



## NOTES & TRENDS

### ADMINISTRATIVE LAW

#### JUDICIAL LAW

■ **PROPRIETARY INFORMATION.** The Minnesota Tax Court denied a taxpayer's motion to close its trial to the public and to seal portions of the record to protect proprietary information, namely data that the company believed could be used by customers and competitors to reduce its profits. In *In Re Rahr Malting*, CX-00-1676, 632 N.W. 2d 572 (Minn. 2001), the Supreme Court denied a writ of prohibition against the Tax Court because Rahr's allegations of harm were conclusory and did not outweigh the Tax Court's statute mandating a public trial and the strong presumption in favor of a public trial. The Court did remand to the Tax Court, however, to conduct an *in camera* hearing on Rahr's motion, at which Rahr could present proprietary data to support its request.

■ **FAILURE TO ADOPT RULES.** In *Marshall County v. State of Minnesota*, CX-01-716, 636 N.W. 2d 570 (Minn. App. 12/4/01), several counties sued the DNR to force it to pay drainage assessments for ditch repairs on conservation lands it owns. The Legislature had directed the DNR to adopt rules setting the criteria for determining benefits from assessments before January 1, 1986, but the DNR has not done so. One argument advanced by the counties was that the failure by the DNR to establish the benefits upon which assessments would be based, by rulemaking, made its actions arbitrary. Following federal case law, the Court of Appeals decided that the failure to adopt rules within a specified time frame does not bar later agency action unless there is some specific indication that a bar was intended. An indication that a bar was intended might be arrived at from legislative history, statutory language setting consequences for failure to adopt a rule, and the availability of less drastic action, such as a suit to compel agency action. Since there was no legislative history or statutory consequence and mandamus was available to compel rulemaking, the Court of Appeals did not find arbitrary action and decided that the DNR was authorized to decline to pay the ditch assessments.

■ **EXHAUSTION OF ADMINISTRATIVE REMEDIES.** A highway contractor brought a declaratory judgment action against the Department of Transportation after DOT began an administrative proceeding against it to enforce the prevailing wage law. *Southern Minnesota Construction Co. v. MDOT*, C4-01-99, 637 N.W. 2d 339 (Minn. App. 1/2/02). The Court of Appeals held that the contractor's rights were not affected until MDOT made its final administrative determination and, therefore, the contractor had to exhaust its administrative remedies with MDOT before appealing to court. The contractor argued that its rights were affected by having to go through an unauthorized administrative proceeding. The court also found that language authorizing DOT to "require adherence" to the prevailing wage law was sufficient to confer broad authority on MDOT to initiate an administrative contested case enforcement proceeding, even though the statute also authorized prosecution in court by a county attorney.

■ **STATUTORY AUTHORITY.** The Board of Soil and Water Resources affirmed a watershed district decision to deny a landowner's request to lower the height of a culvert that caused flooding of their lands. Generally, state statute requires that any drainage of wetlands must be replaced. The landowners claimed federal law exempted them from the replacement requirement because they were doing ditch maintenance. In affirming the denial the board cited its rule that the federal exemption is inapplicable if a wetland will be partially drained. The landowner asserted that the board exceeded its statutory authority in adopting the rule. The Court of Appeals found the rule consistent with the legislative intent to achieve no net loss in wetlands and noted that the rulemaking process disclosed no conflict between the rule and the statutory authority for the rule. *Hentges v. Minn. Bd of Water and Soil Resources*, C7-01-799, 2002 WL 27094 (Minn. App. 1/4/02).

#### LEGISLATION

The 2002 legislative session started later than usual on January 29, 2002. Initial hopes are for an early adjournment by the end of March. (Don't bet the farm on the early end of the session.) With short deadlines providing only three weeks to hear and pass legislation, it will be surprising if any significant administrative law legislation will be enacted. Two significant bills that may get some attention are: HF 2742 — this is the Office of Administrative Hearings bill which would allow the delegation of final agency action to the ALJ. This legislation also would enable arbitration alternatives to the contested case process. HF 2779 is significant legislation that would allow notice and comment rulemaking and interpretive rules notices. We will let you know what happens when the dust settles after the session.

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## NOTES & TRENDS

### CIVIL LITIGATION

#### JUDICIAL UPDATE

The Minnesota Supreme Court Jury Task Force presented its final report on December 20, 2001. The task force, formed in April 2000, developed two subcommittees, one to address juror treatment issues, and one to address issues of trial procedures affecting jurors. The final report includes 37 recommendations, with comments. Those with particular significance to civil litigation include:

- A pilot project to study reducing term of service. The project will monitor anticipated jury improvements vs. increased costs and administration.
- Several recommendations related to jury selection. Examples: Encouraging judges to intervene *sua sponte* when lawyer questioning becomes inappropriate; clearly delineating the proper and improper uses of voir dire; and imposing time limits when necessary.
- In order to avoid wasting jurors' time, mandating that certain procedural tasks be accomplished before jury selection begins, and minimizing interruptions of "jury time" once the jury has been selected.
- To help jurors better understand the evidence presented to them, the task force endorsed several practices already being followed by some trial judges. These include simplifying and shortening instructions; providing instructions in writing to each juror; instructing in advance of final argument and, in some cases, in advance of opening statement; and allowing limited juror questioning of witnesses.
- Giving a closing instruction which would explain and balance jurors' privacy interests with attorneys' desire to better understand the jurors' deliberative process.

The full report of the Jury Task Force is available for download from the Court's website in Microsoft Word or rich text format at [http://www.courts.state.mn.us/cio/public\\_notices.htm](http://www.courts.state.mn.us/cio/public_notices.htm).

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### CRIMINAL LAW

#### JUDICIAL LAW

■ **RIGHT TO COUNSEL: UNEQUIVOCAL DEMAND: REINITIATION: WAIVER.** While in custody, the appellant was a suspect in an arson/murder case. He was told by police that they "knew" that he had killed his girlfriend, to which the appellant responded: "Can I have a drink of water and then lock me up — I think we really should have an attorney." The detective then said: "We'll get you a drink of water," to which the appellant responded: "I don't want to talk anymore please. This is — this is really wrong . . ." The detective then responded: "Okay. If you want to talk to an attorney, you understand that we have to stop talking to you. Okay? And — then your side of the story will never be known. That's your choice. That's the choice you're making."

Contrary to the trial court's determination, this was an unequivocal invocation of his right to counsel. There was no need to stop and clarify because that opportunity for police officers is limited to situations where the invocation to counsel is ambiguous or equivocal. Once there is an unequivocal right to counsel, as was the situation here, further responses may be admitted only on finding that (a) the appellant initiated further discussion with police, and (b) he knowingly and intelligently waived the right to counsel. Neither situation was obtained in this case. Any reinitiation by the appellant was prompted by the improper comments of the detective that the appellant's "side of the story would never be known." Obviously, there was no explicit waiver. Therefore, the statements by the appellant should have been suppressed. The conviction was vacated and the matter remanded for a new trial. *State v. Kevin Terrance Hannon*, CO-00-2013, \_\_\_ N.W.2d \_\_\_ (Minn. 12/20/01). <http://www.lawlibrary.state.mn.us/archive/supct/0112/c0002013.htm>

■ **SEARCH AND SEIZURE: ZONING VIOLATION: WARNING LETTER: DEADLINE.** The Isanti County Zoning Office informed the respondent that they felt he was storing vehicles on his property in violation of the local ordinance. A final letter sent to the respondent on February 12, 2001, extended to the respondent a deadline date of March 9, 2001, to remove the automobiles, indicating that there would be no penalty if he were in compliance by that date. On March 7, 2001, a sheriff applied for, received, and executed a search warrant for the zoning violations. During the execution of the warrant, law enforcement agents found evidence of a methamphetamine lab. The trial court suppressed the evidence because the deadline to comply with the zoning letter had not yet passed.



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Held, the issuance of the search warrant on March 7, 2001, violated the respondent's due process rights because the government had led respondent to believe that he had until March 9, 2001, to correct the violation. There was no probable cause to support a finding of a violation of law under the county's arrangement with the respondent. Furthermore, law enforcement may not mislead individuals as to either their legal obligations or penalties they might suffer if they fail to satisfy those obligations, pursuant to *McDonnell v. Commissioner of Public Safety*, 473 N.W. 848, 854 (Minn. 1991). Suppression by trial court was appropriate. **State v. Glenn Vernon Akers**, C2-01-1388, \_\_\_ N.W.2d \_\_\_ (Minn. App. 12/18/01) <http://www.lawlibrary.state.mn.us/archive/ctappub/0112/c2011388.htm>

■ **FISH HOUSES: PRIVACY: PUBLIC WATERS: LOCKED DOORS: LEGISLATIVE BYPASS.** An officer from the Minnesota Department of Natural Resources, whose conservation officers are P.O.S.T.-certified officers, entered the appellant's fish house to see if he was properly licensed. The method of entry is essentially an announcement that the DNR has arrived with a simultaneous opening of the door. There was no violation observed from the outside. Furthermore, Minn. Stat. §97A.215, subd. 3(1) states that an enforcement officer may, at reasonable times, enter and inspect the premises of an activity requiring a license under the fish and game laws.

Held, the entry and search were illegal. The Court of Appeals has already held that occupants of a fish house have an expectation of privacy which is constitutionally protected. *State v. Krenz*, 634 N.W.2d 231 (Minn. App. 2001). Second, there is no "public waters" exception. Third, the fact that fish houses cannot be locked from the outside, under Minn. Stat. §97C.355, subd. 3, does not vaporize the right to privacy and constitutional limitations on search and seizure. Fourth, there is no conservation officer exception to activity by law enforcement agents. Fifth, Minn. Stat. §97A.215, subd. 3(1), which allows reasonable entry of regulated fish and game activities, may not, by statute, bypass the Minnesota Constitution. The court reads the definition of "constitutional" to the term "at reasonable times." **State v. Marvin Russell Larsen**, C-01-980, \_\_\_ N.W.2d \_\_\_ (Minn. App. 12/26/01) <http://www.lawlibrary.state.mn.us/archive/ctappub/0112/c501980.htm>

■ **AUTOMOBILE: CITIZEN TIP: POSSIBLE INTOXICATED DRIVER: SUFFICIENCY.** Police received a call from a Sherburne County dispatcher about a "possible intoxicated driver." An employee of an identified Elk River gas station reported that a possibly intoxicated driver was heading west on Highway 100 from Proctor Avenue in a maroon van; the employee provided the driver's license plate number. The employee was identified, according to the dispatcher, meaning having given full name, date of birth, address, and phone number.

Based on this information, the arresting officer saw a pair of van tail lights, matched the plates, and stopped the vehicle based upon the information given by the gas station employee. He did not observe any independent erratic or illegal driving conduct.

Held, the stop of the vehicle was illegal. Minnesota case law has determined that there are two lines of inquiry for stops based on citizen tips: (1) identifying information provided by the informant and (2) facts supporting the informant's assertion that a driver was intoxicated, citing *Olson v. Commissioner of Public Safety*, 371 N.W.2d 552 (Minn. 1985). Although the first prong of the inquiry was met, the second was not. The employee's basis for stating that the driver was drunk is lacking, stating only that the driver was "possibly" intoxicated. There is nothing to support an inference that the gas station employee personally observed the appellant, and no information in the record regarding how the employee concluded that the driver might be drunk. **Steven Edward Rose v. Commissioner of Public Safety**, C9-01-884 \_\_\_ N.W.2d \_\_\_ (Minn. App. 12/26/01). <http://www.lawlibrary.state.mn.us/archive/ctappub/0112/c901884.htm>

■ **SQUAD CAR: SURREPTITIOUS TAPE-RECORDING.** The appellant and his friend were placed in the back seat of a squad car on suspicion of DWI. The police officer then turned on his microcassette tape recorder, located in the vehicle, while he stepped outside to talk with the reporting party. During that time, the appellant and his friend talked about how they switched seats shortly before being pulled over and that they should stick with the story. The trial court found that the tape was admissible.

In this case of first impression, the Court of Appeals holds that individuals do not have a reasonable expectation of privacy in the rear seat of a squad car. Whether or not the driver had a subjective expectation of privacy, the controlling issue is whether society is prepared to accept such an expectation. This case distinguishes a telephone booth from a squad car. Furthermore, the conversation need not be suppressed under Minn. Stat. §626A.04, which prohibits surreptitious interception of communications, based upon the same expectation of privacy theory. **State v. Aaron Timothy Torgrimson**, C2-01-905 \_\_\_ N.W. 2d \_\_\_ (Minn. App. 1/2/02). <http://www.lawlibrary.state.mn.us/archive/ctappub/0201/c201905.htm>

■ **CONTEMPT: DIRECT CONTEMPT: SENTENCE LIMIT: AGGRAVATING FACTORS.** During a pretrial hearing, the appellant violated the no-use provision of his release, resulting in a partial forfeiture of bail. The appellant then asked his public defender what had happened and then stated: "This is f---ing stupid." The court then found the appellant in direct contempt, and sentenced him to six months of jail. In a rapid exchange between the court and the defendant, the defendant then told the court: "My f---ing a---," and "suck my d---, too." After each profanity, the defendant was given an additional six months, and was taken to the workhouse with a one-and-a-half-year sentence. While the Supreme Court has held that direct contempts are normally limited by misdemeanor sanctions, there were aggravating factors in



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this case to justify a greater than ordinary 90-day maximum. However, the outburst was a single behavioral incident and the court erred in sentencing him separately on all three findings of contempt. Accordingly, the sentence was modified by vacating two of the three six-month sentences. **State v. Theodore Roy Lingwall**, C2-01-2505, \_\_\_ N.W.2d \_\_\_ (Minn. App. 12/26/01).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0112/c2011505.htm>.

■ **DWI/IMPLIED CONSENT: COLLATERAL ESTOPPEL: AGAINST DEFENDANT.** The respondent in this case brought an implied consent proceeding and lost on the stop issue. In a subsequent criminal action, the court refused to apply collateral estoppel, and litigated the stop issue. Held, the district court correctly refused to apply collateral estoppel against the respondent. First, implied consent and criminal DWI proceedings are fundamentally different, in that one is criminal and the other is civil. Second, fundamental liberty interests are at stake in a criminal proceeding, and an implied consent petitioner may not have the same incentive to fully litigate issues at the implied consent hearing. Third, implied consent proceedings are civil in nature, where presumptions, burdens of proof, and evidentiary rules are different than in a criminal proceeding. Applying a rule of collateral estoppel would result in a situation where evidence is “presumed admissible” in a later criminal proceeding. The only permissible presumption in criminal law is the presumption of innocence. **State v. Jeremy Patrick Wagner**, C9-01-903, \_\_\_ N.W.2d \_\_\_ (Minn. App. 12/26/01). <http://www.lawlibrary.state.mn.us/archive/ctappub/0112/c901903.htm>.

■ **CRIMINAL SEXUAL CONDUCT: ATTEMPTED FIFTH DEGREE: SPECIFIC INTENT.** The appellant parked his vehicle in a handicapped parking space next to a sidewalk, near a playground adjacent to a public beach area. It was possible that children playing on top of the equipment, or someone walking by his car, could peer into his vehicle. The appellant was observed masturbating. It is undisputed that no children saw the appellant doing so.

Held, although the appellant could not have been convicted of the completed crime of criminal sexual conduct by merely acting in the proximity of children, there was sufficient evidence for the district court to find the appellant guilty of the lesser included charge of “attempted” fifth degree criminal sexual conduct. The Court of Appeals also holds that fifth degree criminal sexual conduct under M.S. §609.3451, subd. 1(2) is a specific intent crime, because it uses the term “know”: “masturbation or lewd exhibition of the genitals in the presence of a minor under the age of 16, knowing or having reason to know the minor is present”. **State v. Kerry Dean Stevenson**, C8-01-505, \_\_\_ N.W.2d \_\_\_ (Minn. App. 1/8/02). <http://www.lawlibrary.state.mn.us/archive/ctappub/0201/c801505.htm>.

■ **SENTENCE: STAY OF ADJUDICATION: SENTENCING CIRCLE.** This case reverses the Court of Appeals. The appellant had been charged with two felony counts of wrongfully obtaining public assistance and food stamps. In exchange for a plea of guilty, the prosecution agreed to refer the matter to a sentencing circle. The prosecutor was assured by the court that the sentencing circle would protect the state’s interest and restitution. No other limitation was placed upon the discretion of the sentencing circle. Following 14 hours of meetings, the sentencing circle recommended a stay of adjudication, with other conditions. The rationale was that the appellant was not a risk to public safety by not having a felony record, had no pattern of breaking the law, that a felony record would impede her ability to obtain future employment, and that a traumatic family event contributed to her offense. The state had not been given notice of the sentencing circle meetings, although the county was duly notified.

Held, the district court did have the authority under Minn. Stat. §611A.775 to stay adjudication of the appellant’s guilt based upon the sentencing circle’s recommendation after the state agreed to send the case to the circle. If the state, or any party, is able to place limitations upon the workings of a sentencing circle (and the court leaves this question open), then such limitations “must be made up front, for the laborious process of reconciliation when resolution takes place.” The stay of adjudication was an appropriate sanction for the court to adopt and, to that extent, Minn. Stat. §611A.775 (establishing sentencing circles) abrogates Minn. Stat. §609.095(b) (2000) which, with a few narrow exceptions, prohibits stays of adjudication. **State v. Signe Elisse Pearson**, C9-99-2021, \_\_\_ N.W.2d \_\_\_ (Minn. 1/17/02). <http://www.lawlibrary.state.mn.us/archive/supct/0201/c9992021.htm>.

■ **RACKETEERING: CONTROLLED SUBSTANCES: UPWARD DEPARTURE: EXCESSIVE FINE.** It was not an abuse of discretion for the judge to impose a 162-month sentence for a racketeering conviction involving multiple controlled substance sales. The presumptive sentence was 122 months. The court cited aggravating factors including status as a major controlled substance crime because of 13 separate transactions, transferring cocaine for resale by others, packaging drugs in a way to constitute “manufacturing,” occupying a high position in the drug distribution hierarchy, operating with a high degree of sophistication, racketeering over a lengthy period of time, and committing the crimes as one in a group of three or more persons. The court rejects the defense argument that these factors are “typical” for racketeering and do not justify an upward departure. The court assigned a severity level VIII to the offense, and departed upward. The fine of \$100,000 was not grossly disproportionate to the appellant’s admitted profits (\$12,200 in 1990 alone). **State v. Scott Thomas Kujak**, C2-01-855, \_\_\_ N.W.2d \_\_\_ (Minn. App. 1/15/02).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0201/c201855.htm>.

■ **EXTRADITION: INTERSTATE AGREEMENT ON DETAINERS: 180 DAY LIMITATION: WAIVER BY CONDUCT.** Although a written request



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was made by the appellant, an inmate at a North Dakota state penitentiary, and received by the Minnesota Attorney General, defense counsel's statement and conduct in setting the Omnibus hearing beyond the 28-day limit and a trial date beyond the 180-day Interstate Agreement on Detainers limit constitute a waiver of the defendant's right under the IAD to be brought to trial within 180 days after delivery of his request for final disposition of the complaint. *State v. Lenard Wells*, C4-01-971, \_\_\_ N.W.2d \_\_\_ (Minn. App. 1/15/02) <http://www.lawlibrary.state.mn.us/archive/ctappub/0201/c401971.htm>

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### EMPLOYMENT & LABOR LAW

#### JUDICIAL LAW

■ **AGE DISCRIMINATION.** Comments made by high-level company executives and distributed throughout the company constitute sufficient evidence to submit an age discrimination claim as part of a corporate Reduction-In-Force under the Minnesota Human Rights Act. In *Hamblin v. Alliant Techsystems, Inc.*, 636 N.W.2d 150 (Minn. App. 2001), the Court of Appeals held that such statements can demonstrate a discrimination "corporate culture" that establishes pretext to satisfy the third prong on an age discrimination case. The statements included a remark that "older employees [should be] targeted . . . to maximize cost reduction" and a memorandum urging the hiring of "new people" and "[y]ounger talent," each of which can show pretext.

But the Court of Appeals rejected a claim of disparate impact on grounds that there must be a combined showing under Minn. Stat. §363.03 subd.1 of a specific employment practice that creates a "statistically significant adverse impact" on particular employees and a "comparably effective practice" that would "cause a significantly" less adverse impact.

The U.S. Supreme Court has agreed to hear an important RIF case this term in *Adams v. Florida Power Co.*, No. 01-584. The high court will consider the applicability of the "disparate impact" doctrine to mass layoffs. The issue under the ADEA is whether statistics showing an adverse effect upon older workers establishes a violation of the ADEA. The 11th Circuit rejected the claim, holding the doctrine inapplicable under the ADEA.

#### LEGISLATION

■ **AGE ISSUES.** Individuals may be able to bring age discrimination claims against state governments and their agencies under a proposal in Congress. Legislation seeking to overturn the Supreme Court ruling in *Kimmel v. Florida*, 528 U.S. 62 (2000) has been introduced in both the Senate and House. The measure would allow claims to be brought under the Age Discrimination Employment Act against state agencies that receive federal funds. The legislation introduced in the Senate as S.928, the "Older Workers" Preservation Act," seeks to reverse *Kimmel* case holdings that such claims are barred because of the sovereign immunity provision of the 11th Amendment of the U.S. Constitution. Proponents of the bill maintain that the result of the *Kimmel* case precludes state employees from suing for age discrimination in jurisdictions that lack comparable remedies under state law. In legal action, such claims can be brought under the MHRA, but there are significant differences and remedies than under the ADEA.

The Equal Employment Opportunity Commission has issued an opinion stating that reduction of retiree health benefits by employees due to age or Medicare eligibility violates the ADEA. An EEOC Guidance, issued in 2000, provided that if a company reduced health benefits to older retirees on the basis of Medicare eligibility, it could avoid liability under the ADEA by showing that either:

- The net benefit is equal for older and younger workers, taking into account that retired employees over age 65 also receive Medicare; or
- The employer incurs an equal cost for benefits for older and younger retirees, and the reductions in benefits for older retirees are economically justified.

The commission has decided to review the policy in response to concerns that it has created a disincentive for employers to provide retiree health benefits.

However, the rescission notice makes clear that the EEOC is maintaining its policy that an employer must offer current employees age 65 or over the same health benefits, under the same conditions, that it offers to current employees under age 65.

■ **NON-COMPETE COVENANTS.** Sufficient consideration exists to uphold a pair of non-compete covenants, according to a new pair of rulings by the Minnesota Court of Appeals involving employees who sign non-compete covenants after they had already begun employment. Generally, non-compete agreements are not valid in Minnesota unless they have independent consideration, which means they must be



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entered into when employment begins or for adequate consideration if signed after the employment relationship already has commenced. In the two cases, the Court of Appeals upheld the non-compete clauses entered into after employment began because there was adequate consideration given to the employees to support those restrictions.

In *Twin City Catering Company, Inc. v. LaFond*, 2001 WL 1335685 (Minn. App. 2001) (unpublished), the providing of additional sales support, alteration of duties, and an enhanced compensation formula that allowed the employee to quadruple his income was sufficient consideration for signing a non-compete agreement. In affirming a temporary injunction against the employee who joined a competitor, the court reasoned that the employee had received “real benefits” to support the non-compete covenant.

Similarly, in *Tappe Construction Co. v. Siedow*, 2001 WL 1646653 (Minn. App. 2001) (unpublished), a carpentry foreman for a construction company was deemed subject to a non-compete agreement. The court rejected the employee’s argument that the agreement, entered into two years after he began employment, was not supported by adequate consideration. It noted that he had received a salary increase contingent upon signing the non-compete agreement, which constituted sufficient independent consideration to uphold the non-compete provision.

### LOOKING AHEAD

■ **UNEMPLOYMENT COMPENSATION.** The Minnesota Supreme Court is tackling a pair of rarities, appeals of unemployment compensation decisions from the Minnesota Court of Appeals. In early January, the Court heard two cases involving the scope of the “misconduct” disqualification from unemployment compensation benefits under Minn. Stat. §268.095 Subd. 6.

In *Houston v. International Data Transfer Corp.*, the Court will decide whether the Court of Appeals properly upheld disqualification of an employee who was fired on grounds of rudeness to a customer, a determination by the Department of Economic Security that was upheld last summer by the Court of Appeals. 2001 WL 856262 (Minn. App. 2001) (unpublished). In *Schmidgall v. FilmTech Corporation*, the Court will determine whether an employee was properly denied unemployment compensation benefits because she did not report an injury during the shift in which it occurred, as required by company policy, a determination by the Department that the Court of Appeals also upheld last summer. 2001 WL 800048 (Minn. App. 2001) (unpublished). Both cases are likely to provide significant guidance to employers, employees, and their legal representatives in addressing unemployment compensation issues, including the frequently raised disqualification claim of “misconduct.”

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## ENVIRONMENTAL LAW

### JUDICIAL LAW

■ **WETLANDS; DITCH MAINTENANCE.** In a pair of recent decisions, the Minnesota Court of Appeals held that ditch maintenance is not exempt from wetland approval, permit, and replacement requirements when the work will partially drain a wetland. Ditch maintenance will also require preparation of an Environmental Impact Statement when the work will convert a protected wetland to an unprotected wetland.

In the first case, the claimants owned land adjacent to a county ditch. A culvert in the ditch had risen over the years as a result of natural forces, which caused water to pond on the claimants’ land. The claimants wanted the culvert lowered to its original elevation, and sediment in the ditch removed in order to stop the ponding. The ditch work would drain part of a 25-year-old wetland. Minnesota Statutes §103G.221, subd. 1 requires that partially drained wetlands be replaced, unless an exemption applies. The claimants requested an exemption from the watershed district under Minnesota Statutes §103G.2241, subd. 3(1), which exempts activities that are exempt from federal regulation under 33 U.S.C. §1344(f). The federal rule exempts the discharge of dredged or fill material for purposes of maintaining certain structures. The watershed district denied the exemption and the Minnesota Board of Soil and Water Resources affirmed on grounds that the federal exemption did not apply because draining a wetland does not constitute discharge of material, and that, even if it did apply, Minnesota Rules 8430.0122, subp. 3(A) precludes application of the exemption where activities will partially drain a wetland. Acknowledging the no-net-loss policy behind Minnesota’s Wetland Conservation Act, the court held that BSWR did not exceed its authority in adopting Minnesota Rules 8420.0122, subp. 3(A) and that BSWR’s denial of the exemption was lawful. *Hentges v. Minn. Bd. of Water & Soil Res.* ¶ C7-010-799, \_\_\_ N.W.2d \_\_\_, 2002 WL 27094 (Minn. App. 1/4/02). <http://www.lawlibrary.state.mn.us/archive/ctap-pub/0201/c701799.htm>

In the second case, the drainage authority for Big Stone County petitioned the County Board of Commissioners for removal of sedi-



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ment downstream of a wetland. After the board issued a finding of no significant environmental impact, environmental groups sued and obtained a declaratory judgment requiring the drainage authority to get permission from the Minnesota Department of Natural Resources under Minnesota Statutes §103E.011, and a public waters permit under Minnesota Statutes §103G.245. The district court also ruled that a wetland replacement plan or exemption was required, but that an EIS was not. Both parties appealed.

The Court of Appeals rejected the drainage authority's argument that it is not subject to either the permission requirement of Minnesota Statutes §103E.011 or the permit requirement of 103G.245. The court held that the drainage authority is subject to both statutes, but that either DNR permission or a permit is required — not both. The court also held that an EIS was mandatory because the project would eliminate a protected water by changing a protected Type-5 wetland to an unprotected Type-2 wetland. Like the first case, the court held that the project was not exempt from wetland replacement requirements because it involved the drainage of wetlands as opposed to the discharge of dredged or fill material. *Minn. Ctr. for Envtl. Advocacy v. Big Stone County Bd. of Comm.*, C7-01-1161, 638 N.W.2d 198, 2002 WL 47021 (Minn. App. 1/15/02). <http://www.courts.state.mn.us/opinions/coa/current/c7011161.html>

### ADMINISTRATIVE MATTERS

■ **CLEAN AIR ACT; NEW SOURCE REVIEW.** The Department of Justice recently reviewed several pending EPA New Source Review enforcement actions against companies whose pollution-emitting facilities were allegedly modified in violation of the Clean Air Act. The DOJ concluded that the EPA has a reasonable basis for pursuing such actions under the Clean Air Act and current regulations. Attorney General John Ashcroft issued a letter on January 15, 2002, adopting this conclusion as the DOJ's official position, but expressing no opinion on how the Clean Air Act should be enforced in the future. The Bush Administration is expected to announce changes that will relax NSR rules. The DOJ's report and the Attorney General's letter are available at <http://www.usdoj.gov/olp/nsrreport.pdf> and <http://www.usdoj.gov/olp/agletter.pdf>, respectively.

■ **ELECTRONIC REPORTING; EPA.** The EPA has established a single portal on the Web for electronic submission of environmental data. The Central Data Exchange currently accepts data for certain air, water, waste, and toxic programs. By 2004, it is expected to be the point of entry for nearly all environmental data that is reported to the agency. The CDX is located at <http://www.epa.gov/cdx>.

■ **WETLANDS; NATIONWIDE PERMITS.** The U.S. Army Corps of Engineers has reissued 43 nationwide permits regulating development activities affecting wetlands and other U.S. waters. The new permits take effect March 16, 2002. The permits reinforce a commitment to no-net-loss of wetlands, but take a watershed approach by considering the impact of permit decisions on individual watersheds. As a result, the overall goal for a particular district will be no-net-loss, but the Corps may not require mitigation on a 1:1 basis in all cases. *67 Fed. Reg.* 2019 (1/15/02); <http://frwebgate.access.gpo.gov/cgi-bin/multidb.cgi>

### LEGISLATION

■ **CERCLA AMENDMENTS.** The Small Business Liability Relief and Brownfields Revitalization Act was signed into law on January 11, 2002. The act amends CERCLA by providing liability relief for small businesses and prospective purchasers of brownfield sites. It also authorizes new grant programs to finance assessment and cleanup of brownfields.

Title I of the act creates two new exemptions from liability under Section 107 of CERCLA: one for generators of municipal solid waste and the other for parties responsible for *de micromis* contributions. The exemptions apply to liability for response costs at Superfund sites only. In addition, nongovernmental claimants in contribution actions at Superfund sites bear the burden of proving that a defendant does not qualify for the *de micromis* exemption.

Title II of the Act provides several new incentives to purchase and redevelop brownfield sites. It authorizes up to \$250 million in annual funding for assessment and cleanup of brownfield sites. It provides liability protection to innocent owners of properties that are contiguous to contaminated sites, and also to purchasers who acquire brownfields after discovering contamination during pre-purchase investigations. Title II also clarifies ambiguities in the existing innocent landowner defense by, among other things, establishing standards for the "all appropriate inquiries" which parties must make in order to invoke the defense. Except in limited situations, Title II also bars EPA overfiling at sites that have been closed under approved state programs. Pub. L. No. 107-118 (2002)

— ROBERT F. DEVOLVE  
LEONARD STREET AND DEINARD

### FAMILY LAW JUDICIAL LAW



## NOTES & TRENDS

■ **CHILD SUPPORT AND CUSTODY — UNIFORM INTERSTATE FAMILY SUPPORT ACT; UNIFORM CHILD CUSTODY JURISDICTION AND ENFORCEMENT ACT.** The parties dissolved their marriage in South Dakota. Appellant was granted custody of the children and respondent was obligated to pay support. Appellant now lives in Minnesota and respondent in Missouri. Appellant registered the South Dakota orders in Minnesota and respondent brought a motion to vacate the registration. Appellant brought a motion to have Minnesota assume jurisdiction over custody and support. The district court ruled that appellant failed to meet the statutory requirements for registration of foreign orders and that there was no basis for Minnesota to exercise jurisdiction. The Court of Appeals affirmed, holding that the Uniform Interstate Family Support Act requires a sworn or certified statement showing the amount of any arrearage. Since there were no arrearages in this case, there was no enforcement issue as to the South Dakota support order and appellant was not entitled to register it for enforcement in Minnesota. The Court of Appeals also denied registration for modification and enforcement under Minn. Stat. §518C.609. The Minnesota court may modify the foreign support order only if it finds, among other things, that the petitioner is a nonresident of Minnesota. Appellant in this case was a resident of Minnesota. Appellant also claimed that, because Minnesota is the home state of the children and thus the proper state for jurisdiction, the district court was required under Minnesota law to register the South Dakota orders and assume jurisdiction over custody issues. The Court of Appeals noted that for all custody issues raised after January 1, 2000, the Uniform Child Custody Jurisdiction and Enforcement Act applies. In this case, Minnesota has jurisdiction to modify the South Dakota custody or visitation determination because Minnesota was currently the home state of the mother and the children. However, appellant did not allege an existing custody dispute and did not register the South Dakota order under the UCCJEA. Appellant initially attempted to register the South Dakota orders under UIFSA. However, she failed to register the South Dakota order as required by the UCCJEA. Custody matters must be registered under the UCCJEA and child-support matters must be registered under the UIFSA. Minnesota cannot take jurisdiction of custody issues when there is neither proper registration under the UCCJEA nor assertion of an existing custody dispute. Thus, the district court did not err in denying appellant's motion to have the court take jurisdiction over the visitation issue. Affirmed. *Stone v. Stone*, 636 N.W.2d 594 (Minn. App. 2001).

■ **ADOPTION — PATERNITY AND FATHERS' ADOPTION REGISTRY.** Appellant and respondent are the unmarried biological parents of a child. Respondent informed appellant of the pregnancy soon after conception. During her pregnancy, respondent moved several times to locations in three different states. Appellant and respondent lived together for one month. Respondent gave birth to the child in Minnesota and, two days after being born, the child was discharged to the custody of her adoptive parents. Thirty-one days after the child's birth, appellant learned of the birth and that the child may possibly have been adopted in Minnesota. Appellant telephoned the Fathers' Adoption Registry and mailed the Minnesota adoption registry forms, postmarked the same day. Appellant subsequently commenced a paternity action and respondent and the adoptive parents moved to dismiss the action because no putative father had timely registered. The district court dismissed the action.

The Court of Appeals rejected the appellant's claim that he was entitled to notice of the adoption petition under Minn. Stat. §259.49, subd. 1 (4) (2000) because he had "openly lived with" the mother. The court held that the adoption-notice statute's use of the present tense, "is living openly with," refers to the individual residing with the child or mother after the child's birth.

The court also rejected appellant's claim that he timely registered. Registration was required within 30 days and the Court of Appeals agreed with the district court that it was possible for the appellant to file in the 30-day period and that he did not fall within any statutory exception. The Court of Appeals also refused to recognize a fraud exception to the registration requirement finding no policy basis for such an exception. Not only did the Legislature decline to create a fraud exception, it expressly eliminated the putative father's defense that he did not know of the birth or pregnancy. Finally, the Court of Appeals rejected appellant's due process and equal protection challenges to the Fathers' Adoption Registry. Affirmed. *Heidbreder v. Carton*, C0-01-739, \_\_\_ N.W.2d \_\_\_ (Minn. App. 12/11/2001).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0112/c001739.htm>

— STEPHEN R. ARNOTT  
CHAIR, FAMILY LAW SECTION, MSBA

### FEDERAL PRACTICE

#### JUDICIAL LAW

■ **MOTIONS FOR JUDGMENT AS A MATTER OF LAW; PROCEDURAL REQUIREMENTS.** The 8th Circuit recently had occasion to revisit a number of its prior decisions addressing the procedural requirements governing motions for judgment as a matter of law.

Defendant's motion for JAML was denied at the close of plaintiff's case, and defendant failed to renew its motion at the close of all the evidence. The jury then found for the plaintiff. On appeal, defendant argued that it fell within one of several alleged exceptions to the requirement that JAML motions be renewed at the close of the evidence.



## NOTES & TRENDS

First, defendant cited a 5th Circuit decision for the proposition that “technical noncompliance with Rule 50(b) may be excused” if “the purposes of the rule are satisfied.” The 8th Circuit panel rejected this argument out of hand, noting that “this circuit has never recognized this exception,” and further noting that even if the exception did in fact exist, defendant had failed to meet its requirements.

Next, defendant argued that the brief passage of time between its original JAML motion and the close of the evidence relieved it of its obligation to renew its JAML motion. Again, the panel rejected that argument, finding that “The language and traditional application of Rule 50 are clear; objections must be filed at the close of the evidence to preserve any post-trial challenges to the verdict.”

As this decision demonstrates, given the 8th Circuit’s consistent pattern of strictly applying the procedural requirements of JAML motions, litigants ignore those requirements at their peril. *Mathieu v. Gopher News Co.*, 273 F.3d 769 (8th Cir. 2001).

■ **MOTION FOR CLASS CERTIFICATION; TIMELINESS.** Plaintiffs brought Title IX claims against the University of Minnesota in early 1997. In March 1998, the District Court issued a scheduling order which set July 21, 1998, as the deadline for the filing of dispositive motions. After plaintiffs failed to move for class certification within the scheduling order’s deadline, defendants moved to strike the class allegations. Magistrate Judge Lebedoff recommended that defendants’ motion to strike be granted, and Judge Magnuson adopted the recommendation. After plaintiffs’ individual claims for damages and injunctive relief were dismissed, plaintiffs appealed. Reviewing the striking of the class allegations under an abuse of discretion standard, the 8th Circuit found no abuse of discretion in the striking of the class allegations, where the district court had found that plaintiffs had “no credible excuse” for their delay.

This decision is simply the latest in a long line of 8th Circuit decisions illustrating the importance of compliance with district courts’ scheduling orders. *Grandson v. University of Minnesota*, 272 F.3d 568 (8th Cir. 2001).

■ **OTHER NOTEWORTHY DECISIONS.** The 8th Circuit found no abuse of discretion in a district court’s decision to admit evidence of laboratory tests into evidence under the business records exception found in Fed. R. Evid. 803(6), and rejected appellants’ argument that admissibility of the tests was governed exclusively by Fed. R. Evid. 702. *Shelton v. Consumer Products Safety Commission*, 2002 WL 80898 (8th Cir. 2002).

Judge Alsop issued two opinions in the same case addressing procedural issues.

In the first decision, Judge Alsop denied a motion to reduce a punitive damages award under *BMW of North America, Inc. v. Gore*, rejecting a defendant’s argument that the Constitution required something less than the 5:1 ratio between punitive and compensatory damages awarded by the jury. In the second opinion, Judge Alsop awarded plaintiff’s counsel just over \$70,000 of the \$110,000 requested in a motion for fees and costs, while at the same time bemoaning “the gross distortion fee shifting statutes have wrought upon the objective evaluation of claims for purposes of settlement.” *Storlie v. Rainbow Foods Group, Inc.*, 2002 WL 46997 (D. Minn. Jan. 9, 2002).

■ **FEDERAL RULES AMENDMENTS.** Several amendments to the Federal Rules of Civil Procedure took effect December 1, 2001. In the most significant of these changes, Fed. R. Civ. P. 5 was amended to allow parties to consent in writing to service by “electronic means,” including both facsimile and e-mail.

— JOSH JACOBSON  
LAW OFFICE OF JOSH JACOBSON PA

### INTELLECTUAL PROPERTY

#### JUDICIAL LAW

■ **TRADEMARKS, FRANCHISE AGREEMENTS, PRELIMINARY INJUNCTIONS, AND INSURANCE.** In *Country Inns & Suites by Carlson, Inc. v. Two H.O. Partnership*, Civ. 01-1214, 2001 U.S. Dist. LEXIS 20186 (D. Minn. 11/19/01), Judge Tunheim granted Country Inns’ motion for a preliminary injunction enjoining its former franchisee, Two H.O. Partnership, from continuing use of certain trademarks on signs. Two H.O. allowed its franchise agreement, containing permission to use Country Inns’ trademarks, service marks, and trade dress, to lapse. However, the former franchisee did not stop using the marks. Instead, as the Court found, Two H.O. made only “cosmetic” changes to three infringing signs: the words “by Carlson” had been removed from all three, Carlson’s “flower” design was removed from two, and the flower on one had been covered with a picture of a house.

Granting preliminary injunction, the Court stated, “common sense compels the conclusion that a strong risk of consumer confusion arises when a terminated franchisee continues to use the former franchisor’s trademarks.”

In *Team Tires Plus, Ltd. v. Heartlein*, Civ. No. 01-1197, 2001 U.S. Dist. LEXIS 20444 (D. Minn. 11/20/01), Judge Magnuson denied Team Tires’ motion for a preliminary injunction enjoining its former franchisee, Heartlein, from using certain trademarks. Team Tires terminated its franchise agreement, which ended Heartlein’s license to use certain Team Tires’ trademarks. Heartlein did not stop using the trademarks of its former franchiser, claimed Team Tires. However, at the motion hearing, Heartlein declared that it had ceased all use of Team



## NOTES & TRENDS

Tires' marks, and Team Tires did not have proof to the contrary. Therefore, unlike *Country Inns*, where a portion of the franchisor's trademarks were still in use, here there was no likelihood of success because the franchise had stopped all use of the franchisor's trademarks.

Because there is a strong risk of consumer confusion when a former franchisee continues to use the franchisor's marks, in whole or part, former franchisees should take special care to ensure the marks they do use are clearly distinct from those of the former franchisor.

In *Chisum, L.L.C. v. Chief Automotive Sys., Inc.*, Civ. No. 01-816, (D.Minn. 11/9/01), Judge Magnuson denied Chief's motion for a temporary restraining order protecting its not-yet registered or used "EXCELERATOR" trademark. Chief filed an intent-to-use application on the mark for a new machine Chief was developing. However, the Court found Chief was not entitled to any federal or common-law trademark protection against Chisum's use of "ACCELERATOR" for a similar new machine, because Chief's mark had not yet been used in commerce or registered by the PTO. The motion was denied without prejudice pending Chief's federal registration or market presence of its mark.

In *Triple Crown Nutrition, Inc. v. Old Republic Ins. Co.*, Civ. No. 02-292 (D.Minn. 12/14/01), Judge Magnuson granted Old Republic's motion for summary judgment holding that claims of trademark infringement against Triple Crown do not constitute advertising injury under the language of the insurance policy sold by Old Republic. Recognizing the split between the Minnesota Court of Appeals and the 8th Circuit on this issue, the Court resolved that "[t]his Court is constrained to follow holdings of the 8th Circuit Court of Appeals."

— TONY ZEULI  
— CHARLIE JACOBSON  
MERCHANT & GOULD

### PROBATE AND TRUST LAW

#### JUDICIAL LAW

■ **TRUSTEE ABUSED DISCRETION.** The trial court determined that it was in the conservatee's best interest to live at home. The trustee, who was her son, disagreed. The trustee threatened to sue the conservator and he told the conservator that he would not provide trust money to care for the conservatee during the trustee's vacation. The trial court found the trustee's actions to be an abuse of his discretion, and ruled that the trustee should cooperate with the conservator and should use the income and assets of the trust to accomplish the home placement. The trustee appealed. The Court of Appeals found this to be a "unique litigation topic" with few precedents in Minnesota history. The court ruled that "trustees may be subject to judicial control when they abuse their discretion or act in bad faith," and that "trustees cannot veto or interfere with legal characteristics of a conservatorship." The Court of Appeals quoted the District Court in stating: "As between a trust not subject to the Court and a conservatorship subject to the Court, this Court finds that the supervisory powers of the Court take precedence, particularly when both the trust and the conservatorship explicitly share the same purposes." *In Re: Conservatorship of Hazel Margaret Wolens*, CX-01-523, (Minn. App. 12/11/01) (unpublished). <http://www.lawlibrary.state.mn.us/archive/ctapun/0112/523.htm>

— TONYA ZDON GABBARD  
GARVEY & BOGGIO PA

### REAL PROPERTY

#### JUDICIAL LAW

■ **DRAINAGE LAW.** Respondent counties, as local drainage authorities, constructed drainage systems for which they have levied assessments against the land benefiting from each system, including the state-owned and DNR-managed consolidated conservation lands ("con-con lands"). In 1993, the state ceased paying assessments on the con-con lands, disputing the amount of the assessment. Respondent counties and certain landowners brought this action to force the DNR to pay drainage assessments for ditch repairs. The district court granted respondent counties' motion for summary judgment and this appeal followed. The Court of Appeals reversed, holding that the commissioner of the DNR was authorized under Minn. Stat. Ch. 84A to decline to pay ditch assessments determined by the counties. The DNR's failure to promulgate a rule regarding the payment of ditch assessments within the statutory time frame did not bar it from subsequently declining to pay those assessments. Finally, the existence of a property right in a drainage system does not compel the state to subsidize the cost of that system for the benefit of private landowners. The appellate court reversed the district court and granted summary judgment for the DNR. *Marshall Co. v. The State of Minnesota and its Department of Natural Resources*, CX-01-716, \_\_\_ N.W.2d \_\_\_ (Minn. App. 12/4/01). <http://www.lawlibrary.state.mn.us/archive/ctappub/0112/cx01716.htm>

■ **WETLANDS LAW.** Hentges owns land adjacent to Anoka County Ditch No. 53-62. He claimed that a culvert installed by MNDOT in the



## NOTES & TRENDS

ditch system at I-35W caused water to overflow and flood his lands. Hentges wants the culvert, which has risen to a higher elevation as a result of natural forces, to be lowered to the height of its original placement, which would cause partial drainage of adjacent wetlands. State law requires that wetlands be replaced unless the work that caused the drainage is exempt. Hentges contends that the proposed project is simply ditch maintenance and, therefore, exempt from the replacement requirement. The Rice Creek Watershed District denied the exemption and the Board of Water and Soil Resources affirmed. Hentges sought review of that decision by *certiorari*. The appellate court concluded that BWSR acted properly in promulgating a rule that did not allow an exemption from the state's wetland replacement requirement for ditch maintenance if the ditch work would cause a loss of wetlands and, therefore, that it acted properly in denying the exemption. The appellate court affirmed the decision of the BWSR. **Hentges v. Minnesota Board of Water and Soil Resources**, C7-01-799, \_\_\_ N.W.2d \_\_\_ (Minn. App. 1/4/02). <http://www.lawlibrary.state.mn.us/archive/ctappub/0201/c701799.htm>

■ **ENVIRONMENTAL LAW.** County Ditch No. 2 was built in 1907 and passes through a DNR-protected Type-5 wetland, which is approximately 60 acres. In 1994, landowners petitioned the county to repair County Ditch No. 2, including removal of sediment below the wetland, to reestablish a previous depth. In 1995 and 1996, the county proceeded with the repairs but did not remove sediment downstream of the wetland. In 1998, the county received a new petition for removal of the sediment downstream. The county's consultant prepared an EAW to determine whether there would be significant environmental effects from the project. It was undisputed that the project will transform the wetland from a Type 5 protected wetland to an unprotected Type 2 wetland. Comments were received to the EAW from the Minnesota Board of Water and Soil Resources stating that a replacement plan for the loss of wetlands would be required and that a decision would need to be made as to whether the county was exempt from the replacement plan requirement for wetlands. After a public hearing, the county concluded that an EIS would not be required and that the project is exempt even though they did not seek exemption from the local governmental unit. Respondents brought a declaratory judgment action. The district court granted summary judgment, concluding that the county was required to obtain permission from the DNR to undertake the project because it substantially affects public waters and that a public waters permit was required. The court also found that the EAW was flawed and that a new EAW should be prepared, but that an EIS was not required. On appeal, the Court of Appeals reversed the district court, holding that the county must either obtain permission from the Commission of DNR under Minn. Stat. §103E, or obtain a work permit under Minn. Stat. §103G, but not both; and reversed the district court's decision that a new EAW is required, concluding that the project required an EIS instead. It affirmed the district court's conclusion that the county is not exempt from the wetland replacement requirements, holding that the county must seek approval of a replacement plan or an exemption requirement from the appropriate local governmental unit. Affirmed in part, reversed in part.

**Minnesota Center for Environmental Advocacy v. The Big Stone County Board of Commissioners, et al**, C7-01-1161, 2002 WL 27094 (Minn. App. 1/15/02). <http://www.lawlibrary.state.mn.us/archive/ctappub/0201/c7011161.htm>

— CHRIS DIETZEN  
LARKIN, HOFFMAN, DALY & LINDGREN

### TAX LAW

#### JUDICIAL LAW

■ **REFUND CLAIM; LATE TAX RETURN FILING; PAYMENTS MADE BEYOND STATUTE OF LIMITATIONS.** Taxpayer filed his 1993 return in 1998 and requested a refund of the overpayment. While the claim for a refund was timely, since it was made at the time of the filing of the return, there is a separate limitation on the refund request. The refund request must be made within three years from the date the tax was actually paid plus any extensions for filing. In this case, the taxpayer could not recover any taxes paid before 1995, regardless if he would have otherwise been able to recover them. Even though the taxpayer had sent the IRS a letter requesting this refund before he filed his return, the letter is not the proper form to make this request under the regulations. **George R. Wertz, Jr. v. The United States**, No. 00-418 T., 2002 U.S. Claims LEXIS 3 (Fed. Cl. 1/9/02).

■ **WITHDRAWAL OF OFFER IN COMPROMISE; EFFECTIVE DATE; NOTICE.** In this particular case, the date of the withdrawal was critical because the statute of limitations expired after the date the taxpayer faxed his withdrawal and before the IRS filed suit. While the IRS was claiming that they had to acknowledge the withdrawal of the offer, the court held that IRS standard practice is to accept a withdrawal on the date the taxpayer writes the letter. **United States v. Patrick M. Donovan**, No. 5:01-CV-1457 (N.D. Ohio 1/2/02).

■ **NET WORTH METHOD; UNREPORTED INCOME.** The Tax Court upheld the net worth method used by the IRS in figuring total income by the taxpayers. The IRS agent considered the petitioners' assets, liabilities, and expenses to figure net worth, then determined income by comparing the net worth over the years involved. The Tax Court did not agree with petitioners that the net worth method used was "arbitrary and without merit" because the agent did not review their business records. The agent does not have to go through the business



## NOTES & TRENDS

records first before using the net worth method, and the petitioners also did not provide evidence to defeat the presumption of correctness of the agent's report because the business records provided were in an "incomprehensible state." Petitioners, however, were not imposed fraud penalties, only accuracy-related penalties. *Monty Bisceglia and Patricia Bisceglia v. Commissioner of Internal Revenue*, T.C. Memo No. 2002-22 (1/22/02).

■ **DISCHARGE OF INDEBTEDNESS; INSOLVENT COUPLE.** While a discharge of indebtedness is usually included in gross income, there is an insolvency exception. Petitioner's FMV of assets owned and liabilities owed immediately prior to the discharge indicated their insolvency state. The couple's testimony and demeanor helped to persuade the court that they were truthful about their insolvency state, and the discharged debt was held to fit the exception of untaxable income. *Garry D. Acuncius and Danalene L. Acuncius v. Commissioner of Internal Revenue*, T.C. Memo No. 2002-21 (1/22/01).

■ **PENALTIES; ATTORNEY; REASONABLE CARE IN INVESTING.** An attorney was held liable for negligence penalties and substantial understatement of tax penalties for not seeking proper advice in his investment. The attorney did not have any experience in this type of investment and relied on others without understanding the investment nor investigating the qualifications of the associates and the others he was relying on for information. *William G. & Debra C. Kellen v. Commissioner of Internal Revenue*, T.C. Memo 2002-19 (1/22/02).

■ **THIRD-PARTY SUMMONSES TO OUTSIDE ACCOUNTANTS; CRIMINAL INVESTIGATION.** The IRS issued summonses to the accountants of petitioner's business. Petitioner was under a criminal investigation for federal tax liabilities. The court stated that 26 U.S.C. §7602(b) does allow summonses in cases where the investigation is only for criminal purposes, and the special agent does not need any prior supervisory approval to issue these. It is also the burden of the Petitioner to show bad faith by the IRS. The summons also overrides any accountant-client privilege. *Scotty's Contracting & Stone Co. v. United States*, No. 1:01-CV-118-M (W.D.KY 11/7/01).

■ **NET GIFT DOCTRINE; DONEE LIABILITY; ESTATE TAX.** Donees of a gift were liable for the additional gift tax and estate tax liability that arose after a re-valuation by the IRS of the gift of stock. The deceased, donor, had paid all prior gift tax liabilities based on a lower valuation than the IRS used. Great lengths were taken to value the gifts while the donor was alive, thus indicating that the donees did not wish to be liable for additional gift taxes. Since the gift was not conditioned on the donees paying the gift tax, the donees could not use the net gift doctrine to calculate lower gift taxes upon the new valuation by the IRS. Since the estate tax was also not a definite liability at the time of the gifts, it could also not be netted against the gifts. *Estate of Frank Armstrong, Jr. v. United States of America*, No. 01-1305, 2002 U.S. App. LEXIS 636 (4th Cir. 1/15/02).

■ **PARTNER LIABILITY FOR INCOME, FUTA, AND FICA TAXES .** The plaintiffs owned a business as a partnership. The business was sold to a couple that worked for the business during an interim period of about one year. The court held that the term "employer" was defined as the person who controls the payment of wages, and this definition included FICA and FUTA taxes. Although the couple that purchased the business ran the business, the plaintiffs were not prohibited from being involved in the day-to-day operations and continued to have signatory authority during this period. The plaintiffs were held liable for the unpaid Form 940 and 941 taxes. *Harry Hunison and Bud Vigue v. Commissioner of Internal Revenue Service*, A99-0622 (D. Alaska 12/17/01).

■ **COMMUNITY PROPERTY REGIME; NON-RECEIVING SPOUSE; EARLY IRA DISTRIBUTIONS; INCOME TAX.** Even though petitioner filed a separate return from her spouse, she received benefits from his business that made her subject to taxes on her share of the income. However, early withdraws he had from his IRA were only taxable to him. Although petitioner was not involved in any way with her husband's business, she did benefit from his income. *Angela C. Morris v. Commissioner*, No. 10368-00, T.C. Memo 2002-17 (1/16/02).

■ **NONQUALIFIED WITHDRAWAL FROM CONVERTED ROTH IRA; RETROACTIVE 10 PERCENT TAX .** The correction to code section 408 that had this benefit was not in violation of the Due Process Clause of the 5th Amendment because it was correcting an unintended benefit. The tax is related to a legitimate governmental purpose and the period of retroactivity that was allowed was limited and reasonable. The court also stated that the Takings Clause of the 5th Amendment was not violated since the tax was for a legitimate purpose. Therefore, the assessment of the additional tax on the withdrawal from the Roth IRA was proper and constitutional. *Douglas Q. Kitt and Nancy C. Kitt v. United States*, No. 01-5002, 2002 U.S. App. LEXIS 365 (Fed. Cir. 1/10/02).

■ **SOLE SHAREHOLDER; LIABILITY FOR TAX LIABILITIES OF BUSINESS.** The sole shareholder and president of a real estate company was not liable as a transferee for the company's unpaid federal income tax, additions to tax, and accrued interest. The company had transferred to the individual a portion of the proceeds of a settlement that the individual, the business, and its subsidiaries reached with a creditor. The Tax Court held that even though the transfer facially met the statutory threshold for an insider preference, it was nonetheless a "good faith" transfer under Texas law because it was part of the usual practice of the business and individual. *L.D. Johnson*, Dec. 54,627 (2002 TAXDAY, 1/25/02).

■ **NO EXCISE TAX IMPOSED.** An individual was not a substantial contributor to a private foundation to which he sold his residence.



## NOTES & TRENDS

Therefore, he was not liable for excise taxes imposed under Sec. 4941 for self-dealing. *M. Graham*, Dec. 54,628 (2002 *TAXDAY*, 1/25/02).

■ **CALCULATION OF TAXABLE TIPS FOR FICA PURPOSES.** The Supreme Court granted certiorari in *Fior D'Italia, Inc.* where the IRS used an estimate for cash tips that significantly overstated the actual tips received. The IRS used the charged tips as a method of estimating cash tips, and therefore reached this overstated amount. Congress has not authorized estimates for calculating FICA taxes. *TAXDAY*, Item #J.6 (January 16, 2002).

■ **NONPROFIT CORPORATION; EXEMPTION FROM REAL ESTATE TAXES.** A nonprofit corporation that provides skills training, materials, marketing, and sales support with respect to gift items manufactured by its participants (low-income disabled, elderly Native American or homebound individuals) is not subject to real estate taxes on property used for its charitable purposes. *Lady Slipper Designs, Inc.*, MN. Tax Court, File No. C5-01-227 (1/9/02)

### ADMINISTRATIVE MATTERS

■ **TAXPAYER ADVOCATE REPORT.** The National Taxpayer Advocate Nina Olson submitted her FY 2001 Annual Report to Congress on January 2, 2002. Among other things, she urged Congress to pass legislation simplifying the way taxpayers determine taxable units, creating a uniform definition of a "qualifying child," and repealing the alternative minimum tax. In addition, the report contained information on the IRS's efforts to improve customer service and the Taxpayer Advocate's role in resolving taxpayer problems. The report is available on the IRS web site at [www.irs.gov](http://www.irs.gov).

■ **2002 TAX LAW CHANGES TO RETIREMENT PLANS AND EDUCATION INCENTIVES.** The IRS issued fact sheets on changes to retirement planning and education incentives brought by the Economic Growth and Tax Relief Reconciliation Act of 2001. The act included many benefits to taxpayers in planning their retirement. In 2002, contribution limits to Roth and traditional IRAs have increased. Taxpayers within income guidelines will also benefit from a savers tax credit for contributions to IRAs, 401(k) plans, and other retirement plans. The act included education incentives such as larger Coverdell education savings account allowances and tax benefits for qualified tuition programs. *TAXDAY*, Item #I.2 (1/3/02); Fact Sheet 2002-05; Fact Sheet 2002-06.

■ **FINAL REGULATION ON LIFO UNDER SECTION 472.** The IRS issued a final regulation dealing with LIFO, the last-in, first-out inventory method. The regulation affects the method of valuing dollar-value LIFO pools and inventory price computation methods. *TAXDAY*, Item #I.1 (1/9/02).

■ **NEW THIRD-PARTY DESIGNEE OPTION ON FORM 1040.** Individuals can now designate on Forms 1040 a third-party designee to speak with the IRS on their behalf with regard to issues arising during the return's processing. A power of attorney, however, is still needed for a third party to represent the individual in examinations, underreported income cases, appeals, and collections. *TAXDAY*, Item #I.1 (1/15/02).

■ **IRS STILL INEFFECTIVE AND INEFFICIENT.** The IRS Oversight Board recently released its annual report concluding that poor customer service, decline in enforcement activity, and outdated technology have resulted in overall ineffective and inefficient service. Telephone assistance is still not up to par and the number of calls answered has declined significantly. In addition, the Oversight Board has linked a recent decline in the number of taxpayers opposed to cheating on their taxes to a lack of enforcement activity. Finally, the Oversight Board recommends computer modernization to help deal with the increasing number of tax transactions in the increasingly complex tax code. IRS Oversight Board Annual Report, January 2002; *TAXDAY*, Item #I.2 (1/22/02); *TAXDAY*, Item #I.3 (January 21, 2002).

■ **TAX COURT JURISDICTION; EMPLOYMENT STATUS PROCEEDINGS.** Information on the retroactive expansion of Tax Court jurisdiction to assessments of worker classification pending or made on or after August 5, 1997, is contained in a new IRS notice. The notice explains IRS procedure for issuing a Notice of Determination of Worker Classification and the method of petitioning for Tax Court review of determinations made under Internal Revenue Code Section 7436. Only employers, as opposed to the workers themselves, may seek review under 7436. *Notice 2002-5*; *TAXDAY*, Item #I.1 (1/22/02).

■ **SETTLEMENT INVESTMENT FUND.** A fund established to receive and invest settlement proceeds from lawsuits for violations of state consumer protection and anti-trust laws was not subject to federal income tax. The fund was an integral part of a political subdivision and all of the plaintiffs involved were parts of government bodies already exempt from the applicable tax. *Letter Ruling 200201001*.

■ **COMMUNITY INCOME IN COMMUNITY PROPERTY STATES.** The proposed regulations provide guidance under Code Section 66 for the treatment of community income for some married individuals in community property states who do not file joint federal returns. The regulations provide rules on instances where community income would be taxed to the spouse who earned the income rather than according to community property laws. Proposed Regulations, NPRM REG-115054-01

■ **LEASING TRANSACTION LACKED ECONOMIC SUBSTANCE.** The chief counsel recommended that a transaction not be respected for tax purposes where the taxpayer bought equipment through a trustee, subject to a lender's security interest, and leased it back to a lessee affiliated with the



## NOTES & TRENDS

seller. The transaction resulted in a cash flow of zero between the parties, yet the taxpayer attempted to claim the tax benefits from the lease. FSA Letter Ruling 200201022.

### LEGISLATION

■ **FEDERAL TAX SHELTER LEGISLATION.** The White House has expressed a willingness to consider tax shelter legislation released earlier this legislative session. The bill, introduced by Sen. Charles E. Grassley, R-Iowa, and Sen. Max Baucus, D-Mont., emphasizes greater disclosure of tax shelter activity rather than penalizing taxpayers. *TAXDAY*, Item #W.1 (1/21/02).

■ **DELAY IN TAX CUTS.** President Bush has strongly indicated that he will not consider delaying the tax cuts contained in the Economic Growth and Tax Relief Reconciliation Act of 2001. *TAXDAY*, Item #W.1 (1/8/02). Senate Democrats, however, have indicated their strong disagreement with the administration's philosophy. *TAXDAY*, Item #C.1 (1/8/02); *TAXDAY*, Item #C.1 (1/7/02).

■ **STIMULUS PLAN .** Legislators claim that the stimulus bill passed by the House in December is not dead yet. The Economic Security and Worker Assistance Act of 2001 addresses unemployment and economic growth. It is expected to receive renewed attention early in the second session of Congress from both the Senate and the President. *TAXDAY*, Item #W.1 (1/21/02); *TAXDAY*, Item #C.1 (1/2/02).

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### TORTS & INSURANCE

#### JUDICIAL LAW

■ **INSURER CAN'T SUE COUNSEL CHOSEN TO REPRESENT INSURED.** An insurer has no attorney-client relationship with attorneys that it chooses to represent its insureds. Therefore, in this case both the district court and the Court of Appeals found that a legal malpractice claim could not be brought against a firm which was chosen by the insurance company to represent insureds in a civil negligence action.

All malpractice claims were dismissed by the district court except for one, where the district court granted the insurer standing to sue the law firm under the doctrine of equitable subrogation.

The Minnesota Court of Appeals reversed this decision by the district court, stating that whether an insurer in Minnesota can sue defense counsel under the doctrine of equitable subrogation is best left to the Minnesota Supreme Court. The Court of Appeals found that, under the facts of the case, including a settlement prior to the appeal, the insurer came in seeking equity with unclean hands, preventing recovery under the equitable subrogation theory.

No Minnesota case has discussed equitable subrogation as a viable basis for an insurer to bring a malpractice claim against an insured's attorney; however, the district court had relied on a Michigan Supreme Court opinion which did allow an insurer to sue defense counsel under such a theory. *Pine Island Farmer's Coop v. Erstad & Reimer*, C1-01-670, 636 N.W.2d 604 (Minn. App. 12/11/02).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0112/c101670.htm>

■ **EXCULPATORY CLAUSE UPHELD.** An exculpatory clause on a trail ride's horse rental agreement was found to be valid where it was (1) unambiguous in its scope; (2) there was no disparity in bargaining power; and (3) the service being offered (horse trail rides) was not a public or essential service.

Under these circumstances an exculpatory clause, which is generally disfavored and strictly construed against the benefited party, was enforceable where it sought to release a party from ordinary negligence, and not from extraordinary or gross negligence. *Beehner v. Cragun Corporation and Outback Trail Rides, Inc.*, C3-01-640, 636 N.W.2d 821 (Minn. App. 12/11/01).

<http://www.lawlibrary.state.mn.us/archive/ctappub/0112/c301640.htm>

■ **OPEN AND OBVIOUS DANGERS.** Fernow brought a negligence action against Hillcrest Bowl. She walked down a visibly dark stairway. About halfway down the steps, Fernow realized the light at the bottom of the stairwell was off. She considered retreating, but was in a hurry to get her bowling equipment and decided to go further down the stairs. She fell when she let go of the handrail and missed the last step.

The district court dismissed the negligence action on a finding that Hillcrest Bowl lacked actual and constructive notice that the stairwell was not illuminated. The Minnesota Court of Appeals affirmed, as it concluded as a matter of law that the dark stairwell posed an obvious danger. Therefore, summary judgment was appropriate. *Fernow v. Eastside Hospitality, Inc.*, C1-01-992, 2001 WL 1609336 (Minn. App. 12/18/01) (unpublished). <http://www.lawlibrary.state.mn.us/archive/ctapun/0112/992.htm>

■ **TEENAGERS NOT IN JOINT ENTERPRISE.** Silvola owned an abandoned school building. Silvola sued 13 teenagers and their parents for



## N O T E S   &   T R E N D S

negligence and joint liability after the teenagers trespassed on his property, and one of them accidentally started a fire that destroyed the building. The district court granted summary judgment for the teenagers, concluding there was no factual basis for a joint enterprise and they had no duty to report the fire or otherwise protect the appellant.

The Minnesota Court of Appeals affirmed. First, there was direct evidence in the record that one of the teenagers alone set the fire to the building. The district court found no common purpose and no common control among the 13 teenagers. The court found there was merely an informal gathering of teenagers for a social expedition. Finally, the Court of Appeals found that there was no duty because the teenagers had not accepted any responsibility for Silvola. Therefore, the district court correctly concluded there was no legal duty. *Silvola v. Vedder, et al*, C2-01-614, 2001 WL 1646566 (Minn. App. 12/26/01) (unpublished). <http://www.lawlibrary.state.mn.us/archive/ctapun/0112/614.htm>

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