



NOTES & TRENDS

ADMINISTRATIVE LAW JUDICIAL LAW

■ **FAILURE TO PRODUCE DISCOVERY.** The Court of Appeals decided in that the commissioner of commerce had jurisdiction over an employee of a licensed mortgage originator, even though the employee himself was exempt from the licensure requirement. The commissioner barred Pomrenke from engaging in mortgage origination in Minnesota. At the hearing, it became clear that the Commerce Department had not produced its entire investigative file to Mr. Pomrenke as ordered by the administrative law judge. The ALJ then granted a 1-1/2 month continuance to allow Pomrenke to review the entire file and take a deposition. The Court of Appeals found no prejudice or denial of due process to Mr. Pomrenke due to the Department's failure to initially produce its entire file, in light of the continuance, and where Mr. Pomrenke used the later discovered evidence at the reconvened hearing. *Pomrenke v. Commissioner of Commerce*, A03-497, 677 N.W.2d 85 (Minn. App. 03/02/04)

■ **CONSTITUTIONALITY OF RULE.** The Court of Appeals held that a rule adopted by the Department of Revenue that lists considerations for deciding whether a person is domiciled in Minnesota for income tax purposes is not unconstitutionally vague. The taxpayer argued that the rule, which lists 26 factors to be considered, was too ill-defined to form a basis for criminal prosecution. The court observed that the void-for-vagueness doctrine requires that statutes (and rules) define an offense (1) with sufficient definiteness and certainty that persons of ordinary intelligence can understand what conduct is prohibited or mandated, and (2) in a manner that does not encourage arbitrary and discriminatory enforcement. The doctrine does not preclude the use of broad flexible standards that require persons to exercise judgment. The court affirmed the conviction for filing fraudulent tax returns. *State v. Enyeart*, A03-360, 676 N.W. 2d 311 (Minn. App. 03/23/04).

■ **RIGHT TO A HEARING.** The Public Utilities Commission denied a request for a contested case hearing by the Pimicikamak Cree Nation on the issue of socioeconomic impacts of an agreement by Xcel Energy to purchase power from the Manitoba Hybrid Project. The Court of Appeals observed that the Administrative Procedure Act itself provides no right to a contested case hearing, but only sets forth the procedures to be followed when another statute or rule grants such a right. The appellant argued, however, that the PUC was obligated to make specific findings of fact that could only be done by a contested case hearing. The court disagreed and distinguished this case from *MPIRG v. MEQC*, 237 N.W. 2d 375 (Minn. 1975) (contested case hearing implied by purpose of statute requiring environmental impact statement) because case law does not imply such a right to a hearing under utilities regulation statutes. The court also found no contested material facts, as required by a PUC rule before a hearing is mandated. *In Re Petition of Northern States Power*, E-0021 M-99-888, 676 N.W. 2d 326 (Minn. App. 03/30/04).

■ **AGENCY AS NECESSARY PARTY.** A licensed currency exchange initiated a declaratory judgment action against a competitor seeking a declaration that the competitor could not be issued a license, and an injunction restraining it from operating a currency exchange. Unbank alleged that Merwin was located within one-half mile of it, contrary to statute. The Court of Appeals found that the commissioner of commerce, who was not joined, was a necessary party to the case. The court observed that if the courts undertook to decide administrative licensing issues without the participation of the licensing authority, the coequal branches of government would relinquish a necessary balance. *Unbank Co. v. Merwin Drug Co.* A03-1029, 677 N.W. 2d 105 (Minn. App. 04/06/04).

■ **CIVIL PENALTIES.** The Court of Appeals in April found authority in a Public Utilities Commission (PUC) statute to require financial penalty payments from Qwest for violation of service standards the (PUC) had imposed. The PUC had issued an order imposing service quality standards on Qwest governing its transactions with local exchange carriers. The order required penalty payments by Qwest for failure to meet the standards. Qwest argued that under the Administrative Procedure Act (Minn. Stat. §14.045) an agency may not levy a penalty of more than \$700 per violation without specific statutory authority to do so. The Court of Appeals found adequate authority in a PUC statute that generally allowed it to assess monetary penalties for intentional violations of standards, even though it did not specifically mention service quality standards. The court also found the order consistent with case law requiring an administrative sanction to reflect the seriousness of the violation since Qwest had previously agreed to the payment schedules for the penalties which were designed to be in the nature of stipulated damages. *In Re Qwest's Wholesale Service Quality Standards*, A03-1409, ___ N.W. 2d ___ (Minn. App. 04/13/04)

LEGISLATION

For the second consecutive year, the House and Senate appear poised to send to the governor a significant piece of rulemaking legislation that would establish a process for local units of government to request of the commissioner of finance a "local fiscal impact/fiscal benefit note". HF 2101 Seifert / SF 2845 Senjem, provides, with certain exceptions, that if an impact is over \$50,000 to a small business or municipality with less than 50 employees, the rule will not take effect unless "approved" by a law.

The proposed effective date is effective for certain rules pending July 1, 2004. This is a somewhat moderated version of legislation passed in 2003 which was vetoed by Governor Pawlenty. Stay tuned.

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CIVIL LITIGATION

JUDICIAL LAW

■ **STATUTE OF LIMITATIONS; MAJOR CONSTRUCTION DEFECT.** In a much anticipated decision, the Minnesota Supreme Court held last month that the statute of limitations that applies to the statutory new home warranty, Minn. Stat. §327A.02, subd. 1(c) (1990) does not begin to run until the homeowner discovers, or should have discovered, the builder's refusal or inability to ensure that the home is free from major construction defects.

The trial court had granted summary judgment to the builder and the Court of Appeals affirmed. The Supreme Court reversed and remanded.

For a relatively new home, this one has a lengthy and complicated history. In 1990, the original owners, Rovick, hired R & I Construction of Bloomington to build a luxury home on Lake Minnetonka. In 1991 the home was substantially completed and a Certificate of Occupancy issued. The Rovicks occupied the home until 1999, but between 1992 and 1999 they experienced repeated water and moisture-related problems.

In 1999 Rovicks and plaintiffs, Vlahos, entered into a Purchase Agreement for the purchase of the home. The Purchase Agreement contained a house inspection contingency entitling the plaintiffs to inspect the property. In addition, the sellers provided buyers with a "Seller's Property Disclosure Statement" which disclosed water damage issues and the fact that "some windows may need replacement." The building inspector hired by plaintiffs prepared a report which detailed extensive water damage to the home. Apparently, plaintiffs used that inspection to negotiate a small credit from the sellers. The sale closed in January, 2000, with plaintiffs paying \$5.175 million for the home.

By April, 2000 plaintiffs were in the midst of an extensive remodeling project when they "discovered" significant water damage to the home behind walls and involving "decay of interior floor trusses, ceiling trusses, and other load-bearing supports throughout" The next month, May, 2000, plaintiffs provided both oral and written notice of the problem and of their claim to R & I Construction which, along with its insurers, inspected the home as the repairs were underway. R & I refused to pay for any of the repairs or damages. The total cost of the remodeling project was \$3.8 million, of which \$1.1 million was attributed, by plaintiffs, to repair of the water damages. Plaintiffs then commenced suit against R & I in April, 2001.

The district court granted R & I's motion for summary judgment on the ground that the two-year statute of limitations for claims arising from improvements to real property, Minn. Stat. §541.051, subd. 1(a) (2002), barred the suit because the original owners knew or should have known of the water damage many years prior to the commencement of the Vlahoses' lawsuit; therefore, discovery of the "injury" occurred more than two years before the lawsuit. The trial court also held that the claim for relief under the new home warranty failed because the construction defects leading to the water penetration occurred after the completion of the construction and therefore were not included within the definition of a major construction defect.

In reversing, the Supreme Court explained that, because the new home warranty claims under Minnesota Statute 327A.02 are specifically exempted from the Statute of Repose found at Minn. Stat. §541.051, subd. 1(a), the only statute of limitation which applies is found at §541.051, subd. 4. That provision requires actions be brought "within two years of the *discovery of the breach* ..." (emphasis added). The Court contrasts that language with the Statute of Repose discovery language which states that the cause of action accrues upon "discovery of the injury."

The Court also clarifies that the statute does not focus upon discovery by the vendee currently in possession. Rather, the language would focus upon any vendee in possession at the time of discovery. Finally, the Court explains that a warranty of this type is one which may extend to future performance. Thus, the breach does not occur until the builder refuses or is unable to ensure that the home is free from major construction defects. In this case, then, R & I breached its warranty when it refused Plaintiff Vlahoses' demand in May, 2000, to remedy the alleged major construction defects.

The Supreme Court next turned its attention to what is or is not included within the definition of "major construction defect." Plaintiffs argued that because water infiltrated the home, eventually damaging some of the load-bearing portions of the home, the ten-year warranty applies. R & I contended that the plain meaning of the statute is that the alleged construction defect must be created during and be present upon completion of the construction.

Minnesota Statutes Chapter 327A provides three home warranties for purchasers of new residential construction. The warranty at issue in this case is the ten-year warranty which applied in 1990, Minn. Stat. §327A.02, subd. 1(c) which states:

In every sale of a completed dwelling, and in every contract for the sale of a dwelling to be completed, the vendor shall warrant to the vendee that during the ten-year period from and after the warranty date, the dwelling shall be free from major construction defects.

Major construction defect is then defined as “actual damage to the load-bearing portion of the dwelling or the home improvement, including damage due to subsidence, expansion or lateral movement of the soil, which affects the load-bearing function and which vitally affects or is eminently likely to vitally affect use of the dwelling or the home improvement for residential purposes.” The Supreme Court concludes that the Legislature intended to define “major construction defect” broadly, and to extend to actual damage to load-bearing portions of the dwelling occurring after the completion of construction. The Court does recognize and caution that this statutory warranty includes an extensive list of exclusions to vendor liability, several of which may be found to apply to the facts of this case when actually considered by a trier of fact. The case is remanded for trial. **Vlahos v. R & I Construction of Bloomington, et al.**, 676 N.W. 2d 672 (Minn. 2004)

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EMPLOYMENT & LABOR LAW JUDICIAL LAW

■ **PUBLIC SECTOR EMPLOYMENT.** The termination of the executive director of a municipal housing and redevelopment body constitutes a quasijudicial decision that must be challenged through a writ of certiorari to the Court of Appeals, rather than a lawsuit in district court. Relying on prior case law, the appellate court held that the “exclusive method” for seeking judicial review for termination of a public sector employee is through certiorari. Because the employee sued in district court and did not timely file for certiorari within the 60-day time period, the lawsuit was dismissed and it was too late to start a separate certiorari proceeding. **Tischer v. Housing & Redevelopment Authority of Cambridge**, 2004 WL 384156 (Minn. App. 2004).

■ **VETERANS PREFERENCE.** An employee challenging termination under The Veteran’s Preference Act must comply with the Rules of Civil Procedure in appealing the administrative ruling. The appellate court upheld dismissal of a veteran’s appeal on grounds that he failed to serve his employer with service of process when contesting the outcome of an administrative hearing upholding his termination. Service on the employer’s attorney failed to comply with the service requirements under Rule 4 of the Rules of Civil Procedure. **Sinykin v. Metro Council Transit Operations**, 2004 WL 422584 (Minn. App. 2004) (unpublished).

A company whose workers were on strike committed an unfair labor practice by refusing to give the union the names of replacement workers, but was not obligated to furnish their home addresses and telephone numbers. The 8th Circuit Court of Appeals held that while the identities of those who replace strikers must be disclosed to the striking union, there is no “compelling need” to give out their addresses or phone numbers. **JHP & Associates, LLC v. NLRB**, 360 F.3d 904 (8th Cir. 2004).

■ **RACE DISCRIMINATION.** The 8th Circuit recently affirmed dismissal of a pair of wrongful discharge racial discrimination claims. An African-American woman’s claim of disparate treatment was refuted because the offense for which she was fired differed substantially from those of white employees who were not fired. **Bankhead v. Knickrehm**, 360 F.3d 839 (8th Cir. 2004).

Poor work performance and interpersonal relationships with other employees constituted a legitimate reason to fire an African-American school counselor and overcome a claim of racial discrimination in a second case. The counselor’s failure to improve, after a negative written performance review, belied her contention that the discharge was a pretext for race discrimination. **Cherry v. Ritenour School District**, 2004 WL 513541 (8th Cir. 2004).

■ **SEVERANCE.** An employee was entitled to severance pay for the entire period he worked for a company despite a brief break in service. A written agreement accompanying his return to work stated that he would be entitled to severance based upon “all years of service.” Because the clause was ambiguous, it was construed against the employer, who asserted that it applied only to continuous years of service. But the nonpayment did not trigger a wage penalty or attorney’s fees under Minn. Stat. §181.13 because severance pay is not covered by the “prompt payment” statutes. **Cole v. Holland Neway Int’l, Inc.**, 2004 WL 503751 (Minn. App. 2004) (unpublished).

■ **UNEMPLOYMENT COMPENSATION.** In a rare reversal, the appellate court held that a manufacturing inspector did not commit disqualifying “misconduct” and, therefore, was entitled to unemployment compensation benefits. An employee was terminated for allegedly violating company policy requiring inspectors to personally “observe” chemicals being added to a mixture. However, the appellate court determined that the employee did not intentionally commit misconduct, because there was insufficient evidence that training on the verification policy clarified that “verification” meant “visual verification,” rather than “verbal verification,” which she obtained from another employee. **Wegner v. Diamond Product Co.**, 2004 WL 384149 (Minn. App. 2004) (unpublished).

A pair of unemployment compensation claimants were denied benefits on grounds that they quit without adequate reason. An employee who resigned because she was “frequently criticized” by her boss about her clothing and appearance, including a directive not to wear jeans, even though other employees were allowed to do so, did not have “good reason” to quit. The employer’s request that she “wear appropriate work attire” did not constitute the type of behavior that would prompt a “reasonable employee” to quit. **Starren v. Thief River Falls Times, Inc.**, 2004 WL 377949 (Minn. App. 2004) (unpublished).

An employee in a second case, who was consistently tardy because, as a single parent, he had to drop his son off at a bus stop on the way to work each morning, did not have “good reason” when he quit after being given an ultimatum to be timely for work. The employee’s assumption that he was discharged after he arrived late for work, following the ultimatum, is not considered “good reason to quit.” **Hook v. Bloomington Auto Care**, 2004 WL 376990 (Minn. App. 2004) (unpublished).

An employee who used loud, vulgar language and broke company equipment was denied unemployment benefits on grounds of

“misconduct.” The decision was based, in part, on a written warning given to the employee, a directive to attend counseling, and a negative performance evaluation preceding the discharge. *Hertling v. Anderson Trucking Services, Inc.*, 2004 WL 503848 (Minn. App. 2004) (unpublished).

But an employee who used an employee discount to rent a hotel room for a disorderly party was not disqualified from unemployment benefits. Although the New Year’s Eve celebration turned into a loud, raucous affair, disrupted hotel guests, and invoked underage drinking, smoking in a nonsmoking room, and other revelry, the employee’s failure to control the party reflected “negligent” inaction on his part, not intentional “misconduct.” *Verhaigh v. CSM Corp.*, 2004 WL 422572 (Minn. App. 2004) (unpublished).

LEGISLATION

A pair of proposals in the U.S. House of Representatives and Senate would allow victims of age discrimination to sue states under the Age Discrimination in Employment Act (ADEA). The measure, which has been introduced in both houses, would provide that the acceptance of federal financial assistance by states constitutes a waiver of sovereign immunity and, therefore, permits state employees to sue under the ADEA. The decision would overturn the ruling of the U.S. Supreme Court in *Kimel v. Florida Board of Regents*, 120 S. Ct. 631 (2000), which held that the sovereign immunity provision of the 11th Amendment bars such suits against state entities.

Another portion of the proposed legislation would make arbitration clauses in employment contracts unenforceable unless the parties involved in the dispute knowingly and voluntarily consent to arbitration. The arbitration provision would not prevent an employee or union from enforcing any of the rights of a valid collective bargaining agreement. The House bill is H.R. 3809, titled the “Fairness and Individual Rights Necessary to Ensure a Stronger Society: Civil Rights Act of 2004.” The companion Senate bill, is S.2088.

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ENVIRONMENTAL LAW JUDICIAL LAW

■ **CERCLA; EPA LIABILITY FOR TORT CLAIMS.** A federal district court recently held that the United States Environmental Protection Agency (EPA) cannot be held liable for property damages arising from response actions taken by the EPA.

The EPA discovered releases from drums of hazardous chemicals at a fiberglass plant in Puerto Rico. The EPA exercised its authority under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, 42 U.S.C. §9601 et seq. (CERCLA), and cleaned up ten acres of the site. The EPA had exclusive control over the ten-acre area and hired a guard to protect the EPA’s equipment and supplies. The EPA did not, however, monitor all potential access points through which others could enter the area. After the EPA completed the clean-up, the plant owner filed a counterclaim against the EPA to recover \$20 million in damages allegedly caused by negligence on the part of the EPA. The claimed damages included losses of equipment, marketable goods, and damage to the real estate. The EPA contended that the court lacked jurisdiction under the Federal Tort Claims Act, 28 U.S.C. §2671 et seq. (FTCA), and moved for dismissal of the plant owner’s claim.

The court dismissed the claim, holding that the “discretionary function exemption” to the FTCA’s limited waiver of sovereign immunity, 28 U.S.C. §2680(a), barred the plant owner’s suit. This exception bars claims “based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused.” Citing *U.S. v. Green*, 33 F.Supp.2d 203 (W.D.N.Y. 1998), the court reasoned that Section 104(a)(1) of CERCLA gives the EPA general and broad authority to clean up hazardous substances and does not impose specific mandates. Since CERCLA does not instruct the EPA to follow a specified course of action, the Court reasoned, the EPA’s actions were discretionary and, thus, protected from tort liability. *U.S. v. JG-24 Inc.*, No. Civ. 00-1483 (D.P.R. 03/12/04).

■ **CERCLA; CONSTITUTIONALITY.** The U.S. Court of Appeals for the District of Columbia has reinstated General Electric Company’s constitutional challenge to CERCLA after a lower court had dismissed the claim.

At issue is the timing of judicial review of EPA actions and orders under Section 113(h) of CERCLA, 42 U.S.C. §9613(h). This section states that, unless one of five exceptions applies, federal courts do not have subject matter jurisdiction to review challenges to removal or remedial actions selected by the EPA under Section 104 of CERCLA, or challenges to orders issued by the EPA under Section 106(a) of CERCLA. The EPA may take removal and remedial actions under Section 104 after notice, a comment period and a public meeting in which potentially responsible parties (PRPs) may participate, but no hearing is required. Under Section 106, the EPA is authorized to issue unilateral administrative orders (UAOs) and file suit in district court to enforce the UAOs. The EPA is also authorized to issue penalties for noncompliance with UAOs. General Electric (GE) challenged this regime, specifically the provisions relating to UAOs, as violative of the Due Process Clause of the 5th Amendment. GE argues that the lack of pre-enforcement review and potential for massive penalties “imposes a classic and unconstitutional Hobson’s choice: either do nothing and risk severe punishment without meaningful recourse or comply and wait indefinitely before having any opportunity to be heard on the legality and rationality of the underlying order.”

In reversing the lower court’s dismissal of GE’s claim, the Court of Appeals reasoned that GE’s lawsuit is not a challenge to the EPA’s administration of CERCLA, but rather to CERCLA itself. According to the court, the plain language of Section 113(h) bars challenges to

removal and remedial actions and administrative orders, but does not preclude facial constitutional challenges to the statute itself.

General Electric Co. v. Environmental Protection Agency, 2004 WL 374261 (D.C. Cir. 2004).

■ **CLEAN WATER ACT; FEDERAL JURISDICTION OVER WETLANDS.** The United States Supreme Court recently denied review of three challenges to the federal government's claimed jurisdiction over ditches that are not themselves navigable, but are hydrologically connected to navigable waters. The Supreme Court's decision to deny review let stand three rulings by the Courts of Appeals in the 4th and 6th circuits which upheld the federal government's regulation of ditches as wetlands. The decision also leaves unresolved a split among the Circuit Courts of Appeals on this issue. The 5th Circuit Court of Appeals has held that the federal government's jurisdiction over wetlands does not extend to ditches. See *In Re Needham*, 354 F.3d 340 (5th Cir. 2003). **Rapanos v. United States**, No. 03-929 (U.S. 04/05/04); **Deaton v. United States**, No. 03-701 (U.S. 04/05/04); **Newdunn Associates v. U.S. Army Corps of Engineers**, No. 03-637 (U.S. 04/05/04).

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FEDERAL PRACTICE JUDICIAL LAW

■ **DIVERSITY JURISDICTION; PRINCIPAL PLACE OF BUSINESS; TOTAL ACTIVITY TEST.** Capitol brought a diversity action against multiple defendants in the Eastern District of Arkansas. Capitol's complaint alleged that it was a Wisconsin corporation, but did not contain any allegations as to its principal place of business. Defendants brought a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(1), arguing that Capitol had failed to plead diversity jurisdiction. Because all of the defendants were Arkansas citizens, Capitol needed to establish that its principal place of business was somewhere other than Arkansas, and Capitol cross-moved for leave to amend its complaint to allege that it maintained its principal place of business in Wisconsin. Capitol's motion to amend was granted, but the district court also directed Capitol to provide proof of its Wisconsin citizenship at the time it filed its amended complaint.

Capitol filed its amended complaint, accompanied by a short affidavit stating that Capitol maintained a principal place of business in Wisconsin and had no employees in Arkansas. Defendants then submitted opposing affidavits. The district court ultimately dismissed the action due to an absence of diversity jurisdiction, finding that Capitol's "bald assertion" that its principal place of business was located in Wisconsin was insufficient to meet its burden. Capitol then appealed.

Applying a "clear error" standard, the 8th Circuit reversed, finding that Capitol was only required to demonstrate that its principal place of business was located somewhere other than Arkansas, and that Capitol had met that burden. In reaching that conclusion, the 8th Circuit acknowledged the existence of three prevailing tests for determining a corporation's principal place of business — the "nerve center" or "locus of operations" test, the "corporate activities" test, and the "total activity" test — and adopted the total activity test as the law of the Circuit.

In a vigorous dissent, Judge Colloton argued that the "conclusory allegation" in Capitol's affidavit did not sufficiently establish that Capitol's principal place of business was somewhere other than Arkansas, and that Capitol had "failed to make the requisite showing" necessary to invoke diversity jurisdiction. **Capitol Indem. Corp. v. Russellville Steel Co.**, 2004 WL 840241 (8th Cir. 2004).

■ **OTHER NOTEWORTHY DECISIONS.** The 8th Circuit affirmed the denial of a recusal motion in a long-running school desegregation case, finding that the current district judge's brief involvement as counsel to the previous district judge in a mandamus proceeding which sought that judge's disqualification in the same case did not constitute the same "matter in controversy" for purposes of 28 U.S.C. §455(b)(2), as the representation was limited "solely to the issue of recusal and did not go to the merits of the case." **Little Rock School Dist. v. Armstrong**, 359 F.3d 437 (8th Cir. 2004).

Judge Tunheim awarded the prevailing plaintiff \$748,593.27 in attorney fees and costs under the Minnesota Heavy and Utility Equipment Manufacturers and Dealers Act, after conducting a thorough review of the requested hourly rates and time entries, as well as the numerous costs sought by the plaintiff. **Minnesota Supply Co. v. Raymond Corp.**, 2004 WL 742030 (D. Minn. 03/29/04).

Judge Frank dismissed a False Claims Act action under Fed. R. Civ. P. 9(b) while giving the relators 30 days to amend, finding that the claims lacked the "sufficient particularity" required to satisfy Rule 9(b). **United States ex rel. Vosika v. Starkey Labs., Inc.**, 2004 WL 345432 (02/20/04).

On remand from the 8th Circuit, Judge Ericksen imposed \$73,890.00 in attorney fees and costs under Fed. R. Civ. P. 11 and SLUSA. **Prof. Management Assocs., Inc. Employees' Profit Sharing Plan v. KPMG LLP**, 2004 WL 831134 (D. Minn. 04/15/04).

Judge Tunheim dismissed plaintiffs' securities fraud claims with leave to amend, finding that their fraud allegations, based "on investigation of counsel," did not satisfy the pleading requirements of the PSLRA. **In Re Retek Inc. Sec.**, 2004 WL 741571 (D. Minn. 03/30/04).

Judge Kyle denied a motion to dismiss or stay based on the *Colorado River* abstention doctrine. **Vine Street L.P. v. QBE Int'l Ins. Ltd.**, 2004 WL 831133 (D. Minn. 04/15/04).

Judge Tunheim granted the plaintiff's motion to strike the transcript of an unsworn hearing submitted by the defendant in support of its motion for summary judgment, rejecting defendant's argument that the transcript had sufficient "indicia of reliability," and finding that the transcript constituted "inadmissible hearsay." **Rabe v. City of Bemidji**, 2004 WL 741758 (D. Minn. 03/17/04).

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INTELLECTUAL PROPERTY
JUDICIAL LAW

■ **PATENTS; CLAIM CONSTRUCTION; NONSENSICAL RESULTS.** What good is a patented process for burned bread? The obvious answer to that question did not bother the Court of Appeals for the Federal Circuit when it affirmed a claim construction that defined the words of a patent such that the result was certainly not intended by the inventor: bread burned to a crisp. The disputed phrase was “heating the resulting batter-coated dough to a temperature in the range of about 400° F. to 850° F.” The only issue on appeal was whether the *dough itself* is to be heated to that temperature or whether the claim only specifies the temperature at which the dough is to be heated, *i.e.*, the *temperature of the oven*. There was no dispute that if the dough itself was heated to about 400° F to 850° F it would resemble a charcoal briquette — not at all the invention sought to be protected. Such a nonsensical result did not phase the Court of Appeals. Citing the presumption that the words chosen by the inventor receive their ordinary meaning, the court said: “a nonsensical result does not require the court to redraft the claims of the patent.” ***Chef America v. Lamb-Weston***, 358 F.3d 1371, 03-1279 (Fed. Cir. 02/20/04).

Judge Frank, on the other hand, avoided just such a nonsensical result during a recent patent-claim construction proceeding. Calling the ordinary meaning of the patent term “untenable,” the court defined the term so that it made sense in view of the invention as described by the inventor in the patent. The invention is an electronic funds transfer system. The ordinary meaning of the disputed term “accumulator agency” appeared to be “a computer program or processor that can perform functions on behalf of any number of entities, including government agencies.” The problem with the ordinary-meaning definition, noted the court, is that it would have resulted in “a computer program or processor, apart from any organizational entity, operated with its own bank account.” Using the patent’s claim language and specification, the court reached what it believed to be a definition that made sense. ***Pay Child Support Online v. ACS State & Local Solutions***, Civ. No. 02-1321 (D. Minn. 04/05/04).

■ **TRADEMARK LITIGATION; COMPETITOR NOT CONSUMER.** A recent decision by Judge Tunheim reminds all who do trademark litigation that some claims under the Minnesota Consumer Protection laws are not available in commercial cases. Most trademark actions filed in Minnesota include claims for unfair trade practices, deceptive trade practices, false advertising, and consumer fraud. So too in the complaint filed by Solvay against Ethex. However, the court granted Ethex’s motion to dismiss Solvay’s claim that the Minnesota Consumer Fraud Act was violated. The court reminded readers that the Consumer Fraud Act was enacted to curb deceptive practices in *consumer* transactions. “As a manufacturer of a competing product, Solvay cannot be considered a consumer of Ethex’s products and thus is not entitled to protection under the Minnesota Consumer Fraud Act.” ***Solvay Pharm. v. Ethex Corp.***, Civ. No. 03-2836 (D. Minn. 03/30/04).

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JUVENILE LAW
JUDICIAL LAW

■ **TERMINATION OF PARENTAL RIGHTS; BEST INTERESTS.** Following a contested hearing, the district court terminated a birth father’s parental rights to two children based on findings that he had abandoned the children; substantially, continuously, and repeatedly neglected to comply with the duties imposed upon him by the parent/child relationship; reasonable efforts had failed to correct the conditions leading to the out-of-home placement; and the children were neglected and in foster care. The district court also found that the termination was in the best interests of the children.

The Court of Appeals rejected the district court’s finding of fact and concluded that no statutory grounds for termination existed, but affirmed the termination of the father’s parental rights on the ground that termination was in the best interests of the children. In reviewing that decision, the Supreme Court concluded that the Court of Appeals erred in affirming termination based solely on the best interests of the children. The Supreme Court then affirmed the termination of the father’s parental rights because it found the district court’s order terminating parental rights was based on clear and convincing evidence that statutory grounds for termination were met and that termination was in the best interests of the children.

The Supreme Court reviewed the Court of Appeals’ rather unusual decision without oral argument and found that the Court of Appeals ignored the clear statutory directive that parental rights cannot be terminated in the absence of at least one statutory ground for termination. They held that it was error to affirm a termination of parental rights determination solely on the basis that the termination would be in the children’s best interests. The Supreme Court nevertheless affirmed the Court of Appeals decision because it concluded that the statutory grounds for termination were established by clear and convincing evidence and that the Court of Appeals erred in concluding otherwise. ***In the Matter of the Welfare of the Children of R.W.***, A03-262 (Minn. 04/22/04).

■ **CONSENT TO CONCEDE GUILT; INEFFECTIVE ASSISTANCE OF COUNSEL.** The Minnesota Court of Appeals in a published decision held that where a defense attorney fails to obtain a juvenile defendant’s consent on the record before conceding the defendant’s guilt to a lesser offense, and the record fails to show that the attorney’s strategy was reasonable, prejudice is presumed and a new trial is necessary. This matter followed a bench trial where the minor was found guilty of aiding and abetting first degree criminal damage to property for vandalizing equipment and other property belonging to a mining operation. The Court of Appeals found error when the minor’s consent was not obtained before his attorney conceded the minor’s guilt, and also that the record failed to show that the trial attorney’s strategy was reasonable. ***In the Matter of the Welfare of B.R.C.***, A03-663 (Minn. App. 03/02/04).

■ **TERMINATION OF PARENTAL RIGHTS; COMPLIANCE WITH CASE PLAN.** In a somewhat unusual review of a termination of parental

rights proceeding, the Minnesota Court of Appeals in an unpublished decision reversed and remanded the trial court's determination terminating parental rights of a father. The father's case plan required him to participate in certain rehabilitative programs. While he substantially complied with the plan, the trial court also placed certain restrictions on his contact with his child's mother. The mother was to have a right to reasonable visitation with the children, subject to the approval of the father, and the mother's visits were also to be supervised by a party deemed acceptable to the father. Because the father had allowed the mother unsupervised contact with the children, the district court terminated the father's parental rights based on a finding that he had not substantially complied with the court's orders and he had not substantially complied with the case plan. In reversing this decision by the trial court, the Court of Appeals observed that the mother's contact with the children was not a fair basis in which to terminate the father's rights where the court order addressing visitation rights was vague and allowed the father some discretion. *In re the Children of Meso-M and R.O.-M*, A03-178 (Minn. App. 03/002/04).

■ **CHILD SEXUAL ABUSE; RELIGIOUS ORGANIZATION; DUTY TO REPORT.** The Minnesota Court of Appeals in another case considered a situation involving minors who were allegedly sexually abused by another member of their religious community. The alleged victims then attempted to sue individuals and entities connected with the religious organization, alleging sexual battery and negligence. The district court granted summary judgment in favor of the religious organizations, finding that there was no "special relationship" between the parties, and therefore no duty was owed that would have given rise to the tort claims. The trial court also found no basis to the plaintiff's claim that the religious entity's failure to report abuse was a violation of Minnesota's Child Abuse Reporting Act and thereby constituted negligence *per se* (See, Minn. Stat. §626.556).

The Court of Appeals agreed with the district court that the Child Abuse Reporting Act did not create a private cause of action for violation of its reporting requirement which could be enforced through a common law negligence action. *Heidi Meyer et. al. vs. Derek Lindala, Annandale Congregation of Kingdom Hall of Jehovah's Witnesses, et. al.*, A03-1142 (Minn. App. 03/09/04).

■ **CHILD ABUSE REPORTING; LIABILITY FOR FAILURE TO REPORT.** Where the trustee appointed for a young child who was killed as a result of child abuse commenced a wrongful death negligence action against Freeborn County and several county employees who had been involved in investigating child abuse reports, the county and county employees successfully moved to dismiss the cause of action for failure to state a claim upon which relief could be granted.

On appeal, the appellant's complaint was not based specifically on respondents' failure to follow the Child Abuse Reporting Act, which carries criminal penalties, but rather whether they owed a "special duty" to the child. The Court of Appeals concluded that the Child Abuse Reporting Act, like the Vulnerable Adults Reporting Act, does not contain a legislatively established civil cause of action. *Matthew Radke, as Trustee for the Next of Kin of Makaio Lynn Radke v. County of Freeborn, et al.*, C6-02-1692 (Minn. App. 03/23/04).

■ **THIRD PARTY CUSTODY; SPECIAL NEEDS CHILD; ENDANGERMENT.** In one of the first appellate decisions addressing Minnesota's new third party custody statute (Chapter 257C), the Minnesota Court of Appeals in an unpublished decision affirmed the district court's award of custody to a minor child's half-sister. The district court granted the child's half-sister sole legal and sole physical custody after a two-day evidentiary hearing.

On review, the Court of Appeals found that the district court had properly concluded that the child's half-sister had shown by clear and convincing evidence that placement of the child with her took priority over preserving the day-to-day father-child relationship because of the presence of emotional danger to the child, which constituted extraordinary circumstances under the statute and in case law. The Court of Appeals also found support in the record for the district court's determination that awarding custody to the father would significantly endanger the child's emotional health and well-being. Ultimately, the father's current inability to parent this child precluded placing custody with him.

While the father argued that certain portions of Chapter 257C were unconstitutional, the Court of Appeals declined to address the father's constitutional arguments because the constitutional arguments were not made to nor addressed by the district court. *In re the Custody of C.J.K.*, A03-1163 (Minn. App. 03/23/04).

■ **ADOPTION; FAILURE TO TIMELY FILE PATERNITY ACTION; FATHER'S ADOPTION REGISTRY.** On appeal from a judgment dismissing a putative father's paternity action because he did not show that he had good cause for failing to initiate the action within 30 days after receiving notice as a registered putative father under Minn. Stat. §259.52, the Court of Appeals concluded that the putative father did not need to show that it was literally impossible for him to initiate the action within 30 days.

The putative father had argued that he had good cause for not initiating the paternity action within the 30 days because the district court wrongfully denied him counsel and failed to correctly inform him about his rights, thereby creating a substantial barrier to his exercising any of his rights as a parent. The Court of Appeals held that he had a right to appointed counsel, and that if he had been appointed counsel, he could have easily brought the paternity action within the 30 day period. However, the appellate court found no provision in the Father's Adoption Registry statute that required the district court to inform a putative father about his rights under the statute. *In the Matter of the Petition of T.D. and his wife, J. D. to Adopt N.T.K.*, A03-1207 (Minn. App. 04/06/04).

■ **ADOPTION; BEST INTERESTS; RELATIVE PREFERENCE.** The Court of Appeals held that unless contrary to the best interests of a child, when a birth parent has voluntarily terminated his or her parental rights and has directed that certain relatives not be accorded the relative preference for adoption, the commissioner of the Department of Human Services is required to honor that request.

The case is significant in that it indicates that a relative preference is simply that, and not an absolute mandate. Ultimately, the deci-

sion as to whom the commissioner of human services will consent for an adoption is to be based on the best interests of the child, with appropriate preferences taken into account. ***In the Matter of the Petitions to Adopt T.L.A. and T.E.A. and In the Matter of Children in the Custody of the Commissioner of Human Services***, A03-973 (Minn. App. 04/06/04).

■ **NEGLIGENCE; FOSTER CHILD PLACEMENT; OFFICIAL IMMUNITY.** The Minnesota Court of Appeals reviewed an appeal from summary judgment in a negligence action where foster parents challenged the district court's conclusion that Blue Earth County did not owe them, as foster parents, a legal duty of care when placing foster children in their home, and that the county is protected from liability under the doctrine of official immunity.

Foster children had exhibited behaviors that prompted foster parents to ask the county case manager if foster children placed with them had a history of sexual abuse. Caseworker advised the foster parents that she was not aware of any sexual abuse in foster children's history. Subsequently it was discovered that one of these children had sexually abused two of the foster parents' biological children. Criminal charges were filed against the child, and the foster parents filed a negligence suit against the county.

The district court granted the county summary judgment on all issues, concluding that the county did not owe a duty to warn the foster parents, and that even if there were such a duty, the county was immune from liability for such claims under the doctrine of official immunity. The Court of Appeals concluded that on the facts of the case, the county did not owe these foster parents a legal duty of care, and that the county was entitled to official immunity for its discretionary decisions and conduct. ***D.E.L. and P.E.L. as Parents and Natural Guardians of J.D.L., a Minor, and M.A.L., a Minor, v. Blue Earth County and its Agents***, A03-1114 (Minn. App. 04/06/04) (unpublished).

■ **CHILD PROTECTION; 4TH AMENDMENT; §1983 CLAIMS.** In a recent decision by the United States District Court, District of Minnesota, parents of several children sued child protection workers, county law enforcement, and Swift County with §1983 claims, alleging that these government officials violated the parents' 4th Amendment rights while executing warrants that authorized removal of the parents children from their home. This was part of a child protection proceeding where the county had concerns as to the welfare of the children.

The warrants giving rise to this federal action involved an order allowing Swift County Human Services to remove the children from the home. Law enforcement who accompanied the social services employees while removing the children searched the home and outlying buildings for weapons, which gave rise to the challenge by these parents.

The district court granted the motions for summary judgment brought by the individual Swift County employees as well as Swift County itself based on the qualified immunity doctrine. Public officials such as these defendants were found to be immune from civil liability if their actions were objectively reasonable in light of established law, which the court found them to be. Furthermore, the court found the execution of the warrants to be reasonable, finding that the police officers were merely conducting a protective search to ensure that they could safely remove the children. ***Carla and Sue Ellen Ware v. Swift County, et al.***, 03-2504 (D. Minn. 04/19/04).

■ **SENTENCE; ARMED CAREER CRIMINAL ACT; PRIOR JUVENILE CONVICTION.** In an unpublished decision, the United States District Court, District of Minnesota, reviewed a criminal defendant's sentencing under the Armed Career Criminal Act, 18 U.S.C. §924(e). The statute was applied based on the fact that the appellant/defendant had three prior violent felony convictions. This resulted in the imposition of a term of imprisonment greater than the statutory maximum allowed for a violation. Appellant/defendant argued that the Armed Career Criminal Act did not apply because one of the convictions considered by the district court was a juvenile adjudication. The district court, however, affirmed the sentence, finding that in previous 8th Circuit decisions, it had been held that a juvenile adjudication was a prior conviction for purposes of applying the Armed Career Criminal Act. ***United States v. Joe Daniel Robinson***, 03-2626 (D. Minn. 04/22/04).

LOOKING AHEAD

■ **CUSTODY; GESTATIONAL CARRIER; PENNSYLVANIA.** A gestational carrier in Pennsylvania gave birth to triplets last year and then refused to give them up to the intended parents based on her claim that the biological father and his fiancée showed a lack of interest in the children. The gestational carrier agreed to carry a child for this couple after being contacted through an Indiana-based agency at the end of 2001. This agency matched this gestational carrier with the biological father and his fiancée, and located an egg donor. The children were born slightly premature on November 19, 2003.

The gestational carrier initiated court proceedings seeking custody of the triplets. The district court judge held the gestational carrier to be the children's mother because she "carried them in her womb and then gave birth to them," despite the fact that she had no genetic connection to the children. The court granted the gestational carrier legal custody and directed that she work out visitation and other rights with the intended father, who is biologically related to the children. The intended father has suggested that he intends to appeal this decision.

The case is instructive in that the state of Pennsylvania, like 19 other states across the country — including Minnesota — has no laws governing such assisted reproductive technology proceedings. Also of note is that because the hospital had no policy regarding children born to gestational carriers, the hospital allowed the gestational carrier to take the infants home with her when she was discharged. Reported by ***The Associated Press***, 04/12/04.

■ **SAME SEX, "SECOND PARENT" ADOPTION; CALIFORNIA.** In an earlier juvenile law column, we reported the California Supreme Court decision rejecting an attempt by a birth mother to prevent her former same sex partner from adopting the child whose custody the women had shared jointly. In that case, the partner had previously adopted another biological child of the birth mother in an adoption in which

the birth mother's rights were preserved. The adoption of the second child was pending when the couple split up. The California ruling last year was regarded by gay rights groups as bolstering the thousands of already existing "second parent" adoptions (those in which a non-marital partner adopts the birth parent's child). Unlike many other states, California permits such adoptions, and indeed, such adoptions are occurring in Minnesota despite the lack of clear statutory authority. The aggrieved party in the California case petitioned the United States Supreme Court for certiorari, which has been declined without comment. Thus, at this time, the issue of same sex adoptions and second parent adoptions will not be taken up by the United States Supreme Court, and each state will be left to its own devices in addressing those frequently thorny adoption issues. Reported in the *San Diego Union Tribune*, 03/01/04.

■ **INTERSTATE ADOPTION; CONSENT REVOKED; JURISDICTION.** In an interesting case involving competing state jurisdictions in a disputed adoption, the Colorado Supreme Court ruled on April 13, 2004, that one of its county district courts had jurisdiction in what it termed to be a "custody dispute." The case arose when the birth mother of a child from Missouri revoked her consent to adoption of the child, who was in a three-week preadoption placement with a Colorado couple. Six months later, a Missouri district court ordered the child be returned to his birth mother in Missouri. A Colorado district court determined that it had no jurisdiction in the matter, which prompted the Colorado adoptive couple to appeal to the Colorado Supreme Court. The Colorado Supreme Court then ruled that its district court had jurisdiction over the child and the dispute.

The logic applied by the Court was that in the event Missouri's district court did not take into account the "best interests" of the child with respect to his placement, a Colorado court would then have jurisdiction to resolve the issue. It will now be the district court in Colorado that will decide the custodial placement of this child. Reported in *The News Observer*, 04/13/04.

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REAL PROPERTY JUDICIAL LAW

■ **HOME WARRANTY.** The Vlahoses purchased a home from the Rovicks which had been constructed by R&I Construction (R&I). When the Vlahoses subsequently discovered water damage to the home and R&I refused to repair any of the damage, the Vlahoses commenced suit against R&I asserting claims for breach of the residential ten-year warranty provided by Minn. Stat. §327A.02, subd. 1(c). R&I denied liability and asserted that the two-year statute of limitations for claims arising from improvement to real property, Minn. Stat. §541.051, subd. 1(a) barred the suit because the Rovicks knew or should have known of the water damage many years prior to the commencement of Vlahoses' action. The district court agreed and granted summary judgment in favor of R&I. It further concluded that construction defects leading to water penetration and damage were not major construction defects under the statute.

The Court of Appeals affirmed the district court's decision. On appeal, the Supreme Court reversed holding that Minn. Stat. §541.051, subd. 4 begins to run when homeowner discovers, or should have discovered, the builder's refusal or inability to ensure that the home is free from major construction defects, and that major construction defects in the statute extends to actual damage to load-bearing portions of the dwelling occurring after the completion of construction. Reversed and remanded. *Vlahos, et al. v. R&I Construction of Bloomington, Inc., et al.*, C7-02-1428 (Minn. 04/06/04).

■ **60-DAY RULE.** The Minneapolis Institute of Arts (MIA) applied for an amendment of its 1973 conditional use permit for a PUD to add a new wing. The city considered the application complete on July 23, 2002. On September 9, 2002, after public hearing, the Planning Commission approved the MIA's application subject to conditions. Decisions of the Planning Commission are final subject to appeal to the Minneapolis City Council. On September 19, 2002, appellant appealed the Planning Commission's decision to the City Council which was heard on October 1, 2002. The city determined that Smith's appeal was a separate written request under Minn. Stat. §15.99 triggering a new 60-day deadline. After subsequent hearings, the City Council denied appeal and appellant sought judicial review. The district court found that the MIA's application was not automatically approved by operation of Minn. Stat. §15.99, but affirmed, on the merits, the city's approval of MIA's application. On appeal, the appellate court concluded that under the process established in Minneapolis, a zoning application is not approved or denied for purposes of Minn. Stat. §15.99 until the City Council — not the Planning Commission — has resolved all appeals challenging the application. Therefore, appellants' appeal to the City Council was subject to the initial 60-day time period triggered by the MIA application. Therefore, the MIA's application was automatically approved by operation of Minn. Stat. §15.99. Because the application was automatically approved, the city's approval of the application was not arbitrary or capricious. Affirmed as modified. *Moreno, et al v. City of Minneapolis, et al*, A03-837, A03-943 (Minn. App., 03/09/04).

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TAX

JUDICIAL LAW

■ **EMPLOYEE LEASING COMPANY; LIABILITY FOR EMPLOYEE PAYROLL TAXES.** An employee leasing company was held to be jointly liable for the leased employees' federal employment taxes, even though state law put the ultimate responsibility of paying the tax on the client company. Generally whether an employee-employer relationship exists is determined by common-law principles; however under federal law, I.R.C §3401(d)(1), the term "employer" includes the person that controls payment of the wages. *U.S. v. Total Employment Co., Inc.*, 305 B.R. 333 (M.D.Fla. 2004).

- **INTEREST PAID ON WITHHELD BEQUEST; DEDUCTIBLE ADMINISTRATION EXPENSE.** The interest imposed on a bequest by state law, that accumulated while an issue of law was being determined, was found to be a deductible administration expense. The estate's personal representative was determining whether the beneficiary was a charitable organization as required by the decedent's will. The court held that the expense was "necessarily incurred," as required for an expense to be deductible as an administration expense. *Turner ex. rel. Estate of Jackson v. U.S.*, 2004 WL 405999 (N.D. Tex. 2004).
- **ERISA PLAN; BUSINESS OWNER PARTICIPATION.** A working owner of a business may participate in a business-sponsored ERISA plan, along with other participants, as long as participation is on equal terms and the plan covers one or more employees other than the owner and the owner's spouse. This allows a business owner to use an antialienation clause in the plan as a defense to recovery of payments by a trustee. *Raymond B. Yates, M.D., P.C. Profit Sharing Plan v. Hendon*, 124 S.Ct. 1330 (2004).
- **EXCISE TAX; LONG-DISTANCE TELEPHONE SERVICE; FLAT RATE.** It was not congressional intent to limit the toll telephone call excise tax to those calls with rates that varied by both time and distance. Telephone service, not equipment, was the subject when Congress elected not to eliminate the excise tax on commercial local and long-distance telephone services. *American Bankers Ins. Group, Inc. v. U.S.*, 2004 WL 539224 (S.D.Fla. 2004).
- **STATUTE OF LIMITATIONS; COLLECTING PARTNERSHIP'S TAX DEBT FROM PARTNERS.** A proper assessment of a tax against a partnership was enough to extend the statute of limitations for collection of the tax in a judicial proceeding against the individual general partners liable for the payment of the partnership's debts. The IRS did not assess the partners individually during the three-year statute of limitations but did assess the partnership to extend collections for ten years. In reversing the 9th Circuit, the Court held that "[o]nce a tax has been properly assessed, nothing in the Code requires the IRS to duplicate its efforts by separately assessing the same tax against individuals or entities who are not the actual taxpayers but are, by reason of state law, liable for payment of the taxpayer's debt." *U.S. v. Galletti*, 124 S.Ct. 1548 (2004).
- **CONSIDERATIONS FOR DETERMINING MINNESOTA DOMICILE.** The Court of Appeals found that the Department of Revenue rule stating the considerations for determining whether a person is domiciled in Minnesota for income tax purposes are not unconstitutionally vague. Also, the state's method of counting days is not preempted by 49 U.S.C. §40116, dealing with domicile of air carrier employees. *State v. Enyeart*, 676 N.W.2d 311 (Minn.App. 2004).
- **PROPERTY TRANSFER INEFFECTIVE TO AVOID FORECLOSURE.** Taxpayer's property transfer was not effective as to the U.S. because the property was subject to a federal tax lien before the transfer and the transferees filed quitclaim deeds transferring the property back to the taxpayer. The U.S. was allowed to foreclose on the property. *U.S. v. Key*, 2004 WL 500066 (N.D. Tex. 2004).
- **SALES TAX; TELECOMMUNICATIONS EQUIPMENT.** The Minnesota Supreme Court held that the purchase of telecommunications equipment that produced electronic signals that had physical characteristics was exempt from sales tax as capital equipment used for manufacturing tangible personal property to be sold ultimately at retail pursuant to Minn. Stat. §297A.25 subd. 42 (2000). *Sprint Spectrum LP v. Commissioner of Revenue*, 676 N.W.2d 656 (Minn. 2004).
- **REFUND CLAIM UNDER §6015 UNTIMELY.** Taxpayer overpaid taxes for the tax year in question and did not request a refund during the statutorily allowed period. Later taxpayer was granted equitable relief from joint and several liability. Taxpayer was not allowed a refund from the tax year in question because the court did not have jurisdiction; taxpayer's first attempt at a refund was after the statute of limitations had expired. *Bartman v. Comm'r*, T.C.M. (RIA) 2004-93 (2004)
- **LOTTERY PROCEEDS SOLD TREATED AS ORDINARY INCOME.** A lump-sum payment received by a lottery winner in exchange for a right to receive future lottery proceeds was found to be ordinary income and not capital gain. The lump sum was found to be essentially a substitute for future payments of ordinary income. *Clopton v. Comm'r*, T.C.M. (RIA) 2004-95 (2004).
- **UNTIMELY 1040 QUALIFIES AS A "RETURN."** Taxpayer's untimely Form 1040 qualified as a valid tax return. The "return" allowed the overdue taxes for that year to be discharged through his bankruptcy filing. The mere fact that a federal income tax form was filed after the tax was assessed does not mean that it was not an "honest and reasonable" to attempt to comply with his filing obligation. *In re Payne*, 306 B.R. 230 (Bankr. N.D. Ill. 2004).
- **REPORTING AMOUNT DOES NOT PRECLUDE ACCURACY CHALLENGE.** The Tax Court held that a taxpayer who reports an amount of tax on a tax return is not precluded from challenging the accuracy of that amount in a I.R.C. §6330 collections due process hearing. *Poindexter v. Comm'r*, 122 T.C. No. 15 (T.C. 2004),
- **JURISDICTION; PUNITIVE DAMAGES AGAINST IRS.** Tax Court claimed there was no statutory authority for awarding punitive damages against the IRS. In addition, the court said an award of litigation and administrative costs incurred in a prior case was impermissible. *Grigoraci v. Comm'r*, 122 T.C. No. 14 (T.C. 2004).
- **INSUFFICIENT NOTICE OF DEFICIENCY.** IRS erred in sending notice of deficiency to an individual's previous address. The notice of deficiency did not meet the statutory requirements because before the notice was issued taxpayer filed a Form 2848, Power of Attorney, with his current address. The Power of Attorney was a clear and concise notification of his new address. *Hunter v. Comm'r*, T.C.M. (RIA) 2004-81 (2004).
- **REBATES, PAYMENTS RECEIVED IN BUSINESS INCLUDED IN INCOME.** Taxpayers were required to recognize manufacturer coupon payments, bulk sales income and vendor refunds, received by the husband's business, in income. *Kikalos v. Comm'r*, T.C.M. (RIA) 2004-82 (2004).
- **CLAIM OF RIGHT DOCTRINE; STOCK PROCEEDS; RECOGNITION OF INCOME.** Taxpayer received money in sale of S Corporation's stock but did not claim the proceeds as income in that year. Subsequently the transaction was set aside. The court held that he received

the income without restriction as to its use. The mere fact that the income may later be required to be returned is not sufficient to allow a delayed recognition of income. *Hamlett v. Comm'r*, T.C.M. (RIA) 2004-78 (2004).

■ **WILLFUL EVASION OF TAX PAYMENTS; BANKRUPTCY.** Taxpayer's tax liabilities were not allowed to be dischargeable in bankruptcy because he willfully attempted to evade the payment of taxes for the two years at issue. Fraudulent evasion is an exemption from discharge pursuant to 11 U.S.C. §523(a)(1)(C). *In re Gardner*, 360 F.3d 551 (6th Cir. 2004).

■ **PRIOR PLEA AGREEMENT DOES NOT PREVENT ASSESSED PENALTY.** Taxpayers claimed that tax liability was previously satisfied as part of a criminal case against the taxpayer in which a satisfaction of judgment, plea agreement and a sentencing stipulation was made or satisfied in the alternative by an entry of judgment in the criminal matter. The district court granted the IRS's motion to dismiss stating that the IRS is not required to prosecute criminal and civil liability together and restitution paid only satisfies civil liability when the precise amount due was known and paid as a condition to avoid imprisonment. Since there was never any formal adjudication of the amount due the plea agreement only required taxpayer to "cooperate" in the assessment and payment of his civil liabilities. It was not a discharge of the liabilities. *Gnifkowski v. U.S.*, 2004 WL 569534 (D.Minn. 2004).

■ **OWNER'S DAUGHTER EMPLOYEE OF CORPORATION, NOT DAD.** The daughter of a corporation's vice-president and coowner was found to be an employee of the corporation rather than an employee of her father. Thus, the corporation was liable for employment taxes on her compensation. A factual analysis showed that she was doing work for the corporation although she was never formally hired and there was an explicit policy preventing her from being formally hired without a waiver. *Barium & Chemicals, Inc. v. Comm'r*, T.C.M. (RIA) 2004-59 (2004).

■ **UNAUTHORIZED DISCLOSURE IS SINGLE ACT; DAMAGES LIMITED.** Taxpayers were limited in an award of statutory damages to the amount of \$1,000 for an unauthorized disclosure made by an IRS employee of an individual and corporate taxpayers' tax information. The disclosure was made at a party attended by 100 people and it was determined that only a single act of disclosure occurred. *Siddiqui v. U.S.*, 359 F.3d 1200 (9th Cir. 2004).

■ **SETTLEMENT PROCEEDS; INCOME; DISCHARGED EMPLOYEE.** A terminated employee was not allowed to exclude settlement proceeds received from employer from gross income because there was no record that they were on account of personal physical injury or sickness suffered by the taxpayer pursuant to 26 U.S.C. §104(a)(2). *Tamberella v. Comm'r*, T.C.M. (RIA) 2004-47 (2004).

■ **BUSINESS DEDUCTIONS; CORPORATE PAYMENTS TO FORMER SHAREHOLDER.** The Tax Court held that all of the following were deductible as business expenses: payment made to relinquish obligations under employment agreement; settlement of various legal claims filed by shareholder against corporation; and payments to acquire shareholder's stock. *Chief Indus., Inc. v. Comm'r*, T.C.M. (RIA) 2004-45 (2004).

■ **EXHUSBAND'S RETIREMENT PAYMENT; SPOUSE'S TAX LIABILITY.** Taxpayer was determined to have a deficiency for the portion of her exhusband's military retirement payment that she received. The payment was not judged to be a property transfer incident to divorce. *Pfister v. Comm'r*, 359 F.3d 352 (4th Cir. 2004).

■ **MEDICAL EXPENSE ALLOCATION UNDER §213.** The Tax Court has found that taxpayers were entitled to use the percentage method to determine the portions of monthly service fees paid for lifetime residence at a continuing care retirement facility that are allocable as a deduction under I.R.C. §213. A §213 deduction is limited to the extent the expense exceeds 7.5 percent of adjusted gross income for a taxpayer. *Baker v. Comm'r*, 122 T.C. No. 8 (2004).

■ **CLOSELY HELD STOCK VALUATION.** Where closely held stock was transferred from sibling donors to trusts for the benefit of their respective children, the court held that the value was properly determined by using a combination of market and income approaches and applying discounts for lack of marketability and voting rights. *Okerlund v. U.S.*, 2004 WL 757792 (Fed. Cir. 2004).

■ **LIABILITY FOR UNREPORTED WAGES.** Taxpayer had income reported by his employer on Form 1099-MISC. This income was not reported on his Form W-2 and taxpayer failed to pay taxes on any income not reported on the W-2. The Tax Court held that taxpayer received income that he failed to report, taxpayer failed to show that income tax was being withheld from his pay during the disputed period, and there was evidence supporting the finding that taxpayer was an independent contractor subject to self-employment tax. *Del Monico v. Comm'r*, T.C.M. 2004-92 (RIA) (2004).

■ **COLLECTION ACTIVITIES; TAX LIEN NOT DISCHARGED IN BANKRUPTCY.** The Tax Court held that even if an individual's taxes were discharged in bankruptcy the tax lien, attached to taxpayer's property prior to filing for bankruptcy, was still valid pursuant to 11 U.S.C. §522(c)(2)(B) (2000). *Iannone v. Comm'r*, 122 T.C. No. 16 (2004).

■ **AMT; LOW-INCOME TAXPAYER.** A low-income taxpayer was required to use the alternative minimum tax. The individual's tax liability was zero as a result of a significant itemized deduction. The court rejected the argument that the AMT was intended only to prevent high-income taxpayers from avoiding taxes. *Katz v. Comm'r*, T.C.M. (RIA) 2004-97 (2004).

■ **JURISDICTION; OBJECTION TO ADVERSE INNOCENT SPOUSE DECISION.** The 2nd Circuit Court of Appeals affirmed that the Tax Court does not have jurisdiction to hear a challenge to the IRS's decision to grant husband's former wife innocent spouse relief. *Maier v. Comm'r*, 360 F.3d 361 (2d Cir. 2004).

■ **TAX LIEN; PENDING TAX COURT PETITION.** Taxpayer's innocent spouse claim was pending in the Tax Court and the IRS placed a federal tax lien on her during this time period. The court held the lien was valid but a levy or proceeding was barred during the time of review of her claim. *Beery v. Comm'r*, 122 T.C. No. 9 (2004).

■ **TELECOM REFUND CASE; NO RULING ON MULTISTATE CLASS ACTION.** Oklahoma asserted jurisdiction in a class action case against AT&T alleging that it improperly collected municipal sales tax throughout the nation. AT&T was asking the court to decide whether principles of state sovereignty and the 14th Amendment's Due Process Clause prohibited Oklahoma from asserting jurisdiction over claims challenging the collection of a municipal sales tax in 27 other states. *AT&T Corp. v. Allen*, 2004 WL 102838 (2004).

■ **PER DIEM DEDUCTION.** The Tax Court affirmed the section of Rev. Proc. 96-64 that treats a per diem allowance as entirely attributable to meals if the allowance is computed on a basis similar to that used in computing an employee's wages or other compensation. The full amount of per diem was subject to a 50 percent deduction limitation. Also, taxpayer's reasonable estimates and averages of expenses that the long-haul drivers incurred on the road did not entitle taxpayer to a greater deduction than 50 percent. *Boyd v. Comm'r*, 2004 WL 886993 (T.C. 2004).

ADMINISTRATIVE MATTERS

■ **RECOVERABLE OIL AND GAS RESERVES.** Rev. Proc. 2004-19 provides a safe harbor that an owner of domestic oil and/or gas properties may use an estimate of the properties' "probable" or "prospective" reserves for purposes of computing cost depletion pursuant to §611 of the I.R.C. This revenue procedure will avoid fact-intensive arguments between taxpayers and the IRS over what constitutes the appropriate quantity of probable or prospective reserves.

■ **LOW INCOME TAXPAYER CLINICS.** The IRS has awarded \$7.5 million in matching grants to Low-Income Taxpayer Clinics. The grants will fund 135 clinics that represent low-income taxpayers involved in tax disputes with the IRS. Qualifying organizations in Minnesota are Mid-Minnesota Legal Assistance and the University of Minnesota Income Tax Clinic. IR-2004-55.

■ **FLEP COST-SHARE PAYMENTS; §126 EXCLUSION.** Cost-share payments pursuant to the Forest Land Enhancement Program (FLEP) qualify for the I.R.C. §126 exclusion for cost-sharing conservation payments. Small-watershed programs administered by the secretary of agriculture also qualify if the IRS determines that the programs are substantially similar to those described in §126. Rev. Rul. 2004-8.

■ **PARKING RENTS; QUALIFYING FOR REIT TREATMENT.** A real estate investment trust (REIT) that provides parking facilities at its rental real properties can recognize rents from the parking facilities under certain circumstances listed in Rev. Rul. 2004-24 in order to help qualify for REIT treatment under I.R.C. 856(d).

■ **WITHHOLDING PROCEDURES; QUALIFIED INTERMEDIARIES.** Availability of simplified documentation and reporting for qualified intermediaries has been expanded. Rev. Proc. 2004-21.

■ **AVERAGE AREA PURCHASE PRICE SAFE HARBORS.** Issuers of qualified mortgage bonds and mortgage credit certificates can now take advantage of a state-specific list of average purchase prices for both new and existing residences listed in Rev. Proc. 2004-18. The national average purchase price for computing housing cost/income ratio under I.R.C. §143(f)(5) is \$218,100 but in the specific locations listed the regional averages may be used. The safe harbors are effective February 10, 2004, and end when obsolete. Rev. Proc. 2004-18.

■ **ABUSIVE TRANSACTIONS BY S CORPORATIONS AND TAX-EXEMPT ENTITIES.** The IRS, in Notice 2004-30, stated its intention to challenge transactions structured to shift taxation away from taxable S corporation shareholders to an exempt party. Notice 2004-30.

■ **THEFT LOSS DISALLOWED; FRAUDULENT STOCK PRICE DECREASES.** Taxpayers are not allowed to take a theft loss deduction for a decline in stock value due to accounting fraud or corporate officer misconduct. In addition, taxpayers who take the deduction may be subject to accuracy-related penalties. I.R.C. §165(c) says that theft losses must be incurred in a trade or business, incurred in any transaction entered into for profit, though not connected with a trade or business, or be a loss of property not connected with a trade or business or a transaction entered into for profit, arising from fire, storm, shipwreck, or other casualty, or from theft. Notice 2004-27.

■ **EXPIRED CHARITIES, PRIVATE FOUNDATIONS.** In Ann. 2004-22 the IRS has released a list of organizations that have failed to establish or maintain their status as public charities or operating foundations.

■ **INNOCENT SPOUSE RELIEF.** A revised version of Publication 971 is available. It discusses treatment of relief provisions available to taxpayers whose spouses improperly reported omitted items on their joint returns. Ann. 2004-24.

■ **MINNESOTA REVENUE NOTICES.** Minnesota has released Revenue Notice 04-04 which states how the Department of Revenue distinguishes between real property and tangible personal property for sales tax purposes when the property is not subject to an *ad valorem* tax.

Revenue Notice 04-03 has been issued to clarify the Department of Revenue's position on what camp fees are under Minn. Stat. 297A.70 subd. 16. The statute deals with camp fees for children, persons with disabilities, and religious and educational camps operated by I.R.C. §501(c)(3) organizations.

■ **HEALTH SAVINGS ACCOUNTS.** The IRS has issued guidance that clarifies the types of preventive care that can be provided under a high-deductible health plan. It also has commented on prescription drug benefits under a high-deductible health plan. Rev. Proc. 2004-22 and Rev. Rul. 2004-38.

■ **RECOURSE NOTE; REDUCTION IN STATED PRINCIPAL.** The IRS issued guidance on the treatment of a reduction in the stated principal on a recourse note from an employee to the employer to acquire employer stock. The employee will generally recognize discharge of indebtedness income. Rev. Rul. 2004-37.

■ **ASSETS-OVER PARTNERSHIP MERGERS.** The IRS released Rev. Rul. 2004-43, which explains how to treat built-in gains in an assets-over partnership merger under I.R.C. §§704 and 737.

■ **"ISSUE AD" TAX TREATMENT; TAX-EXEMPT ORGANIZATIONS.** Rev. Rul. 2004-6 is a guide for tax-exempt organizations to determine whether or not an issue ad represents an attempt to influence the election of an individual to public office under the Bipartisan Campaign Reform Act of 2002.

■ **CHARITIES; POLITICAL CAMPAIGN ACTIVITIES.** Charities may educate voters but must be careful not to participate or intervene in any political campaign on behalf of, or in opposition to, any candidate for public office. I.R.C. §501(c)(3) charities may not endorse any candidates, make donations to their campaigns, engage in fund raising, distribute statements, or become involved in any

other activities that may be beneficial or detrimental to any candidate. These activities may risk losing §501(c)(3) tax-exempt status for the charities or be subject to an excise tax.

LEGISLATION

- **INFORMATION PACT.** Thirty-eight states, including Minnesota, have signed an information-sharing pact to fight abusive tax shelters. The goal is to encourage exchanges of case listings and documents as well as confirm the role of joint promoter audits and coordinated enforcement actions. Press Release, Federal Tax Administrators, "38 States Sign Agreement to Share Data on Abusive Tax Shelters" (Mar. 4, 2004).
- **TAX BILLS IN COMMITTEE.** A bill has been introduced to repeal the alternative minimum tax. H.R. 4131. A bill has been introduced to simplify the definition of child for purposes of the personal exemption, the dependent care credit, the child tax credit, the earned income credit, and the health insurance refundable credit, and for other purposes. H.R. 4132. Also, there is a bill to better describe the persons qualifying for "head of household" status. The bill would change the name of the status to "single parent" or "guardian." H.R. 4133.
- **H.R. 4137; TO ELIMINATE S CORPORATION STATUS.** A bill has been introduced to eliminate elections of new S Corporations after 2004 and to treat current S Corporations as partnerships beginning in 2015. H.R. 4137.
- **PENSION FUNDING EQUITY ACT OF 2004.** As a result of the Pension Funding Equity Act the IRS has issued a new interest rate for pension plan funding. The rate no longer reflects the 30-year Treasury bond rate; instead it is based on high-quality, long-term corporate bonds, as specified by the secretary of the treasury. Announcement 2004-38 and Notice 2004-34 implement and explain the change.
- **INTERNET TAX BILL.** The Internet Tax Nondiscrimination Act (S. 150) will come to a vote in the Senate. The bill would permanently prohibit state and local taxes on Internet access and multiple or discriminatory state and local taxes on electronic commerce. However, there are competing proposals that range from extending the current moratorium to expanding the scope of the moratorium to allowing specific exemptions to the moratorium. See S. 150; S. 2082; and S. 2348.
- **MINNESOTA OMNIBUS TAX BILL.** The Omnibus Tax bill, for foreign corporate income taxes, as passed earlier this session in the Minnesota House, would: phase-in a single factor sales apportionment formula; require an addition to federal taxable income for excess losses from lease-in/lease-out or sale-in/lease-out transactions involving exempt property; allow S corporations that convert from C corporations to claim the subtraction bonus depreciation add-back; and disqualify foreign operating corporations that lack business purpose or engage in transactions that lack economic substance. The bill would allow for organ donor expense and military pay deductions. Total sales taxes on certain leased motor vehicles would be required to be paid at the start of the lease, rather than at the time of payments. H.F. 2540.
- **SUV TAX INCENTIVE.** A congressional report was filed that states concerns with federal tax code loopholes that create a federal policy that encourages the purchase of heavy-duty SUVs. Depreciation on SUVs is accelerated, like a light-truck rather than a passenger car, while at the same time SUVs are exempt from the gas guzzler tax. CRS Report (04/27/04).
- **REPEAL OF FOREIGN EXPORT SUBSIDIES.** The Senate is debating and pushing through a bill to repeal the foreign sales corporation/extraterritorial income tax structure as a result of possible sanctions by the WTO. The income tax structures were deemed to be illegal export subsidies. However, there is a large amount of disagreement over 82 pending amendments that are likely to be pared down to a few of the most important germane amendments. News-Federal, 2004 Taxday, Senate to Return to FSC/ETI Repeal Legislation (04/28/04).
- **MARRIAGE PENALTY RELIEF.** The House passed a bill that would permanently increase the standard deduction and maximum taxable income in the 15 percent bracket for married persons filing jointly to twice that of single taxpayers. H.R. 4181. Included in the bill is a provision extending the earned income tax credit phase out for lower income taxpayers to factor in marriage penalty relief. In the future there will be more bills permanently enacting portions of the Economic Growth Tax Relief Reconciliation Act (P.L. 107-16) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (P.L. 108-27).

LOOKING AHEAD

- **ST. CLOUD IRS OFFICE MOVING.** As of March 15 the IRS opened a new office in St. Cloud. It is located in Suite 101 of the Highway 15 Business Centre, at 3800 8th Street North.
- **ELECTRONIC TAX FILING FOR CORPORATIONS.** Corporations and tax-exempt organizations can now file annual income tax and information returns electronically using the IRS's new technology. IR-2004-43.
- **SUPREME COURT: CAN CLIENTS ESCAPE TAX ON CONTINGENT ATTORNEY FEES?** The Supreme Court will settle the circuit split over whether contingent fees paid to an attorney out of a taxable award or settlement are excludible from the client's gross income or are includible but deductible as a miscellaneous itemized deduction. *Comm'r v. Banks*, 2004 WL 602077 (2004).
- **JOINT INTERNATIONAL TASK FORCE DISCUSSIONS.** Tax administrations from Australia, Canada, the United Kingdom, and the United States have begun discussions to create a task force to fight abusive tax transactions. It would increase collaboration and coordinate information about abusive transactions. The task force would be particularly helpful in stopping abusive transactions that cross national boundaries. IR-2004-35.
- **INDIAN TRIBAL GOVERNMENT PUBLICATIONS.** Various publications on the IRS website address tip reporting agreements, tribal enterprise structure issues, excise tax claims, federal tax deposits and other topics.

■ **TAXPAYER'S CHALLENGE TO SPECIAL TRIAL JUDGE PROCEDURES.** The Supreme Court consolidated two cases for upcoming review. The Court of Appeals held that the Tax Court's refusal to make the special trial judge's original report available to the taxpayer did not violate the taxpayer's due process rights. The Tax Court had adopted the special trial judge's report. **Ballard v. Comm'r**, 2004 WL 875549 (2004).

■ **E-FILER APPLICATION ONLINE.** The IRS has released a new online registration form to give tax professionals a faster, easier method of applying to become and authorized e-filer. IR-2004-58.

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■ **IMMUNITY REVISITED: ROAD MAINTENANCE.** Minders sued Anoka County, alleging it failed to maintain its roads, place warning signs, and identify and correct a pothole which caused his motorcycle accident. The county moved for summary judgment, asserting official and statutory immunity, or, alternatively, that Minder could not prove causation or that the county had notice of a dangerous condition. The district court granted summary judgment. The Minnesota Court of Appeals affirmed.

Jon Olson, the county's former highway engineer, submitted evidence surrounding road repair priorities. The county also asserted it did not know the pothole existed. The Court of Appeals found that where a plaintiff alleges a failure-to-warn claim based on constructive notice that actually challenges an inspection and maintenance policy, a county which does not have actual knowledge of the dangerous condition will be immune from suit when its policy balances competing social, economic and political factors. **Minder v. Anoka County**, A03-1132 (Minn. App. 04/13/04).

■ **NEGLIGENCE: PRIMA FACIE CLAIM OF CAUSATION.** DiRico, trustee for the next-of-kin of Charles Barker, sued RESTART, Inc. ("RESTART"), an adult foster care center. An employee of the house where Barker lived said there would be a continuous monitoring of Barker's room. The employee knew the current system would not meet the needs of Barker, but did nothing to remedy the situation, though even something as simple as a baby monitor would have helped.

The Dakota County Coroner found Barker died of "apparent positional asphyxia" and that he had struggled to get someone's attention. The trial court granted summary judgment on the negligence claim, finding that there was no non-speculative evidence supporting the claim that failure to place a monitor in the room caused the death.

The Minnesota Court of Appeals reversed. It found there was sufficient circumstantial evidence in the record from which a jury could conclude that the failure to continuously monitor Barker was a prima facie case of causation and that the matter should be remanded to the district court for trial. **DiRico v. RESTART, Inc.**, A03-1173, (Minn. App. 04/13/04. (unpublished)

■ **SAFETY RESPONSIBILITY ACT.** Father, the owner of a vehicle, drove his mother and daughter to purchase take-out food. Father parked and waited as his mother and daughter went into the restaurant. Upon returning, daughter, carrying take-out food, entered the rear passenger door. Mother entered the passenger side door with her hand on the top part of the rear passenger door to brace herself. Granddaughter closed the rear passenger door, severing one of grandmother's fingers.

Grandmother argued that the Safety Responsibility Act, Minn. Stat. §170.54, provided coverage to the granddaughter as an "operator" of the vehicle. Appellant cited **Melchert v. Melchert**, 519 N.W.2d 223 (Minn. App. 1994), as authority for her position. In **Melchert**, the plaintiff borrowed a pickup truck from its owner and attached a trailer to it. As the plaintiff was hitching the trailer, a hay bale thrown by plaintiff's son hit and injured plaintiff. The owner of the vehicle was nowhere near the scene. The court in **Melchert** concluded that for purposes of the Safety Responsibility Act, "operating" a vehicle included participating in loading and unloading activities, and therefore the pickup was being operated when the injury occurred. The Safety Responsibility Act provides that a person who operates a motor vehicle with the express or implied consent of its owner is deemed to be the owner's agent in the case of accident. Minn. Stat. §170.54. The Safety Responsibility Act was adopted to effectuate the legislative policy determining that as between an innocent third party injured by the negligent operation of an automobile and the owner of that automobile who permits another person to drive it, the owners should bear the cost of injury.

The Court of Appeals declined to extend the scope of the Safety Responsibility Act to this case. The Court of Appeals distinguished the **Melchert** case, noting that the owner of the vehicle was present and actually driving the vehicle in the present case. To the extent that **Melchert** included loading and unloading activities within the definition of "operate," it did not reach so far as to embrace the concept of two concurrent operators, which would be required to find coverage in this case. **White v. White**, A03-1315 (Minn. App. 03/30/04).

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