



## N O T E S & T R E N D S

### CIVIL LITIGATION

#### JUDICIAL LAW

m **MINN. R. CIV. P. 60.02, FINDEN FACTORS.** The Minnesota Court of Appeals reversed the district court's entry of default judgment, finding the trial court issued an order for a default judgment without applying the four-factor test of *Finden v. Klaas*, 268 Minn. 268, 271, 128 N.W.2d 748, 750 (1964). *Finden* applied Rule 60.02, which provides for relief from a final judgment for, among other reasons, "mistake, inadvertence, surprise, or excusable neglect." In order to obtain relief from a default judgment, a party must show (1) that it has a reasonable defense on the merits; (2) it has a reasonable excuse for the failure or neglect to answer; (3) it has acted with due diligence after notice of entry of judgment; and (4) no substantial prejudice will result to the other party. Because the district court failed to apply the four-part test, the appellate court declined to engage in fact-finding to resolve the first issue — namely, whether the defendant has a reasonable defense on the merits. Instead, the appellate court reversed the entry of default judgment and remanded the case to the district court for application of the *Finden* factors. ***Joseph v. Aztec Roofing and Construction Co.***, 2002 WL 31750258 (Minn. App. 12/03/02).

m **MINN. R. CIV. P. 60.02; PATERNITY; MOTION TO VACATE; NO PENALTY FOR RELYING ON SWORN STATEMENTS OF PATERNITY.** In a paternity case in which the purported father of a child admitted paternity based upon sworn statements of the child's mother, the Court of Appeals refused to penalize the purported father for his reliance, when he subsequently learned through genetic testing that he could not be the biological father and therefore moved to vacate the paternity adjudication. In this case, the purported father had been led to believe, since 1995, that he was the father of the child. His belief was based upon his girlfriend's consistent statements that he was the father, an affidavit of paternity that she submitted to Ramsey County in 1997, and her sworn statements in a paternity adjudication initiated in 2000. After admitting that he was the father in the paternity adjudication, the purported father had genetic tests performed which excluded him as the child's biological father. He moved to vacate pursuant to Minn. R. Civ. P. 60.02(b) (new evidence), (c) (fraud) and (f) (catch-all). The district court summarily rejected his motion. However, the Court of Appeals reversed the denial, and ordered a hearing regarding the validity of the genetic testing. The court was very concerned about penalizing the purported father for believing the sworn statement of the mother regarding who her child's father was, stating that "to hold that parties must preserve their rights by disbelieving sworn statements relating to the identity of the person with whom a woman conceived a child would result, we conclude, in a judicially mandated atmosphere of distrust and acrimony that is contrary to public policy strongly favoring stipulations in family cases." It therefore reversed the denial to grant the motion based upon fraud. Regarding the motion to vacate based upon newly discovered evidence, the court reiterated that, while it would have been preferable if the purported father had sought genetic testing before admitting paternity, it would not consider his reliance upon the mother's sworn statements to constitute failure to exercise "due diligence" justifying a denial of the motion to vacate. ***Turner v. Suggs***, 653 N.W.2d 458 (Minn. App. 2002).

m **COUNSEL SANCTIONED FOR INAPPROPRIATE REMARK.** A recent decision from the federal courts provides a timely reminder to litigation counsel practicing in federal or state court to behave in a respectful fashion. During oral argument on cross-motions for summary judgment, counsel for defendants used a curse word ("damn company"). At the time counsel made the remark, "numer-

ous juveniles and young adults were present in the gallery of the courtroom.” The court concluded that the use of the word “damn” was appropriately sanctionable because it was “outside the realm of acceptable conduct. A curse word has no place in the courtroom, especially where its sole purpose is to drive home the point of an assertion.” The court concluded that the appropriate sanction was a letter of apology and a \$500 fine, which was subsequently suspended upon receipt of the letter of apology. *Nelson v. Ellerbe Becket Construction Services, Inc.*, 2002 WL 3157117 (D. Minn. 11/15/02) (Davis, J.).

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## CRIMINAL LAW

### JUDICIAL LAW

**m FIREARMS: FELON IN POSSESSION: INOPERABLE FIREARM.** Possession of an inoperable gun falls within the prohibition of Minn. Stat. §609.165 subd. 1b(a). The appellant was charged with being in “constructive possession” of an antique firearm, manufactured between 1880 and 1920, that was inoperable because the hammer springs were broken, or had been removed, but which could be made to fire if the hammer were manually struck with sufficient force. The district court concluded that a temporarily inoperable gun was a firearm for purposes of Minn. Stat. §609.165 subd. 1b(a).

Held, the district court was correct in concluding that a felon may not possess a firearm, whether operable or not. The court rejects any distinction based on actual use or type of firearm possessed, whether illegal (e.g., sawed off shotgun) or legal, as in the current case.

Second, the Court of Appeals holds that the general statement of policy contained in Minn. Stat. §624.711, against legislative regulation of long-arms, does not bar prosecution under the specific statutory prohibitions against possession of firearms by convicted felons. *State v. Ray Howard Knaeble*, C8-01-1735, (Minn. App. 10/29/02). <http://www.lawlibrary.state.mn.us/archive/ctappub/0210/c8011735.htm>

**m FIREARMS: FELON IN POSSESSION: EX POST FACTO.** The appellant was convicted in 1986 of Possession of Controlled Substances in violation of chapter 152. At that time, controlled substance offenses were not classified as “crimes of violence” with respect to firearms prohibitions. In 1987, the Minnesota Legislature amended the definition of crimes of violence to include chapter 152 violations. The Legislature did not specifically instruct that the statute was to have retroactive effect.

Held, Minnesota’s Felon in Possession law does not violate the federal or state constitutional prohibitions against the enactment of ex post facto laws. In this case the illegal act was the appellant’s possession of a firearm in 2000, not the possession of LSD in 1986. The firearms prohibition does not increase the burden of the appellant’s 1986 conviction; it merely changes his status. Here, the Court of Appeals follows the 4th Circuit’s retroactive prohibition against firearms in the case of misdemeanor domestic assault. *United States v. Mitchell*, 209 Fed.3d 319 (4th Circuit 2000), cert denied 531 U.S. 849 (2002). *State v. Stephen Lari Schluter*, C3-02-48, (Minn. App. 12/10/02).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0212/c30248.htm>

**m MIRANDA: SCALES: NONCUSTODIAL INTERROGATION.** *Scales* requires that all custodial interrogation, including any information about rights, waiver of rights, and all questioning, shall be electronically recorded where feasible and must be recorded when questioning occurs at a place of detention. Here, the appellant was interviewed twice at a police station but was not in custody. Police declined to record the conversation, although equipment was available, for the reason that they felt people talk more freely when the interview is not being recorded. During a second noncustodial statement at the police station, the appellant, under suspicion for criminal sexual conduct, stated that “If my daughter said it happened, it must have happened.”

On appeal, the defendant asked that *Scales* be extended to require that police

record noncustodial interrogation of suspects in police stations. Held, extending the recording requirement to noncustodial interrogations would be a significant departure from *Scales*, and the Supreme Court declines to do so. Law enforcement is, however, “reminded” that the administration of justice is not served if police manipulate the custody status of suspects in order to avoid *Scales*’ recording requirements. ***State v. Douglas Arthur Conger***, C3-01-699 (Minn. 11/7/02).

<http://www.lawlibrary.state.mn.us/archive/supct/0211/c301699.htm>

**m EVIDENCE: SPREIGL: NOTICE: ACTUAL.** In a trial for child solicitation, the state disclosed a possible witness, J.L., but did not identify her as a *Spreigl* witness. No formal *Spreigl* notice was given concerning computer file folders within which J.L.’s identity was discovered. In the folder, found on the defendant’s computer during a search, the defendant asked the 15-year-old, J.L., to go out with him. Prosecution moved to admit this evidence at trial, conceding that a formal *Spreigl* notice had not been given. The trial court ruled that evidence concerning J.L. could be admitted on the basis that it was produced during a valid police search.

Held, the evidence concerning J.L. was improperly admitted, and requires reversal of the conviction. The fact that the computer files were seized during a valid search does not define trial admissibility, and the Court of Appeals states that it does not “understand that ruling of the trial court.”

Although defense counsel admitted receiving the police reports which referenced the computer files, the prosecution did not recite any evidence found in that search to indicate that the state might be using such evidence to prove the offense. Hence, there was no substantial compliance with the notice requirement.

An additional reason for reversal is that the court did not instruct the jury on how to properly consider the evidence, by giving a cautionary *Spreigl* instruction. The evidence concerning J.L. was highly suggestive and could have indicated to the jury that the appellant was a predatory person with a propensity to seek out teenage girls. ***State v. Paul Nelson Coonrod***, CX-01-2062 (Minn. App. 11/5/02). <http://www.lawlibrary.state.mn.us/archive/ctappub/0211/cx012062.htm>

**m CHILD SOLICITATION: FICTIONAL PERSON: STING OPERATION.** The appellant was charged with solicitation of a child to engage in sexual conduct. A sting operation caught the appellant communicating in a chat room with “Jamie 14,” a fictional persona created by a U.S. postal inspector. Appellant entered the chat room and then sent a “whisper” (private communication) to Jamie 14, and eventually arranged a face-to-face meeting.

Held, Minn. Stat. §609.352, which prohibits solicitation of a child “or someone the person reasonably believes is a child,” is broad enough to encompass fictional persons. The term “solicit” requires that the target be “a specific person,” but that language does not require an “actual” person. The court notes that sting undercover operations, while not unduly favored by the courts, would be hamstrung if the statute required use of actual children. “Sending emails in chat room ‘whispers’ to a specifically identified computer persona with the aim of engaging that person in sexual activity fits within the purpose and language of the statute.” ***State v. Coonrod, supra***.

**m CONTROLLED SUBSTANCE: LABORATORY TEST: MARIJUANA: EVIDENCE.** The appellant was found to be in possession of a small amount of marijuana, and charged in juvenile court. No contraband was actually found on the appellant, but a putative “joint” was found in one of his companion’s shoes. An arresting officer noted that the boys smelled of marijuana, had bloodshot watery eyes, and finally, two of the boys, including the appellant, admitted to smoking marijuana. At trial, the state failed to conduct or present any laboratory tests of the substance in question.

Held, the circumstantial evidence in this case was sufficient to establish guilt beyond a reasonable doubt. The Court of Appeals rejects the appellant’s position that the existence of marijuana must be supported by laboratory tests. The evidence of the witnesses, coupled with the appellant’s admission, was sufficient to establish that the substance in question was marijuana. ***In re J.R.M.***, C9-02-474

(Minn. App. 11/19/02).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0211/c902474.htm>

m **SENTENCE: INPATIENT TREATMENT: PRIOR ADJUDICATIONS.** Minn. Stat. §260B.235 sub. 6 (2000) requires that on a third or subsequent finding by the court, pursuant to an admission, or after trial, that a child has committed a controlled substance offense, the court may order the child to participate in inpatient treatment. Here, however, the child's first "prior" offense involved diversion which did not require him to admit in court to a controlled substance violation. Hence, the prior diversion could not be used as a prior violation for purposes of Minn. Stat. §260B.235, subd. 6, and the district court was not authorized to order inpatient treatment. ***In re J.R.M., supra.***

m **SENTENCE: GUIDELINES: WAIVER: GIVENS v. MISQUADACE.** The prosecution and defense reached a sentencing agreement in this case calling for a 16-month sentence, although the sentencing guidelines called for one year and one day. On the date of sentencing, the Minnesota's Supreme Court case in *State v. Misquadace*, 644 N.W.2d 65 (Minn. 2002) had not yet been filed. Although the appellant had been sentenced, the time for direct appeal had not yet expired when *Misquadace* was then filed. *Misquadace* states that its rule applies to pending and future cases. Hence, the instant case was "pending" and *Misquadace* applies. The ruling in *Misquadace* states that a sentencing court cannot rely on the parties' plea agreement as the sole reason for departure.

Secondly, the district court's decision to depart from the guidelines must be viewed on an abuse of discretion standard. Here, there were no sufficient reasons stated on the record to support the four and one-half time upward departure. In order for such a departure to exist, there must not only be aggravating circumstances, but "severe aggravating circumstances" to justify this extraordinary departure, citing *State v. Claraton*, 425 N.W.2d 831 (Minn. 1998) (generally, when aggravating circumstances are present, the upper limit on a durational departure is double the sentencing guidelines maximum presumptive sentence). ***State v. Joen Sanchez Sanchez***, C0-02-1044 (Minn. App. 12/10/02).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0212/c0021044.htm>

m **SENTENCE: MULTIPLE VICTIM VERSUS SINGLE VICTIM: SINGLE BEHAVIORAL INCIDENT.** Appellant sexually and physically assaulted D.L. and physically assaulted D.L.'s boyfriend, A.H. Following a *Lothenbach* procedure, appellant was convicted of all counts, but sentenced only on the criminal sexual conduct and assault charge against D.L. The judge imposed consecutive sentences for these two offenses.

Held, it was error for the court to impose consecutive sentences. The record shows nothing but a singleness of purpose on the part of the defendant and it is unclear whether the appellant intended to commit a sex offense or an assault at the time he entered the apartment, and there is no evidence in the record that the assault and the sexual offense were separated by any period of time. Hence, the multiple conduct "exception" to double sentencing does not apply (see *State v. McLemore*, 351 N.W.2d 927 (Minn. 1987)).

Also, the judicially created exception to double sentencing involving multiple victims does not apply in this case, because the appellant was sentenced only for the criminal sexual conduct and assault charges against D.L. Had the appellant been sentenced for a sex charge against D.L. and an assault charge against A.H., the multiple victim exception would have permitted imposition of consecutive sentences. ***State v. Tjuan Donte Johnson***, C7-02-960 (Minn. App. 11/26/02).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0211/c702960.htm>

m **DRIVER LICENSE: ALTERED OR FICTIONAL LICENSES: OUT-OF-STATE LICENSES.** Minn. Stat. §171.22 subd. 1(1), (2000), which prohibits the display or possession of "any fictitious or marginally altered driver's license" is not limited to licenses issued by the state of Minnesota, and clearly includes the possession of fictitious out-of-state driver's licenses. Hence, the appellant in this case may be convicted for possessing a fraudulent driver's license issued by the state of Illinois. The Court of Appeals adopts a plain language interpretation of the section, and finds it unnecessary to consider Minn. Stat. §171.01 subd. 14, which defines "license" as a license issued under the laws of Minnesota by the Commissioner of Public Safety.

**State v. Richard Howard Stern**, C9-02-264 (Minn. App. 11/19/02).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0211/c902264.htm>

m **PROCEDURE: WAIVER OF TRIAL RIGHTS BY DEFENDANT: LOTHENBACH.**

Defense counsel, prosecution, and the judge apparently reached an understanding that via the *Lothenbach* procedure, the court would find the appellant not guilty of the more serious charge of 2nd degree assault, and guilty of the less serious charge of terroristic threats. Defense counsel also wished to argue for a stay of imposition of sentence or, possibly, a gross misdemeanor disposition. The appellant was convicted of terroristic threats, and given a stay of imposition. At trial, defense counsel, not the appellant, waived rights to cross-examination and presentation of evidence. The right to jury trial, however, was properly and expressly waived by the defendant.

The conviction is reversed. The waiver by counsel of the appellant's other trial rights is insufficient under Minnesota Rule of Criminal Procedure 26.01, subd. 3, which is specific: Before proceeding with a trial on stipulated facts, the defendant shall acknowledge and waive, in writing or orally on the record, the following rights: to testify at trial, to have witnesses testify in open court in trial in the defendant's presence, to question prosecution witnesses, and to require any favorable witnesses to testify for the defense. No such express waiver of those rights occurred in this case, and the conviction is reversed for the reason that Rule 26.01, which pertains to fundamental constitutional rights, is strictly construed. **State v. Lee Richard Halseth**, C2-02-543 (Minn. App. 11/26/02). <http://www.lawlibrary.state.mn.us/archive/ctappub/0211/c202543.htm>

m **SELF-DEFENSE: DUTY TO RETREAT: HOME: CORESIDENT.** The Supreme Court rules that the rule in *State v. Glowacki*, 630 N.W.2d 392 (Minn. 2001), is retroactive: When acting in self-defense there is no duty to retreat from one's own home even if the aggressor is a coresident. The district court's instruction to the jury that the respondent had a duty to retreat from his home constitutes plain error and requires a new trial. The facts of this case involve the respondent and the victim living together in a motor home. The victim approached respondent with a screwdriver in his hand following an altercation between the two. The respondent feared that he was going to be stabbed, at which point he hit the victim in the face and wrenched his arm to take the screwdriver away from him. Respondent admitted, at trial, that he was nearest the motor home door and could have left at any time. The respondent was charged with disorderly conduct, 5th degree assault, and 3rd degree assault.

The Supreme Court notes that the general rule regarding new principles of law is that, absent special circumstances or specific pronouncements of prospectivity, a decision is given retroactive effect, *citing Hoff v. Kempton*, 317 N.W.2d 361 (Minn. 1982). The Supreme Court declines to apply the special circumstances test to the instant case, noting that such a test was assigned in the context of civil cases, and is "ill suited to the present criminal case." **State v. Jeffrey Warren Baird**, C1-01-894 (Minn. 12/5/02). <http://www.lawlibrary.state.mn.us/archive/supct/0212/c101894.htm>

m **INEFFECTIVE ASSISTANCE OF COUNSEL: DNA EVIDENCE: MANDATORY SAMPLE: REVERSAL OF CONVICTION REQUIRING SAMPLE.** Respondent had originally been charged with 1st and 3rd degree criminal sexual conduct, in 1997. In 1998, following a plea agreement, respondent pled guilty to a charge of promotion of prostitution by fraud, in violation of Minn. Stat. §609.322, subd. 2(1). In exchange, the state dismissed the criminal sexual conduct charges. The terms of the negotiation were that respondent would seek probation and a stayed sentence. At sentence, the district court rejected the respondent's argument that his conviction "did not arise from the same set of circumstances" as the original criminal sexual conduct charges, and ordered him to register as a sex offender under Minn. Stat. §243.166, sub. 1(a)(1)(iii) (1996).

At a probation violation hearing, for failure to complete treatment, the respondent moved to withdraw his guilty plea, claiming ineffective assistance of counsel and because he had been unaware of the sex offender registration requirement. At this hearing, he did not mention the DNA sample. This motion was denied.

On appeal of the probation violation, the DNA sample requirement was still not mentioned. On appeal, the Minnesota Court of Appeals held that his conviction for the prostitution matter did not arise from the same set of circumstances as the original criminal sexual conduct charge and the respondent did not have to register as a sex offender. *State v. Johnson*, 2000 WL 365051 (Minn. App. 4/11/00). This appeal opinion did not mention the DNA sample requirement.

While the appeal was pending, the BCA noted that the respondent's DNA sample matched an unsolved 1992 rape, and the respondent was charged with this new rape. At the bail hearing, respondent's first attorney did bring up the subject of challenging the DNA sample, because it had been taken as part of a sentencing order in a case that by now had been reversed. However, this attorney was replaced by another attorney, who did not argue that the initial DNA sample should not have been taken, because the conviction had been reversed. The respondent subsequently pled to the new charge. He later filed a petition for post-conviction relief, arguing that his attorney was ineffective by not challenging the admissibility of the DNA evidence.

Held, respondent's attorney was ineffective by failing to challenge the admissibility of the DNA evidence, respondent was prejudiced by the deficient performance, and that the respondent is not barred from raising this challenge, even though he did not raise it in his direct appeal. The Court of Appeals rejects the state's argument that the exclusionary rule does not apply because police misconduct is not at issue. **Kevin Johnson v. State of Minnesota**, C8-02-790 (Minn. App. 12/3/02). <http://www.lawlibrary.state.mn.us/archive/ctappub/0212/c802790.htm>

**m FORFEITURE: DWI: EXCESSIVE FINES: INDIVIDUAL FINANCIAL CIRCUMSTANCES.** The respondent's \$16,000 vehicle was seized as a result of a conviction for first degree DWI. This second DWI conviction was within seven months of the first offense, and her blood alcohol concentration was .29 percent. The trial court examined the respondent's financial circumstances, found the forfeiture unconstitutionally excessive because of its individual impact on the respondent, and ordered all but \$1,000 of the proceeds of the sale of the vehicle to be returned to the respondent.

The Court of Appeals reverses the trial court. The forfeiture in this case was not unconstitutionally excessive under the 8th amendment. Applying the "gross disproportionality" test articulated in *Solem v. Helm*, 463 U.S. 277, 288 (1983), the Court of Appeals considered the three factors for testing the excessive fines theory: the gravity of the offense and the harshness of the penalty, a comparison of the contested fine with fines imposed in the commission of other crimes in the same jurisdiction, and the comparison of other contested fines with fines imposed for commission of the same crime in other jurisdictions.

Held, the district court erred in assessing the respondent's individual financial circumstances when applying the first factor of the *Solem* test for gross disproportionality. Courts must use an objective evaluation of the harshness of the penalty, not a subjective assessment of the individual circumstances of the person affected by it. The court concludes that the forfeiture of a \$16,000 vehicle is not excessive in light of the respondent's conduct. Next, the court concludes that the forfeiture of the \$16,000 vehicle is not excessive when compared to the maximum possible fine for gross misdemeanor (\$3,000). The court notes that in a similar case, a forfeiture as high as \$40,000 was not unconstitutional. Finally, the court notes that other jurisdictions have comparable forfeiture laws (California, Michigan, North Dakota and Wisconsin). **Debra Jane Miller v. One 2001 Pontiac Aztek**, C8-02-613 (Minn. App. 12/17/02).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0212/c802613.htm>

**m SEARCH AND SEIZURE: AUTOMOBILE: PASSENGER: DRUGS.** The appellant was a passenger in a vehicle stopped by St. Paul police for making two turns without signaling. The driver was asked for his license and proof of insurance, while the appellant was seated in the front passenger seat. The police officer could smell the odor of burned marijuana coming from inside the vehicle, and noted that the appellant was moving constantly, his eyes were darting back and forth, and he was

eating a sandwich “faster than [he] had ever seen one eaten before.” The officer concluded that the appellant’s actions were above and beyond the normal nervousness he had encountered in prior stops.

The arresting officer discovered that the driver’s license had been revoked, had no proof of insurance, and registration was from another city. Accordingly, the driver was placed under arrest, and back-up called.

While the appellant remained in the vehicle, the arresting officer asked him for identification, then to step out of the vehicle. At this time, the arresting officer stated that the burned marijuana odor was coming directly from the appellant. Based upon the odor, the appellant’s constant movements, and extraordinary nervousness, the officer concluded that the appellant was under the influence of a controlled substance. While still standing outside of his car, the appellant was asked if he had any outstanding warrants, which he denied. He was then asked if he had any weapons, which he also denied. He was then asked if he would consent to a pat down, and the police officer found nothing. However, the officer decided to investigate further, based upon all the circumstances and, in particular, the appellant’s hesitation in answering the question about whether a warrant existed for him. The appellant was then escorted to a back-up squad car, where he was told to sit in the back while the officer checked for warrants. The appellant was told that if there were no warrants, he could leave. As he began to enter the squad car, the appellant brushed against the arresting officer who then felt a bulging hard object on the appellant’s hip. The appellant declined to answer the officer’s question about what this object was. When the officer lifted his jacket to expose the object, he continued to smell strong odors of both burned and unburned marijuana, and then saw a black pouch on the hip of the appellant and thought it might contain a weapon. When he opened the pouch, he found drug paraphernalia, marijuana, and a vial of methamphetamine. The appellant was then arrested.

Held, the act of the officer requesting the appellant to step out of the impounded vehicle was not an unreasonable extension of the stop. The vehicle was going to be impounded, and there was no evidence that the owner of the vehicle consented to the appellant having possession of it. Next, although the original purpose of the stop had been accomplished, the police officer acquired additional reasonable suspicion during the stop, based upon the appellant’s extraordinary nervousness, the odor of marijuana, and the conclusion that the appellant was under the influence of a controlled substance. These indices provided the officer reasonable and articulable suspicion that the appellant was in possession of marijuana, and allowed the officer to inquire further.

The court notes that the odor of burned marijuana inside a stopped motor vehicle provides *probable cause* for the search of the vehicle’s occupants, citing *State v. Wickland*, 205 N.W.2d 50 (1973).

Next, the court holds that the questions, frisks, and check were reasonable as an extension of the probable cause deriving from the smell of burnt marijuana alone. Other grounds include the appellant’s hesitation with respect to the warrant in question, his out-of-proportion anxiety, and his admission at the suppression hearing that he was high on drugs during the stop. Finally, the second frisk was clearly justified as a proper protective search under *Terry*, because of the hard bulge and the appellant’s refusal to respond. *State v. Elliott Kamalani Doren*, C6-02-58 (Minn. App. 12/17/02). <http://www.lawlibrary.state.mn.us/archive/ctap-pub/0212/c60258.htm>

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## EMPLOYMENT & LABOR LAW

### JUDICIAL LAW

m **DATA PRACTICES.** A number of disclosures of information about a teacher’s medical condition and disciplinary action against her by a school district constitutes a violation of the Minnesota Government Data Practices Act, Minn. Stat. §13.43, but the case was remanded to determine damages for emotional distress stemming from the wrongful disclosures.

Affirming in part and reversing in part, the Supreme Court held that the claimant teacher established several violations of the act, but upheld reversal of the jury verdict of \$520,000. It remanded the case to allow the school district to introduce evidence about the teacher's preexisting emotional condition to rebut her claim for emotional distress. **Navarre v. South Washington County Schools**, 652 N.W. 2d 9 (Minn. 2002).

m **RETALIATORY CLAIMS.** An employee who worked for the county assessor's office did not have a valid 1st Amendment claim of retaliatory firing in this case from Arkansas. The 8th Circuit upheld summary judgment on grounds of qualified immunity for the retiring assessor who fired his subordinate after she wrote a memorandum to the deputy, who was running for the office to be vacated by the retiring assessor, stating that she did not support the deputy's candidacy and did not want promotion if the deputy won the election. Since the document was motivated primarily by the employee's concerns over her own employment, not over matters of public concern, it was not protected by the 1st Amendment. In addition, the memorandum did not constitute a protectable expression of the 1st Amendment because it was distributed to the deputy assessor and the personnel director and was not given to the public and intended to be a complaint. **Sparrow v. Ward**, 306 F. 3d 589 (8th Cir., 2002)

But a mine worker who was fired after filing a confidential safety complaint with a government agency, which resulted in inspection of eight safety citations, was entitled to damages for retaliatory firing. The 8th Circuit affirmed the order of the regulatory commission holding that the firing was discriminatory and awarding back pay and imposed a civil penalty. The evidence reflected that the employee was terminated in retaliation for filing the complaint. The company's claim that the employee failed to mitigate damages was rejected because, although he was enrolled as a full-time evening college student, he was still able to look for work and did, in fact, find a day job. **Gabel Stone Co. v. Federal Mine, Safety and Health Review Commission**, 307 F.3d 691 (8th Cir., 2002).

The firing of a disabled employee, shortly after filing a charge of disability discrimination with the Equal Employment Opportunity Commission (EEOC) constituted an improper retaliatory discharge and warranted affirmation of a large jury verdict in another 8th Circuit case. Although the injured employee sought and received some accommodation of the workplace, he was fired after filing an Equal Employment Opportunity Commission (EEOC) charge. The employer's contention that the firing was due to failure to properly call in an absence from work was pretextual. The employee established pretext by showing that, despite the accommodation, he had been chided because of the medical restrictions that resulted from a serious workplace fall, coupled with testimony that his manager indicated that he was going to "teach" him a lesson, after he learned of the EEOC filing. The court upheld the front pay award of \$445,000, which consisted of lost income through the employee's anticipated retirement, together with a \$100,000 award of punitive damages, and nearly \$130,000 of attorney's fees and costs. **Salitros v. Chrysler Corp.**, 306 F. 3d 562 (8th Cir. 2002).

m **EMPLOYMENT "MISCONDUCT."** The Minnesota Court of Appeals found "misconduct" in a pair of recent rulings, denying unemployment compensation to each of the claimants. In the first case, an employee who needed a driver's license for his work but had lost his license previously for alcohol-related offenses was not entitled to unemployment compensation benefits. Although the employer offered to assist the claimant in obtaining a new license, the employee refused to cooperate in obtaining a new license, which was required to enable him to carry out his duties. His refusal to obtain a driver's license constituted "misconduct" and disqualified him from unemployment compensation benefits. **Rime v. Crysteel Truck Equipment Company, Inc.**, 2002 WL 31247067 (Minn. App. 2002) (unpublished)

In the second case, an employee who failed to timely pay company credit card bills and also used the company's credit card to take cash advances was not entitled to unemployment compensation benefits. The claimant's assertion that he suffered from short-term memory loss was unsubstantiated by medical records or his application for disability insurance benefits. **Sarles v. Paper Payment Services, LLC**, 2002

WL 31247088 (Minn. App. 2002) (unpublished)

m **ERISA ISSUES.** An oral COBRA notification to extend health insurance for up to 18 months is valid, according to a ruling of the 8th Circuit Court of Appeals. An employee, who quit her job, sued for violation of COBRA rights under the Employee Retirement & Income Security Act (ERISA), claiming that she was not told about her right to continue health insurance benefits. However, the employer testified that insurance options were twice discussed with the employee and corroborated by other witnesses, who also testified that the employee had stated several times that she did not want temporary COBRA coverage. The employee sought a permanent individual policy, which was then denied due to preexisting health conditions. She then had a heart attack, incurred uncovered health expenses, and commenced the lawsuit, claiming that the employer should be responsible for payment of the expenses because it did not furnish her with written COBRA notification.

However, COBRA notification need not be in writing. Since there was sufficient evidence for the trial court that oral notice had been given, the case was properly dismissed. Although the employee's husband did not receive any separate notice of his COBRA option, he incurred no medical expenses. Since there was no harm resulting from the failure to furnish notice to him, a claim could not be made on his behalf, either. *Chesnut v. Montgomery*, 307 F. 3d 698 (8th Cir. 2002).

A provision in an ERISA plan that requires mandatory arbitration and splits the costs of the arbitration between the employee and the employer is invalid because it does not provide the employee a reasonable opportunity for a full and fair review of a denial of ERISA benefits, as required by the statute, 29 U.S.C. §1133. In this 8th Circuit case, the court reversed a ruling of the district court in Minnesota and directed that the employer must pay all of the arbitration costs. Accordingly, it found that requiring the employer and employee to split the costs "unduly inhibits" an employee's right to pursue an ERISA claim in violation of the statutory and regulatory ERISA framework. *Bond v. Twin City Carpenters Pension Fund*, 307 F. 3d 704 (8th Cir. 2002),

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## ENVIRONMENTAL LAW

### JUDICIAL LAW

m **CLEAN WATER ACT; CITIZEN SUIT DISMISSAL.** The United States District Court for the District of Minnesota recently dismissed a citizens' suit brought under the Clean Water Act to challenge St. Paul's storm sewer discharges. Plaintiffs Mississippi River Revival and West Side River Watch Inc. claimed that the city's 2001 annual report did not satisfy the terms of its National Pollutant Discharge Elimination System (NPDES) storm sewer permit. Plaintiffs also accused St. Paul of violating the Clean Water Act by discharging unacceptably high concentrations of pollutants through its storm sewer system and into the Mississippi River, Lake Como, Lake Phalen and other receiving waters. Plaintiffs filed a motion for summary judgment; St. Paul responded with a motion for judgment on the pleadings or, in the alternative, a cross-motion for summary judgment.

The court denied plaintiffs' motion for summary judgment and granted the city's cross-motion on two grounds. First, plaintiffs lacked standing on their NPDES reporting requirement claims because they failed to assert how the alleged reporting deficiencies amounted to particularized injuries to their environmental interests. (In a footnote, the court noted in the alternative that plaintiffs also lacked standing to allege "management program violations." The court found that plaintiffs had no basis on which to claim the city had violated the program when the Minnesota Pollution Control Agency (MPCA) had approved the program and apparently was satisfied with the city's compliance with its terms.)

The court found plaintiffs had standing to make their effluent violations claim, but rejected that claim nonetheless. The court rejected plaintiffs' arguments that the cover sheet of the NPDES permit, which included a goal of compliance with

state and federal statutes and rules, and the MPCA's incorporation of federal regulations into the permit created an obligation to comply with the numeric water quality discharge standards of section 301 of the Clean Water Act. The court noted that the city's NPDES permit did not impose numeric standards on the city. Instead, it merely required the city to utilize "best management practices (BMPs)" in controlling its effluent discharges. More importantly, the court found that the Clean Water Act specifically exempted municipalities from having to comply with the section 301 standards. The court granted the city's cross-motion for summary judgment and dismissed plaintiffs' claims with prejudice. **Mississippi River Revival, Inc. v. City of St. Paul**, 2002 WL 31767798 (D. Minn. 12/02/02).

m **CLEAN WATER ACT; 404 PERMITS FOR WETLANDS PLOWING.** The U.S. Supreme Court, in a 4-4 vote, let stand a 9th Circuit decision that found that "deep plowing" in a wetland on a California ranch constituted a discharge in need of a dredge-and-fill permit under the Clean Water Act. The 9th Circuit found that even normal plowing may fall within the recapture provision of the act requiring a Section 404 permit if the plowing involves discharges into navigable waters incidental to an activity designed to bring an area of navigable waters into a use to which it was not previously subject. The 9th Circuit found that the plaintiff-appellant should have obtained a 404 permit from the Corps before he deep-plowed his property so as to convert ranch land to orchards and vineyards. It also held that plaintiff-appellant could be found guilty of a Clean Water Act violation with every pass of the ripper plow on his property. **Borden Ranch Partnership v. U.S. Army Corps of Engineers**, 123 S.Ct. 599 (2002).

m **CLEAN WATER ACT; DRAFT GENERAL STORM WATER PERMIT.** The Environmental Protection Agency (EPA) published notice in the December 20, 2002 *Federal Register* of its draft general permit for storm water runoff. The draft permit is a product of Phase II of the EPA's storm water discharge program. Phase I, implemented in 1990, requires construction sites that disturb five or more acres to obtain a storm water discharge permit. Phase II, finalized in 1999, requires discharge permits for "small construction activity," defined as sites that disturb more than one but less than five acres or sites of less than one acre that are part of a larger common plan of development or sale if the larger common plan will disturb more than one but less than five acres. Comments on the draft permit were accepted through February 3, 2003.

m **CLEAN WATER ACT; FINAL FEEDLOT RULES.** EPA Administrator Christine Whitman signed the final version of the EPA's new Concentrated Animal Feedlot Operations (CAFO) rules on December 15, 2002. The new rules are expected to apply to approximately 15,500 livestock operations across the country. The final version differs from the one previously announced by the EPA in January 2001 (66 Fed. Reg. 2960) in that it focuses on only the largest operations. In addition, the EPA excluded an earlier requirement that "integrators" — large companies that produce and sell the meat product — be included as "co-permittees." States, however, may require co-permittee status of integrators through their own rules. Sprayfields and the land application of manure will be regulated under the new rule, in addition to discharges from buildings. The EPA plans to publish the final rule in the *Federal Register* soon. Copies of the new rules may be viewed in the meantime at <http://cfpub.epa.gov/npdes/af/cafofinalrule.cfm>

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## FAMILY LAW

### JUDICIAL LAW

m **PROPERTY DIVISION — UNCONDITIONAL GIFT.** The parties separated in 1991 after a 21-year marriage, but did not initiate dissolution proceedings until 2000. During the separation, wife moved out and husband remained in the family home. In 1994, husband gave wife \$65,000 to purchase a town home. The parties divided most of their assets in 1991, but issues remained regarding their residences and husband's retirement account. The district court found that both parties had been self-sufficient during the separation, though husband earned sig-

nificantly more money, and that the \$65,000 was an “unconditional gift” from husband to wife that did not affect the marital property division. Additionally, the court awarded wife 25 percent of husband’s retirement account *at the time of the decree*, noting that it “technically remain[ed] marital property” during the long separation.

Husband appealed, challenging the district court’s property division. Wife appealed the district court’s retroactive child support award and denial of attorney fees.

The Court of Appeals rejected husband’s argument that the \$65,000 was not a gift, but part of his nonmarital property, and that he was entitled to this money, plus half of its appreciated value (\$57,000). Despite the agreement that the money was originally nonmarital property, there was no evidence of anything but a donative intent. Husband simply gave wife the money and presented no evidence that it constituted a loan or that he intended to maintain an interest in the property. Wife purchased the town home in her name and maintained, renovated, and paid taxes on it. The court also noted that a finding that the money was nonmarital property would require a reevaluation of the property division and wife’s need for maintenance.

The Court also rejected husband’s argument that wife should not have received a percentage of his retirement account because she made no post-separation contribution to it. Even though the increased value of a retirement account is generally presumed to come from joint spousal contributions, this presumption does not extend to increases during periods of separation. The district court found the account to be marital property, but it could have awarded a portion of that (or any) property to wife to avoid unfair hardship, since she had spent part of her share of marital assets to meet her basic daily needs. The district court factored in the pension as part of the equitable distribution of marital property between the parties, so husband was not entitled to a corresponding portion of wife’s retirement account. Each party’s contribution to the account is only one of the relevant factors and is not dispositive. Regarding wife’s appeal, the Court of Appeals declined to address the merits, agreeing with the district court that the issues had not been timely raised. Affirmed. **Parker v. Parker**, C7-02-571 (Minn. App. 12/31/02) (unpublished). <http://www.lawlibrary.state.mn.us/archive/ctapun/0212/571.htm>

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## FEDERAL PRACTICE

### JUDICIAL LAW

m **REMOVAL JURISDICTION: ALL WRITS ACT.** In May/June, 2002, this column noted the Supreme Court’s grant of certiorari in *Henson v. Ciba-Geigy Corp.*, 261 F.3d 1065 (11th Cir. 2001), *cert. granted*, 122 S. Ct. 1062 (2002), to determine whether the All Writs Act permits federal district courts to exercise removal jurisdiction under 28 U.S.C. §1441 over lawsuits brought in state courts that might threaten the integrity of a federal court’s rulings in ongoing complex litigation. A unanimous Supreme Court has now held that the act does not provide a basis for removal jurisdiction either alone, or in combination with the principles underlying ancillary enforcement jurisdiction.

This decision effectively overrules the 8th Circuit’s recent decision in *Xiong v. Minnesota*, 195 F.3d 424 (8th Cir. 1999). The Supreme Court case is **Sygenta Crop Protection, Inc. v. Henson**, 123 S. Ct. 366 (2002).

m **CONSENT TO MAGISTRATE JUDGE; POST-TRIAL CONSENT.** The Supreme Court has granted certiorari to determine whether litigants’ post-judgment consent to a magistrate judge’s trial of a case cures any jurisdictional defects.

Plaintiff commenced a *pro se* Section 1983 action against a number of defendants, and gave his written consent to have his case heard by a magistrate judge. Only one defendant consented to have the magistrate judge hear the case, but the matter was referred to the magistrate anyway. Subsequently, the magistrate judge

dismissed some claims, and other claims were tried to a jury, which found for the defendants. After the plaintiff appealed, the 5th Circuit, *sua sponte*, questioned whether all parties had consented to have the magistrate hear the case, and remanded the case for a determination as to whether the necessary consents had been obtained. On remand, the remaining defendants finally provided their consent, but the magistrate issued a Report and Recommendation finding that the defendants' post-judgment consents did not cure the underlying jurisdictional defect. The magistrate's finding was adopted by the district court.

The 5th Circuit noted a split in the courts of appeal, with the 7th and 11th Circuits repeatedly holding that post-judgment consents are effective, and the 9th Circuit finding that post-judgment consent is not effective. (It appears that the 8th Circuit has yet to address this issue.) Relying primarily on the plain language of 28 U.S.C. §636(c), the court found that the statute requires consent *before* trial or judgment, and that "Post-judgment consent is contrary to the ... plain language" of the statute. The 5th Circuit also appeared troubled by the gamesmanship that would inevitably occur under the 7th and 11th Circuit rule, as non-consenting parties could proceed through trial, and then offer their post-trial consent only if they emerged victorious. **Withrow v. Roell**, 288 F.3d 199 (5th Cir.), *cert. granted*, 123 S. Ct. 512 (2002).

m **OTHER NOTEWORTHY DECISIONS.** The 8th Circuit found that Judge Kyle did not abuse his discretion in granting a preliminary injunction without first holding an evidentiary hearing, finding that no hearing was required because there were no material facts in dispute. **United Healthcare Ins. Co. v. AdvancePCS**, \_\_\_ F.3d \_\_\_ (8th Cir. 2002).

Judge Tunheim denied a defendant's request for leave to file a Motion to Reconsider under Local Rule 7.1(g), finding that motions to reconsider are granted only in "compelling circumstances," and that a request which "simply restates arguments made in writing and orally before the Court" and "appears to seek nothing more than 'a second bite at the apple'" did not present the compelling circumstances required to support the request. **Hormel Foods Corp. v. Cereol, S.A.**, 2002 WL 31553544 (D. Minn. 11/07/02).

Judge Davis sanctioned an attorney \$500 for saying "damn" during oral argument, finding use of the word "outside the realm of acceptable conduct." (The fine was subsequently suspended after the attorney sent a letter of apology to the court.) **Nelson v. Ellerbe Becket Construction Services, Inc.**, 2002 WL 31571177 (D. Minn. 11/15/02).

Magistrate Judge Erickson awarded \$2,310 in sanctions where the plaintiff failed to provide a knowledgeable witness in response to the Fed. R. Civ. P. 30(b)(6) deposition notice. **Arctic Cat, Inc. v. Injection Research Specialists, Inc.**, 210 F.R.D. 680 (D. Minn. 2002).

Judge Tunheim affirmed an Order by Magistrate Judge Noel requiring the defendant's production of personnel files in an employment discrimination case. **Burns v. Hy-Vee, Inc.**, 2002 WL 31718432 (D. Minn. 11/21/02).

Magistrate Judge Erickson issued an Order establishing a protocol for the preservation and inspection of computer files, which included the appointment of a neutral computer forensics expert to inspect and copy computer files in an attempt to recover deleted data. This decision provides significant guidance for future litigants who may feel the computer forensic experts are required in their cases. **Antioch Co. v. Scrapbook Borders, Inc.**, 210 F.R.D. 645 (D. Minn. 2002).

#### COURT RULES

m **RULE AMENDMENTS IN EFFECT.** Minor amendments to both the Federal Rules of Civil Procedure and Federal Rules of Appellate Procedure took effect on December 1, 2002. One rule likely to have immediate impact on civil practitioners is new Fed. R. Civ. P. 7.1, which requires corporations to file corporate disclosure statements along with their initial pleadings. The District of Minnesota views this rule as retroactive, and has indicated that all corporate parties in pending litigation are to file corporate disclosure statements "immediately."

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## INTELLECTUAL PROPERTY

### JUDICIAL LAW

m **PATENTS; NEW “BEST MODE” TEST.** The Court of Appeals for the Federal Circuit may have created a new “best mode” test in deciding a recent patent case. In exchange for a patent, an inventor is required to disclose the “best mode” for making and using the invention. If the best mode is not disclosed, the patent is invalid. This case involved an allegation that a Bayer patent protecting Cipro failed to disclose the best mode for making the drug because it did not disclose the best method for making an *unclaimed intermediate* compound. The case turned on whether an inventor is required to disclose the best mode for making an unclaimed intermediate compound when that compound is new but obtainable. Although the court held that the best mode requirement was not violated, after reciting the well-known test for best mode, the court went on and said that unclaimed matter did not need to be disclosed because it did not “materially affect carrying out the invention.” This “materially affect” addition to the test, if not dicta, would be new law. It would require an inventor to disclose the best mode for making and using both claimed and unclaimed subject matter that materially affects the invention. In his concurrence, Judge Rader expressed concern that this new test created traps for unwary patent applicants who misunderstand best mode requirements. By expanding the best mode analysis to unclaimed matter that would materially affect the claimed invention, it could create a large degree of uncertainty until the limits of the test are clarified. However, based on a fair reading of the case, the court’s statements concerning “material effect” are dicta and the best mode test should remain that which it was before this decision. *Bayer AG v. Schein Pharma.*, 01-1286, 01-1287 (Fed. Cir. 09/09/02)

m **SUMMARY JUDGMENT OF NON-INFRINGEMENT; EMBEDDING V. EMBOSSED.** Judge Doty granted respondent’s motion for summary judgment of non-infringement because embedding is not the same as embossing. 3M sued Avery for infringing a patent that required “a multiple embossed pattern having a first embossed pattern and a second embossed pattern.” 3M argued that Avery infringed the claims requiring the multiple embossed patterns because Avery’s product contained a pre-embossed pattern and a second embossed pattern. The court found that Avery’s accused product did not infringe, however, because it had only one embossed pattern. The court, in comparing the accused product to the construed patent claims, relied on a dictionary and other technical references to distinguish between “embedding” and “embossing.” The court distinguished between the two terms-of-art, stating that one skilled in the art recognized that the two processes are distinct. The court held that there was no literal infringement based on the difference between embedding and embossing. The court further held there could be no infringement under the doctrine of equivalents since it cannot be used to read-out a claim limitation, in this case the “multiple embossed patterns.” *3M v. Avery Dennison*, No. Civ.01-1781 (DSD/FLN) (D. Minn. 10/19/02).

— TONY ZEULI

— RICK FRANZEN

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## JUVENILE LAW

### TRENDS

m **PROSECUTING JUVENILE OFFENDERS AS ADULTS.** Over the past four years, society has learned that youth violence is not confined to the ghetto streets of the big city; it never solely was. The recent surge in media attention towards youth violence raises a panoply of concerns with respect to the juvenile justice system. As criminal acts committed by juveniles become increasingly more violent, there is a corresponding increase in societal pressure for change with respect to the political, as well as judicial, response to youth crime.

The foundation of juvenile court originally rested in the notion of creating a system of justice whose punitive goals were treatment-oriented rather than purely retributive. This ideal was supported by the belief that the younger generation was the future of society, and as a productive society we had a duty to make

every attempt to rehabilitate those individuals, specifically children, who, through their actions, appeared to be most in need of services.

Although there has been no notable increase in the incidence of juvenile crime as a whole, there is an increase in the seriousness of those crimes being committed. Between 1982 and 1991, juvenile arrests for violent crimes increased 41 percent. "During that nine-year period, juvenile murder arrests increased 93 percent and aggravated assault arrests increased 72 percent." Such increases in serious violent crimes among juvenile offenders have continued. As a result, juvenile courts have adapted and responded by reforming the system by replacing rehabilitative ideals with retributive policies and goals.

The modern regime of juvenile justice attempts to synthesize many needs by providing juvenile offenders with a system, which is rehabilitative in nature, while fashioning appropriate punishments insuring deterrence. As a direct result of the increase in publicly reported violent juvenile crimes, there is a corresponding increase in societal beliefs that the juvenile court system needs to alter its perception that rehabilitation and retribution are mutually exclusive ideals.

There is an immediate public demand for punitive responses to youth violence. New laws have been passed in a majority of the states, providing for the prosecution of younger children as adults. Piggybacking these new policies is imposition of longer, more restrictive placements on convicted juvenile offenders. While the juvenile offender was once presumed to be the most easily redeemable and susceptible to rehabilitation, there is now an *emerging consensus* that these youths are as dangerous as their adult counterparts and accordingly must be treated like them.

With each new publicized incident of youth violence, the debate concerning how the criminal justice system should treat juvenile offenders amplifies. Should society continue to treat juveniles as juveniles, or should they be treated as adults?

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## REAL PROPERTY

### JUDICIAL LAW

m **JUDGMENT LIENS.** A creditor obtained a judgment against debtor and purchased debtor's real estate at an execution sale. After the sale, debtor conveyed the property by quit claim deed to grantee who then redeemed the property. Because the sale did not fully satisfy the judgment amount, the district court ruled that the property remained subject to the outstanding judgment lien. Creditor initiated another execution sale against the property. Creditor purchased the property at the second sale and no redemption occurred. Creditor conveyed the property to purchasers. The grantee commenced a quiet-title action to declare him the fee owner, however the district court granted summary judgment to purchasers. The Court of Appeals found that collateral estoppel prevented grantee from challenging the propriety of the second execution sale in the quiet-title action. According to Minnesota law grantee needed to raise any alleged irregularities in the second sheriff sale before the redemption period expired. *Henricksen v. Bruckelmyer, et al.* C5-02-732 (Minn. App. 12/3/02) (unpublished). <http://www.lawlibrary.state.mn.us/archive/ctapun/0212/732.htm>

m **CONTRACT FOR DEED.** Parents sold real estate to their son and his wife pursuant to a contract for deed. Parents attempted to cancel the contract for deed after son and wife defaulted by serving a notice of cancellation. Parents rescinded the cancellation, however later served a second cancellation notice only on son. Wife filed a petition to dissolve her marriage to son and commenced a lawsuit against parents and son arguing that the cancellation was defective. During the lawsuit parents served a third notice of cancellation on both son and wife. The Court of Appeals held that the third notice effectively cancelled the contract for deed. The court found that a cancellation notice is effective absent any ambiguity or prejudice to the purchaser by an error in the notice. Wife could have avoided the cancellation of the contract for deed if she would have tendered the amount in default. *Serbus v.*

**Serbus et al.**, C3-02-664 (Minn. App. 11/5/02) (unpublished). <http://www.lawlibrary.state.mn.us/archive/ctapun/0211/664.htm>

m **CONSTRUCTION.** Developer commenced development plans for a golf course and residential housing. Developer entered into a written contract with contractor to perform excavation work on the project. Contractor entered into an oral agreement with subcontractor to install utility services. Developer signed a change order waiving the contractual requirement to obtain performance and payment bonds. Subcontractor did not receive notice of this change. Subcontractor performed the work and received partial payment from contractor before contractor filed for bankruptcy. Subcontractor did not file any mechanic's liens. Subcontractor sued developer for the unpaid amount. The Court of Appeals found that the contract between developer and contractor, does not support subcontractor's claim that the contract intended to make subcontractor a third-party beneficiary. The court reasoned that under the intended-beneficiary approach, the contract clearly disclaimed any obligation developer may have to pay or provide notice to any subcontractor. Finally, subcontractor failed to pursue the remedy available to it by not filing a mechanic's lien. **Hennen Construction Co. v. Pilot Land Development**, C5-02-620 (Minn. App. 12/3/02) (unpublished).

<http://www.lawlibrary.state.mn.us/archive/ctapun/0212/620.htm>

m **REGISTERED LAND.** In 1996, the prior owners of the property and the adjacent property owner entered into an easement agreement which permitted the adjacent owners a tile drain across the property. The registrar of titles did not memorialize the easement on the certificate of title. Owner purchased the property from the prior owners. Again the easement did not appear on owner's certificate of title. In April 2001, the registrar of titles memorialized the easement on the certificate of title. Owner initiated an action seeking peremptory writ of prohibition and mandamus directing removal of the easement memorial. The district court dismissed the action finding that owner's remedy was through a proceedings subsequent under Minn. Stat. §508.71. The Court of Appeals agreed with the district court finding that to obtain mandamus relief, petitioner must show the failure of an official duty imposed by law, a public wrong injurious to petitioner, and no other adequate legal remedy. In this case, while the failure of the registrar of title to carry out its duties by not referring the matter to the examiner of titles constituted a public wrong, Owner did not prove that a proceedings subsequent action was an inadequate remedy. **Walther v. Lundberg, Lincoln County Registrar of Titles**, C2-02-798 (Minn. App. 12/17/02). <http://www.lawlibrary.state.mn.us/archive/ctapub/0212/c202798.htm>

m **DRAINAGE SYSTEM.** After performing a cost-benefit analysis, the County Board of Commissioners approved proposed drainage improvements to a county ditch. Several affected landowners commenced a benefits and damages appeal. At trial the jury issued a verdict reducing the estimated benefits and increasing the damages. The viewers amended their report to reflect changes to their calculations which increased the benefits amount. The project engineers also filed a modified report. The County Board accepted both amended reports and the landowners appealed. While the appeal was pending the County Board awarded the construction contract to contractor. The Court of Appeals held that according the Minn. Stat. §103E.511, once a drainage system is established, the drainage authority may accept an amended viewers' report if the report is provided to correct errors in calculating the benefits and costs of a project. Furthermore, a drainage authority may award a construction contract during the pendency of a benefits and costs appeal under Minn. Stat. §103E.505. **Pestka et al. v. County of Blue Earth**, C3-02-566 (Minn. App. 12/17/02). <http://www.lawlibrary.state.mn.us/archive/ctappub/0212/c302566.htm>

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## TAX

### JUDICIAL LAW

m **REAL PROPERTY VALUATION INCURRED BECAUSE OF COMPARABLE SALES.** The Minnesota Tax Court increased the value of the taxpayer's industrial facility over its assessed value over the taxpayer's objection. The income valuation estimation,

while a useful benchmark, was problematical because of the lack of true market data for the property. The sales approach was supported by the evidence and led to the increase in value. **Paddock Properties LLC, et al. v. County of Hennepin**, Nos. 27971, 28803, 29088, 2002 WL 31108684 (Minn. T.Ct. 9/19/02).

m **SENIOR LIVING FACILITY QUALIFIED FOR REAL PROPERTY EXEMPTION.** The Minnesota Tax Court held that a senior living facility qualified for property tax exemption under Minn. Stat. § 272.02(26) (ii). The specific wording of the exemption in Subd. 26(ii) reads: "Housing lower income families or elderly or handicapped person, as defined in Section 8 of the United States Housing Act of 1937, as amended." The court rejected the county's contention that the phrase "lower income" should be applied to families, elderly and handicapped persons. The court agreed that the phrase is disjunctive and did not apply to the elderly because the terms of the statute are plain and clear. **ILHC of Eagan, LLC v. County of Dakota**, No. CO-01-7361, 2002 WL 31323691 (Minn. T. Ct. 10/01/02).

m **REAL PROPERTY JUDGMENT VACATED BECAUSE OF MISTAKE.** The Minnesota Tax Court granted a motion to vacate a property valuation dismissal, ruling that the taxpayer's petition was dismissed on a mistake of fact. Taxpayer dismissed its appeal when told that the real estate he occupied was subject to only a 3 percent tax increase. Within days after the dismissal, the business learned from its landlord that it was responsible for not only the property that it actually occupied but was responsible for a percentage of real property taxes on the entire property. **Marudas Graphics, Inc. v. County of Ramsey**, No. C9-02-3063, 2002 WL 31323501 (Minn. T. Ct. 10/11/02).

m **REAL PROPERTY HOMESTEAD CLAIM REJECTED.** The Minnesota Tax Court rejected the taxpayers' contention that they were entitled to homestead status under the Four Township Rule in Minn. Stat. § 273.124(14) (b) (i) (4). The subject property was more than four townships or cities away from the location of taxpayers' current homestead. In addition, taxpayers' inclusion of multiple years in their Notice of Appeal was in violation of Minn. Stat.

§ 278.02 that provides the Notice of Appeal shall not include more than one assessment date. **Allan W. & Janet T. Lamkin v. County of Sibley**, No. C2-02-70, 2002 WL 31409323 (Minn. T. Ct. 10/21/02).

m **TAX PROTESTER MUST PAY MINNESOTA INCOME TAX.** The Minnesota Tax Court determined that the taxpayer was not excused from filing or paying Minnesota income tax because the 16th Amendment to the United States Constitution was not properly ratified. Courts have long held that Minnesota has the power to impose an income tax regardless of the limits of the 16th Amendment. **Timothy J. Hanson v. Commissioner of Revenue**, No. 7412, 2002 WL 31323494 (Minn. T.Ct. 10/15/02).

m **REAL PROPERTY JUDGMENT VACATED BECAUSE OF LACK OF JURISDICTION.** The Minnesota Tax Court held that it did not have jurisdiction for the assessment year 1999 since the taxpayer's appeal was filed in March, 2001, well past the March 31, 2000 statutory deadline set forth in Minn. Stat.

§ 278.01(1). This was true notwithstanding the fact the court had ordered a refund for the assessment years 1999 and 2000 when it determined that the subject property was tax-exempt in **Point Rejuvenate of Minnesota Inc. v. County of St. Louis**, No. C2-01-100656 (Minn. T. Ct. 04/04/02). The court balanced the underlying policy in respecting final judgments and the time-worn rule that lack of jurisdiction can be raised at any point in time by holding that the county's raising of the subject matter jurisdiction issue was within a reasonable time after the entry of the final judgment and therefore came within the precedent of **Bode v. Minn. Dept. of Natural Res.**, 612 N.W. 2d 862 (Minn. 2000). In **Bode**, the Minnesota Supreme Court said that direct attacks on a final judgment based on subject matter jurisdiction must be brought within a reasonable time. Since the court disposed of the case because of a lack of jurisdiction, it did not respond to the county's alternative argument that the court did not have jurisdiction over the 1999 taxes because Minn. Stat. § 278.02 provides that no real property petition shall include more than one assessment date and taxpayer's petition contained both 1999 and 2000 taxes. **Point Rejuvenate of**

**Minnesota v. County of St. Louis**, No. C2-01-100656, 2002 WL 31651161 (Minn. T. Ct. 11/14/02).

m **FILING PETITIONS IN MINNESOTA COURTS BY NONLAWYER.** The Minnesota Court of Appeals stated that a nonlawyer is not authorized to file a petition in the Court of Appeals on behalf of another for a writ of certiorari to review a decision of the commissioner of economic security. **In the Matter of Jesse H. Evjen and Flatwater Fleet, Inc. and Commissioner of Economic Security**, No. CO-02-1240, 653 N.W.2d 212 (Minn. App. 2002).

m **INTEREST ON UNPAID TAX ACCRUES DESPITE DELAYED CONSENT TO ACCOUNTING CHANGE.** Taxpayer that was required to adjust its taxable income upward as a result of a change in accounting method was also liable for interest on the additional tax from the due date of the return. This was mandated even though IRS's consent to the accounting change only became effective at a later date when an audit examination closed. **Anderson Columbia Co. v. United States**, No. 96-405T, 90 AFTR 2d 2002-7620 (Fed. Cl. Ct. 11/11/02).

m **DELIBERATIVE PROCESS PRIVILEGE — WHAT CONSTITUTES INTER-AGENCY INFORMATION.** The 2nd Circuit rejected lawyer's and his law firm's FOIA complaint for access to memorandum that assistant United States attorney sent to public commission recommending how IRS should conduct criminal tax investigations: memorandum fell under Exemption 5's deliberative process privilege. **Tigue, Jr., v. U.S. Dept. of Justice**, No. 01-6243, 90 AFTR 2d 2002-7302 (2nd Cir. 2002).

m **OUT-OF-STATE COMPANIES MUST HAVE "PHYSICAL" NEXUS IN MISSOURI.** Missouri assessed a company for income from the licensing of trademarks and trade names to a related corporation for the 1992 through 1996 tax years. Although out-of-state companies are related to companies that do some business in Missouri, they each are separate legal entities that must themselves have property, payroll, or sales in Missouri to be taxed in Missouri. None of the out-of-state corporations, in fact, have any contact or sales in Missouri and, therefore, the income the director attempted to reach was outside the scope of Missouri taxation. **ACME Royalty Company and Brick Investment Company v. Director of Revenue**, No. SC84225 and SC84226 (Mo. 11/26/02).

m **COMMISSIONER LACKS AUTHORITY TO ABATE INTEREST ASSESSED ON EMPLOYMENT TAXES.** IRS's interpretation of Code Section 6404(e)(1) which grants IRS authority to abate interest on taxes attributable to ministerial errors, is applicable only to interest on income, estate, gift, generation-skipping, and certain excise taxes, but not to interest on employment taxes, is reasonable and entitled to deference. **Miller v. Commissioner**, No. 00-712-71285, 90 AFTR 2d 2002-7159 (9th Cir. 07/16/02).

m **REFUND SUITS LIMITATIONS PERIODS VARIANCE DOCTRINE.** Power company's refund suit based on untimely "claim letter" for deficiency interest was dismissed for lack of jurisdiction. Taxpayer's attempt to relate letter back to original claim as amendment was rejected since letter's miscalculation theory wasn't germane to original claim and letter was filed late, after original claims were resolved and limitations period had expired. **Sierra Pacific Resources and Subsidiaries v. U.S.**, No. 01-482T, 90 AFTR 2d 2003-7501 (Ct. Fed. Cl. 11/21/02).

m **WIFE CANNOT GET INNOCENT SPOUSE RELIEF TAKING INTO ACCOUNT FACTS, CIRCUMSTANCES.** Wife is not entitled to innocent spouse relief for taxable years 1982 to 1988 because, taking into account all facts and circumstances, it is not inequitable to hold her liable for deficiencies. **Alt v. Commissioner**, T.C. No. 2964-01, 119 T.C. No. 19 (12/19/02).

m **TAX MATTERS PARTNERS' ATTORNEY-CLIENT, BUT NOT WORK PRODUCT, PRIVILEGE WAIVED.** Tax matters partners, who petitioned for readjustment of their basis in stock transactions involving partnership, waived their attorney-client privilege with respect to a legal opinion they obtained with respect to partnership transactions. The opinion was protected by work product doctrine. **Long-Term Capital Holdings v. United States**, No. 3:01 CV 1290 (JBA), 90 AFTR 2d 2002-7446 (D. Conn. 10/30/02).

m **NO TAX COURT JURISDICTION FOR INDIVIDUAL'S CHALLENGE TO FORMER**

**WIFE'S INNOCENT SPOUSE RELIEF.** The U.S. Tax Court lacks jurisdiction to hear an individual's challenge to IRS's decision to grant former wife innocent spouse relief. When there is a tax court proceeding, the other spouse is permitted to file a notice of intervention under Code Section 6015(e)(4) and tax court rules. But in this case there was no proceeding in which the husband could intervene. The tax court noted that, as provided in Code Section 6015(h)(2), the husband was notified of the wife's claim and that he was permitted to submit information to IRS. While the husband was dissatisfied with the level of participation afforded him during the administrative process, the tax court stressed that there is no directive in Code Section 6015, or any other statutory provision, vesting it with jurisdiction to review IRS's administrative determination to grant the wife relief. **John Maier III**, T.C. No. 5410-02 119 TC No. 16 (2002).

**MULTISTATE MARKET RESEARCH FIRM INCOME APPORTIONED BY THREE-FACTOR FORMULA.** The three-factor apportionment formula in Connecticut, rather than single-factor one, is applicable in determining the business tax liability of a multistate corporation that performs market research for clients with the use of equipment such as computers and telephones. **Millward Brown Inc. v. Connecticut Commissioner of Revenue Service**, No. AC 22258 (Conn. App. Ct. 11/26/02).

**ROYALTIES PAID TO SUBSIDIARIES HOLDING TRADEMARKS DEDUCTIBLE BY PARENT FIRM.** Subsidiaries formed by paint manufacturer to hold its trade names, trademarks, and service marks were not sham, and thus royalties paid to subsidiaries pursuant to licensing agreement are deductible from parent's taxable income. **Sherwin-Williams Co. v. Massachusetts Commissioner of Revenue**, No. SCJ-08516 (Mass. 10/31/02).

**TAX COURT MAY DECIDE EMPLOYEE STATUS OF ADDITIONAL INDIVIDUALS NAMED IN ANSWER.** The U.S. Tax Court has jurisdiction over IRS's affirmative allegations contained in its answer to taxpayer's petition that other individuals, in addition to those named in IRS's notice of determination, are employees and that taxpayer is liable for additional employment taxes with respect to them. **Evans Publishing Inc. v. Commissioner**, T.C. No. 8278-00, 118 T.C. No. 14 (11/07/02).

**TAX COURT CAN REVIEW LEVY DETERMINATION AFTER WRONGLY LABELED "EQUIVALENT HEARING".** "Decision letter" issued by an IRS appeal officer following a hearing that officer labeled as an "equivalent hearing" on mistaken belief that taxpayer's request for a collection due process hearing was untimely is a "determination" that invokes the tax court's jurisdiction. **Craig v. Commissioner**, T.C., No. 14649-OIL, 119 T.C. No. 15 (11/14/02).

**SUMMARY JUDGMENT VACATED ON STATUS OF HOURLY PER DIEM TRAVEL REIMBURSEMENTS.** District court erred in granting summary judgment holding that taxpayer's hourly per diem travel expense reimbursements made to its nonlocal employees were not made pursuant to an accountable plan and thus were taxable wages. **Worldwide Labor Support of Mississippi Inc. v. United States**, No. 01-60535, 90 AFTR 2d 2002-7294 (5th Cir. 11/15/02).

**TAX COURT MANDATES USE OF INFORMAL DISCOVERY PRIOR TO FORMAL DISCOVERY.** Before parties can use the tax court's discovery procedures, they must attempt to secure the objectives of discovery through informal consultation or communication (see Tax Court Rule 70(a) and *International Air Conditioning Corp. v. Commr.*, 67 TC 89). This is normally done through a "Branerton letter" (see *Branerton Corp. v. Commr.*, 61 TC 691) — a written request addressed to opposing counsel, detailing the information and documents desired. Only after failure of such informal efforts may discovery procedures be invoked. The tax court recently stayed formal discovery, determining the IRS tried to rush the process and, in doing so, did not make an adequate effort to let informal discovery work. **Schneider Interests, L.P. v. Commr.**, T.C. 200-02 119 TC No. 8 (2002).

**ACCOUNTANT-CLIENT PRIVILEGE DOES NOT SHIELD PAPERS RELATED TO NONFINANCIAL CONSULTING.** The Illinois accountant-client privilege does not extend to documents generated by an accountant performing quality control assess-

ments. Documents generated by accountant rendering nonfinancial consulting services are not “opinion of financial statement” within meaning of Illinois statute defining “public accountant” and thus are not shielded from discovery by accountant-client privilege. However, the court found that the quality control assessments prepared after the underlying suit was filed were prepared in anticipation of litigation, and that plaintiff did not show a substantial need for those records. It therefore affirmed the district court’s ruling that those records were protected by the work product doctrine. **PepsiCo. v. Baird, Kuntz & Dobson LLP**, No. 02-2168 (8th Cir. 09/19/02).

m **IRS’ RECONSTRUCTION OF INCOME BASED ON STATISTICAL AVERAGES UPHeld.** Income tax assessments made by IRS against taxpayer who refused to meet with IRS agent or provide documents but who admitted that he earned income during the years in issue are presumed correct and are reduced to judgment, even though assessments are based in Bureau of Labor Statistics data concerning average income. **United States v. Bannister**, No. 02-C-075-S, 90 AFTR 2d 2002-6550 (W.D. Wis. 08/07/02).

m **DEDUCTION FOR CERTAIN RACETRACK EXPENSES LIMITED TO 50 PERCENT BY SECTION 274(N).** Certain expenses incurred in 1994 and 1995 by racetrack owner are limited to deduction of only 50 percent as expenses qualified as entertainment for purposes of Code Section 274(n). **Churchill Downs Inc. v. Commissioner**. No. 01-1274, 90 AFTR 2d 2002-6615 (6th Cir. 10/08/02).

m **BASEBALL TEAM’S ADVANCE TICKET SALES NOT INCOME UNTIL YEAR GAMES PLAYED.** The U.S. Tax Court has held that a partnership that was granted a major league baseball franchise didn’t have to accrue revenues received in 1995 and 1996 from advance ticket sales until the games were played in 1998. But a sponsor fee received in 1996 that was used to convert a truck into a mobile exhibit promoting the team was taxable in the year received. **Tampa Bay Devil Rays, Ltd.**, TC Memo 2002-248 (2002).

m **U.S. SUPREME COURT TO RULE ON NEVADA COURT SUIT AGAINST CALIFORNIA TAX OFFICIALS.** The Supreme Court agrees to decide whether the courts of Nevada interfered with the state of California’s sovereignty by taking jurisdiction over a tort suit against California taxing authorities brought by a former California resident, who now resides in Nevada. The Court will review a claim by the California Franchise Tax Board that the Nevada courts violated the U.S. Constitution by failing to give “full faith and credit” to a California statute that accords state employees immunity from liability for an injury resulting from the assessment or collection of state taxes. **California Franchise Tax Board v. Hyatt**, U.S., No. 02-42, cert. granted (10/15/02).

m **TAXPAYER WHO FILED SEPARATE RETURN HELD NOT ENTITLED TO SPOUSAL RELIEF.** Commissioner is entitled to summary judgment in taxpayer’s lien or levy action denying spousal relief to taxpayer because taxpayer did not file a joint return. **Raymond v. Commissioner**, T.C. No. 2354-O1L, 119 T.C. No. 11 (10/22/02).

m **GAIN ON TRANSFERRED LIABILITIES RECOGNIZED BY INCORPORATORS DESPITE PERSONAL GUARANTY.** Taxpayers, who transferred assets and liabilities to their newly formed corporation, must recognize taxable gain equal to the excess of transferred liabilities over the adjusted basis of transferred assets. This was true even though taxpayers remained secondarily liable as guarantors on all of the transferred debt. **Seggerman Farms Inc. v. Commissioner**, No. 01-3638, 90 AFTR 2d 2002-6981 (7th Cir. 10/24/02).

m **COMPANY’S MINORITY STOCK VALUE SHOULD BE BASED ON FREELY TRADED DETERMINATION, INCOME, AND CAPITAL MARKET METHODS.** The fair market value of a minority nonvoting interest in Schwan’s Sale Enterprises, Inc. (“SSE”) as of December 31, 1992 and as of December 31, 1994 should be determined on a freely traded basis following the income and capital markets methods. The court determined that the IRS presented no reliable evidence to refute the value established by the company’s shareholders. The value of SSE stock on November 31, 1992 was \$24.36. The court adopted the expert appraisal of the company stock for the December 31, 1994, valuation date. The court found that a 45 percent discount should be applied for lack of marketability, and a 5 percent discount for lack of vot-

ing rights, to the unadjusted value per share of \$39.54. The court further determined that the value of the company stock as of December 31, 1994, was \$19.77 per share. *Jeffrey L. Okerlund, et ux., et al. v. United States*, No. 99-133T, 90 AFTR 2d 2002-6124 (Fed. Cls. Ct. 08/23/02).

#### ADMINISTRATIVE

m **NEW REGULATIONS REVISE TAX SHELTER TRANSACTIONS REQUIRING DISCLOSURE, REGISTRATION, AND LIST MAINTENANCE.** For the fifth time in less than three years, IRS issued temporary and proposed regulations governing the filing of tax shelter disclosure statements under Code Section 6011(a). The regulations provide more objective rules and eliminate certain tests and exceptions relating to disclosures. Conforming changes also have been made to related rules for registration of confidential corporate tax shelters under Code Section 6111(d). IRS also issued temporary and proposed regulations under Code Section 6112, generally requiring organizers and sellers to maintain lists of persons for transactions required to be registered under Code Section 6111 or reported under Reg. §1.6011-4T(b). The amended regulations expanded the rules for the disclosure by taxpayers of their participation in potentially abusive tax avoidance transactions and maintenance of lists by promoters of taxpayers, who have entered into such transactions. The amended regulations generally apply to transactions entered into on or after January 1, 2003. The existing temporary regulations will continue to apply until that time. T.D. 9017, 9018.

m **FAST TRACK MEDIATION.** Do you know that General IRS Appeals Program now offers trained mediators to facilitate a fast resolution of disputes with SB/SE taxpayers? The Appeals LBSP (Large Business and Specialty Program) also provides fast-track mediation (FTM), however, the General Appeals Program FTM is different. The IRS first began exploring the feasibility of mediation of 1995 with a limited pilot for Coordinated Examination Program taxpayers. New guidelines have eliminated a \$1 million adjustment threshold, made legal issues eligible for mediation, and made mediation available for issues where the taxpayer intends to seek competent authority assistance, among other things. For more information on this topic download the full version in PDF

at: [format.http://groups.yahoo.com/group/TaxTalkNews/files/Newsletters/200246.pdf](http://groups.yahoo.com/group/TaxTalkNews/files/Newsletters/200246.pdf)

m **SALES TAX — TREE REMOVAL SERVICES.** The commissioner announced that tree, bush, shrub, and stump removal services are taxable even if they are sold to a contractor and used by the contractor to complete a construction contract involving a building or residence. Revenue Notice No. 92-12 (04/20/82) was revoked. Revenue Notice No. 02-18 (10/28/02).

m **SALES TAX — SOLID WASTE.** The commissioner explained that waste generated by school housing units, including dormitories and apartments, is considered commercially generated waste for solid waste management purposes. The commissioner's position is based upon the reference to "school" in the definition of commercial generator in Minn. Stat. §297H.01(2). Revenue Notice No. 02-19 (11/04/02).

m **INCOME TAX — PART OR FULL-YEAR NONRESIDENTS WITH ZERO OR LESS MINNESOTA ASSIGNABLE FEDERAL AGI.** The commissioner clarified that, in the case when an individual part-year or full-year nonresident has net Minnesota assignable income of zero or less under Minn. Stat. §290.17, the Minnesota income tax for that year is zero, even if the taxpayer has either a Minnesota alternative minimum tax computed under Minn. Stat. §290.091(1), or a regular tax computed under Minn. Stat. §290.06(2c). Revenue Notice No. 02-21 (12/02/02).

m **MINNESOTA TAXES — TECHNICAL CORRECTIONS OF PRIOR REVENUE NOTICES.** The commissioner issued a Revenue Notice that corrects obsolete statutory references cited in previously issued Revenue Notices. This Revenue Notice is not intended to have any substantive effect, but is published to assist readers of previously issued notices to reflect changes that stem from various recodifications since the original notices were issued. This Revenue Notice is issued in two parts. The first part is a table that contains statutory citations that have changed as a result of subsequent

law changes. The second part also contains statutory citations that have changed, but also contains either direct quotes from, or references to, provisions that have been amended in such a manner as to make a portion of the notice obsolete and contains a brief explanation of the obsolete parts. Revenue Notice No. 02-20 (12/02/02).

m **INCOME TAX — INCOME TAX RATE BRACKETS INDEXED.** The commissioner announced the inflation-adjusted personal income tax rate brackets for use in the year 2003. The inflation rate change is about a 2 percent increase from the income brackets for 2002. News Release (12/06/02).

m **SALES TAX — LOCAL TAXES.** The commissioner indicated that, starting January 1, 2003, the cities of St. Cloud, Sartell, Sauk Rapids, and St. Augusta will impose a 0.5 percent sales and use tax. The tax is separate from and in addition to the 1 percent St. Cloud food and liquor tax. Notice Release (11/14/02).

m **MINNESOTA TAXES — INTEREST RATES.** The commissioner announced that the interest rate on the tax refunds and delinquent state taxes, other than property taxes, is 5 percent for 2003. News Release (10/09/02).

m **EO TECHNICAL CPE TEXT FOR 2003 RELEASED.** The 25th edition of the *IRS Exempt Organizations Continuing Professional Education (CPE) Technical Instruction Program for Fiscal Year 2003* was published on the IRS website ([www.irs.gov](http://www.irs.gov)) in October.

m **2003 WAGE WITHHOLDING.** The Social Security Administration has announced the 2003 Social Security wage base will be \$87,000 (\$84,000 in 2002). The FICA rate (combined Social Security and Medicare) remains unchanged for 2003 at 7.65 percent for employees and 15.30 percent for self-employed individuals. The Social Security portion is 6.20 percent on earnings up to \$87,000 (12.4 percent for self-employed). The Medicare portion remains at 1.45 percent on all earnings (2.90 percent on self-employed). *Daily Tax Report*, No. 204 at G-1 (10/21/02).

m **STREAMLINED AUDITING PROCESS ANNOUNCED FOR LARGE, MIDSIZE BUSINESSES.** The IRS launched a streamlined auditing process for large and mid-size businesses called the Limited Issue Focused Examination (“LIFE”). LIFE is intended to create a more efficient, less contentious audit atmosphere. Under this process, taxpayers will sign a memorandum of understanding with the IRS to govern key aspects of the audit examination. The memorandum will contain dollar-limit thresholds, established on a case-by-case basis, below which the IRS will agree not to raise issues and the taxpayer will agree not to file claims. IR-2002-133.

m **IRS PROPOSES EXPANDING DEFERMENT OF ADVANCE PAYMENTS FOR ACCRUAL TAXPAYERS.** IRS issued a proposed procedure that would allow accrual basis taxpayers to defer including advance payments in income until the year following their receipt in more situations than they may currently. IRS will also modify the existing regulations to conform to the proposed liberalized rule. Notice 2002-79, 2002-50-IRB.

m **MINNESOTA REVENUE DEPARTMENT STUDY REVEALS GAP OF \$451 MILLION IN SALES TAX COLLECTIONS.** In November, 2002, the DOR issued a report that revealed a \$451 million gap between the amount of sales and use taxes paid in 2002 and the amount that should have been paid. The gap is expected to grow over the next two budget cycles — to \$500 million for 2002 and \$700 million by 2007, the report projected. Approximately \$125 million of the sales tax gap was attributed to out-of-state, Internet, and catalog purchases by businesses and households. *Minnesota Sales and Use Tax Gap Project*, prepared by the American Economics Group, Inc.

m **JOINT COMMITTEE ON TAXATION ISSUES FY 2003-2007 TAX EXPENDITURE ESTIMATES.** The Joint Committee on Taxation issued tax expenditure estimates for the fiscal years 2003-2007. The estimates are based on projections of gross income, deductions, and expenditures by staff of the Congressional Budget Office and the Joint Committee, using IRS statistics from recent returns. Tax expenditures are shown for both corporations and individuals. “Estimates of Federal Expenditures, JCS-5-02 (12/19/02).

m **“LIKE KIND” EXCHANGE BY RELATED PARTIES FOR CASH FROM THIRD PARTY NOT TAX-FREE.** An exchange of like-kind property in which the taxpayer first transferred property to a qualified intermediary is not tax-free where a related party disposed of like-kind property for cash in the transaction. The transaction was not entitled to tax-free treatment because of Code Sections 1031(f)(1) and 1031(f)(4). Those provisions are designed to prevent related taxpayers from exchanging high-basis property for low-basis property tax-free in anticipation of a sale. Rev. Rule 2002-83 (12/09/02).

m **TREASURY ISSUES RULES REQUIRING CORPORATIONS TO NOTIFY IRS, SHAREHOLDERS OF INVERSION DEALS.** The Treasury Department issued proposed and temporary regulations requiring corporations to notify the IRS and the corporation's shareholders when they moved their headquarters offshore or are acquired by a foreign company. The regulations are part of the Bush administration's effort to curb abusive “corporate inversion” transactions — whereby companies move their legal residence from the United States to another country, usually a low-tax or no-tax jurisdiction such as Bermuda, in order to avoid U.S. income taxes. TD 9022 and REG 143321-02.

m **IRS PROPOSES LONG-AWAITED REGULATIONS TO CAPITALIZE INTANGIBLE ASSET PAYMENTS.** The IRS issued long-awaited proposed regulations under Code Section 263, 167, and 446 on the capitalization of amounts paid to acquire, create, or enhance intangible assets. An “intangible asset” is defined in the proposed regulations as:

- m any intangible acquired from another person in a purchase or similar transaction;
  - m certain rights, privileges, or benefits that are created or originated by the taxpayer;
  - m a separate and distinct intangible asset; or
  - m a significant future benefit identified in subsequent published guidance as an intangible asset that must be capitalized.
- m Capitalization also would be required under the proposed regulations for transaction costs:
- m that facilitate the acquisition, creation or enhancement of an intangible asset;
  - m that facilitate a restructuring or reorganization of a business entity; or
  - m that invoice the acquisition of capital — a stock issuance, a loan, or a recapitalization, for example. REG 125638-01 (12/19/02).

m **TAX REFUNDS DON'T ACCRUE UNTIL STATE APPROVES THEM UNDER CHANGED IRS STANCE.** In a change of position, IRS has held that a state or local income or franchise tax refund is not includible in the income of a taxpayer using the accrual method of accounting under Code Section 451 until the state or local taxing authority approves the claim. Rev. Rule 2003-3, 2003-2 IRB.

m **IRS OFFERS NEW TOLL FREE NUMBERS TO ASSIST TAXPAYERS.** The IRS has two new toll-free telephone numbers to provide taxpayers with better service. These new telephone numbers recently became operational. Small businesses, corporations, partnerships and trusts that need information or help preparing business returns should now call 1-800-829-4933. People looking for their refunds now call 1-800-829-1954. Individuals who filed a 1040 series return can check on the status of their current year tax refund. For full details, please visit the IRS website at: <http://www.irs.gov/pub/irs-news/ir02-130.pdf>.

m **VOLUNTARY DISCLOSURE PRACTICE REVISED.** A taxpayer's timely, voluntary disclosure of a substantial unreported tax liability to the IRS has long been an important factor in deciding whether the taxpayer's case should ultimately be referred for criminal prosecution. The IRS practice was updated to allow more taxpayers to voluntarily comply with their obligations and to reduce the uncertainty over what constitutes a “timely” disclosure. Under the revised practice, a disclosure is considered timely if it is received before:

- m the IRS has initiated a civil examination or criminal investigation of a taxpayer, or has notified the taxpayer that it intends to commence an examination or investigation;

- m the IRS has received information from a third party (for example, an informant, other governmental agency, or the media) alerting it to a taxpayer's noncompliance;
- m the IRS has initiated a civil examination or criminal investigation that is directly related to the liability of a taxpayer; or
- m the IRS has acquired information directly related to the liability of a taxpayer from a criminal enforcement action (for example, a search warrant, or grand jury subpoena).

Get the facts at IR-2002-135.

m **IRS PERMITS DROPDOWN OF ASSETS AS PART OF NONDIVISIVE "D" REORGANIZATION.** IRS held that an acquiring corporation's transfer of the target corporation's assets to a controlled subsidiary as part of a plan of reorganization won't prevent a transaction otherwise qualifying as a D reorganization Rev. Rul. 2002-85, 2002-52 IRB; Notice 2003-77, 2002-52 IRB. IRS also announced in Notice 2002-77 that it will amend Reg. §1.367(a)-3(d) to provide specifically that a D reorganization followed by a dropdown of the target corporation's assets to a controlled subsidiary constitutes an indirect transfer of stock or securities for purposes of Reg. §1.367(a)-3. The IRS previously permitted dropdowns in reverse subsidiary mergers in Reg. §1.368-2(k)(2) and in forward subsidiary mergers in Rev. Rul. 2002-24.

m **CAR DONATION TO CHARITY'S FUND-RAISING AGENT IS VALID TRANSFER; DETERMINING CAR'S FMV.** The IRS concluded that an individual's transfer of a car to a dealership that administers a charity's car donation program is a valid transfer and that the donor may use a used car pricing guide to determine its fair market value. Rev. Rule 2002-67 (11/25/02).

m **TREATMENT OF OWNERSHIP OF LLCs AND DISREGARDED ENTITIES IN COMMUNITY PROPERTY STATES.** Taxpayers' treatment of a business entity owned solely by married couple as community property under applicable local law, where no other person would be considered owner for tax purposes and where entity isn't treated as corporation, as either disregarded entity or as partnership, will be respected for federal tax purposes. The IRS became aware of the need for guidance due to taxpayers' uncertainty on the issue. Rev Proc 2002-69.

#### LEGISLATION

m **SECTION 527 AMENDED TO CHANGE POLITICAL ORGANIZATION DISCLOSURE RULES.** In October 2002, President Bush signed H.R. 5596. Provisions in the measure eliminated the requirement for state and local candidates to file notice with the IRS of an organization's formation and purpose. For other organizations that are required to file the notice, it need only be filed electronically. The law also exempts qualified state and local organizations from filing regular reports detailing contribution and expenditure information. In order to be a "qualified" organization, one of the requirements is that it file such information with the appropriate state agency, and that agency must make this information available to the public. Organizations without "political organizations taxable income" and with gross receipts of at least \$25,000 would no longer have to file Form 1120-POL. The Form 990 is still required for organizations with gross receipts of more than \$25,000. A description of the filing requirements for political organizations in Fact Sheet 02-13 is available at <http://www.irs.gov/charities/political/article/0,,id=96355,00.html> on the IRS's website.

m **PRESIDENT BUSH SIGNS HOMELAND SECURITY BILL.** The President signed the Homeland Security Bill (H.R. 5005). In addition to establishing the Department of Homeland Security, the law contained a tax provision to set-up a new type of charitable trust. While the law bars the Department of Homeland Security from entering into contracts with companies that invert outside the United States after November 25, 2002, it would give the secretary broad authority to grant a waiver, if he deemed it necessary in the interest of homeland security, to protect jobs in the United States, or to prevent the U.S. government from incurring any additional costs. Lastly, the law makes some administrative changes such as transferring customs from Treasury to the new Department of Homeland Security.

## LOOKING AHEAD

▫ **SARBANES-OXLEY AUDITOR INDEPENDENCE PROPOSALS COULD BAR TAX STRATEGY SALES TO CLIENTS BY ACCOUNTING FIRMS.** Under auditor independence rule proposals issued by the SEC in December 2002 under the Sarbanes-Oxley law for public companies, accounting firms might be barred from selling tax strategies, such as tax shelters, to their auditing clients. The SEC discussed the issue in a release proposing amendments to bolster its existing requirements on auditor independence. The highlights are:

▫ The proposed rules would not bar an accounting firm from providing tax services to its audit clients when those services have been pre-approved by the client's audit committee. From the legislative history of the accounting reform law, auditor independence would not be considered to be impaired by an accountant providing traditional tax preparation services to an audit client or its affiliates.

▫ Tax services, however, can include a range of activities, including the preparation of tax returns, tax compliance, tax planning, tax recovery, and other tax related services. The SEC noted that classifying a service as a "tax service" does not mean that the service may not be within one of the rule's categories of prohibited services or may not result in an impermissible impairment of independence.

▫ The accounting firm and the client's audit committee should consider whether the proposed nonaudit service is an allowable tax service or constitutes a prohibited legal service or expert service.

▫ The SEC offered the tests of where the provision of a tax service may require the accountant to audit his or her own work, to become an advocate for the client's position, or to assume a management function to show that there would be an impairment of independence.

Examples of conflicts are:

▫ The case of an audit firm that creates tax strategies designed to minimize an audit client's tax obligations.

▫ Where an accountant provides representation before a tax court, thus serving as an advocate for his or her client. *Daily Tax Report*, No. 234 at G-12 (12/05/02) and Tax Analysts cite: Doc. 2002-26775.

▫ **2003 MINNESOTA LEGISLATIVE SESSION LOOKS LONG AND CONTENTIOUS.** When lawmakers convene in January 2003, they will be faced with a \$350 million plus shortfall for the fiscal year ending June, 2003 and a massive \$4.5 billion deficit for the biennium ending 2004 and 2005. Under the Minnesota Constitution a balanced budget is required. With the severity of the budget situation and with the Governor's pledge of no new taxes, look for a long and contentious legislative session. Proposals for budget balancing are:

▫ Targeting public subsidies at people who are financially needy, not institutions or whole classes of people.

▫ Using competition to force government to become a more efficient and effective provider of services.

▫ Allowing public services to reflect their true costs, so citizens stop demanding things they can't afford.

▫ Meeting more public responsibilities through community institutions — families, churches, ethnic and neighborhood groups — in which people already have relationships of mutual obligation.

▫ Considering long-term economic growth to be one of the objectives of state spending, rather than merely a consequence or side effect. This means giving priority to investments and infrastructure, research, technology, and education that promises long-term payoffs.

— JERRY GEIS  
Briggs & Morgan

## TORTS & INSURANCE

### JUDICIAL LAW

m **NO-FAULT — WAIVER OF JURISDICTIONAL LIMITATION.** Under the No-Fault Arbitration rules, a party must object in writing if it contends a rule was not complied with, but it does not waive its objection by proceeding with the arbitration hearing after objecting. **Regenscheid v. Farm Bureau Mut. Ins. Co.**, CX-01-862 (Minn. 10/24/02).

<http://www.lawlibrary.state.mn.us/archive/supct/0210/cx01862.htm>

m **NEGLIGENCE — GOOD SAMARITAN LAW.** After a woman injured her leg while snowmobiling, a passing motorist stopped to offer assistance. The motorist unsuccessfully summoned for help on her cell phone, and agreed to drive the injured snowmobiler to a hospital. The motorist intended to stop at her home so the woman's companions could drop their snowmobiles off there and ride along to the hospital. Enroute to her home, the motorist pulled out in the path of a speeding tractor trailer which struck her vehicle, killing the snowmobiler. The snowmobiler's estate brought an underinsured motorist claim against the motorist's insurer.

The trial court granted summary judgment based on the Good Samaritan law, which generally provides immunity to any person who renders emergency care or assistance after an accident. The plaintiff argued that the Good Samaritan law did not apply to the mere act of transporting an injured party to a hospital, but only protected those who provide emergency care during the transport. The Court of Appeals rejected this argument, reasoning that under such a narrow interpretation of the law, a layperson would have little protection from liability and little incentive to help others in peril. The decedent's family also argued that the Good Samaritan law should not apply because in light of the snowmobiler's minor injury, and the fact that she was not being transported directly to the hospital, the motorist was not facing a statutorily required emergency. The Court of Appeals also rejected this argument, reasoning that given the courts' broad definition of the phrase "emergency," the circumstances qualified as an emergency. **Swenson v. Waseca Mut. Ins. Co.**, C5-02-651, (Minn. App. 12/10/02).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0212/c502651.htm>

m **ARBITRATION; WAIVER OF OBJECTION; ARBITRATOR EXCEEDING POWER.** Plaintiff Wolfer executed an asset purchase agreement for the sale of certain assets to Microboards Technology, LLC. As a part of the transaction, under a separate operating agreement, defendant Microboards Manufacturing, LLC was formed. Under the terms of the agreement, Technology and Wolfer (not defendant) were members. Upon his termination, Wolfer entered into a "confidential termination of employment agreement and general release." When Manufacturing breached the operating agreement by failing to pay Wolfer for shares agreed to, he demanded arbitration.

After an award in favor of Wolfer, Manufacturing brought a motion to modify the award claiming, for the first time, that it was not subject to the arbitration agreement. The district court affirmed the arbitrator's award and Manufacturing appealed.

The Court of Appeals, strictly construing Minn. Stat. §572.19, recognized a distinction between whether the claims were arbitrable under the arbitration provision, as opposed to denying the very existence of the agreement. The latter situation, governed by Minn. Stat. §572.19, subd. 1(5), was applicable as Manufacturing failed to raise the issue until after the award.

The Court of Appeals further concluded that the arbitrator did not exceed its power in issuing the award, reiterating that Manufacturing participated in the hearing without raising objection to the existence of the agreement, and because Manufacturing's counterclaims arose under a separate agreement conferring jurisdiction in arbitration. **Wolfer v. Microboards Manufacturing, LLC**, C1-02-839, (Minn. App. 12/17/02).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0212/c102839.htm>

m **JOINT TORTFEASORS -N LIMITED LIABILITY.** Two members of the Lanz family were injured when a city-owned van lurched into a crowd of parade watchers at the Holidazzle parade. The trial court allocated 12.5 percent of the liability to Federal Signal Corporation (“Federal”) and the remaining 87.5 percent to the city of Minneapolis. Damages approached \$4 million. The city’s liability was capped by statute, leaving a significant portion of the damages uncollectible. The Lanzes sought recovery from Federal, arguing that as a joint tortfeasor, Federal had an obligation to pay the difference. Federal argued that since its liability was less than 15 percent, its damages were limited by Minn. Stat. §604.02 to four times its liability.

The trial court agreed with Federal, and the Court of Appeals affirmed, holding that there is no exception to the “15x4” rule even when a municipality’s liability is limited. Moreover, legislative policy determinations govern the balance between municipal liability limits and joint liability, and the Court of Appeals was not the proper place to establish or alter policy. **McCarty v. City of Minneapolis**, C6-02-755, (Minn. App. 12/13/02).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0212/c602755.htm>

m **PAINTBALL — INHERENTLY DANGEROUS ACTIVITY.** Plaintiff was injured when defendant accidentally shot him in the eye with a paintball. Defendant moved for summary judgment on the grounds that plaintiff primarily assumed the risk of injury when he removed his eye protection. Plaintiff admitted that he knew he could be injured if he didn’t wear eye protection, but chose to remove his goggles because it was too hard to see the targets.

The trial court granted summary judgment to the defendant and the Court of Appeals affirmed. The Court of Appeals noted that plaintiff appreciated the risks inherent in the game of paintball and that plaintiff had relieved defendant of its duty of care with regard to those risks. **Schneider v. Erickson** C7-02-800, (Minn. App. 12/17/02).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0212/c702800.htm>

m **INSURANCE — RETROACTIVE REFORMATION OF A POLICY.** Aaron Lee purchased a farm insurance policy providing \$1,000 of medical coverage for his employees in lieu of workers’ compensation insurance. Heim, an employee, was severely injured on the job, and Lee’s insurer paid the limits. Heim applied to the Special Compensation Fund for additional benefits because of Lee’s failure to maintain either workers’ compensation insurance or \$5,000 in medical coverage.

Lee, his agent, and his insurer attempted to reform the policy to provide \$5,000 in medical coverage, claiming this was Lee’s original intent. Heim objected and Lee brought a declaratory judgment action to validate the reformation.

The district court refused to validate the reformation and the Court of Appeals agreed. Although a contract may be reformed to reflect the contracting parties’ original intent, it may not be reformed where it prejudices the rights of a third party whose interests have already become fixed. Because Heim’s right to compensation from the Special Fund became fixed on the date he was injured, the attempted reformation was invalid. **Heim v. Lee**, C2-02-1174, C0-02-1190, (Minn. App. 12/17/02).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0212/c2021174.htm>

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