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

CIVIL LITIGATION

JUDICIAL LAW

■ **SERVICE OF COMPLAINT WITHOUT SUMMONS; NO PERSONAL JURISDICTION.** A defendant who is personally served with a complaint but no summons, who attends hearings in the action (but makes no written submissions), and against whom a default judgment is obtained, may assert a personal jurisdiction defense for the first time in a Rule 60 motion. Thomas & Betts (T&B), a manufacturer of waste-oil furnaces, sued Ronald Leger, one of its distributors, under a variety of contract and tort theories. T&B later amended its complaint to name as defendants Janet Leger, Ronald Leger's wife, and Independent Waste Oil Furnaces, Inc., (IWOF) the Legers' newly created distributing company. The sheriff served Janet Leger and IWOF with copies of the amended complaint, but not with summonses. Neither of the newly joined defendants answered the amended complaint. At a subsequent scheduling conference, the trial court found that Janet Leger and IWOF were in default for their failure to respond to the amended complaint. Thereafter a default hearing took place, but Janel Leger and IWOF did not make written submissions. The Legers were present at both the scheduling conference and the default hearing. The court entered judgment against Janet Leger and IWOF. After filing for bankruptcy protection, the Legers obtained relief from the automatic stay in order to bring a Rule 60 motion to vacate the judgment against Janet Leger and IWOF. In their Rule 60 motion, the defendants argued for the first time that the failure to provide a summons rendered the judgment against them void for lack of personal jurisdiction. The court granted the motion, acknowledging that the defendants had not been properly served.

The Court of Appeals agreed, noting that Minn. R. Civ. P. 3.01 makes service of a summons a prerequisite to the court's ability to exercise personal jurisdiction. The defendants in this case did not waive the insufficiency-of-process defense. While a party waives the defense if she omits it from a pleading or motion, the defendants included the defense in their Rule 60 motion — their initial pleading in the case. Moreover, simply appearing at hearings, without more, does not constitute an "affirmative step to invoke the court's jurisdiction" and thus does not result in a waiver of the defense. ***Thomas & Betts Corporation v. Leger***, A04-260 (Minn. App. 11/24/04) (unpublished opinion). *www.lawlibrary.state.mn.us/archive/ctapun/0411/opa040260-1124.htm*

— EMILY DUKE
— JAMES MAYER
Fredrikson & Byron

CRIMINAL LAW

JUDICIAL LAW

■ **POST-CONVICTION; INEFFECTIVE ASSISTANCE OF COUNSEL; REJECTION OF *MASSARO*.** The Minnesota Supreme Court declines to adopt the recent decision of the United States Supreme Court in *Massaro v. United States*, 585 U.S. 500 (2003), wherein the Court overturned the procedural default rule that had been followed in some federal circuits, which held that a claim of ineffective assistance of counsel was barred if the defendant did not raise it on appeal. "Because the ruling in *Massaro* is based on the Supreme Court's supervisory power over federal courts and is not constitutional in nature, it does not bind us and we decline to adopt it." ***Rusttee Allan Torres v. State of Minnesota***, A03-1624 (Minn. 11/18/04). *www.lawlibrary.state.mn.us/archive/supct/0411/opa031624-1118.htm*

■ **DWI/IMPLIED CONSENT; ENHANCEMENT; REVOCATION BEYOND TEN YEARS; CONVICTION WITHIN TEN YEARS.** For purposes of charging out a felony DWI, where the date of the offense and the license revocation are both beyond ten years previous to a new offense, but the conviction for the old offense occurred within ten years of the new offense, the conviction may still be used for enhancement to felony DWI under Minn. Stat. §169A.24, Subd. 1 (2002). ***State v. Robert A. Miller***, KX-03-3273 (Minn. App. 11/23/04). *www.lawlibrary.state.mn.us/archive/ctappub/0411/opa040396-1123.htm*

■ **DWI/IMPLIED CONSENT; MEDICAL PRIVILEGE; BLOOD TEST; CONFLICT OF LAW.** Respondent was involved in an accident resulting in a death in Minnesota. The closest hospital was in Wisconsin, where the respondent submitted to a medically administered blood test, showing an alcohol concentration of .14 percent within two hours of driving. Following Wisconsin statutory procedures, which allow for the admission of such medically administered blood tests, the Minnesota officer completed a request for protection of documents, and a deputy Lacrosse County district attorney filed a request with circuit court, resulting in a subpoena for the documents as well as an order requiring the medical center to release the requested documents and blood samples. Under Wisconsin law, such blood test results are not medically privileged in cases of homicide. Wisc. Stat. §905.04, Subd. 2. However, in Minnesota, such evidence would be inadmissible under Minn. Stat. §595.02, Subd. 1(d), which is held to include blood samples for treatment purposes within medical privilege.

Held, following the Restatement of the Law, in alignment with the states of Iowa, Washington, and Illinois, the Minnesota Supreme Court now adopts the rule of "most significant relationship with the communication" rule, which states that a state where the "communication" took place, unless there is a prior relationship between the parties, will govern the law of medical privilege. Resolving the conflict

of law issue in favor of the law in Wisconsin, the court holds that under the "most significant relationship with communication" rule, the Wisconsin blood alcohol is admissible in the respondent's trial in Minnesota. ***State v. Joseph Steven Heaney***, A03-1401 (Minn. 12/02/04). *www.lawlibrary.state.mn.us/archive/supct/0412/opa031401-1202.htm*

■ ***BLAKELY;*** **RETROACTIVITY;** ***APPRENDI*** **NOT WATERSHED:** Appellant was convicted and sentenced in 1997. Appellant was given a double durational departure for first-degree assault involving a child victim. Appellant did not perfect a direct appeal. Hence, his conviction became final in 1998. In 2000, *Apprendi* was decided. In this challenge to the double durational departure, the Court of Appeals holds that, because neither *Apprendi,* nor *Blakely* (applying *Apprendi)* were of watershed magnitude, neither rule has retroactive application on collateral review. ***State v. Shane Michael Petschl***, A03-1803 (Minn. App. 11/23/04). *www.lawlibrary.state.mn.us/archive/ctappub/0411/opa031803-1123.htm*

■ ***BLAKELY; LOTHENBACH; BLAKELY*** **APPLIES.** Appellant waived his right to a jury, and submitted the case to the court on stipulated facts pursuant to *Lothenbach.* The parties agreed that the appellant would receive "the bottom of the box" sentence of 98 months. However, the district court found appellant guilty and sentenced him to 128 months in prison, finding that the upward departure was warranted by the appellant's failure to abide by the terms of the conditional release and the fact that the victims of the accident included children under the age of six and a pregnant woman, citing Minnesota Sentencing Guidelines II.D.2.b.

Held, the appellant's challenge to the sentence is upheld under *Blakely.* Although the *Lothenbach* procedure requires a waiver of the right to a jury trial on the elements of the offense, there is no waiver, implicit in the procedure, of the right of a jury to determine aggravating factors relating to sentencing. Hence, because the parties do not stipulate to the additional facts found by the court to support the sentencing departure, the matter is reversed and remanded for sentence. ***State v. Todd Allen Johnson***, A04-176 (Minn. App. 11/23/04). *www.lawlibrary.state.mn.us/archive/ctappub/0411/opa040176-1123.htm*

■ ***BLAKELY;*** **NOT RETROACTIVE; NEW CONSTITUTIONAL RULE.** Appellant was sentenced to a 20-year sentence, instead of the presumptive sentence of 6 1/2 years under the Minnesota Sentencing Guidelines. The court made this determination based upon the presentence report that appellant met the criteria of the career offender statute under §609.1095, Subd. 4. Appellant was sentenced on January 11, 2002, and filed a direct appeal which did not argue *Blakely*, resulting in his conviction becoming final in 2003. *Apprendi* was decided in 2000, while *Blakely* was decided in 2004.

Held, appellant is not entitled to sentencing relief under *Blakely* in a collateral attack initiated four months after his conviction became final. *Blakely* will not be applied retroactively: "For a conviction and sentence becoming final after *Apprendi* … *Blakely* … does not merely alter the application of *Apprendi* but establishes a new constitutional rule governing the process of determining facts forming the basis for sentencing; *Blakely* was neither dictated by *Apprendi* nor made apparent to most reasonable jurists after *Apprendi* was decided. As a result, the rule of *Blakely* will not be applied retroactive to *Apprendi* in a collateral attack on a sentence; and exceptions to the general rule against retroactivity of new rules are inapplicable, *Blakely* neither defining a new offense nor altering our understanding of bedrock procedural elements." ***State v. Gerald E. Houston,*** A04-324 (Minn. App. 12/07/04). *ww.lawlibrary.state.mn.us/archive/ctappub/0412/opa040324-1207.htm*

■ **CHILD PORNOGRAPHY; SENTENCING; MULTIPLE ACTS; SEVERITY LEVEL; DISPOSITIONAL DEPARTURE DENIED.** Appellant, a 22-year-old student, maintained a file server on a laptop computer resulting in the collection of thousands of child pornography images. The appellant was extremely obese, and presented evidence that it was normal for an individual his age to have an interest in teenage females. The images, however, contained pornography involving very young children. The server was a type of "set up and leave" software program. The appellant was convicted for one count of dissemination of child pornography and 19 counts of possession. At sentencing, the state argued that each image should be treated as an individual offense against a separate victim, and asked the court for an executed sentence of 270 months. Appellant argued for a 15-month stayed sentence, and a dispositional departure based upon amenability of probation. District Court ranked the dissemination charge as a Level 8 offense, with possession of still images as a Level 4 offense, and possession of a movie image as a Level 5 offense. Relying on the multiple victim exception to Minn. Stat. §609.035, appellant was sentenced to 78 months in prison: 48 months on the dissemination conviction and a consecutive 12 months and a day for one charge of possession, and a consecutive 18 months for one count involving the movie images.

Held, possession of child pornography is a lesser-included offense of dissemination. However, a judicially created exception allows the court to disregard the limiting effect where there are multiple victims, and the Court of Appeals upholds the trial court's determination that each of the children identified in the images was a victim.

The court erred by using the *Hernandez* method of sentencing: according to Minnesota Sentencing Guideline II.B.1.c, the district court, when sentencing for a single behavioral incident involving multiple victims, is limited in its use of the sentence to enhance to two offenses of the highest severity level. Hence, the sentence is remanded on this score.

It was error for the court to impose consecutive sentences of 12 months and 18 months for possession of child pornography. Minnesota Sentencing Guidelines §II.F states that a sentence imposed consecutively must use a zero criminal history score: in this case, the two charges are Level 4 and Level 5, so they would be presumptively stayed.

The court erred in assigning a Level 8 severity offense level to the charge of dissemination: the court notes that similar offenses at this high level are criminal sexual conduct first degree, arson first degree, and manslaughter. The trial court appeared to focus on the large number of images, rather than the offense itself, and this decision is remanded to determine a more appropriate severity level for dissemination.

Finally, the court declines, with reservation, to reverse the district court's decision to refuse to depart dispositionally. ***State v. Joshua Stafford Bertsch***, A04-177 (Minn. App. 11/30/04). *www.lawlibrary.state.mn.us/archive/ctappub/0411/opa040177-1130.htm*

■ **CHILD PORNOGRAPHY; SENTENCE; CONSECUTIVE FOR MULTIPLE VICTIMS.** Appellant pleaded guilty to six counts of child pornography for six separate images, two of which possibly involved the same child. Appellant agreed that each count be ranked as a Level 4 offense

(child pornography is still unranked accordingly to Sentencing Guidelines) and further agreed to receive a separate sentence on each count, to be served consecutively. With a criminal history of 5, and an offense level of 4 for Count 1, appellant agreed to a sentence of 27 months imprisonment on that count, with an additional year and a day for each subsequent count, to be served consecutively. Ultimately, the appellant received an 84-month executed prison term.

The district court did not err in imposing consecutive sentences, according to the plea agreement, for the six counts of possession of child pornography, with the exception that the imposition of separate sentences for possessing two images of the same minor.

Citing the codified legislative intent found in Minn. Stat. §617.247, the court holds that children are, indeed, victims, allowing the court to apply the multi-victim exception to the single behavioral incident rule. The court notes that there is no "direct harm" component compelled by the case law implicit in the multi-victim exception. Next, the court upholds the use of consecutive sentences as not unfairly exaggerating the criminality of the defendant's conduct. The court properly used zero criminal history scores for the subsequent counts; furthermore, the appellant committed the offenses while on probation and violated his conditions of probation. ***State v. Jason Michael Rhoades***, A04-525 (Minn. App. 12/07/04). *www.lawlibrary.state.mn.us/archive/ctappub/0412/opa040525-1207.htm*

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EMPLOYMENT & LABOR LAW

Judicial Law

■ **Employee Liability.** The Minnesota Court of Appeals recently ruled in favor of employees in a pair of cases brought against them by their former employers, claiming they breached their employment-related duties.

In an unpublished decision, the appellate court ruled that a pair of employees who left to form a competing firm were not liable for breach of fiduciary duty, duty of loyalty, duty of confidentiality, or misappropriation of trade secrets, tortious interference with business or civil conspiracy. Reversing a decision of the trial court, the Court of Appeals held that it was no breach of loyalty because the employees did not engage in "direct solicitation" of their former employer's customers, engage in "direct competition" with their employer while still employed, that there was no breach of confidentiality nor improper use of confidential or trade secret information, and there was no evidence that the new business "wrongfully interfered" with the former business. ***Signergy Sign Group, Inc. v. Adam***, 2004 WL 2711312 (Minn. App. 2004)

In the second case, also an unpublished decision, the appellate court upheld dismissal of a lawsuit by a company against a former bookkeeper for breach of fiduciary duty and negligence. The company alleged that the bookkeeper allowed customers to avoid paying bills in order to aid a new employer, which began servicing those customers. The Court of Appeals held that the claim that the employee failed to assure collection from the customers is merely an assertion that she "did her job poorly," which is not actionable by an employer against an employee. ***Bellboy Import Corporation v. Banghart***, 2004 WL 2711052 (Minn. App. 2004) (unpublished).

■ **Employer Lien.** A joint nonprofit labor trust fund for employee fringe benefits may file a mechanics' lien in real estate owned by a defaulting employer. The appellate court held that the trustees of the fund are entitled to seek collection of unpaid contribution by a lien on real property improved by the work of union employees who are beneficiaries of the fund. ***Twin City Pipe Traders Service Assn, Inc. v. Peak Mechanical, Inc.***, 2004 WL 2796039 (Minn. App. 2004).

■ **Civil Service.** The failure of a police Civil Service Commission to independently evaluate evidence and make a decision to terminate a police officer warranted reversal and removal in a recent unpublished decision. The agency was admonished for adopting "verbatim" proposed findings drafted by the Police Department after a two-day evidentiary hearing. The appellate court directed the agency to take a "hard look" at the evidence, and make a more "reflective" decision. ***In re Civil Service Hearing of Decker***, 2004 WL 2793281 (Minn. App. 2004) (unpublished).

Administrative Matters

For the third time within the past year, the National Labor Relations Board ("NLRB") reversed itself on a labor matter by overturning a decision from the Clinton era. The Board, now dominated by appointees of President Bush, ruled that employees who are jointly employed by an employer at a staffing agency cannot be included in the same bargaining unit as the employer's regular employees. In 2000, the Board, then dominated by appointees of President Clinton, ruled that employees provided by a staffing agency, who have similar working conditions with the employer's workers, are deemed to be jointly employed by the employer and may be included in the same bargaining unit as the employer's employees, regardless of the desire of the employer or the staffing agency.

In its new ruling, however, the Board reverted to its pre-2000 position, that these arrangements constitute "multi-employer unions," and are permissible only with the consent of both the employer and the staffing agency. The ruling does not bar employees of staffing agencies from joining labor unions. But they must do so with coemployees of the staffing agency, not with those of the employer where they are working. ***H.S. Care L.L.C.***, 2004 WL 2681621 (2004).

Earlier in 2004, the Board overturned a Clinton-era decision that nonunion employees are entitled to have a coworker present during interviews conducted by the employer that may lead to discipline. (*IBM Corp.* 2004 WL 1335742). The Board also reversed a previous ruling that graduate teaching assistants are considered "employees" entitled to collectively bargain with the university or college where they work. (*Brown University*, 2004 WL 1588744).

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ENVIRONMENTAL LAW

JUDICIAL LAW

■ **CERCLA: SUITS BY VOLUNTARY PARTIES FOR CONTRIBUTION FROM OTHER LIABLE PARTIES**. The United States Supreme Court in December ruled that a private party who has not been sued under CERCLA §§106 or 107(a) may not sue other potentially liable parties for contribution under CERCLA §113(f)(1). The Court's 7-2 decision could affect voluntary cleanup efforts across the country, as it suggests that a party may not seek contribution from others until after the party has been the subject of a CERCLA civil action brought by the government.

Petitioner Cooper Industries, Inc. ("Cooper") owned four aircraft engine maintenance sites in Texas until 1981, when it sold them to Aviall Services, Inc. ("Aviall"). Aviall operated the sites for a number of years before it discovered that it and Cooper Industries had contaminated the soil and ground water on the sites with petroleum and other hazardous substances. Aviall informed the Texas Natural Resource Conservation Commission ("the Commission") of the contamination. The Commission directed Aviall to address the contamination, lest it face an enforcement action. Neither the Commission nor the U.S. Environmental Protection Agency ("EPA"), however, ever took judicial or administrative action to compel Aviall to address the contamination.

Aviall voluntarily cleaned up the sites, under the Commission's supervision, beginning in 1984. It sold the properties to a third party in the mid-1990s, yet it remains contractually responsible for contamination cleanup. To date, Aviall has spent $5 million to clean up the sites, with the possibility that it may incur additional costs if future cleanup becomes necessary.

Aviall filed suit in the U.S. District Court for the Northern District of Texas in August 1997 seeking to recover its cleanup costs from Cooper. Originally, Aviall asserted a claim for cost recovery under CERCLA §107(a), a separate claim for contribution under CERCLA §113(f)(1) and other various state-law claims. It eventually amended its complaint to combine the two CERCLA claims into a single, joint claim. The new claim alleged that Aviall was entitled, pursuant to §113(f)(1), to seek contribution from Cooper, a Potentially Responsible Party ("PRP") under §107(a), for response costs and other liabilities that Aviall incurred.

Both parties eventually moved for summary judgment. The district court granted Cooper's motion because Aviall had abandoned its §107 claim for a §113(f)(1) claim, which, the court held, was unavailable to Aviall because it had not been sued under CERCLA §106 or §107(a). The district court declined to exercise jurisdiction over the state-law claims in light of its dismissal of the CERCLA claim.

A divided 5th Circuit Court of Appeals panel affirmed the district court's dismissal of the federal claim. The majority, in upholding the dismissal, focused on language in the first sentence of §113(f)(1), which states that a person may seek contribution from another party "during or following" a civil action brought under §106 or §107(a). As Aviall had never been the subject of either type of action, the majority reasoned, it could not bring a contribution action under §113(f)(1). On rehearing en banc, however, the 5th Circuit reversed the panel's decision, holding that §113(f)(1) does allow a PRP to obtain contribution form other PRPs even if the former has not been sued under either §§106 or 107. To reach this conclusion, the court relied on the statement in the last sentence of §113(f)(1) that "nothing" in that section shall diminish a party's right to seek contribution. The 5th Circuit concluded that a contribution claim under §113(f)(1) was possible, therefore, even in the absence of a §106 or §107(a) action.

The Supreme Court reversed the 5th Circuit's decision. In doing so, the Supreme Court adopted the reasoning of the district court and the original 5th Circuit panel; namely, that the plain meaning of the first sentence of §113(f)(1) requires that there be a §106 or §107(a) action against a party before it may seek contribution from another party. The Supreme Court rejected Aviall's argument that the phrase "may seek contribution … during or following" a §106 or §107(a) civil action meant that while a party could seek contribution "during or following" either type of action, such circumstances were not the exclusive routes to recovery. The Court noted two problems with Aviall's argument. The first was that the plain meaning of the word "may" suggests an intent to limit contribution actions to only those circumstances specified within the first sentence. The second problem with Aviall's argument was that the phrase "during or following" in the first sentence would be meaningless if a party could bring a contribution claim regardless of whether a §106 or §107(a) action were ever brought.

The Supreme Court rejected the reasoning in the en banc 5th Circuit decision, which found that the last sentence of §113(f)(1) preserved the right to seek contribution, even in the absence of a §106 and §107(a) action against a party. The Court instead read that sentence to indicate merely that nothing within §113(f)(1) shall in any way "diminish" a party's ability to seek contribution under any cause of action independent of §113(f)(1), such as a §113(f)(3)(B) claim following an administrative or judicially approved settlement that resolves liability to the United States or a state. To read that sentence otherwise, the Court reasoned, would again be to render meaningless the "during or following" condition in the first sentence of §113(f)(1).

The Supreme Court left unresolved a number of issues that were raised by Aviall and *amici curiae* in their arguments to the Court but that were not addressed by the lower courts. The first was the argument that even without the ability to bring a §113(f)(1) claim, Aviall may still recover costs under §107(a)(4)(B), despite the fact that it is a PRP itself. Besides the fact that Aviall had not properly raised that issue before the lower courts, the Supreme Court was further disinclined to address this issue because the question remained whether, in light of its amendment to its complaint to "consolidate" its CERCLA claims, Aviall retained any §107 claim in the current action. Furthermore, to address the §107 issue, the Court would have had to address the large body of decisions within the appellate courts that have held that a private party that is itself a PRP may not pursue a §107(a) action against other PRP s for joint and several liability. In light of all this, the Court found it prudent to postpone resolution of that issue to another time, when it could be properly raised and briefed by the involved parties.

The Supreme Court also refused to address the suggestion in certain portions of the 5th Circuit's decision that Aviall might have an implied right of contribution under §107. Although it expressed skepticism that such an argument by Aviall on remand would be successful, it nonetheless declined to resolve that issue in this context.

In the end, the Court remanded the case for further proceedings consistent with its decision. ***Cooper Industries, Inc. v. Aviall Services, Inc.***, 125 S.Ct. 577 (2004).

— BILL HEFNER
Greene Espel

FEDERAL PRACTICE

JUDICIAL LAW

■ **TWO REMOVALS; ONE REMAND.** Judges Kyle and Ericksen reached different conclusions on two recent motions to remand.

In the first case, plaintiffs brought one of a number of actions in the Minnesota courts arising out of a railroad tanker car leak near Minot, North Dakota. The complaint alleged that defendant Canadian Pacific had violated North Dakota and Minnesota law "as well as United States law," and Canadian Pacific seized on this language in removing the action to the District of Minnesota on the basis of federal question jurisdiction. Plaintiffs subsequently moved to remand, arguing that their complaint did not include — nor had they intended that it include — a claim under federal law. However, Judge Kyle found that plaintiffs' reference to "United States law" was "unequivocal" and created federal question jurisdiction under the well-pleaded complaint rule. ***Lundeen v. Canadian Pacific Railway Co.***, 342 F. Supp. 2d 826 (D. Minn. 2004).

In the second case, plaintiffs Hormel HealthLabs and Hormel Foods commenced an action in the Minnesota courts. Defendants removed the action on the basis of diversity jurisdiction, alleging that while both Ventura Foods and Hormel Foods were Delaware corporations, Hormel Foods had been fraudulently joined as a plaintiff. What defendants failed to acknowledge was the Ventura Foods was actually a limited liability company rather than a corporation, and that as an LLC, Ventura's citizenship included the citizenship of each of its members, including a corporation which owned 50.7 percent of Ventura and which maintained its principal place of business in Minnesota. Judge Ericksen granted plaintiffs' motion to remand, and also awarded the plaintiffs their reasonable expenses (including attorney's fees) incurred as a result of the improper removal. ***Hormel HealthLabs, Inc v. Ventura Foods, LLC***, 2004 WL 2526423 (D. Minn. 11/04/04).

■ **OTHER NOTEWORTHY DECISIONS**. The 8th Circuit vacated a *sua sponte* award of sanctions, finding that the district court had failed to provide the plaintiff with notice and an opportunity to be heard on the sanctions issue, and also had erred in failing to identify the specific authority under which the sanctions were imposed. ***Fuqua Homes, Inc. v. Beattie***, 388 F.3d 618 (8th Cir. 2004).

While finding that the defendant was not subject to personal jurisdiction in Minnesota, Judge Frank denied the defendant's motion to dismiss for lack of personal jurisdiction, and instead transferred the action to the District of North Dakota pursuant to 28 U.S.C. §1631, finding that the "interests of justice" warranted the transfer. ***Wieler v. Entrenet Nutritionals, Inc.***, 2004 WL 2988522 (D. Minn. 12/22/04).

Judge Magnuson relied on Fed. R. Civ. P. 56(f) in denying a motion for summary judgment brought just one week after the parties' Rule 26(f) meeting, based on the plaintiff's "detailed affidavit" describing the "specific facts discovery might unveil." ***Modtland v. Mills Fleet Farm, Inc.***, 2004 WL 2730100 (D. Minn. 11/28/04).

Judge Montgomery affirmed an order by Magistrate Judge Erickson denying defendants' motion to disqualify plaintiff's counsel, finding that plaintiff's counsel's prior work for the defendants was not "substantially related" to the current litigation. ***Arctic Cat, Inc. v. Polaris Industries Inc.***, 2004 WL 2944110 (D. Minn. 12/20/04).

Judge Magnuson denied the plaintiff's request for certification for appeal under Fed. R. Civ. P. 54(b), finding that the plaintiff would suffer neither "hardship or injustice" if forced to wait for the conclusion of the case before filing an appeal. ***Transclean Corp. v. Bill Clark Oil Co.***, 2004 WL 2730101 (D. Minn. 11/18/04).

Judge Frank granted the plaintiff's motion to enforce a settlement agreement, finding that the parties had reached agreement on "all of the essential terms" while leaving only "ancillary issues" for further negotiation. ***Heaven & Earth, Inc. v. Wyman Properties L.P.***, 2004 WL 2931347 (D. Minn. 12/14/04).

Where the plaintiff and his counsel failed to preserve the allegedly defective vehicle, Judge Magnuson denied the defendants' motion to dismiss the plaintiff's claims as a spoliation sanction, but did sanction the plaintiff by limiting the theories he could present at trial. ***Lord v. Nissan Motor Co. Ltd.***, 2004 WL 2905323 (D. Minn. 12/13/04).

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INTELLECTUAL PROPERTY

JUDICIAL LAW

■ **PATENTS; PRESUMPTION OF VALIDITY**. Judge Magnuson recently illustrated the presumption of validity a patent enjoys. This presumption requires a challenger to prove a patent invalid by clear and convincing evidence. 3M moved for summary judgment arguing that Barton could not meet its burden that 3M's patent was invalid as obvious. In obviousness determinations, courts require some showing of a motivation or teaching to combine the prior art. Barton argued that it would have been obvious to combine the prior art to create 3M's invention. The court granted 3M's motion, however, concluding that Barton failed to show that issues of fact exist because Barton failed to point to any teaching or motivation to combine the prior art. ***3M Innovative Properties Co. v. Barton Nelson, Inc.***, No. 02-3591, 2004 U.S. Dist. LEXIS 22998 (D. Minn. 10/24/04),

■ **Patents; Obviousness; Multiple References.** In a separate case, the Federal Circuit expanded a different presumption that favors obviousness: "when there is a range disclosed in the prior art, and the claimed invention falls within that range, there is a presumption of obviousness." The court expanded the presumption to include ranges found not only in a single piece of prior art but also found in multiple references. A patentee may rebut this presumption, however, if it can show that the prior art taught away from the claimed invention or that the claimed invention had new and unexpected results. The court found that Iron Grip's claim to a weightlifting-weight plate having three handles invalid as obvious in view of three prior art references showing weight plates having one, two and four handles, respectively. ***Iron Grip Barbell Co. v. USA Sports, Inc.***, No. 04-1149, 2004 U.S. App. LEXIS 25769 (Fed. Cir. 12/14/04).

■ **Trademark; Jewelry; Irreparable Harm.** Judge Frank found plaintiff Connelly's loss of control over her reputation and the good will associated with her trademark for jewelry sufficient to establish irreparable harm in support of a temporary restraining order. In arguing against irreparable harm, respondent ValueVision made four points: (1) that because of a noncompete agreement Connelly would not lose any sales revenue or customers for three months; (2) that the jewelry it sells is of similar quality and that any difference in quality is irrelevant because Connelly is associated with the jewelry ValueVision sells; (3) that money damages would be adequate; and (4) that Connelly's delay of three months in bringing this action demonstrates no irreparable harm. The court disagreed because, among other things, there was evidence of actual confusion, and granted Connelly's motion to temporarily enjoin ValueVision from using the trademarks in connection with selling jewelry. ***Connelly v. ValueVision Media, Inc.***, No. 04-4559, 2004 U.S. Dist. LEXIS 22908 (D. Minn. 11/09/04).

— Tony Zeuli
— Tom Leach
Merchant & Gould

REAL PROPERTY

Judicial Law

■ **Landlord/Tenant.** Tenant began leasing farmland from Landlord in 1988. In 1999, Landlord and Tenant renegotiated the terms of their lease and entered into a new lease that provided Tenant with a right of first refusal to purchase the leased land. The new lease did not specify the manner with which Landlord must notify Tenant of an offer to buy the land and did not indicate the method or time frame in which Tenant must exercise its right of first refusal. Buyer made Landlord an offer to purchase the land. Shortly after Landlord verbally informed Tenant of the offer, Landlord sent Tenant a partially illegible but signed copy of the purchase agreement and later a legible but unsigned copy. Both copies of the purchase agreement revealed the purchase price and the closing date. Tenant did not exercise its right to buy the land; instead, Tenant initiated this lawsuit and recorded a notice of *lis pendens* against the land. Affirming the decision of the Minnesota Court of Appeals, the Minnesota Supreme Court found that Tenant had been properly afforded his right of first refusal, but failed to exercise it. Since the lease failed to specify the nature and sufficiency of notice, the Court concluded that the two copies of the purchase agreement received by Tenant reasonably disclosed all necessary terms of the sale to trigger the right of first refusal. Furthermore, Tenant had an obligation to respond to Landlord within a reasonable period of time. Lastly, Tenant had a duty to seek clarification within a timely manner of any terms that are essential to the sale in order to make an informed decision. ***Dyrdal v. Golden Nuggets, Inc. et al.*** A03-214 (Minn. 12/16/04). *www.lawlibrary.state.mn.us/archive/supct/0412/opa030214-1216.htm*

■ **Foreclosure.** Owner received a construction loan from Bank to build a new hotel. Owner also intended to obtain permanent financing from Bank. The Bank's commitment letter provided that a portion of its loan would come from the United States Small Business Administration ("SBA"). During the underwriting stage, Owner certified that no material, adverse changes had occurred in the status of Owner's business since the date of the loan application that would threaten Owner's ability to pay off the loan. In February 1998, Owner completed construction of its hotel. Thereafter, SBA received financial statements showing that the hotel was operating at a loss. SBA considered this to be a "material adverse change" and declined to proceed with its portion of the loan. For more than two years, Bank extended Owner's deadline to repay the construction loan. Nevertheless, Owner was unable to obtain permanent financing, so Bank brought this foreclosure action. The Minnesota Court of Appeals held that pursuant to the terms of the commitment letter, when SBA denied Owner's application for its portion of the loan, Bank had no duty to provide Owner with permanent financing. Moreover, the Court of Appeals upheld the district court granting summary judgment in favor of Bank, dismissing Owner's counterclaims for defamation, promissory estoppel, breach of contract and breach of the covenant of good faith and fair dealing. ***Minnwest Bank Central v. Flagship Properties LLC et al.*** A04-476 (Minn. App. 12/07/04). *www.lawlibrary.state.mn.us/archive/ctappub/0412/opa040476-1207.htm*

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TAX

Judicial Law

■ **Property Tax: 60-Day Rule Violated.** The Minnesota Tax Court recently dismissed an appeal on grounds that the property taxpayer failed to comply with sufficient business and financial information required under Minn. Stat. §278.05 (6), also known as the "60-day rule." The court rejected the taxpayer's argument that the financial information was unavailable due to his wife's illness and subsequent death. Even though there was a dispute as to whether the taxpayer had knowledge of the location of the information, the court found the financial information was in the taxpayer's possession and available. ***Andrejs Vape v. County of Hennepin***, Nos. 30550 and 30549, 2004 WL 1843008 (Minn. T. Ct. 08/09/04).

■ **PROPERTY TAX: 60-DAY RULE VIOLATED.** In a separate matter, the Minnesota Tax Court dismissed the taxpayer's Notice of Appeal for failure to submit the required financial information within the 60 Day Rule in Minn. Stat. §278.05 (6). Taxpayer had failed to meet its burden of proof in establishing that "the petitioner was not aware of or informed of the requirement to provide the information" not later than 60 days after the petition was filed. ***Stillwater Village Limited Partnership v. County of Washington***, C1-04-2980, 2004 WL 2199537 (Minn. T. Ct. 09/27/04),

■ **PROPERTY TAX: TAXPAYER OPTION TO USE ADMINISTRATIVE APPEAL OR JUDICIAL CONTEST.** The Minnesota Tax Court denied Anoka County's motion to dismiss on the basis of an election of either an administrative or a Chapter 278 appeal or on the basis of Minn. Stat. §278-05 (6) also known as the "60-Day Rule". The county argued that the taxpayer's petition filed under Chapter 278 should be dismissed because it failed to comply with Minn. Stat. §272.025 on the procedure for an administrative appeal to the assessor when claiming an exemption from property taxes under Minn. Stat. §272.025 (1(a)). The Tax Court responded that the failure to use the administrative review process under Chapter 272 did not necessarily mean that the taxpayer could not utilize the judicial petition under Chapter 278. That is, the plain language of the statute allows a taxpayer to file a Chapter 278 petition without first filing under Chapter 272. Moreover, Minn. Stat. §278 (3) provides for exemptions where Chapter 278 cannot be used as a path for appeal, but Chapter 272 is not listed as any one of the exceptions Taxpayer has the election to use an administrative appeal under Chapter 272 or utilize the judicial challenge under Chapter 278. The Tax Court deferred on the county's motion to dismiss under the 60-Day Rule since the size of the property at issue and whether it is tax-exempt will be determined at trial. ***Allina Medical Clinics v. County of Anoka***, C2-02-2904 and C9-03-4191, 2004 WL 2436069 (Minn. T. Ct. 10/14/04).

■ **REAL PROPERTY: MULTIPLE PROPERTIES IN PETITIONS REQUIRE DISMISSAL.** The Minnesota Tax Court dismissed a property tax petition for properties in multiple cities and towns for failure to file separate petitions for each property. The single filing failed to comply with Minn. Stat. §278.02, which requires separate petitions for all noncontiguous property located in different cities. The court held that the statute was not vague on the definition of "city" and "town" and barred any legislative history since the statute was plain on its face and was not ambiguous. Furthermore, although the court found Minn. Stat. §278.02 was a directory provision, which could excuse technical noncompliance, it found the county prejudiced by the filing and therefore, did not excuse the noncompliance. ***American Crystal Sugar v. County of Polk***, C5-03-1769, CX-03-617, and C3-04-596, (Minn. T. Ct. 12/02/04),

■ **HUSBAND LIABLE FOR BUSINESS TAXES PURSUANT TO DIVORCE DECREE.** Affirming the district court, the Minnesota Court of Appeals held the husband liable for business taxes pursuant to a decree of marriage dissolution. The marriage termination agreement, which was incorporated into the court's order, made the husband responsible for preparing the business's 1996 state and federal income tax returns. A subsequent IRS and Minnesota state audit adjusted the returns for 1996 and found the wife was liable. The wife petitioned the court for enforcement of the decree, and the court specifically found the wife's tax arrearages arose out of the husband's operation of the business and the resulting tax consequences. The wife received no income from the business and had no involvement in operating the business or the preparation of tax returns. In light of the tax arrearages being incurred by the husband's preparation of the 1996 tax returns, the debt was properly the husband's and — consistent with the judgment and decree — must be borne by husband. Consequently, the district court opinion was affirmed. ***Re: Judith K. Miller, n/k/a Judith K. Nolte, v. Robert H. Miller***, A04 892, 2004 WL 2796401 (Minn. App. 12/07/04),

■ **PROPERTY TAX: QUALIFICATION FOR PUBLIC CHARITY EXEMPTION.** The Minnesota Tax Court held that properties of the Institute for Agricultural and Trade Policy, as an "institution of purely public charity," were exempt under Minn. Stat. §272.02(1(6)) but that the Institute's use of the properties required *pro rata* exemption from real property taxes for the tax years payable in 2001 and 2002. The court applied the six factor test set forth in *Northstar Research Inst. v. County of Hennepin*, 236 N.W.2d 754, 757 (Minn. 1975). The Institute met the first factor since its research and reports on issues related to trade and agricultural policy promoted resilient family farms, communities, and ecosystems and were therefore helpful to others without immediate expectation of reward. The court found that the Institute was supported by donations and the Institute's work was available to the public. Nor did the Institute require recipients to pay for its research. Lastly, the court found that the Institute's beneficiaries were not restricted and that it did lessen the burdens of government by protecting the environment, public health and rural communities, and representing the United States in the World Trade Organization. ***Institute for Agricultural and Trade Policy v. County of Hennepin***, Nos. 29612, 30562, 2004 WL 3021371 (Minn. T. Ct. 12/15/04),

■ **PROPERTY TAX: QUALIFICATION FOR PUBLIC CHARITY HOSPITAL EXEMPTION.** In a Cottonwood County dispute, the Minnesota Tax Court held that a clinic owned by Westbrook Health Center was tax exempt as a public hospital but that another subject property did not qualify for tax exempt status under Minn. Stat. §272.02(1)(b) as a "purely public charity". The clinic was open to the public, operated without private profit, was devoted to what a public hospital does, and was reasonably necessary for the accomplishment of the purposes of the hospital seeking the property tax exemption. However, a congregate care facility was taxable since it did not provide senior citizens with services or rents free of charge or at considerably reduced rates. Moreover, the health care facility failed to carry its burden of proof that the beneficiaries of the nursing home were unrestricted. ***Westbrook Health Center v. County of Cottonwood***, CX-03-128, (Minn. T. Ct. 12/14/04),

■ **BUY-SELL AGREEMENTS DIDN'T DETERMINE TRANSFER TAX VALUE OF FAMILY BUSINESS INTERESTS.** The 10th Circuit held that the estate and gift tax value of interests in six different businesses transferred to family members under buy-sell agreements was not controlled by formula price in the agreements. The agreements served as testamentary substitutes. These agreements were entered long ago and were not subject to IRC Code section 2703, which applies to agreements created or substantially modified after October 8, 1990. Rather, the agreements at issue were subject to Reg. §20.2031-2(h) and case law, as discussed below. ***True v. Commissioner***, 390 F.3d 1210, 94 AFTR 2d 2004-7039 (10th Cir. 12/02/04).

■ **DISCOVERY: EXECUTIVE PRIVILEGE; DELIBERATIVE PROCESS: AUTHORITY TO INVOKE PRIVILEGE.** IRS granted motion to amend and certify for interlocutory appeal prior order that granted in part taxpayers' motion to compel IRS to produce allegedly privileged documents.

Although purely procedural in nature, underlying question as to invocability of deliberative process privilege by subordinate IRS employee was question that could materially affect remaining issues, was subject to differing opinions among circuits, and could by its resolution on appeal ultimately advance case's termination. ***Marriott International Resorts, L.P., et al. v. U.S.***, 94 AFTR 2d ¶ 2004-5524 (Ct. Fed. Cl 2004).

■ **CORPORATE INCOME, FRANCHISE TAXES; DEBT COLLECTION ACTIONS; NEXUS.** Delaware-domiciled bank that issued and serviced credit cards throughout the United States was entitled to West Virginia corporate net income tax and business franchise tax refunds because it lacked substantial nexus with the state. Although the West Virginia statutes may have provided authority to tax the bank consistent with the minimum contacts requirements of the Due Process Clause, *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) and other relevant precedents of the U.S. Supreme Court established the standard that under the Commerce Clause, the bank was not subject to West Virginia tax unless the bank's activity has a "substantial" nexus with the state. Nexus required a finding of a physical presence in West Virginia, not merely an economic exploitation of the market. The physical presence must be more than a "slightest presence"; it must have made possible the realization and continuance of valuable contractual relations between the taxpayer and the taxing state. While a sufficient level of debt-collection work by in-state lawyers, or a sufficient level of use of the West Virginia courts on behalf of a taxpayer may constitute substantial nexus, the bank's collections activities under the facts in this case were not sufficient to meet this requirement. ***MBNA America Bank, N.A. v. State Tax Commissioner***, Nos. 03-185 RN, 03-186 RFN, 04-074 RFN, 04-0975 RN (W. Virg. Office of T. App. 10/22/04).

■ **PARTIAL TERMINATION OF PENSION PLAN.** The 7th Circuit adopted a 20 percent rule as the correct approach to decide whether a partial termination had occurred for a deferred contribution plan. The court generalized a rebuttable presumption that a 20 percent or greater reduction in plan participants is a partial termination. Answering its own question of "how rebuttable?" the Court said "there is a band around 20 percent in which consideration of tax motives … can be used to rebut the presumption …. A generous band would run from 10 percent to 40 percent. Below 10 percent, the reduction in coverage should be conclusively presumed not to be a partial termination; above 40 percent, it should be conclusively presumed to be a partial termination." ***Matz v. Houshold International Tax Reduction Investment Plan***, 2004 WL 2483101 (7th Circuit 2004).

■ **BANK PROPERLY REQUIRED TO INCLUDE INTANGIBLE ASSETS IN APPORTIONMENT FORMULA.** The Oregon Department of Revenue did not err in requiring taxpayer to depart from the standard three-factor apportionment formula for financial organizations and to include its intangible personal property in that formula on the ground that the standard formula failed to provide an accurate reflection of taxpayer's net income from business done within Oregon. Normally, the standard formula only incorporates tangible personal property and not intangibles. ***U.S. Bancorp v. Oregon Department of Revenue***, No. S51013 (Or. 12/16/04).

■ **RELEASE OF MEMORANDUM ON TAX SHELTERS WAIVED PRIVILEGE CLAIM.** Accounting firm partner who shared memorandum relating to tax shelters, originally addressed to firm's outside counsel and members of firm's tax solutions opinions committee, with third-party law firm that advised clients common to accounting firm waived attorney-client privilege with respect to such memorandum. Without deciding whether the memorandum was a privileged attorney-client communications, the Court concluded that BDO Seidman intentionally disclosed the memorandum to a third party and that the disclosure waived whatever privilege might once have attached to the memorandum. ***Denney v. Jenkens & Gilchrist***, No. 03 Civ. 5460 (SAS) (S.D.N.Y. 11/23/04). *See also Miron v. BDO Seidman LLP*, No. 04-CV-968 (E.D. Pa. 10/19/04) (August, 2000 memorandum from limited liability partnership's outside counsel in connection with confidential issues regarding potential litigation and tax liability is protected by attorney-client privilege).

■ **BAR ON DEDUCTION FOR ACCRUED INTEREST.** Accrued but unpaid interest owed by an accrual basis corporation to its cash basis sole shareholder for years prior to the year in which the sole shareholder assigned the note to an unrelated third party is no longer deductible by the corporation, even though the interest attributable to the year of assignment is deductible. The restriction on deduction of interest owed between related persons in IRC Code 267(a)(2) applies on a year-by-year basis. ***Ronald Moran Cadillac Inc. v. United States***, No. 02-57052, 94 AFTR 2d ¶ 2004 - 6291 (9th Cir. 2004).

■ **EMPLOYMENT TAX; PAYROLL SERVICE FIRM, AGGREGATION OF WAGES PAID BY CLIENTS.** Production companies that develop, produce, and distribute motion pictures, television programs, and commercials, rather than the firms that provide payroll services to them, are considered the employers of production worker employees for purposes of calculating FICA contribution and benefit base and FUTA wage base. Thus payroll service firms may not aggregate wages paid to each employee by the several production companies for which such employee performs services during the year. Court upheld a long-standing uniform administrative practice of interpreting the withholding opinions and the fact that Congress repeatedly reenacted the employment law opinions without substantial change. ***Cencast Services LP v. United States***, No. 02-1916 T, 94 AFTR 2d 2004-6165 (Ct. Fed. Cl. 2004).

■ **"FIRM AND FIXED PLAN" TEST; INTEGRATING TRANSACTIONS AS REDEMPTION.** "Firm and fixed plan" test is the appropriate method for determining whether two transactions conducted at different times may be integrated to constitute a redemption of stock in complete termination of a shareholder's interest under IRC Code section 302(b)(3). Tax Court did not err in applying that test and concluding that such a firm and fixed plan existed in connection with cross-chain stock sales between brother-sister corporations in the Merrill Lynch consolidated group and the later sale of the cross-chain seller outside the group. ***Merrill Lynch & Co. v. Commissioner***, No. 03-40676-AG, 94 AFTR 2d 2004-6119 (2nd Cir. 2004).

■ **IRAS: EXEMPT FROM BANKRUPTCY ESTATE?** The U.S. Supreme Court heard oral argument on the question of whether and to what extent individual retirement accounts are exempt from a bankruptcy estate under Bankruptcy Code section 522(d)(10)(E). The debtors had sought review of an 8th Circuit decision that two IRAs held by a married couple were not exempt from their bankruptcy estate where the couple had the unfettered ability to withdraw funds from the IRAs. ***Rousey v. Jacoway***, 96 AFTR 2d 2002-6467 (8th Cir. 2002); U.S. No. 03-1407, oral argument (U.S. S. Ct. 12/01/04).

■ **FAILURE TO FILE EMPLOYMENT RETURNS, PAY TAXES: NO "REASONABLE CAUSE."** Company that continued to pay other creditors and gave salary increases to its officers fails to carry burden of showing reasonable cause for nonpayment of employment taxes. The majority of circuit courts recognize that financial hardship may constitute "reasonable cause" for abatement of penalties for nonpayment of taxes in some circumstances but those circumstances are not present here. ***Diamond Plating Co. v. U.S.***, No. 04-2199, 94 AFTR 2d 2004-7100 (7th Cir. 2004).
■ **STOCK OPTIONS NOT ERISA PLAN.** A company's stock option plans, whose stated purpose was to attract and retain key employees, were not ERISA pension benefit plans because any retirement advantages provided by the plans were deemed incidental. Thus, an executive's ERISA claims for additional benefits under the plans were properly dismissed, even though the executive was funding his retirement with a sale of company stock awarded under the plans. ***Peter Houston v. Aramark Corp***. 2004 WL 2203981 (3rd Cir. 2004).
■ **TELEPHONE TAX: EXCISE TAX.** Ordering refund of communications excise taxes, the court concluded that long-distance voice service wasn't taxable as "toll telephone service" under IRC Code section 4252(b)(1) because the charges were based on the duration of the calls and not the distance traveled. ***Reese Brothers Inc. v. United States***, No. 03-745, 94 AFTR 2d ¶ 2004-5590 (W.D. Pa. 2004). In ***Am. Bankers Ins. Group v. United States***, 308 F. Supp.2d 1360 (S.D. Fla. 2004), the U.S. District Court for the Southern District of Florida found that long-distance services were taxable, even though the charges were based on time and not distance. The U.S. District Court for the Northern District of Ohio reached the opposite conclusion in ***OfficeMax Inc. v. United States***, 309 F. Supp.2d 984 (N.D. Ohio 2004), expressly rejecting the reasoning in *American Bankers*. In August 2004, the IRS issued Notice 2004-57, advising that IRS would continue to assess and collect the communications excise tax, notwithstanding the conflicting decisions in *American Bankers* and *OfficeMax*.
■ **SUPREME COURT DOCKET: TAXATION OF ATTORNEYS' FEES, SPECIAL TRIAL JUDGES.** The U.S. Supreme Court opened its 2004-2005 term and agreed to address two tax issues: one on the appropriate treatment of contingent fees paid by taxpayers to their attorneys and the other the constitutionality of a Tax Court procedural rule regarding the use of special trial judgments. In the first set of cases, the Court, stepping in to resolve an issue that has divided the circuits for years, will decide whether the contingent fee portion of a legal settlement or litigation proceeds, which is payable to a taxpayer's attorney, is includable in the taxpayer's gross income. ***Commissioner v. Banks***, U.S., No. 03-892, *cert. granted* (03/29/04); ***Commissioner v. Banaitis***, U.S., No. 03-907, *cert. granted* (03/29/04). In the second set of cases, the Court will decide whether the findings of special trial judges of the U.S. Tax Court must be made available to the litigating parties. ***Estate of Kanter v. Commissioner***, U.S., No. 03-1034, *cert. granted* (04/26/04); ***Ballard v. Commissioner***, U.S., No. 03-184, *cert. granted* (04/26/04).
■ **ESTATE TAX VALUATION OF RETIREMENT FUNDS; DISCOUNT.** Valuation of retirement accounts in decedent's estate for estate tax purposes is not subject to discount reflecting federal income tax liability that will be triggered when distributions are made from those accounts to beneficiaries. The potential federal income tax liability that beneficiaries of a decedent's retirement accounts will face is not a factor in determining the value of those accounts for estate tax purposes. The IRS had previously ruled in TAM 200247001, that the income tax reduction of IRC Code section 691(c) "operates in lieu of an estate tax reduction in the form of a valuation discount" when valuing assets in an estate that will generate income tax when paid to the estate or beneficiaries. That reduction is for the estate tax attributable to the inclusion of an item that will be "income in respect of a decedent" in the estate of the decedent. ***Smith v. United States***, 94 AFTR 2d ¶ 2004-5501 (5th Cir. 2004).
■ **PARTNERSHIP REALIZED INCOME ON PARTNER'S PAYMENT OF LOAN.** Real estate partnership realized ordinary income that was not a tax-free capital contribution when one of its partners, as part of an agreement to abandon its involvement in the partnership and in the real estate project, paid the balance of a construction loan owed by the partnership to a bank. ***Mas One Limited Partnership v. United States***, 94 AFTR 2d 2004-6952 (6th Cir. 2004).
■ **LESSOR'S PARTNERSHIP WITH FOREIGN BANKS NOT SHAM TRANSACTION.** Partnership formed by commercial aircraft lessor with foreign banks as a way to securitize its assets amidst problems in the airline industry, pursuant to an agreement that allocated 98 percent of the income from fully tax-depreciated aircraft to the banks, thereby enabling aircraft lessor to avoid enormous tax burden while shifting very little book income, was not a sham transaction, and did not justify reallocation of taxable income. ***TIFD III-E Inc. v. United States***, No. 3:01 CV 1938 (SRU), 94 AFTR 2d 2004-6635 (D. Conn. 2004).

ADMINISTRATIVE MATTERS

■ **SALES TAX: EXEMPTION FOR ADVERTISING MATERIALS.** In Minnesota Department of Revenue Notice 04-09 (October 4, 2004), the commissioner clarified the term "advertising materials" under Minn. Stat. §297A.68(11). This provision exempts gross receipts received from the sale or use of advertising materials if the materials are mailed or transferred to a person outside Minnesota for use outside the state. According to the commissioner, the terms "mailing and reply envelopes and cards" used in that provision include shipping materials or mailing devices when they are used exclusively to mail or ship advertising materials, boxes, labels which are part of the envelope, styrofoam, containers or bandings. The commissioner's position is that items that have a primary purpose other than advertising are not materials designed to advertise and to promote the sale of merchandise or services even if those items also incorporate an advertising content. For example, non-advertising materials include items used to fulfill a legal obligation such as purchased or ordered goods, rebate checks, and materials sent to transmit non-advertising information, *e.g.*, billing statements or invoices.
■ **MODIFICATION OF DOR REVENUE NOTICES.** Recently, a number of Revenue Notices have been modified and some have been revoked, as follows:

- Revenue Notice #02-13: Sales and Use Tax — Game Farms, Shooting Preserves and Hunting Clubs — Game Release Charges (modified 09/07/04).
- Revenue Notice #96-10: Sales and Use Tax — Capital Equipment — Lease Renewal or Buyout (modified 09/20/04).

■ Revenue Notice #96-13: Sales and Use Tax — Capital Equipment — Used by Purchaser (modified 09/20/04).

■ Revenue Notice #96-14: Sales and Use Tax — Capital Equipment — Research, Development and Design; Revocation of Revenue Notice #96-09 (modification and revocation dated 09/20/04).

■ Revenue Notice #96-15: Sales and Use Tax — Capital Equipment — What Activities Qualify; Revocation of Revenue Notice #96-11 (modification and revocation dated 09/20/04).

■ Revenue Notice #97-04: Sales and Use Tax — Special Purpose Buildings (modified 09/20/04).

■ Revenue Notice #97-05 Sales and Use Tax — Integrated Production Process for Tangible Personal Property (modified 09/20/04).

■ **Sales and Use Tax: Isolated or Occasional Sales**. The Minnesota Department of Revenue modified Revenue Notice 1991-06, relating to isolated or occasional sales. The modified notice states that generally, sales of tangible personal property primarily used in a trade or business do not qualify for the isolated or occasional sales tax exemption under Minn. Stat. §297A.68, Subd. 25. Minnesota Revenue Notice 1991-06, 12/20/04.

■ **Application Form For Charitable Organizations.** The IRS released a revised application form for charitable organizations seeking tax-exempt status. The new form streamlines the application process and helps the IRS spot potentially abusive charities. The revised Form 1023, Application for Exemption Under Section 501(c)(3) of the Internal Revenue Code, is available online at *www.irs.gov/newsroom/article/0,,id=130666,00.html* or by calling the IRS toll-free at (800) 829-3676. IR-2004-133, 11/01/04.

■ **Section 403(b) and 457 Retirement Plans.** The IRS issued new Publication 4406, "403(b) and 457 Retirement Plans (with Plan Feature Comparison Chart)." The publication outlines the key features of IRC §403(b) and IRC §457 plans while comparing them to IRC §401(k) plans. The publication is available online at *http://www.irs.gov* by clicking on "EP Forms & Publications" under the "Related Topics" section. The publication is also available in hardcopy by calling 800-TAX-FORM.

■ **Schedule M-3.** The IRS released the final draft of Schedule M-3 "Net Income (Loss) Reconciliation for Corporations with Total Assets of $10 Million or More", which will be filed with Form 1120, "U.S. Corporation Income Tax Return," by companies with total assets of $10 million or more. Schedule M-3 requires corporations to disclose more information than does the current Schedule M-1. A principal goal of the new form is to increase the transparency of significant book-tax differences. Schedule M-3 is effective for tax years ending after December 30, 2004. However, the completion of columns A (income or loss per income statement) and D (income or loss per tax return) of parts II and III is optional for the first year in which a corporation is required to file Schedule M-3.

■ **Using Per Diems to Substantiate Employees' Travel Expenses.** The IRS updated its rules for determining per diem rates that businesses may use to reimburse employee expenses for business travel. The revenue procedure provides rules under which the amount of ordinary and necessary business expenses of an employee for lodging, meals, and incidental expenses or for meals and incidental expenses incurred while traveling away from home will be deemed substantiated under Section 1.274-5 of the Treasury Regulations when an employer, its agent, or a third party provides a per diem allowance under a reimbursement or other expense allowance arrangement. Revenue Procedure 2004-60 (10/01/04).

■ **Social Security 2005 Wage Base Rising To $90,000.** Social Security tax rates on wages will remain the same in 2005, while workers' Social Security taxable wages maximum will increase 2.4 percent to $90,000. Social Security tax rates for employees and self-employed taxpayers — 6.2 percent and 12.4 percent, respectively — will not change in 2005. The Medicare tax rate will also remain unchanged at 1.45 percent in 2005. The resulting total Federal Insurance Contributions Act tax rate for 2005 is thus 7.65 percent for employees. Social Security Administration News Release 10/19/04.

■ **Payments for Signing or Canceling Employment Contracts.** In an about face, IRS issued two revenue rulings that treat payments by employers to employees in connection with employment contracts as wages for purposes of FICA, FUTA, and federal income tax withholding:

1. Rev Rul 2004-109 — concludes that employment taxes must be paid — and income taxes withheld — on bonuses paid for signing an employment contract.
2. Rev Rul 2004-110 — concludes that, if an employment contract is canceled before its agreed-upon end, a payment made in lieu of the remaining period of employment is treated as wages for purposes of employment taxes and income tax withholding.

Because these new rulings revoke or modify prior ones, they won't apply to qualifying payments made before Jan. 12, 2005, as explained below. Rev Rul 2004-109, 2004-50 IRB, Rev Rul 2004-110, 2004-50 IRB.

■ **Standard Mileage Rate Increases.** The IRS announced that the optional mileage allowance for owned or leased autos (including vans, pickups or panel trucks) is 40.5¢ for business travel after 2004. That's 3¢ more than the 37.5¢ allowance for 2004 business travel. This largest-ever year-to-year mileage-rate increase is due to higher prices for vehicles and fuel. Revenue Procedure 2004-64, 2004-49 IRB; IR 2004-139.

■ **Disclosure Requirements for Reportable Transactions and Material Advisers.** The IRS issued interim guidance addressing changes made by the newly enacted American Jobs Creation Act of 2004 (P.L. 108-357) to disclosure requirements for reportable transactions by taxpayers and material advisers. The new rules imposed by the Jobs Act require material advisers to file returns disclosing reportable transactions and to maintain investor lists. The new rules also impose monetary penalties on material advisers who fail to provide an investor list within 20 business days after the date of a written request by Treasury. The new penalty amount is $10,000 per day after the 20th day that the material adviser fails to provide lists as required by IRC Code §6112(a). IRC Code §6708(a)(2) provides an exception to the penalties for "reasonable cause." In Notice 2004-80, 2004-50 IRB 1, material advisers must comply with the new reporting and list maintenance requirements under IRC Code §§6111 and 6112. According to the interim guidance, practitioners should look to

regulation section 1.6011-4(b) for the definition of reportable transaction and to regulation section 301-6112-1(c)(2) for the definition of material adviser. Notice 2004-80 is effective for transactions that received material aid, assistance, or advice after 10/22/04.

■ **FINAL CIRCULAR 230 REGULATIONS.** The IRS issued final regulations changing its rules of practice found in Treasury Department Circular 230. The changes are aimed at setting high standards for tax advisers and firms that provide tax opinions and opinions supporting tax-shelter-type transactions. The final regulations are effective 180 days after they are published in the Federal Register. Circular 230 applies to all tax practitioners who practice before the Internal Revenue Service. The IRS also issued separate proposed changes to Circular 230 relating to standards for state or local bond opinions. IR 2004-152; T.D. 9165. 12/17/04; Reg. §10.33, Reg. §10.35, Reg. §10.36, Reg. §10.37, Reg. §10.38, Reg. §10.52; Preamble to Prop Reg 12/17/04; Prop Reg §10.35, Prop Reg §10.36, Prop Reg §10.38, Prop Reg §10.39.

■ **ASSOCIATION WEB POSTINGS; UBIT.** Fees derived from Internet postings by a trade association that feature visual displays, product descriptions, and order forms in conjunction with a convention or trade show do not qualify as unrelated business income and therefore do not trigger unrelated business income tax ("UBIT"). Revenue Ruling 2004-112.

■ **EXCHANGES QUALIFY UNDER SECTION 1031 DESPITE RELATED PARTY PARTICIPATION.** The IRS issued a private letter ruling that determines that the IRC Code §1031(f) bar to nonrecognition under IRC Code §1031(a) for a like-kind exchange by related parties does not apply to real property exchanges by related partnerships by means of a qualified intermediary. The IRS noted that each partnership's exchange of real property does not involve a "cashing out" of its investment in real estate, since it will receive real property in replacement for the real property it surrenders. IRS P.L.R. 200 44002.

■ **PREFILING AGREEMENT PROGRAM EXPANDED.** IRS expanded the prefiling agreement (PFA) program to cover future years. As a result, Large and Mid-Size Business (LMSB) division taxpayers seeking to resolve certain tax issues before filing their tax returns may now do so for multiple years including a limited number of future tax years. IR 2004-156; Revenue Procedure 2005-12, 2005-3 IRB.

■ **FARMLAND PARTNERSHIP INTERESTS DISCOUNTED BEFORE ARRIVING AT SPECIAL USE VALUE.** IRS privately ruled that an estate properly valued the decedent's partnership interests in farmland by applying lack of marketability and minority interest discounts and then reducing the value so determined by $770,000 to arrive at the special use value under IRC Code §2032A. The ruling also concluded that this method was properly applied for funding a generation-skipping transfer tax trust established by the decedent's will. IRS P.L.R. 200 448006.

LEGISLATION

■ **REINSTATEMENT OF INTERNET MORATORIUM TAXATION.** The Internet Tax Nondiscrimination Act was signed into law. It ended a year-long struggle to extend the expired Internet Tax Freedom Act ("ITFA") of 1998.

Specifically, the legislation does the following:

■ prohibits, beginning November 1, 2003, and ending November 1, 2007, state and local taxes on Internet access, and multiple or discriminatory state and local taxes on electronic commerce (this provision reinstates retroactively the ITFA moratorium originally enacted in 1998);

■ extends until November 1, 2007, the original ITFA grandfather clause that permits Internet access taxes that were generally imposed and actually enforced prior to October 1, 1998 (however, the grandfather for the Wisconsin telecommunication service tax is extended only until November 1, 2006);

■ expands the definition of exempt Internet access to include telecommunications services "to the extent such services are purchased, used, or sold by a provider of Internet access to provide Internet access" (this provision narrows the moratorium exception for taxes on telecommunications services that had been used by some states to tax digital subscriber line (DSL) service, and it presumably exempts telecommunications services used by Internet service providers over the so-called Internet backbone (*i.e.* the "middle mile" of access) and high-speed wireless, as well as DSL).

■ enacts a new grandfather clause to permit, until November 1, 2005, other Internet access taxes that were generally imposed and actually enforced as of November 1, 2003 (this provision permits, for instance, states and localities that have been taxing DSL service to continue to do so for another two years, despite the narrowed exception for taxes on telecommunications services);

■ provides that taxation of charges for voice or similar service using Voice Over Internet Protocol ("VOIP") are unaffected (this exception for taxation of VOIP services specifically does not apply to services incidental to Internet access, such as voice-capable email or instant messaging);

■ amends the ITFA definition of "tax on Internet access" to state specifically that it applies regardless of whether a tax is imposed on a provider of Internet access or a buyer of Internet access, and regardless of the terminology used (the definition, however, would specifically exclude taxes on, or measured by, net income, capital stock, net worth, or property value); and

■ allows the taxation of otherwise exempt Internet access service that is bundled with taxable services, unless the internet access provider can reasonably identify the charges for Internet access from its books and records kept in the regular course of business;

■ **WORKING FAMILIES TAX RELIEF ACT OF 2004.** The Working Families Tax Relief Act, was signed by the president in 2004 and is now effective. The act extends a number of federal tax measures that were set to expire. Specifically:

■ Child tax credit will continue to be $1,000 through 2010.

■ Married filing joint lower tax brackets and standard deduction will continue to be twice that of single taxpayers.

■ AMT exemption levels will remain elevated for 2005.

■ **AMERICAN JOBS CREATION ACT OF 2004**. The American Jobs Creation Act of 2004 was enacted in October and is now effective. Specifically:

1. Repeals Export Subsidies and the Exclusion for Extraterritorial Income. The driving force behind the recently enacted American Jobs Creation Act of 2004 was the need to repeal the export subsidies that had been found to be in violation of World Trade Organization agreements. The violations had provoked the European Union to impose tariffs on U.S. companies. However, the act goes far beyond simply repealing the export subsidies, and instead ushers in a large variety of tax incentives and revenue offsets that apply to a wide range of taxpayers.

2. Deduction for U.S. Production Activities. Beginning in 2005, taxpayers will receive a deduction for taxable income attributable to domestic production activities. There are certain specific industry nuances, but essentially, any taxpayer that engages in the production of tangible property within the U.S. will receive a deduction. The deduction amount will be a certain percentage of the taxpayer's net income from that production. The percentage is initially set at 3 percent for 2005-2006, increases to 6 percent from 2007-2009, and then is set at 9 percent after 2009. The deduction is also limited to 50 percent of the employer's W-2 wages paid for the tax year.

3. Extension of $100,000 Section 179 Expensing Through 2007. The act also extends the expensing provision (§179) which allows businesses to expense up to $100,000 of assets instead of depreciating them over several years. This limit was scheduled to drop to $25,000 in 2006, but has now been extended two more years through 2007.

4. Deduction of State and Local General Sales Taxes. In a move that will primarily benefit individuals in states with sales taxes but with no or limited individual income taxes, taxpayers who itemize will be able to deduct on their federal tax returns for 2004 and 2005 either what they pay in state and local income taxes or what they pay in sales taxes, Previously, only state and local income tax payments were deductible. Taxpayers who itemize may deduct their actual sales taxes or use IRS-published tables.

5. Crackdown on SUV Expensing. Prior to this act, certain business owners with new business vehicles were allowed to expense as much as $100,000 of the purchase price of heavy (over 6,000 pounds) vehicles using the §179 expensing previously outlined. The act has narrowed the so-called "SUV loophole" by rolling back the expense deduction to $25,000 for most purchases. And, unlike many tax changes which take effect at some time in the future, this change became effective when the bill was signed on October 22, 2004. Nonetheless, heavy SUV s will remain eligible for unrestricted first-year depreciation and bonus depreciation on top of the $25,000 that is allowed to be expensed. However, because bonus depreciation will not be available after 2004, the results are less favorable for purchases in 2005.

6. Charitable Deduction Restrictions on Donating Autos to Charity. The act also toughens the rules for charitable donations of autos made after 2004. Beginning in 2005, the act will link the deduction to the charity's use of the auto. Specifically, if the charity sells the vehicle without any "significant intervening use" or "material improvement" (*e.g.* major repairs), the donor's charitable deduction can't exceed the gross proceeds from the charity's sale.

7. Tax Shelters. The law gives the IRS some new weapons for its ongoing campaign to restrict tax shelters.

8. Private Tax Collectors. The act also gives the IRS another weapon against individuals who default on their taxes by allowing it to enter into "qualified tax collection contracts" with private parties.

9. Attorney Fees. Incorporated into the tax bill is the Civil Rights Tax Relief Act. It relieves plaintiffs who settle or win court awards under an array of federal and state civil rights statutes from having to pay taxes on the attorney fee portion of their awards. Actions covered by the provision include cases alleging discrimination on the basis of race, sex or age. The provision also applies to actions for housing discrimination, wage-and-hour issues, ERISA benefits and whistleblower laws. The new provision applies to fees and costs paid after the date of enactment with respect to any judgment or settlement occurring after such date.

LOOKING AHEAD

■ **TAX LEGISLATION: FEDERAL AND MINNESOTA**. The 2005 legislative sessions in Congress and in Minnesota promise to be long, controversial, and confrontational.

At the federal level, Congress will be debating:

■ **Federal tax reform**;
■ **Social Security reform**;
■ **Deficit reduction and balanced budgets**;

The State Legislature will be faced with:

■ **Conformity: Minnesota Income Tax**. The Minnesota Department of Revenue has reminded corporate and personal income taxpayers that Minnesota has not yet adopted changes enacted by recent federal legislation, such as the Working Families Tax Relief Act of 2004 (P.L. 108-311) and the American Jobs Creation Act of 2004 (P.L. 108-357). Therefore, adjustments must be made to determine Minnesota corporate and personal income tax due for 2004. *Income Tax News Letter*, Minnesota Department of Revenue, 12/01/04.

■ **Funding for Roads**. With the state's transportation infrastructure deteriorating, there are proposals for a 10¢ per gallon gasoline tax increase.

■ **Budget Deficit**. With a $450 million or $1.1 billion budget shortfall in revenues, depending on whether inflation is counted, how will the state balance the budget — spending cuts or tax increases or a combination?

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TORTS & INSURANCE

JUDICIAL LAW

■ **ARBITRATION — ADVERSARIAL HEARINGS.** Former husband and wife agreed to enter into binding arbitration to resolve two issues that were not determined by the judgment of dissolution. The arbitrator did not conduct an adversarial hearing but instead met separately with each of the former spouses. Neither party waived his or her right to an adversarial hearing on the issues. After the arbitrator issued an award that held that neither party was entitled to any relief, the former wife moved the district court to vacate the award on the ground that the arbitrator failed to conduct an adversarial hearing. The district court denied the motion.

The Court of Appeals reversed the district court and vacated the award. The court stated that Minnesota statutes require arbitrators to conduct adversarial hearings to allow parties to be heard, present evidence, and cross-examine witnesses. The court noted that parties may waive their right to a hearing but held that because neither party effected a waiver of that right, the arbitrator's failure to conduct a hearing was a valid ground for vacating the award. ***Volkmann v. Volkmann***, A04-1085 (Minn. App. 11/09/04).
www.lawlibrary.state.mn.us/archive/ctappub/0411/opa041085-1109.htm

■ **ARBITRATION — APPEALABILITY OF DISCOVERY/INTERLOCUTORY ORDERS.** Plaintiff was injured in an automobile accident. Plaintiff failed to attend any of five scheduled independent medical examinations (IMES). The defendant insurance company sought dismissal of the claim from no-fault arbitration. Instead of granting defendant's petition to dismiss, the arbitrator took evidence regarding plaintiff's failure to attend the previously scheduled IMES and ordered plaintiff to attend the next IME. The defendant insurance company appealed the arbitrator's order to the district court arguing that the arbitrator had exceeded his powers. The district court vacated the arbitrator's order, dismissed plaintiff's claim, and ordered plaintiff to pay defendant's costs. Plaintiff appealed.

The Court of Appeals vacated the district court ruling, holding that the arbitrator's order was an interlocutory order involving discovery rather than an "award." A party can only seek relief from an arbitrator's ruling when it is a final judgment or decision. Thus, a party cannot obtain judicial review of an arbitration order regarding discovery because it is not an "award" under Minnesota Statute §572.19. ***State Farm Mut. Auto. Ins. Co. v. Ahmed***, A04-310 (Minn. App. 12/07/04. *www.lawlibrary.state.mn.us/archive/ctappub/0412/opa040310-1207.htm*

■ **AUTOMOBILE INSURANCE — UNINSURED MOTORIST BENEFITS (UM) — ARBITRATION CLAUSE.** Plaintiff was injured in an auto accident involving an uninsured motorist (UM). After presenting a UM claim to his insurance company, plaintiff notified his insurer of his intent to bring suit against the UM. The insurer neither intervened nor demanded arbitration. Plaintiff subsequently obtained a default judgment against the UM, presented it to his insurer, and requested payment of the UM policy limits. The insurer refused payment and asserted that judgment was not binding because plaintiff had not submitted the claim to mandatory arbitration, pursuant to the policy's UM arbitration clause.

Plaintiff sued his UM insurer and moved for judgment on the pleadings. The district court granted plaintiff's motion and found that the insurer's failure to intervene in the tort action against the UM prevented the insurer from compelling arbitration. The Court of Appeals reversed, holding that the arbitration clause required plaintiff to arbitrate the UM claim.

In reversing the Court of Appeals, the Supreme Court held that a UM insurer cannot avoid paying damages established by a valid judgment against an uninsured motorist through enforcement of an arbitration clause where, as here, the UM insurer received notice of and had an opportunity to intervene in the suit against the uninsured motorist. ***Gerdesmeier v. Sutherland,*** A03-07 (Minn. 12/16/04).
www.lawlibrary.state.mn.us/archive/supct/0412/opa030007-1216.htm

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