

A06-0881
STATE OF MINNESOTA
IN COURT OF APPEALS

Allete, Inc., d/b/a
Minnesota Power, Inc.,

Appellant,

-vs-

GEC Engineering, Inc., and
Jerry W. Brougher,

Respondents.

APPELLANT'S BRIEF AND APPENDIX

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LEGAL ISSUES

- I. THE TRIAL COURT ERRED IN CONCLUDING THAT MINNESOTA POWER DOES NOT HAVE A VALID AND PERFECTED SECURITY INTEREST IN THE COLLATERAL.

- II. ASSUMING THAT A GENUINE ISSUE OF MATERIAL FACT EXISTS REGARDING THE VALIDITY OF MINNESOTA POWER'S SECURITY INTEREST, RESPONDENT HAS NOT ESTABLISHED A SUPERIOR RIGHT TO POSSESS THE COLLATERAL.

STATEMENT OF THE CASE

Appellant, Allete, Inc., d/b/a Minnesota Power (“Minnesota Power”) is a company based in Duluth, Minnesota. It is engaged in a variety of business concerns, but is primarily known as a utility company. Minnesota Power, in partnership with the East Range Development Corporation and Iron Range Resources (“IRR”) had engaged in a long-term practice of participating in providing burgeoning northeastern Minnesota businesses with start-up loans. Minnesota Power, in participation with IRR and East Range Development Corporation made two (2) separate loans to GEC Engineering, Inc. (“GEC”) to assist GEC’s business plan to locate to Aurora, Minnesota to conduct business.¹ GEC is a Minnesota corporation, which was engaged in the business of developing in-cylinder water-injected engines and engine conversion kits, which would operate at higher efficiencies and lower emissions, with lower operating costs. At all times relevant to these proceedings, Respondent Danielle Delhommme (“Respondent”) was a member of GEC’s Board of Directors, as well as one of its major shareholders.²

GEC eventually became delinquent on the two (2) loans. The amount of \$481,000.70 was due on the above-referenced Notes as of October 22, 2003, and interest was accruing at the rate of \$54.86 per day, collectively, on the loans. Minnesota Power made demand for payment of the loans but GEC failed to reply to these demands or to pay the amounts due. By virtue of GEC’s breach of the terms of the loans, Minnesota Power commenced suit and judgment was ultimately entered against GEC on February 11, 2004, in the sum of \$488,202.24. Post-judgment collection efforts and

¹ Locating a business within the geographical confines of the IRR and East Range Development is a prerequisite for receiving such participation loans.

² Respondent claims to have lost a great deal of money by virtue of GEC’s operations.

related inquiries eventually led Minnesota Power to discover that some of the collateral for the loans---a proto-type engine and testing equipment attached to it----were actually in the possession of Respondent, one of GEC's directors and shareholders. Respondent, for reasons not addressed in the record, refused to allow Minnesota Power to recover the collateral; accordingly, Minnesota Power served Respondent with garnishment pleadings on or about June 7, 2005 in order to bring the issue to a resolution. A short time after the garnishment pleadings were served upon Respondent, Minnesota Power moved the trial court pursuant to chapter 571 of the Minnesota Statutes for an Order as follows:

- “1. For an Order pursuant to Minn. Stat. §571.85, directing the safe keeping and sale of the prototype engine in the possession of Garnishee-Defendant, Danielle Delhomme;
2. For an Order requiring Garnishee-Defendant to submit to an oral disclosure pursuant to Minn. Stat. §571.75, subd. 3;
3. In the alternative to Paragraph 1 herein, for an Order permitting Plaintiff to amend its Complaint to include a claim against Garnishee-Defendant, Danielle Delhomme, of like form and effect as the proposed pleadings attached to the Affidavit of John H. Bray as Exhibit “C”; and
4. For an Order requiring garnishee Danielle Delhomme to surrender and deliver to Plaintiff, Allete, Inc., d/b/a Minnesota Power, the following property:

prototype engine and all accessories in the possession of Garnishee-Defendant, including any and all testing equipment and accessories, were attached to the engine.” (Appendix-page 1; hereinafter “A-page”)

The parties agreed that the extent and validity of Minnesota Power's security interest could be heard by the trial court pursuant to cross-motions for summary judgment. The trial court heard the parties' cross-motions for summary judgment on March 6, 2006, and issued its Order and Judgment on March 10, 2006. Minnesota Power appeals the trial court's decision on the basis that

Respondent did not introduce sufficient facts to justify summary judgment in her favor relating to the issue of to establish, as a matter of law, that Minnesota Power's security interest in the engine and accessories was invalid.

STATEMENT OF THE FACTS

On April 15, 1999, GEC purchased a salvaged engine from Thompson Motors in St. Paul, Minnesota and had it shipped to CK Engineering, Inc. ("CK Engineering") in Ballwin, Missouri, for alterations and for testing. The engine was tested extensively, and apparently met GEC's requirements. GEC and Minnesota Power entered into a security agreement on December 28, 2000, whereby GEC granted Minnesota Power a security interest in "[a]ll equipment and inventory located at [GEC]'s facility at 510 W. 3rd Ave. North, Aurora, Minnesota." A UCC-1 Financing Statement was filed in Minnesota concurrently with the agreement. A conflict erupted between members of GEC's board of directors after GEC apparently lacked the funds to continue testing the engine and began to receive pressure from Minnesota Power to move the business operations to Aurora (including the engine). In reply to such pressure, GEC agreed to execute a new UCC-1 financing statement to be filed in Missouri to reflect the location of the engine, and to reflect that Minnesota Power had a security interest in the engine. Accordingly, Minnesota Power filed the financing statement in Missouri on May 3, 2001, which stated that Minnesota Power had a security interest in, inter alia, "All equipment and inventory located at Borrower's facility located at 116 Holloway Road, Ballwin, MO". (A-76).

GEC later failed to pay CK Engineering in full for the work that had been completed and the rental fees it incurred. After storing the engine at its facility, CK Engineering contacted Respondent and negotiated a "sale" of the engine to her for \$15,000 plus \$3,000 for shipping and handling costs. The engine was shipped from Missouri to Respondent in Texas in August, 2004 and it remains in

Respondent's possession.³

GEC ceased operations at the end of 2001 or beginning of 2002, and Minnesota Power filed a lawsuit against GEC on January 20, 2004 alleging that Minnesota Power had the right to an audit of GEC's books, replevin, and breach of contract. Minnesota Power was granted a default judgment in the amount of \$488,202.24 on February 9, 2004. After failing to recover the judgment, Minnesota Power served Respondent with a Garnishment Summons on June 7, 2005 because she was in possession of the prototype engine that had been held by CK Engineering in Missouri.

In this respect, Respondent appears to be asserting that she is entitled to possession of the engine as a "buyer in the ordinary course of business", and that Minnesota Power's security interest is invalid as a matter of law as a "third party" would not have notice of Minnesota Power's specific lien. These assertions are not premised upon the factual record before the trial court, or on appeal.

With regard to the former assertion, the record is quite instructive. Respondent served on (and has never resigned from) GEC's Board of Directors. During the course of her service as a director, Respondent was quite active in trying to correct what she perceived as deficiencies of other directors or officers. Specifically, Respondent complained to the Texas State Securities Board, as well as the Minnesota Department of Commerce. (See attachments to Supplemental Affidavit of John H. Bray.) Respondent was upset by what she claimed was director Sidney Binion's "fraudulent promises/misrepresentations". Additionally, the record is replete with other lengthy correspondence and corporate records indicating Respondent's active involvement in corporate matters, including a June 13, 2002 Notice of Special Meeting of The Stockholders of GEC Engineering, in which it is

³ It is unknown why Respondent purchased the engine while still a member of GEC's board of directors.

made clear that Minnesota Power asserted a security interest in the engine at issue (See Supplemental Affidavit of John H. Bray.) Respondent is simply not an innocent third party who acquired the engine from an entity primarily engaged in the sale of engines.

Respondent has also claimed that CK Engineering was entitled to simply sell the engine to her. Once again, the facts do not bear this assertion out. To the extent that Respondent is asserting that she acquired the engine and accessories pursuant to some sort of Missouri “garageman’s lien”, there is absolutely no evidence in the record suggesting that a sale occurred in accordance with Missouri law in that respect.

ARGUMENT

STANDARD OF REVIEW

In an appeal from summary judgment, the appellate courts determine if there are any genuine issues of material fact. Northern States Power Co. v. Minn. Metro. Council, 684 N.W. 2d 485, 491 (Minn. 2004). This court must “view the evidence in the light most favorable to the party against whom summary judgment was granted.” Westrom v. Minn. Dept. Of Labor and Industry, 686 N.W. 2d 27, 32 (Minn. 2004).

The trial court erred in granting summary judgment Respondent for two (2) essential reasons. First, the trial court erred in concluding that, as a matter of law, the Missouri UCC-1 and other documents reflecting the parties’ intent cannot act to amend the parties’ earlier security agreement, regardless of evidence of the parties agreement. The record is clear that GEC and Minnesota Power agreed that, since the engine had not yet been moved to Aurora, Minnesota by the summer of 2001, that Minnesota Power would still maintain its security interest in the engine while it was being tested in Missouri. (A-77; A-34-74 It is further uncontested that the parties memorialized this agreement in the form of a new UCC-1 Financing Statement signed by GEC’s President, Jerry W. Brougher and then filed with the Missouri Secretary of State. The trial court based its decision that the new financing statement reflecting the reality of the situation - - - that the engine was temporarily in Missouri being tested - - - would not have provided “third parties” with notice of Minnesota Power’s security interest in the engine. Second, Respondent did not establish as a matter of law that she is entitled to possession of the collateral by presenting facts demonstrating that she was entitled to possession in her own capacity. Respondent is certainly not a “buyer in the ordinary course of business” under the UCC, and there are no facts demonstrating that CK Engineering sold the engine

to Respondent pursuant to any possessory lien laws.⁴ For these reasons, the trial court's judgment must be reversed, and this matter is remanded for further proceedings to determine the extent, validity and priority of Minnesota Power's security interest in the prototype engine.

I. THE TRIAL COURT ERRED IN CONCLUDING THAT MINNESOTA POWER DOES NOT HAVE A VALID AND PERFECTED SECURITY INTEREST IN THE COLLATERAL.

The trial court erred in concluding that Minnesota Power does not have a valid security interest in the prototype engine and its accessories. GEC and Minnesota Power plainly agreed, as between each other, that since the collateral for the loan was located in Ballwin, Missouri, that Minnesota Power's security interest in the equipment needed to be protected by way of an agreement amending the collateral's description. Accordingly, a new UCC-1 financing statement was prepared, specifically identifying collateral and its location in Ballwin, MO. The financing statement was then signed by GEC's president, and was then subsequently filed with the Missouri Secretary of State. The trial court concluded that, even though the parties took the extra step of preparing, executing and recording a new financing statement to reflect the location of the collateral and their agreement that Minnesota Power's security interest should attach to it, that Minnesota Power's security interest was not valid. The trial court's finding in this respect constitutes reversible error.

Unless collateral is in the possession of a secured party, for a security interest to attach and be enforceable, there must be a signed security agreement containing a description of the collateral, value must be given the debtor must have rights in the collateral. Minn Stat. §336.9-202(1)(a)(b) and (c). (2005). In this case, Respondent apparently disputes only whether there is a signed security

⁴ In this respect, it is evident that CK Engineering gave no notice to any anybody of its pending sale, and simply conveyed the engine to Ms. Delhomme without bothering to comply with Missouri's possessory lien laws.

agreement that contains a sufficient description of the collateral necessary to establish Minnesota Power's security interest in the engine, which was located in Ballwin, MO at the time.

Under the former version of Minnesota's Uniform Commercial Code, "security agreement" is defined as "an agreement which creates or provides for security." Minn. Stat. §336.9-105(1) (2001). An "agreement" is the "bargain of the parties in fact as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade...". Minn. Stat. §336.1-201(3)(2005).

In this case, there are, at the very least, genuine issues of material fact with regard to whether the parties intended their course of performance, correspondence and the new financing statement to amend the description of the collateral in the security agreement. The underlying circumstances, the language used by the parties, and their course of conduct demonstrate that they *agreed* that Minnesota Power was to have a security interest in the engine and its accessories. The record in this case is rife with facts demonstrating that the parties so agreed, including:

- (1) a notice of a special meeting of the corporation dated June 12, 2002, in which it is specifically indicated that Minnesota Power had a security interest in the engine (See Supplemental Affidavit of John H. Bray);
- (2) the UCC Financing Statement executed by GEC's president, specifically identifying the prototype engine located in Ballwin, MO (A-76); and
- (3) correspondence between the parties, specifically indicating that it was the parties' intent all along to relocate the engine to Aurora, MN, which was the initial description for the collateral contained in the parties' security agreement. (A-34-74).

Construed together, these documents and the parties' course of performance constitute the agreement for security between the parties, and it satisfies the signed writing requirement of Minn. Stat. §336.9-203. Additionally the course of conduct of the parties supports the conclusion that the

security agreement, the loan documents, and the Financing Statement signed by GEC's president should be construed together as comprising the security agreement. It is the purpose of the UCC to promote and facilitate commercial transactions, "to simplify, clarify, and modernize the law governing commercial transaction, [and] to permit the continued expansion of commercial practices through custom, usage and agreement of the parties." Minn. Stat. §336.1-103(1) and (2). To deny enforcement of the security interest in this case would unduly elevate form over substance, and negate the underlying principles of the UCC, as well as to relegate the intent of the parties as evidenced by their conduct and their writings to be entirely irrelevant.

Additionally, it is puzzling as to why the trial court determined that Minnesota Power's security interest was invalid because a "third party" may not be in a position to recognize the parties' agreement in that respect. Respondent is not a "third party", but rather a corporate insider. Not only did Respondent have actual notice of Minnesota Power's security interest in the collateral, but even lacking evidence of such notice, such notice should have been imputed to her.⁵

Because such notice should be imputed to Respondent, as Respondent was a director and in privity with the corporation, the same standard which might apply in a priority dispute with another lien holder do not apply here. The drafters of the Uniform Commercial Code required a signed writing describing the specific collateral before a security interest could attach to the collateral in order to address disputes such as the one raised by Respondent. "A signed writing prevents disputes over precisely which items of property are covered by a security interest." In re Numeric Corp., 45 F.2d 1328, 1331 (1st Cir. 1973) (citing Uniform Commercial Code §9-203, comment 3; J.K. Gill

⁵ See Page 16 of this Brief concerning imputed notice to directors of corporations, and directors being in privity with corporations.

Co. vs. Fireside Realty, Inc., 262 Or. 486, 488, 489 P.2d 813, 814 (1972)). A signed writing requirement serves as a statute of frauds to prevent enforcement of claims based on wholly oral representations. Id. Minnesota courts have stated, “the principal function of a description of the collateral in a security agreement is to enable the *parties themselves* . . . to identify it, particularly if the secured party has to repossess the collateral” In re Immerfall, 216 B.R. 269, 273 (Bankr. D. Minn. 1998).

Indeed, in the case of In Re Cantu, 238 B.R. 796 (8th Cir. BAP 1999), the court’s comments are quite instructive. In that case, the court stated as follows:

“In light of these purposes, and the flexible definition of “security agreement” which includes documents that are incorporated into one another or clarify one another (citing In re Nickerson & Nickerson, Inc., 452 F.2d 56, 57 (8th Cir. 1971)) (deficient description of collateral on security agreement can be clarified by financing statement), where there is no question about the understanding of the parties, the court finds no reason to insist that the description of collateral must appear on the very same document which bears the debtor’s signature.” Id.

In this case, there is no question that GEC and Minnesota Power agreed to amend the security agreement’s collateral description by preparing, executing and filing the Missouri UCC-1 financing statement. Accordingly, the trial court erred by making use of such a standard, and by arriving at its conclusion that Minnesota Power’s security interest was not a valid security interest in the prototype engine and its accessories.

II. ASSUMING THAT A GENUINE ISSUE OF MATERIAL FACT EXISTS REGARDING THE VALIDITY OF MINNESOTA POWER'S SECURITY INTEREST, RESPONDENT HAS NOT ESTABLISHED A SUPERIOR RIGHT TO POSSESS THE COLLATERAL.

Assuming that this court determines that the trial court erred in concluding that Minnesota Power's security interest is invalid, Respondent may suggest an entitlement to possess the collateral by virtue of her "purchase" of it from CK Engineering. Such a suggestion would be without merit.

In this respect, Respondent seems to advance two (2) theories. First, she claims that CK Engineering was entitled to sell the engine pursuant to a "possessory lien." Second, and related to Respondent's first assertion, is Respondent's assertion that she acquired the engine without notice of the claimed security interest. Respondent, however, offered no facts to support either contention as part of the parties' cross-motions for summary judgment.

In Paragraph 5 of Respondent's Affidavit in support of her motion for summary judgment, Respondent stated as follows:

"CK Engineering then did consulting work for GEC Engineering regarding the engine and rented space to GEC. GEC ended up abandoning the project. GEC then abandoned the engine and testing equipment at CK Engineering. CK Engineering apparently was owed over \$40,000.00 by GEC for its consulting and space rental fees. CK Engineering, therefore, had a right to possession of the engine under Missouri law."

(See Affidavit of Danielle Delhomme)

In spite of this assertion, however, Respondent offered utterly no facts to substantiate her bare contention that CK Engineering even *claimed* a possessory lien in the engine when she purchased it, let alone that it had properly taken the required steps under applicable possessory lien laws to convey the engine to Respondent.

Additionally, Respondent asserts that she is somehow an "innocent third party purchaser,"

and therefore acquired the engine free and clear of any claimed security interest therein. There are no facts in the record to support such a contention, as Respondent was not only a shareholder of the corporation which owned the engine, but is also one of its directors. Respondent's assertion of not being aware of Minnesota Power's security interest in the engine is also belied by her own discovery responses. Respondent was provided with a notice of special meeting of the corporation on June 13, 2002, which specifically mentions moving the GEC Engineering test equipment from CK Engineering in Ballwin, Missouri to Aurora, Minnesota, and addresses Minnesota Power's security interest as follows:

“Concerns hereby raised concerning the disposition of the equipment sitting idle and subject to lease costs in Ballwin, MO. The IRRA, Minnesota Power, and East Range Joint Powers Board have a potential lien against the property and intellectual property and their offer to safeguard such property has not been addressed in a timely manner.”

(See Supplemental Affidavit of John H. Bray)

This specific notice of Minnesota Power's security interest is notwithstanding the fact that, as a shareholder and director of the corporation, Respondent should be charged with knowledge of corporate activities, [See Anderson v. First Northtown Nat. Bank, 361 N.W.2d 116 (Minn. App. 1985); Kenneally v. First Nat. Bank of Anoka, 400 F.2d 838 (8th Cir. 1968)], or at least held to be in privity with the corporation so as to preclude her from denying that the new financing statement did not, as a matter of law, act to amend the security agreement's description of collateral. [See Balasuriya v. Bemel, 617 N.W.2d 596 (Minn. App. 2000); Towle v. Boeing Airplane Co., 364 F.2d 590 (8th Cir. 1966)(director in corporation is sufficiently connected with corporation to support a finding of privity); Johnson v. Hunter, 447 N.W.2d 871 (Minn. 1989)(privity should be determined under individual facts of each case).

Additionally, Respondent offered absolutely no evidence that she should be considered a “buyer in the ordinary course of business” under the UCC (See, Minn. Stat. §336.9-320 (Minn. 2005)).

“Buyer in the ordinary course of business” is defined as:

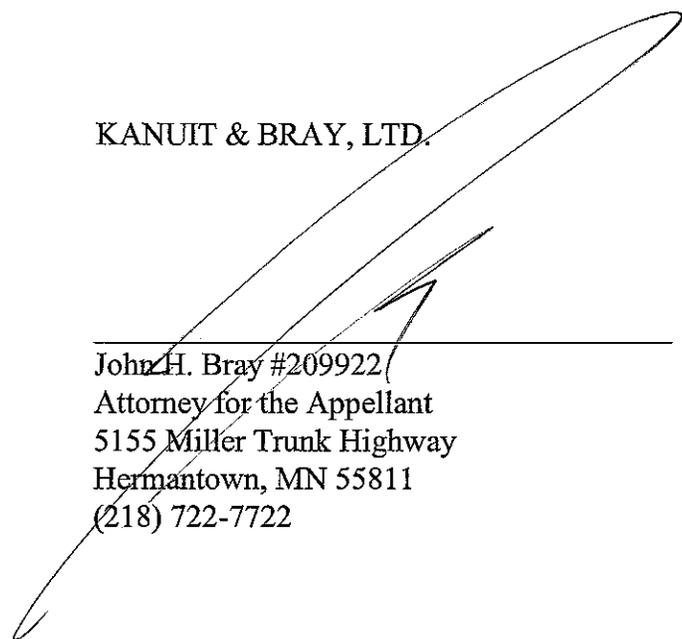
“Buyer in ordinary course of business” means a person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind. A person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller’s own usual or customary practices. A person that sells oil, gas, or other minerals at the wellhead or minehead is a person in the business of selling goods of that kind. A buyer in the ordinary course of business may buy for cash, by exchange or other property, or on secured or unsecured credit, and may acquire goods or documents of title under a preexisting contract for sale. Only a buyer that takes possession of the goods or has a right to recover the goods from the sell under article 2 may be a buyer in ordinary course of business. “Buyer in the ordinary course of business” does not include a person that acquired goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt.’ (Minn. Stat. §336.1-201(b)(6) (2005)).

Respondent failed to offer any evidence that she purchased the goods in “good faith,” “without knowledge that the sale violates the rights of another person in the goods,” or that she acquired the goods in the “ordinary course from a person . . . *in the business of selling goods of that kind.*” (*Id.*) There is no factual basis for the assertion that Respondent should be permitted to retain possession of the engine in spite of her knowledge of the Minnesota Power’s security interest, and her purported acquisition of the engine from a party which failed to comply with possessory lien laws when it “sold” it to her. For these reason, the trial court must be reversed in this matter and remanded for further proceedings to determine the extent and validity of Minnesota Power’s security interest.

CONCLUSION

Based upon the foregoing reasons, the trial court's judgment must be reversed, and the matter remanded for further proceedings concerning the extent and validity of Minnesota Power's security interest in the prototype engine and accessories.

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2) (with amendments effective July 1, 2007).