need more money to combat the virus. He urged states to postpone their plans to cut taxes."[1] That result appears to follow from the fungibility of money and the Tax Mandate's broad ban on using funds "directly *or indirectly* [to] offset" tax cuts.[2]

[1] Alan Rappeport, *A Last-Minute Add to Stimulus Bill Could Restrict State Tax Cuts*, N.Y. Times (March 12, 2021), https://www.nytimes.com/2021/03/12/us/politics/biden-stimulus-state-tax-cuts.html.

[2] American Rescue Plan Act of 2021, Pub. L. No. 117-2 (2021), *available at* https://www.congress.gov/bill/117th-congress/house-bill/1319/text (emphasis added).

3. By contrast, the U.S. Department of Treasury ("Department"), a Defendant here, disagrees. The Department appears to believe that the Tax Mandate only prevents the States from using the funds provided by the Act specifically to fund tax cuts, but does not prevent the States from otherwise cutting taxes as long as they do not explicitly designate moneys appropriated by the Act as the funding source. Under that view, the Tax Mandate seemingly regulates speech more than taxation: *i.e.*, "Just don't *say* you are using these moneys to cut taxes." A Department spokesman told the Associated Press on or before March 18 that the "[S]tates are free to make policy decisions to cut taxes – they just cannot use the pandemic relief funds to pay for those tax cuts."[3] The Treasury Department eventually told the States the same essential message directly in a March 23, 2021 letter, which stated "the limitation in the Act is not implicated" if "States lower certain taxes but do not use the funds under the Act to offset those cuts."

4. These divergent views—which exist even amongst Congressional Democrats who passed the Act and the Administration of the President that signed the Act into law, to say nothing about non-aligned parties—underscore the palpable ambiguity in the Tax Mandate. The fact that those politically allied to enact the Act *cannot even agree with each other* as to what the Tax Mandate means provides powerful evidence that it is subject to multiple potential interpretations. Indeed, the language of the Tax Mandate is patently ambiguous, and even borderline incoherent.

5. This ambiguity alone renders the Tax Mandate unconstitutional. "[I]f Congress desires to condition the States' receipt of federal funds, it 'must do so unambiguously.'" *South Dakota v. Dole*, 483 U.S. 203, 207 (1987) (quoting *Pennhurst State School and Hospital v. Halderman*, 451 U.S. 1, 17 (1981) (identifying this

[3] *See* Laura Davison, *Treasury Clears States to Cut Taxes -- But Not With Stimulus*, Bloomberg (March 18, 2021), https://www.bloomberg.com/news/articles/2021-03-18/u-s-states-approved-to-cut-taxes-but-not-with-federal-money.

requirement as one amongst multiple constitutional requirements). The inability of even the Act's supporters to agree about what the Tax Mandate actually means is sufficient to demonstrate that the provision cannot satisfy this *Dole*/*Pennhurst* requirement.

6. Conversely if the Act actually prohibits the States from engaging in any form of tax relief—an interpretation that the Tax Mandate's text is susceptible to and what Senator Manchin seemingly intended, without whose vote the Act would never have become law—it is an unconstitutional intrusion upon the sovereignty of the States. Indeed, it would violate constitutional constraints on Congress's Spending Clause power for three reasons.

7. *First*, the Tax Mandate is unrelated to the federal interest in the national program advanced in the Act. The ostensible purpose of the Act is to assist states in responding to the economic impact of the COVID-19 pandemic. But in prohibiting states from making any tax reduction, no matter the justification for the change, possibly years after the impact of the pandemic has dissipated, Congress goes too far in attaching conditions insufficiently related to the asserted federal interest. *See Dole*, 483 U.S. at 208.

8. *Second*, the Tax Mandate asks the states to sell out key aspects of their sovereignty, and thus induces the states to engage in unconstitutional activities. *Id.* at 210. A fundamental part of the structure of the U.S. Constitution is its establishment of *separate* federal and state sovereigns: "The federal system rests on what might at first seem a counterintuitive insight, that 'freedom is enhanced by the creation of two governments, not one.'" *Bond v. United States*, 564 U.S. 211, 220-21 (2011) (citation omitted). "For this reason, 'the Constitution has never been understood to confer upon Congress the ability to require the States to govern according to Congress' instructions.' Otherwise the two-government system established by the Framers would give way to a system that vests power in one central government, and individual liberty would suffer." *See National Fed'n of Indep. Bus. v. Sebelius ("NFIB"),* 567 U.S. 519, 582 (2012)

(opinion of Roberts, C.J.) (quoting *New York v. United States*, 505 U.S. 144, 162 (1992) (citation omitted)).

9. Under the broad/Machin reading, the Tax Mandate does precisely this: it attempts to eviscerate the federal structure of the Constitution by collapsing a system of dual sovereigns, each with their own taxing authority, into a system where Congress—and *Congress alone*—has authority to set tax policy. For 2021-24, if voters wish to elect officials to lower their tax burdens, their votes for state elected officials are effectively worthless: only Congress would have the power to lower their taxes, either by reducing federal taxes or amending the Act to restore to the States power to set their own tax policies. Because the Tax Mandate attempts to "vest[] power in one central government, … individual liberty would suffer" if it is not enjoined. *NFIB,* 567 U.S. 519, 582

10. *Third*, Congress cannot use its power under the Spending Clause to "coerce" the states into adopting a preferred policy. *See id.* at 582. "[E]conomic dragooning that leaves the States with no real option but to acquiesce" crosses the line from permissible persuasion to impermissible coercion and effectively amounts to unconstitutional commandeering of state sovereignty. *Id.*

11. The Tax Mandate crosses this line. It offers an enormous amount of money to the States—for Arizona, a total amount that is about 40% of its general fund budget—at a time when that budget is strained by the ravages of a once-in-a-century pandemic. Indeed, addressing the financial straits of the States is Congress's explicit motivation for this third wave of stimulus aid. In this context, the Act presents the States with effective offers-they-can't-refuse.

12. Arizona needs clarity on the legality and meaning of this provision. Policymakers in the state have real and present interest in tax policy which could potentially decrease net tax revenue against some baselines. Those policymakers need to know how their decisions could interact with their use of funds under the Act.

13. Whether the Act is too ambiguous to carry out its patron's desired intent or actually unambiguously provides for a result that is patently unconstitutional—the result is the same: the Tax Mandate cannot stand. Its violations of the Constitution are patent, and Arizona is entitled to relief preventing Defendants from employing the Act to prohibit it from providing tax relief for their citizens with funds not derived from the Act.

PARTIES

14. Plaintiff State of Arizona is a sovereign state of the United States of America. The Attorney General is the chief legal officer of the State of Arizona and has the authority to represent the State in federal court.

15. Defendant Janet L. Yellen is the Secretary of the Treasury and is named in her official capacity.

16. Defendant Richard K. Delmar is the Acting Inspector General of the Department of the Treasury and is named in his official capacity. On information and belief, the Inspector General is responsible for monitoring and oversight of existing coronavirus relief funds to the States, and is generally responsible for informing the Secretary of the Treasury about programs administered by the Department and advising on the necessity for corrective action.

17. Defendant the Department of the Treasury is an agency of the United States.

JURISDICTION AND VENUE

18. This Court has jurisdiction under 28 U.S.C. §§ 1331, 1346, and §§ 2201-02.

19. Venue is proper within this federal District pursuant to 28 U.S.C. § 1391(e) because (1) Plaintiff Arizona resides in this District and no real property is involved and (2) a "substantial part of the events and omissions giving rise to the claim occurred" in this District—*i.e.*, the injury to the state's sovereign interests and the state's management of its fiscal affairs.

20. Arizona has standing to challenge the Tax Mandate and to seek declaratory and injunctive relief. The Tax Mandate injures the State in several ways. Two stand out. *First*, the Tax Mandate directly threatens Arizona's sovereign interests, including its ability to "exercise … sovereign power over individuals and entities within the relevant jurisdiction—[which] involves the power to create and enforce a legal code, both civil and criminal." *Alfred L. Snapp & Son, Inc. v. Puerto Rico, ex rel., Barez*, 458 U.S. 592, 601 (1982). By diminishing the State's power to tax its residents as it sees fit, the Tax Mandate necessarily and gravely injures Arizona's sovereign interests.

21. *Second*, the Tax Mandate harms Arizona's interest in "securing observance of the terms under which it participates in the federal system." *Id.* at 607-08 (1982). The Tax Mandate specifically attacks those terms and affects the State's sovereign power within the system.

22. In addition, the Tax Mandate is harming Arizona's ability to govern itself effectively right now. Because the Tax Mandate fails to speak clearly as to the scope of its prohibition, Arizona policy makers are unable to engage in informed decision-making on whether to accept the funds offered by the Act and how to structure their conduct afterwards. Furthermore, by unconstitutionally limiting the ability of Arizona officials to manage a full one-half of the fiscal ledger, and by subjecting the state to the risk that it may be made to return funding to the federal government, Arizona and its residents are directly harmed.

THE ACT AND ITS TAX MANDATE

23. The Act was passed by the House and Senate by votes of 219-212 and 50-49, respectively. *See* H.R. 1319, American Rescue Plan Act of 2021, *Actions*, *available at* https://www.congress.gov/bill/117th-congress/house-bill/1319/actions.

24. On March 11, 2021, President Biden signed the American Rescue Plan Act into law. *See* American Rescue Plan Act of 2021, Pub. L. No. 117-2 (2021), *available at* https://www.congress.gov/bill/117th-congress/house-bill/1319/text.

25. The Act includes $195.3 billion in aid to make payments to each of the 50 states and the District of Columbia. *See id.* § 9901 (adding § 602(b)(3)(A) to the Social Security Act ("SSA")). Of that $195.3 billion, $25.5 billion is allocated equally among the states and the District of Columbia. The remainder, minus a fixed sum to be allocated to District of Columbia, is to be allocated in an amount proportional to the average estimated number of seasonally adjusted unemployed individuals in each state during the period of the three months ending in December 2020. *Id.* (adding § 602(b)(3)(B) to the SSA).

26. Under this formula, Arizona is expected to receive approximately $4.7 billion. *See* Jared Walczak, *State Aid in American Rescue Plan Act is 116 Times States' Revenue Losses*, TAX FOUNDATION (Mar. 3, 2021), https://taxfoundation.org/state-and-local-aid-american-rescue-plan/

27. These funds are to remain available until December 31, 2024. *See* American Rescue Plan Act, American Rescue Plan Act of 2021, Pub. L. No. 117-2 § 9901 (2021).

28. The Act provides several permissible uses of the funds, including to "respond to the public health emergency with respect to the Coronavirus Disease 2019 (COVID–19) or its negative economic impacts, including assistance to households, small businesses, and nonprofits, or aid to impacted industries such as tourism, travel, and hospitality" and to "make necessary investments in water, sewer, or broadband infrastructure." *Id.* (adding § 602(c)(1) to the SSA).

29. The Act also provides that "No State or territory may use funds made available under this section for deposit into any pension fund." *Id.* (adding § 602(c)(2)(B) to the SSA).

30. The Tax Mandate, in the same section of the Act, provides: "A State or territory shall not use the funds provided under this section or transferred pursuant to section 603(c)(4) 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." *Id.* (adding § 602(c)(2)(A) to the SSA).

31. If a state violates the Tax Mandate, the Act provides that such state "shall be required to repay to the Secretary" the lesser of either the applicable reduction in tax revenue or the total amount of funds received by the state. *Id.* (adding § 602(e) to the SSA).

32. The Act provides no process for a State to dispute or contest an alleged violation of the Tax Mandate.

33. The Act gives the Secretary authority "to issue such regulations as may be necessary or appropriate to carry out this section." *Id.* (adding § 602(f) to the SSA).

34. The Tax Mandate does not explain or define the terms "indirectly offset," "reduction in net tax revenue," or provide any additional clarity regarding which tax policies could lead to recoupment by the Secretary.

FACTUAL ALLEGATIONS

35. The coronavirus pandemic drastically damaged the national economy, leading to all states experiencing some sort of slowdown and impairing their ability to support needed programs and stimulus for their local economies.

36. Meanwhile, demand for certain state services has increased, such as Medicaid and unemployment insurance.

37. After Arizona was forced by COVID-19 to shut down portions of the state's economy, revenue the second quarter of calendar year 2020 (*i.e.*, the end of Fiscal Year 2020) came in well below projections. The State then forecast a budget deficit of between $600M to $1.1B for Fiscal Year 2021 (July 1, 2020 to June 30, 2021). However, due to shifts in consumer behavior, revenue for Fiscal Year 2021 has come in $1B over the projection and the State now has an estimated surplus in terms of state revenues specifically.

38. In order to improve Arizona's economy and stimulate demand, and to assist struggling businesses and individuals trying to make ends meet, state policymakers in Arizona may desire to reduce their tax rates. Arizona's Governor specifically proposed an income tax cut before the Act was enacted, which its Legislature is presently considering. The Arizona Legislature is not a full-time body but is currently in session. It must finalize a budget before it adjourns for the year and before the State's new fiscal year begins on July 1, 2021.

39. The Tax Mandate threatens these plans and is casting uncertainty over tax policy in the States, creating the concern that any policy changes in state taxation could lead to recoupment if the States accept funds under the Act.

40. The amount of moneys allocated to the States is quite large relative to state budgets: Arizona has an annual budget of around $12.4 billion from its general fund, and the total moneys from the State Recovery Fund are anticipated to be $4.7 billion—about 40 percent of one year's general fund budget.

41. This large sum of money effectively presents each of the States, including Arizona, with an "offer it cannot refuse." In particular, the States are in no position to

turn down the federal government's offer given their financial situations, which have been significantly strained by the Covid-19 pandemic.

42. Notably, there is no indication that Congress ever contemplated that any State would refuse funds under the Act, and instead every indication that Congress simply assumed—almost certainly correctly—that the inherent coercion of the Act would induce all of the States to accept the Tax Mandate with all of its attending infringement on their sovereign authority.

43. The Tax Mandate, under its broad reading, also would dramatically undermine democratic accountability. Take, for example, candidates for state legislatures that categorically oppose all tax cuts. That unpopular position might easily cost them votes. But the Tax Mandate lets them duck accountability and claim that their opposition to tax cuts is based on their illegality under federal law. Similarly, candidates that favor tax cuts may not be able to run effectively on that platform as voters may correctly recognize that electing such candidates is unlikely to delivery any actual state tax relief, since the Tax Mandate may simply invalidate them or make them too costly to enact.

44. Similarly, the Tax Mandate may undermine democratic accountability by empowering current governors in ways that violate separation of powers and/or democratic principles. For example, current governors appear to be permitted to accept funds under the Act, and thereby bind their successors elected in 2021, 2022, or 2023, to the Tax Mandate. Similarly, current governors may undermine the authority of their legislatures over fiscal manners by accepting funds under the Act.

45. The Tax Mandate also drastically injures the sovereignty of the States. For example, pre-Tax Mandate the States—like all sovereign governments with independent fiscal authority—could engage in macroeconomic stimulus in two broad ways: (1) spending additional moneys or (2) cutting taxes. But the Tax Mandate effectively strips the States of half of that power, and reflects Congress's apparent judgment that the

only appropriate stimulus measures for the States is spending more money. That judgment is particularly bizarre as Congress itself enacted a variety of stimulative tax-cutting measures in the Act. But Congress apparently wishes to reserve purely to the federal government the power to engage in macroeconomic stimulus through tax cuts and strip the States of that sovereign authority. Under the Act and its Tax Mandate, Congress has effectively told the States: "Tax cuts for me, but not for thee." But the Constitution does not permit Congress to place the States in such a demeaned and subservient position.

46. Because of the potential injuries that the Tax Mandate would cause Arizona, the Arizona Attorney General sent a letter to Secretary Yellen along with 20 other state attorneys general on March 16, 2021. A copy of that letter is attached as Exhibit A.

47. That letter posed many specific examples and asked the Secretary to explain whether the Tax Mandate would prohibit specific actions. *See* Exhibit A at 3-4.

48. Secretary Yellen wrote the state attorneys general a letter in response on March 23, 2021. A copy of that letter is attached as Exhibit B.

49. Secretary Yellen's letter appears to tell the state attorneys general what she told the press five days prior: she is essentially disavowing the broad interpretation of Senator Manchin and other Senators. Instead, Secretary Yellen argued that the Tax Mandate "simply provides that funding received under the Act may not be used to offset a reduction in net tax revenue resulting from certain changes in state law." Ex. B at 1. "If States lower certain taxes but do not use funds under the Act to offset those cuts—for example, by replacing the lost revenue through other means—the limitation in the Act is not implicated." *Id.* The letter also promises "further guidance" but provides little additional information about that guidance. *Id.* at 1-2. The letter does not address the specific examples that the state attorneys general requested clarification upon. *Id.*

50. This dispute over the extent of the limitations in the Tax Mandate presents a present, justiciable, controversy. The response from the Department of the Treasury fails to provide Arizona policy makers with sufficient information and assurances to inform their decisions. Judicial resolution is required—and quickly—for Arizona to make informed decisions on tax policy as it recovers from the economic impacts of COVID-19.

CLAIMS FOR RELIEF

COUNT I

Violation of the Spending Clause – Ambiguous Condition

51. The allegations in the preceding paragraphs are reincorporated herein.

52. Article I of the U.S. Constitution enumerates the powers of Congress.

53. Article I, § 8, cl. 1 empowers Congress to "lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States."

54. While Congress may provide conditional grants to the states under the Spending Clause, those conditions are subject to several limitations, including that "if Congress desires to condition the States' receipt of federal funds, it 'must do so unambiguously.'" *Dole*, 483 U.S. at 207 (quoting *Pennhurst*, 451 U.S. at 17).

55. The Tax Mandate runs afoul of these requirements and thereby attaches unconstitutional strings to the state aid in the Act.

56. In particular, the Tax Mandate is ambiguous and fails to give the State clear notice of what it means to "indirectly offset a reduction in the net tax revenue" of the state.

57. The disagreement as to what the Tax Mandate means between its chief proponent and Defendants underscores the ambiguity inherent in its text.

58. The Department's inability or unwillingness to address the specific examples provided by the State's letter expeditiously supplies further evidence that the text of the Tax Mandate does not provide readily ascertainable answers.

59. The Tax Mandate creates very complicated issues as to what the proper baseline against which potential tax-cut measures are to be judged. Moreover, it appears to rely on unidentified balanced-budget or similar budgeting requirements (without which it is unclear why tax-revenue reductions would need to be "funded" with specific moneys at all).

60. Because the Tax Mandate is ambiguous, it is an unconstitutional attempt to place conditions upon the States.

61. No other enumerated power in the constitution entitles Congress to impose this condition.

COUNT II

Violation of The State's Sovereignty Under The Spending Clause, Tenth Amendment, Anti-Commandeering Principle, And Structure Of The Constitution

62. The allegations in the preceding paragraphs are reincorporated herein.

63. The Tenth Amendment states: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

64. As the Supreme Court has explained, "the Constitution has never been understood to confer upon Congress the ability to require the States to govern according to Congress' instructions." *New York v*, 505 U.S. at 162. This prohibition against commandeering state governments serves important values, such as safeguarding individual liberty and promoting political accountability. *See Murphy v. Nat'l Collegiate Athletic Ass'n*, 138 S. Ct. 1461, 1477 (2018).

65. If the Tax Mandate is not ambiguous, it prohibits the States from cutting taxes in essentially any manner. That result necessarily follows from the fungibility of money and the prohibition on relief funds to "directly *or indirectly* offset a reduction in … net tax revenue." So construed, the Tax Mandate is unconstitutional in at least three independent ways.

66. *First*, the Tax Mandate is unrelated to the asserted federal interest in the national program advanced in the Act. *See Dole*, 483 U.S. at 208. Congress can readily achieve its aims here without this severe intrusion upon state sovereignty. The Tax Mandate thus wildly exceeds any permissible nexus between the funds provided under the Act and conditions imposed upon the States.

67. *Second*, the Tax Mandate violates the Constitution by transgressing upon the fundamental federal character of the Constitution and represents an unconstitutional attempt by Congress to usurp the sovereign taxing powers of the States. Congress cannot employ its power under the Spending Clause to fundamentally subvert the federal nature of the Constitution. As the Supreme Court has explained, if such an attempt were to succeed, "individual liberty would suffer" in a manner that the Constitution prohibits. *New York*, 505 U.S. at 162.

68. *Third*, the size and nature of the aid in the Act combine with the conditions created by the pandemic to effectively coerce Plaintiffs and commandeer their taxing authority.

69. In the current challenging fiscal environment, Arizona has "no real choice," but to accept the $4.7 billion available through the American Rescue Plan Act. *NFIB*, 567 U.S. at 687. But accepting that money requires that the State sacrifice its sovereign power to set its own tax policy, since virtually any revenue-reducing measure would violate the Tax Mandate.

70. By coercing and commandeering the State's tax policy, the federal government has violated the Constitution, including the Tenth Amendment and the structural protections inherent in the Constitution. *See also Bond*, 564 U.S. at 226 ("Whether the Tenth Amendment is regarded as simply a truism or whether it has independent force of its own, the result here is the same." (cleaned up)).

PRAYER FOR RELIEF

Plaintiffs respectfully request that this Court enter judgment:

A. Declaring that the Tax Mandate is ambiguous and thus violates the Constitution;

B. Declaring that the Tax Mandate is in excess of Congress's powers enumerated in Article I and is thus unenforceable;

C. Declaring that the Tax Mandate violates the Tenth Amendment to the Constitution of the United States and/or the structural protections of the same and is thus unenforceable;

D. Enjoining the Defendants, and any other agency or employee of the United States, from recouping funds based on a violation of the Tax Mandate;

E. Enjoining the Defendants, and any other agency or employee of the United States, from otherwise enforcing the Tax Mandate against Plaintiffs;

F. Awarding Plaintiffs' reasonable costs and expenses of this action, including attorneys' fees; and

G. Awarding all other further relief to which Plaintiffs might be entitled.

MARK BRNOVICH
ATTORNEY GENERAL

By: /s/ Drew C. Ensign
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Exhibit 2

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IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ARIZONA

Douglas A. Ducey, Governor of the State of Arizona, in his official capacity,

Plaintiff,

v.

Janet Yellen, Secretary of the Treasury, in her official capacity; Richard K. Delmar, Acting Inspector General of the Department of Treasury, in his official capacity; and U.S. Department of the Treasury,

Defendants.

No.

Complaint for Declaratory and Injunctive Relief

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INTRODUCTION

"All legislative Powers herein granted shall be vested in a Congress of the United States…" U.S. Const. art. I, § 1.

1. The COVID-19 pandemic has created havoc in the lives of every citizen of our nation, and its biggest impact has been on our children. The loss of learning, socialization and opportunity has set our children back years, even with the great efforts made by parents and educators.

2. This is why the State of Arizona, through the Governor's Office, implemented programs in accordance with federal law and regulations, using funds appropriated to it by Congress, to bridge the gaps, get our children back in school and get them back on track academically.

3. Yet, following implementation of these programs, Arizona has been put on notice that funding, along with the children and parents it assists, will be held hostage if Arizona fails to bend to the arbitrary and capricious authority of a federal regulatory agency.

4. Douglas A. Ducey, Governor of the State of Arizona, cannot allow this action to stand without protest. The work of mitigating COVID-19 "belongs to state and local governments across the country and the peoples elected representatives in Congress." *Nat'l Fed'n of Indep. Bus. v. Dep't of Labor, Occupational Safety & Health Admin.*, 2022 WL 120952, at *3 (U.S. Jan. 13, 2022) (Gorsuch, J., concurring).

5. This case arises out of the U.S. Department of the Treasury ("Treasury") seeking to usurp Congressional power in the area of COVID-19 financial relief. Through its attempted legislative action, Treasury seeks to deprive the State of Arizona of millions of dollars in aid that Congress appropriated for the purpose of mitigating the negative economic impacts of the COVID-19 pandemic—monies that are critically needed to recover from the pandemic's effects on education, including the remote learning that disproportionately impacted low-income students. If these effects are not addressed, they will have long-term economic, educational and social, consequences.

6. The genesis of the dispute is Congress's passage of the American Rescue Plan

Act of 2021 ("ARPA"). Among other things, ARPA created the Coronavirus State and Local Fiscal Recovery Fund (the "SLFRF"). In the text of ARPA, Congress specifically described the permissible uses of SLFRF monies by States and also specifically described restrictions on such uses.

7. Initially, Treasury—which was tasked with distributing SLFRF monies and creating implementing regulations—correctly recognized that ARPA gave the States "*broad latitude* to choose whether and how to use the [SLFRF funds] to respond to and *address the negative economic impact*" of COVID-19. Coronavirus State and Local Fiscal Recovery Funds, 86 Fed. Reg. 26786, 26794 (May 17, 2021) (emphasis added). Treasury further recognized that one way for States to address the negative economic impact of COVID-19 would be through programs focused on the educational impacts of remote or hybrid learning, which disproportionately affected low-income and minority students.

8. In accordance with Treasury's statements, as well as the text of ARPA, Governor Ducey used some of the SLFRF monies to create two grant programs that addressed the long-term, negative economic impacts on disadvantaged communities from school closures and overbearing mask mandates. The programs empower parents and students to exercise their freedom to make informed decisions regarding their health and educational needs.

9. More recently, however, Treasury arbitrarily changed its guidance, and through a clear abuse of discretion, is seeking to unilaterally amend ARPA by adding new health conditions on how SLFRF monies may be used. In particular, and even though Treasury has no background expertise in public health, Treasury recently issued a Final Rule that purports to prohibit SLFRF monies from being used in a manner that, in the subjective and ill-informed opinion of Treasury, would undermine efforts to stop the spread of COVID-19. Based on its policy objections to the two grant programs referenced above, Treasury has also indicated to Governor Ducey that, even though this Final Rule does not become effective until April 1, 2022, the Rule somehow authorizes Treasury to: (1) recoup SLFRF monies distributed to the State; and (2) withhold future SLFRF distributions.

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10. Treasury's actions far exceed the statutory authority granted to it under ARPA. Nothing in that underlying statute authorizes Treasury to condition the use of SLFRF monies on following measures that, in the view of Treasury, stop the spread of COVID-19. If Congress had truly intended to give Treasury the power to dictate public health edicts to the States, and recoup or withhold SLFRF monies based on an alleged lack of compliance with such edicts, it would have spoken clearly on the matter. It did not. Moreover, even if Treasury were correct that ARPA conferred it the broad authority it now claims to attach new conditions on SLFRF monies, then the statute would violate the Spending Clause of the U.S. Constitution and the non-delegation doctrine. This Court should declare the Final Rule invalid, declare that Treasury has acted arbitrarily and capriciously and has abused its discretion, and enjoin Treasury's legislative overreach.

PARTIES, JURISDICTION AND VENUE

11. Plaintiff Douglas A. Ducey is the Governor of the State of Arizona. Under Arizona law, Governor Ducey is the official authorized to accept and expend funds received from the federal government or any agency thereof. *See* Ariz. Rev. Stat. § 41-101.01(A). Pursuant to this authority, Governor Ducey has accepted and expended SLFRF monies. Additionally, Governor Ducey serves as the sole State official responsible for communications between the State of Arizona and the federal government. *See* Ariz. Rev. Stat. § 41-101(A)(4).

12. Defendant Janet L. Yellen is the Secretary of the Treasury of the United States and is named in her official capacity.

13. Defendant Richard K. Delmar is the Acting Inspector General of the Department of the Treasury and is named in his official capacity. On information and belief, the Inspector General is responsible for monitoring and oversight of COVID-19 relief funds that have been disbursed to the States, and is generally responsible for informing and advising the Secretary of the Treasury about programs administered by Treasury and the need for corrective action.

14. Defendant the U.S. Department of the Treasury is an agency of the United

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States. Treasury is not a public health agency and does not have expertise in this area. Rather, on its website, Treasury describes its role as follows:

> The Treasury Department is the executive agency responsible for promoting economic prosperity and ensuring the financial security of the United States. The Department is responsible for a wide range of activities such as advising the President on economic and financial issues, encouraging sustainable economic growth, and fostering improved governance in financial institutions. The Department of the Treasury operates and maintains systems that are critical to the nation's financial infrastructure, such as the production of coin and currency, the disbursement of payments to the American public, revenue collection, and the borrowing of funds necessary to run the federal government. The Department works with other federal agencies, foreign governments, and international financial institutions to encourage global economic growth, raise standards of living, and to the extent possible, predict and prevent economic and financial crises. The Treasury Department also performs a critical and far-reaching role in enhancing national security by implementing economic sanctions against foreign threats to the U.S., identifying and targeting the financial support networks of national security threats, and improving the safeguards of our financial systems.[1]

15. This Court has jurisdiction under 28 U.S.C. §§ 1331, and 2201-02.

16. Venue in the District of Arizona is proper under 28 U.S.C. § 1391(e) because: (1) Governor Ducey resides in this district, is the State official responsible for communications between the State of Arizona and the federal government, and this case does not involve real property; and (2) "a substantial part of the events and omissions giving rise to the claim occurred" in this district—namely, the receipt and disbursement of SLFRF monies.

GENERAL ALLEGATIONS

I. The Provisions of ARPA

17. On March 11, 2021, President Joseph Biden signed ARPA into law.

18. Section 9901 of ARPA amends Title VI of the Social Security Act (42 U.S.C. § 801 *et seq.*) to establish the SLFRF.

19. The SLFRF appropriates $219,800,000,000 to States, territories, and Tribal

[1] *Role of the Treasury*, U.S. Department of the Treasury (last visited Jan. 20, 2022), https://home.treasury.gov/about/general-information/role-of-the-treasury

governments "to mitigate the *fiscal* effects stemming from the public health emergency with respect to the Coronavirus Disease." 42 U.S.C. § 802(a)(1) (emphasis added).

20. In Section 9901 of ARPA, Congress expanded on the permissible uses of SLFRF monies. 42 U.S.C. § 802(c)(1). In particular, Congress mandated in 42 U.S.C. § 802(c)(1) that the funds be used for one of four purposes:

> (A) to respond to the public health emergency with respect to the Coronavirus Disease 2019 (COVID–19) or its negative economic impacts, including assistance to households, small businesses, and nonprofits, or aid to impacted industries such as tourism, travel, and hospitality;
>
> (B) to respond to workers performing essential work during the COVID–19 public health emergency by providing premium pay to eligible workers of the State, territory, or Tribal government that are performing such essential work, or by providing grants to eligible employers that have eligible workers who perform essential work;
>
> (C) for the provision of government services to the extent of the reduction in revenue of such State, territory, or Tribal government due to the COVID–19 public health emergency relative to revenues collected in the most recent full fiscal year of the State, territory, or Tribal government prior to the emergency; or
>
> (D) to make necessary investments in water, sewer, or broadband infrastructure.

21. In 42 U.S.C. § 802(c)(2), Congress described two restrictions on the use of SLFRF monies:

> (A) IN GENERAL.—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.
>
> (B) PENSION FUNDS. —No State or territory may use funds made available under this section for deposit into any pension fund.

22. ARPA also provided that Treasury may provide SLFRF funds to States in separate installments with the only requirement for acceptance of each installment that the

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State sign a certification stating that the funds will only be used for the purposes outlined in the statute. 42 U.S.C. § 802(b)(6)(A)(ii) and (d).

23. ARPA does *not* contain any provisions that prohibits State, local, or Tribal governments from using SLFRF monies on programs that according to Treasury "undermine" efforts to stop the spread of COVID-19 or that require compliance with CDC recommendations or guidance—notably such provisions would put Treasury responsible for determining public health protocols, for which it is not qualified or, more importantly, statutorily-authorized.

24. In discussing the recoupment remedy, Congress explained that "[a]ny State, territory, or Tribal government that has failed to comply with" 42 U.S.C. § 802(c) in its use of SLFRF monies "shall be required to repay to the Secretary [of the Treasury] an amount equal to the amount of funds used in violation of such subsection." 42 U.S.C. § 802(e).

25. Congress also provided some authority to Treasury to withhold monies based on a lack of compliance with 42 U.S.C. § 802(c): "If a State or territory is required under [42 U.S.C. § 802(e)] to repay funds for failing to comply with [42 U.S.C. § 802(c)], the Secretary may reduce the amount otherwise payable to the State or territory. 42 U.S.C. § 802(b)(6)(ii)(III).

26. Congress also gave the Secretary of the Treasury "the authority to issue such regulations as may be necessary or appropriate to carry out this section." 42 U.S.C. § 802(f).

II. Treasury's Interim Final Rule

27. On May 17, 2021, Treasury published in the Federal Register an "Interim Final Rule" implementing the SLFRF. Coronavirus State and Local Fiscal Recovery Funds, 86 Fed. Reg. 26786 (May 17, 2021). A copy of the Interim Final Rule is attached as Exhibit 1.

28. The Interim Final Rule described how a state could use SLFRF in order to fall within one of the four categories of permissible uses described in 42 U.S.C. § 802(c)(1).

29. For instance, with respect to the first category of permissible use (42 U.S.C. § 802(c)(1)(A)), the Interim Final Rule described how a program could respond to the

COVID-19 public health emergency *or* the negative economic impacts of the pandemic. In fact, the Interim Final Rule addressed each of these two topics separately, under different headings—one section was titled "Responding to COVID–19," while another was titled "Responding to Negative Economic Impacts." The Interim Final Rule also explained: "While the COVID–19 public health emergency affected many aspects of American life, eligible uses under this category must be in response to the disease itself *or the harmful consequences of the economic disruptions resulting from or exacerbated by the COVID–19 public health emergency*." 86 Fed. Reg. at 26788 (emphasis added).

30. In the section addressing "Responding to Negative Economic Impacts," the Interim Final Rule provided that "[w]here there has been a negative economic impact resulting from the public health emergency, States, local, and Tribal government *have broad latitude to choose whether and how to use the Fiscal Recovery Funds to Respond to and address the negative economic impact.*" 86 Fed. Reg. at 26794 (emphasis added).

31. The Interim Final Rule then detailed, on several occasions, how a state could respond to negative economic impacts of COVID-19 by addressing the educational impacts of the pandemic. For instance, the Interim Final Rule stated:

a. "The negative economic impacts of COVID-19 also include significant impacts to children in disproportionately affected families *and include impacts to education*, health, and welfare, all of which contribute to long-term economic outcomes." 86 Fed. Reg. at 26793 (emphasis added).

b. "Many low-income and minority students, *who were disproportionately served by remote or hybrid education during the pandemic*, lacked the resources to participate fully in remote schooling or live in households without adults available throughout the day to assist with online coursework." *Id.* (emphasis added).

c. "Given these trends, *the pandemic may widen educational disparities* and worsen outcomes for low-income students, an effect that would substantially impact their long-term economic outcomes. Increased economic strain or

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material hardship due to the pandemic could also have a long-term impact on health, educational, and economic outcomes of young children." *Id.* (emphasis added).

32. Accordingly, the Interim Final Rule stated that SLFRF monies may be used on: "Evidence-based educational services and practices to address the academic needs of students, including tutoring, summer, afterschool, and other extended learning and enrichment programs." 86 Fed. Reg. at 26796. Other permissible uses of SLFRF monies include: "Evidence-based practices to address the social, emotional, and mental health needs of students." *Id.*

33. Although Treasury included examples of allowable uses of SLFRF monies, it also noted that such examples were not exhaustive and provided the following guidelines for States to use to analyze whether programs complied with the statutory provisions: (1) "a recipient should first consider whether an economic harm exists;" and (2) whether use of the funds would "respond to" or address the harm. 86 Fed. Reg. at 26794.

34. Treasury also released a "Frequently Asked Questions" guidance document about the Interim Final Rule, which similarly explained that SLFRF monies may be used to "Address[] educational disparities exacerbated by COVID-19, including: early learning services, increasing resources for high-poverty school districts, educational services like tutoring or afterschool programs, and supports for students' social, emotional, and mental health needs." [Exhibit 2, *Coronavirus State and Local Fiscal Recover Funds Interim Final Rule: Frequently Asked Questions*, U.S. Department of the Treasury, at 7-8 (Jan. 2022), https://home.treasury.gov/system/files/136/SLFRPFAQ.pdf.]

35. The Interim Final Rule does *not* contain any provision that prohibits States from using SLFRF monies on programs that supposedly "undermine" efforts to mitigate the spread of COVID-19 or are inconsistent with any CDC guidance or recommendations relating to the spread of COVID-19.

III. Arizona's Use of SLFRF Monies

36. With the Interim Final Rule in place, on May 21, 2021, Matthew Gress,

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Director of the Governor's Office of Strategic Planning and Budgeting ("OSPB"), signed a certification form issued by Treasury authorizing Treasury to make SLFRF payments to the State.

37. Subsequent to that certification, the State received the first "tranche" of SLFRF funding.

38. On August 17, 2021, Governor Ducey announced the Education Plus-Up Grant Program ("Plus-Up"). Plus-Up made $163 million in ARPA funds available to Arizona school districts and charter schools that received less than $1,800 per pupil under previous programs that were also intended to mitigate the economic impacts of COVID: namely, the Enrollment Stabilization Grant Program and/or the Elementary and Secondary School Emergency Relief Fund.

39. Governor Ducey's announcement of Plus-Up explained that the program "is designed to further aid in the mitigation of the economic impacts of COVID-19 and further ensure financial stability to Arizona Local Education Agencies." *State Fiscal Recovery Fund: Education Plus-Up (EPU)*, eCivis (last visited Jan. 20, 2022), https://gn.ecivis.com/GO/gn_redir/T/1sdmeoc0bsnvo.

40. Consistent with this purpose, Plus-Up funds must be used on expenses directly related to the mitigation of the impacts of the COVID-19 pandemic. *Id.* (under "Eligibility" tab). Expenditures not directly related to mitigating the impacts of the COVID-19 pandemic are prohibited. *Id.* (under "Eligibility" tab).

41. To be eligible for Plus-Up grants, districts and charters may not "requir[e] the use of face coverings during instructional hours and on school property (with the exception of CDC transportation guidelines);" though schools have every ability to encourage practices recommended by the CDC and students were not prohibited from doing so. District and charters must also "remain[] open for in-person instruction as of August 27, 2021 and throughout the remainder of the school year." *Id.* (under "Eligibility" tab).

42. Also on August 17, 2022, Governor Ducey announced the COVID-19 Educational Recovery Benefit Program ("ERB") program. The ERB program supplied $10

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million in ARPA monies for K-12 students and families facing financial and educational barriers due to school closures and mandates.

43. To be eligible for an ERB award, K-12 students and parents must demonstrate that: (1) their household income is at or below 350% of the Federal Poverty Level; and (2) their current school is requiring the use of face coverings during instructional hours and on school property (with the exception of CDC transportation guidelines). *Covid-19 Educational Recovery Benefit*, FACTS (last visited Jan. 20, 2022), https://online.factsmgt.com/grant-aid/inst/4NXJL/landing-page. The ERB program provides funding of up to $7,000 per student. *Id.* Among other things, ERB funds may be spent on school tuition, online tutoring, childcare, daycare fees, after-school care fees, and before-school care fees of Arizona Department of Economic Security-contracted providers. *Id.*

44. The application materials for Plus-Up and the ERB both state: "The Arizona Office of the Governor supports and encourages schools informing educators, parents and students of the CDC recommendations regarding COVID-19 Mitigation Policies." *See Covid-19 Educational Recovery Benefit*, *supra*; *State Fiscal Recovery Fund: Education Plus-Up (EPU)*, *supra*.

45. Plus-Up and the ERB both fall within the ARPA's authorization to use SLFRF monies to address the "negative economic impacts" of COVID-19. 42 U.S.C. § 802(c)(1).

IV. The Governor's Office Responds to Treasury's Concerns about Plus-Up and ERB

46. On October 5, 2021, Treasury wrote a letter to the Governor's Office of Strategic Planning and Budgeting ("OSPB"), asserting that Plus-Up and ERB "undermine evidence-based efforts to stop the spread of COVID-19." [Exhibit 3, Oct. 5, 2021 Letter from U.S. Department of Treasury to Governor Ducey, at 1.]

47. More specifically, Treasury took issue with the Plus-Up program stating that the program conditions SLFRF funding on "the recipient school districts not requiring the

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use of face coverings during instructional hours and on school property." [*Id.*] Similarly, Treasury complained that the ERB program provides "up to $7,000 per student to families for tuition or other educational costs at a new school that does not require face coverings if the student's current school is requiring the use of face coverings during instructional hours and on school property."[2] [*Id.*]

48. In the October 5 letter, Treasury, without asking for information to justify the State's program, stated that "[a] program or service that imposes conditions on participation or acceptance of the service that would undermine efforts to stop the spread of COVID-19 or discourage compliance with evidence-based solutions for stopping the spread of COVID-19 is not a permissible use of SLFRF funds." [*Id.* at 2.] However, Treasury did not cite any text from ARPA to support its contention that Plus-Up or ERB were not permissible uses of SLFRF funds.

49. In support of its position that SLFRF funds may not be used on programs that, in Treasury's view, "discourage compliance with evidence-based solutions for stopping the spread of COVID-19," Treasury instead cited to pages 26786 and 26790 of the Interim Final Rule. But this language is not found on page 26786 or page 26790. *See* 86 Fed. Reg. 26786, 26790. Indeed, nothing in page 26786 of the Interim Final Rule places constraints on the use of SLFRF monies. Rather, that page provides "background information" about the COVID-19 pandemic. *See* 86 Fed. Reg. at 26786.

50. Similarly, nothing on page 26790 of the Interim Final Rule places constraints on the use of SLFRF monies. Rather, that page sets forth certain "Eligible Public Health Uses" of SLFRF monies. *See* 86 Fed. Reg. at 26790.

51. In the October 5 letter, Treasury demanded that OSPB supply a "response describing how the State will remediate the issues identified" with Plus-Up and ERB. Citing 31 C.F.R. § 35.10, Treasury stated that "[f]ailure to respond to or remediate may result in administrative or other action." [Ex. 3 at 2.]

[2] Nothing in either the Plus-Up program or the ERB program prohibited students from wearing masks or taking other precautions against COVID.

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52. The Governor's Office responded on November 4, 2021 with a letter to Treasury detailing how these programs sought to address the negative economic impacts of COVID-19, as permitted by ARPA, and how the programs were consistent "with the guidance released by the Treasury governing the program, including the Interim Final Rule and all posted Frequently Asked Questions (FAQs)." [Exhibit 4, Nov. 4, 2022 Letter from OSPB to Treasury, at 3.]

53. Regarding Plus-Up, OSPB stated that this program "addresses educational disparities by ensuring schools have the funding necessary to effectively meet the needs of every student, regardless of their family's income or socioeconomic status.[3] Moreover, by limiting funding to only schools that remain open for in-person instruction, the State is addressing the significant educational disparities caused by remote learning during the COVID-19 pandemic." [*Id.*]

54. Regarding ERB, OSPB stated that this program "empowers parents to exercise their freedom to make informed decisions regarding their child's educational needs. For parents who prioritize their child's social, emotional, and mental health needs and believe a mask mandate would adversely impact their child, the program offers these parents the freedom and funding to enroll their student in a different program absent of a mask mandate. To reduce the spread of COVID-19 without the need for masks, Arizona already offers free COVID-19 testing for all residents." [*Id.* at 3-4.]

55. The November 4 letter also cited specific provisions of the Interim Final Rule, and Treasury FAQs on that rule, further demonstrating that Plus-Up and ERB were permissible uses of SLFRF funds. [*Id*. at 3.]

56. Additionally, the November 4 letter provided other important background information supporting the two programs. For instance, the November 4 letter explained that students in the "poorest 20% of U.S. neighborhoods" are most damaged by the COVID-19 pandemic. [*Id* at 1.] It also noted that, according to the CDC, COVID-19 "has a lower

[3] This funding was necessary because of the grossly disproportionate distribution of federal funding to some schools over others when all schools suffered effects from COVID-19.

likelihood of transmission among students." [*Id.*] "Indeed, in the United Kingdom, frequent rapid testing was found to be effective at reducing the transmission of the Delta COVID-19 variant amongst students, even if students did not wear masks." [*Id.*] The November 4 letter further stated that "experts have warned that masks can be harmful to children's emotional development, as seeing faces and reading emotional queues are critical for school-aged children." [*Id.* at 2.]

V. Treasury Issues a Final Rule Attaching New, Unlawful Restrictions on the Use of SLFRF Funds.

57. On January 6, 2022, Treasury issued a Final Rule that "adopt[ed] as final the interim final rule published on May 17, 2021 with amendments." [Exhibit 5, Final Rule, at 1.]

58. One such "amendment" added in the Final Rule, though, was a wholesale change to the previous provisions that is not supported by ARPA. That amendment is a purported prohibition on using SLFRF funds on a "program or service that imposes conditions on participation or acceptance of the service that would undermine efforts to stop the spread of COVID-19 or discourage compliance with recommendations and guidelines in CDC guidance for stopping the spread of COVID-19." [*Id.* at 346 (also explaining that "recipients may not use funds for a program that undermines practices included in the CDC's guidelines and recommendations for stopping the spread of COVID-19"); *see also id.* at 10, 58 (similar).]

59. Supposedly impermissible "programs or services" to be determined by Treasury include "programs that impose a condition to discourage compliance with practices in line with CDC guidance (e.g., paying off fines to businesses incurred for violation of COVID-19 vaccination or safety requirements), as well as programs that require households, businesses, nonprofits, or other entities not to use practices in line with CDC guidance as a condition of receiving funds (e.g., requiring that businesses abstain from requiring mask use or employee vaccination as a condition of receiving SLFRF funds)." [*Id.* at 346.]

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60. The Final Rule does not cite any statutory text from ARPA to support this new prohibition. No such text exists.

61. The prohibition on using SLFRF funds for programs that allegedly "undermine" constantly changing CDC recommendations related to COVID-19 mitigation efforts is also not found in the Interim Final Rule.

62. Treasury is not a public health agency and does not have expertise in stopping the spread of COVID-19.

63. The effective date of the final rule is April 1, 2022. [*Id.* at 1.] Until the Final Rule becomes effective, the Interim Final Rule remains binding and effective. [*Id.* at 121.]

VI. Citing the Final Rule, Treasury Demands Action by the Governor Within 60 Days.

64. On January 14, 2022, Treasury sent another letter to the Governor's Office, once again raising concerns with Plus-Up and ERB. The letter re-iterated Treasury's flawed position that SLFRF monies may not be used on programs that supposedly "undermine" efforts to stop the spread of COVID-19 and that Plus-Up and the ERB supposedly fail that test because of how they address school mask mandates. [Exhibit 6, Jan. 14 Letter from Treasury to OSPB, at 1-2.] Based on this, Treasury claimed that the Plus-Up program and the ERB program "as currently structured are ineligible uses of SLFRF funds." [*Id.* at 2.]

65. Similar to its previous letter, Treasury did not point to any statutory text from ARPA to support its position. The January 14 letter does not even cite 42 U.S.C. § 802(c) or any other provision of the ARPA.

66. The January 14 letter instead makes the irrelevant point that "the Interim Final Rule permits SLFRF funds to be used for a range of COVID-19 mitigation strategies, including face coverings, vaccination programs, and improved ventilation." [*Id.* at 1 n.1.] But this is simply one of the *non-exclusive*, possible uses of SLFRF monies. There is no mandate in ARPA, or the Interim Final Rule, that SLFRF monies be used on "COVID-19 mitigation strategies."

67. At different points, the January 14 letter also cites the Final Rule. Most

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relevant here, the January 14 letter asserts: "[t]he Final Rule, which was issued on January 6, 2022, further clarifies how SLFRF funds may be used, including that a recipient may not use SLFRF funds for a program, service, or capital expenditure that includes a term or condition that undermines efforts to stop the spread of COVID-19." [Jan. 14 Letter at 1 n.1.]

68. The January 14 letter does not acknowledge that the Final Rule only becomes effective on April 1, 2022. Nor did Treasury provide any basis for giving the Final Rule retroactive effect to recoup previously distributed SLFRF monies. *See*, *e.g.*, *Afanador v. Garland*, 11 F.4th 985, 991 (9th Cir. 2021) ("When an agency engages in formal rulemaking, the rules it promulgates are analogous to legislation and are construed to apply only prospectively (unless Congress has expressly authorized it to promulgate a retroactively applicable rule).").

69. Nevertheless, the January 14 letter used that not-yet-effective Final Rule to demand action by the Governor. In particular, Treasury stated that the Governor must "(i) redirect SLFRF funds to eligible uses or (ii) remediate the issues with the Education Plus-Up Grant Program and the COVID-19 Educational Recovery Benefit Program by redesigning the programs to eliminate any elements that are inconsistent with the purpose and requirements of the SLFRF program." [Ex. 6 at 2.]

70. Treasury described two consequences from a lack of compliance with its demands. First, it stated that "[f]ailure to take either step within sixty (60) calendar days may result in Treasury initiating an action to recoup SLFRF funds used in violation of the eligible uses." [*Id.*] Second, Treasury stated that it "may also withhold funds from the State of Arizona's second tranche installment of SLFRF funds until Treasury receives information that confirms that the issues described above have been adequately addressed." [*Id.*]

71. In light of this history, there is no question that this controversy is ripe and that Governor Ducey has Article III standing. Treasury had no statutory authority to require the State to use SLFRF monies in a manner that, pursuant to Treasury's sole discretion, would not undermine efforts to stop the spread of COVID-19. Instead, Treasury, in an

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abuse of discretion, issued the Final Rule well in excess of its statutory authority. With the recent issuance of the Final Rule, however, Treasury has demanded that Governor Ducey either comply with the Rule—even though it far exceeds Treasury's statutory authority—or else face recoupment and withholding of SLFRF monies within 60 days.[4] The Governor's Office will not eliminate or change the Plus-Up and ERB programs to conform to Treasury's unlawful dictates. The concrete and particularized injury-in-fact to the Governor is therefore actual or imminent, not conjectural or hypothetical. *See, e.g.*, *Skyline Wesleyan Church v. Cal. Dep't of Managed Health Care*, 968 F.3d 738, 748 (9th Cir. 2020); *Bishop Paiute Tribe v. Inyo Cty.*, 863 F.3d 1144, 1153-54 (9th Cir. 2017).

FIRST CAUSE OF ACTION

(Violation of the Administrative Procedure Act—Final Rule)

72. Governor Ducey incorporates the allegations in the preceding paragraphs as if fully set forth herein.

73. The Administrative Procedure Act ("APA") authorizes the Court to hold unlawful and set aside agency action that is "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right," or is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2).

74. The Final Rule is a final agency action within the meaning of the APA. 5 U.S.C. § 551(13).

75. Governor Ducey has suffered legal wrong and is adversely affected or aggrieved by the Final Rule. 5 U.S.C. § 702. As stated, Governor Ducey is the party authorized by Arizona law to accept and expend the SLFRF monies that Treasury seeks to withhold and recoup. *See* A.R.S. § 41-101.01(A). The Final Rule seeks to impose new conditions on how Governor Ducey may exercise this authority, and prohibit programs like Plus-Up and ERB that were instituted before the issuance of the Final Rule. Indeed,

[4] The Governor notes that Treasury further abused its authority by requiring the State of Arizona to comply with the Final Rule before that rule ever goes into effect, since the response would be due to Treasury on March 15, 2022 and the rule would not go into effect until April 1, 2022.

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Treasury specifically cited the Final Rule as grounds to demand that Governor Ducey change these programs within 60 days or else face recoupment and withholding of SLFRF monies.

76. It is axiomatic that a federal agency must have statutory authority for the regulations it issues. *See, e.g.*, *Mexichem Fluor, Inc. v. Env't Protection Agency*, 866 F.3d 451, 460 (D.C. Cir. 2017) ("The agency must have statutory authority for the regulations it wants to issue."). "Merely because an agency has rulemaking power does not mean that it has delegated authority to adopt a particular regulation." *N.Y. Stock Exch. LLC v. SEC*, 962 F.3d 541, 554 (D.C. Cir. 2020).

77. Here, the Final Rule far exceeds the limited statutory authority granted to Treasury by ARPA. That statute did not confer Treasury with power to prohibit States from expending SLFRF monies in a manner that in Treasury's subjective and extraordinary determination "would undermine efforts to stop the spread of COVID-19 or discourage compliance with recommendations and guidelines in CDC guidance for stopping the spread of COVID-19." [Ex. 5 at 346].

78. To the contrary, Congress specifically described the permissible uses of SLFRF funds, as well as restrictions on such uses, in 42 U.S.C. § 802(c). In describing how the funds may be used, Congress did not prohibit States from expending SLFRF monies in a manner that Treasury subjectively believes will "undermine" COVID-19 mitigation efforts or require states to follow CDC guidance in implementing programs that expend SLFRF monies. Neither § 802(c), nor any other provision of ARPA, authorizes Treasury to create new restrictions that are untethered to and inconsistent with the text of the ARPA.

79. The first category of permissible use of SLFRF monies identified by Congress discussed is particularly instructive here. That category allows SLFRF monies to be used "to respond to the public health emergency with respect to the Coronavirus Disease 2019 (COVID–19) *or* its negative economic impacts." 42 U.S.C. § 802(c)(1)(A) (emphasis added). Congress used the word "or"—not "and." At no point did Congress suggest that, in addressing "negative economic impacts," States must structure programs to comply with

COVID-19 mitigation guidance.

80. Nor is the Final Rule's extra-statutory restriction on SLFRF monies "necessary or appropriate to carry out" Section 802 of ARPA. *See* 42 U.S.C. § 802(f).

81. Although the plain language of ARPA is sufficient to conclude that the Final Rule exceeds Treasury's statutory authority, this conclusion is buttressed by the "major questions" doctrine. Under this doctrine, and as recently affirmed by the U.S. Supreme Court, courts "expect Congress to speak clearly when authorizing an agency to exercise powers of vast economic and political significance." *Ala. Assn. of Realtors v. Dep't of Health & Human Servs.*, 141 S. Ct. 2485, 2489 (2021) (quotation omitted); *Nat'l Fed'n of Indep. Bus.*, 2022 WL 120952, at *3 (same).

82. If Congress intended to give Treasury—which has absolutely no expertise in matters of public health—the authority to withhold or recoup tens of millions of dollars from States based on Treasury's subjective assessment of whether a State program "undermines" COVID-19 mitigation efforts, Congress needed to "speak clearly."

83. The need for Congress to "speak clearly" is particularly pressing where, as here, Treasury's Final Rule would "intrude[] into . . . area[s] that [are] the particular domain of state law"—public health and education policy. *Ala. Assn. of Realtors*, 141 S. Ct. at 2489. By contrast, public-health policy is completely outside the domain of Treasury, which lacks the expertise required to assess whether a particular expenditure of SLFRF funds "would undermine efforts to stop the spread of COVID-19."

84. Because Congress did not "speak clearly" (or, indeed, speak at all) on this issue of vast economic and political significance, the Final Rule exceeds Treasury's statutory authority. It is also arbitrary, capricious, an abuse of discretion, and contrary to law. The Final Rule must therefore be held unlawful and set aside pursuant to 5 U.S.C. § 702(2)(A) and (2)(C).

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SECOND CAUSE OF ACTION

(Violation of the Administrative Procedure Act—January 14 Treasury Demand Letter)

85. Governor Ducey incorporates the allegations in the preceding paragraphs as if fully set forth herein.

86. The January 14 letter is a final agency action within the meaning of the APA. 5 U.S.C. § 551(13).

87. Because Arizona law makes Governor Ducey responsible for accepting and expending the SLFRF monies that Treasury seeks to withhold and recoup, A.R.S. § 41-101.01(A), Governor Ducey has suffered legal wrong and is adversely affected or aggrieved by the January 14 letter. 5 U.S.C. § 702.

88. Treasury exceeded its statutory authority under 42 U.S.C. § 802, acted arbitrarily and capriciously, and abused its discretion, and acted contrary to law in demanding that Governor Ducey eliminate or modify the Plus-Up and ERB programs on the grounds that these programs allegedly "impose[] conditions on participation in or acceptance of the service that would undermine efforts to stop the spread of COVID-19 or discourage compliance with recommendations and guidelines in CDC guidance for stopping the spread of COVID-19." [Ex. 5 at 346; *see also* Ex. 6 at 1.].

89. Nothing in ARPA authorizes Treasury to impose such conditions on SLFRF monies. None of the four categories of permissible use, or the two use restrictions, in 42 U.S.C. § 802(c) come close to prohibiting States from expending SLFRF monies in a manner that Treasury determines will "undermine" COVID-19 mitigation efforts or require compliance with CDC guidance or recommendations. Nor does anything in ARPA give Treasury authority to impose new conditions on how SLFRF monies are used that are not found anywhere in the statutory text.

90. Likewise, the Interim Final Rule fails to authorize Treasury's action. That rule does not say anything about mask mandates in schools or any other measures that supposedly "undermine" COVID-19 mitigation efforts. Similarly, the Interim Final Rule

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does not require States to abide secondhand, ever-changing CDC guidance in implementing programs that expend SLFRF monies.

91. The Final Rule also cannot provide any grounds for recoupment or withholding since that Rule exceeds Treasury's authority and does not become effective until April 1, 2022.

92. Plus-Up and ERB are entirely consistent with 42 U.S.C. § 802(c) because they respond to the "negative economic impacts" of the COVID-19 pandemic by, among other things, providing economic assistance to households and schools to address the pandemic's impact on education.

93. Because Treasury's actions have no basis in statute or the currently effective regulation, Treasury has exceeded its authority, abused its discretion, and acted arbitrarily, capriciously, and contrary to law, all in violation of the APA. *See* 5 U.S.C. § 706(2). The January 14 letter must therefore be held unlawful and set aside pursuant to 5 U.S.C. § 702(2)(A) and (2)(C).

THIRD CAUSE OF ACTION

(Declaratory Judgment—Violation of the Spending Clause)

94. Governor Ducey incorporates the allegations in the preceding paragraphs as if fully set forth herein.

95. Article I, § 8, cl. 1 of the U.S. Constitution (the Spending Clause) empowers Congress to "lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States."

96. If, however, Congress "desires to condition the States' receipt of federal funds," then 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 State Sch. & Hosp. v. Halderman*, 451 U.S. 1, 17 (1981)) (alteration in original).

97. If the Final Rule is authorized by statute (it is not), then it violates the Spending Clause because the enabling statute, 42 U.S.C. § 802, is ambiguous in the strings

it attaches to the use of SLFRF monies.

98. In particular, 42 U.S.C § 802 does not give States any notice that SLFRF monies could, at some future date, be withheld or recouped based on Treasury's determination that the State's use of the monies "undermine[s] efforts to stop the spread of COVID-19." And § 802 certainly does not alert States to the possibility that their use of SLFRF monies must comport with the CDC's ever-changing COVID-19 guidance.

99. Accordingly, even if the Final Rule is somehow authorized by statute, it violates the Spending Clause.

FOURTH CAUSE OF ACTION

(Declaratory Judgment—Violation of the Non-Delegation Doctrine)

100. Governor Ducey incorporates the allegations in the preceding paragraphs as if fully set forth herein.

101. Article I, § 1, of the U.S. Constitution vests "[a]ll legislative Powers herein granted ... in a Congress of the United States."

102. Thus, "when Congress confers decisionmaking authority upon agencies Congress must 'lay down by legislative act an intelligible principle to which the person or body authorized to [act] is directed to conform.'" *Whitman v. Am. Trucking Assoc.*, 531 U.S. 457, 472-73 (2001) (quoting *J.W. Hampton, Jr. & Co v. United States*, 276 U.S. 394, 409 (1928)) (emphasis in original omitted).

103. If the Final Rule is authorized by ARPA (again, it is not), then this means that the Act sets forth no "intelligible principle[s]" guiding Treasury's decisions to withhold or recoup SLFRF monies.

104. Rather, if the Final Rule is authorized by ARPA, then this means Treasury has unfettered discretion to add new conditions on SLFRF funds, including conditions based on Treasury's beliefs about what COVID-19 mitigation strategies are appropriate, despite the fact that Treasury is not a public health agency and does not have expertise in this area.

105. Accordingly, if the Final Rule falls within the authority granted to Treasury by ARPA, then the Act violates the non-delegation doctrine.

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PRAYER FOR RELIEF

Wherefore, Governor Ducey requests that this Court:

A. Declare that the Final Rule is unlawful and must be set aside because the Final Rule exceeds Treasury's statutory authority, is an abuse of discretion, is arbitrary and capricious, and is contrary to law;

B. Declare that Defendants have abused their discretion, exceeded their statutory authority, and acted arbitrarily, capriciously, and contrary to law by demanding that Governor Ducey eliminate or modify existing SLFRF programs;

C. Permanently enjoin Defendants from enforcing against Governor Ducey and the State of Arizona the Final Rule's unlawful restriction on programs that allegedly undermine efforts to stop the spread of COVID-19 or discourage compliance with recommendations and guidelines in CDC guidance for stopping the spread of COVID-19.

D. Permanently enjoin Defendants from withholding or recouping SLFRF monies from the State of Arizona based on the conditions of the Plus-Up and ERB programs;

E. Awarding Plaintiff reasonable costs and expenses of this action, including attorneys' fees; and

F. Grant other such relief as may be just and proper.

DATED this 21st day of January, 2022.

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UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA

State of Arizona,

Plaintiff,

v.

Janet Yellen, in her official capacity as Secretary of the Treasury, *et al.*,

Defendants.

Case No. 2:21-cv-00514-DJH

Related case: 2:22-cv-00112-SPL

[PROPOSED] ORDER

Upon consideration of Defendants' motion to transfer the related case of *Ducey v. Yellen*, 2:22-cv-00112 under Local Rule 42.1, it is hereby **ORDERED** that Defendants' motion is **GRANTED** and *Ducey v. Yellen* shall be marked as related and transferred to the undersigned.

SO ORDERED.

Dated this _____ day of _____, 2022

_____
Diane J. Humetewa
U.S. District Judge