

No. A10-1498

State of Minnesota
In Court of Appeals

BARBARA BERGEN,

Relator,

vs.

SONNIE OF ST. PAUL, INC,

Respondent,

and

DEPARTMENT OF EMPLOYMENT AND ECONOMIC DEVELOPMENT,

Respondent.

RESPONDENT-DEPARTMENT'S BRIEF AND APPENDIX

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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).

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Legal Issue

Under the law, only individuals who have worked in employment “covered” by the unemployment insurance program earn the wages necessary to establish an unemployment benefit account. Officers who own 25 percent or more of a corporation do not work in “covered employment” unless the corporation files an election to have the officer’s employment covered, and the Department approves the election. Barbara Bergen owned 100% of BA Bergen LLC, which owned 100% of Sonnie of St. Paul, a retail store, and nothing else. Bergen was the president of Sonnie. After Sonnie closed due to lack of sales, Bergen attempted to establish a benefit account. But neither BA Bergen LLC nor Sonnie filed an election to have Bergen’s wages “covered.” Can Bergen use wages from her work as the president of Sonnie to establish a benefit account?

Unemployment Law Judge Christine Steffen held that Bergen did not have wages that could be used to establish a benefit account. Bergen, by owning 100% of BA Bergen LLC, effectively owned 100% of Sonnie, and neither BA Bergen LLC nor Sonnie elected coverage for her wages.

Statement of the Case

Barbara Bergen seeks to establish a benefit account in order to receive unemployment insurance benefits. She applied for a benefit account effective April 25, 2010, and her “base period” was January 1, 2009, through December 31,

2009.¹ The Department issued a determination of ineligibility holding that Bergen did not meet the qualifications for establishing a benefit account, as Bergen was an officer/owner of 25 percent or more of the employer corporation, and the corporation had not filed an election of coverage to have Bergen's employment considered covered under the unemployment insurance program.² Bergen then filed an appeal with the Department,³ and a de novo evidentiary hearing was held before Unemployment Law Judge Christine Steffen.

The ULJ issued a decision holding that Bergen's employment as an officer/owner of the employer corporation was not covered by the unemployment insurance program, and that she therefore could not establish an unemployment benefits account.⁴ Bergen requested reconsideration, and the ULJ affirmed.⁵

This matter now comes before the Minnesota Court of Appeals by a writ of certiorari obtained by Bergen under Minn. Stat. § 268.105, subd. 7(a) (2009) and Minn. R. Civ. App. P. 115.

¹ E-3; Minn. Stat. § 268.035, subd. 4 (2009).

² E-1. Exhibits in the record will be "E-" for the department with the number following. Transcript references will be indicated at "T," with the page number following.

³ Return-2A.

⁴ Appendix to Department's brief, A5-A8.

⁵ Appendix, A1-A4.

Statement of Facts

Barbara Bergen began working at Sonnie of St. Paul, a women's retail clothing store, in 1998.⁶ In 2008 Bergen formed BA Bergen LLC, a closely-held corporation of which she was the sole owner.⁷ BA Bergen LLC then purchased Sonnie of St. Paul, a corporation, from its original owner.⁸ Bergen owned BA Bergen LLC and served as the president of Sonnie until BA Bergen LLC shuttered Sonnie in 2010 due to lack of sales.⁹ Neither BA Bergen LLC nor Sonnie elected coverage for Bergen.¹⁰

Standard of Review

When reviewing an unemployment benefits decision, the Court of Appeals may affirm the decision, remand for further proceeding, reverse, or modify the decision if Bergen's substantial rights were prejudiced because the decision of the ULJ violated the constitution, was based on an unlawful procedure, was affected by error of law, was unsupported by substantial evidence, or was arbitrary or capricious.¹¹

⁶ T. 9-10, 12.

⁷ T. 11-12, 15.

⁸ T. 11-12.

⁹ T. 11, 12, 13.

¹⁰ T. 13-14.

¹¹ Minn. Stat. § 268.105, subd. 7(d)(1)-(6) (2010).

paid within the applicant's "base period" for "covered employment."¹⁸ "Covered employment" is defined as all employment performed in the state of Minnesota (and some work performed outside Minnesota) unless excluded as "noncovered employment."¹⁹

There are currently 34 specific exclusions to covered employment set out in the definition of "noncovered employment."²⁰ In 2004, the Legislature enacted Laws 2004, Ch. 183, Sec. 10, expanding the definition of noncovered employment. Since January 1, 2005, the statute has provided in part that:

"Noncovered employment" means:

(28) Employment of a corporate officer, if the officer owns 25 percent or more of the employer corporation...²¹

Because the legislative enactment specifically excludes corporate officers from coverage if the officer also owns 25 percent or more of the employer corporation, in 2004 the Department notified each of the over 125,000 employers in Minnesota of this change. Included with that notice was information that the employer could elect to have "noncovered employment" considered "covered employment" for purposes of the unemployment insurance program. The statute requires that the election be filed, and only after discretionary approval by the

¹⁸ Minn. Stat. § 268.035, subd. 27 (2009).

¹⁹ Minn. Stat. § 268.035, subd. 12 (2009).

²⁰ Minn. Stat. § 268.035, subd. 20 (2009).

²¹ Minn. Stat. § 268.035, subd. 20 (2009).

commissioner does the Department consider noncovered employment to be covered.²² The statute explains:

Any employer that has employment performed for it that is noncovered employment under section 268.035, subdivision 20, may file with the commissioner, by electronic transmission in a format prescribed by the commissioner, an election that all employees in that class of employment, in one or more distinct establishments or places of business, is considered covered employment for not less than two calendar years. The commissioner has discretion on the approval of any election...

If employment is considered covered, the employer is required to report the wages paid quarterly to the employee.²³ From the quarterly wage detail report, the Department (online and automatically) computes the taxable wage base and applies the employer's tax rate, which determines the quarterly unemployment taxes due.²⁴ If the owner/officer becomes unemployed, unemployment benefits may be available based on the wage credits the applicant earned in covered employment.

The only question, then, is whether the work that Bergen performed at Sonnie during her base period was "noncovered employment." If it was not in covered employment, Bergen has no wage credits and cannot establish a benefit account, and no unemployment benefits are payable.

²² Minn. Stat. § 268.042, subd. 3(a) (2009).

²³ Minn. Stat. § 268.044 (2009).

²⁴ Minn. Stat. § 268.051, subd. 1(a) (2009).

2. Bergen did not perform work in “covered employment” during her base period.

a. Bergen was an officer of her employer.

This case boils down to the question of whether Bergen was a corporate officer who owned 25 percent or more of her employer corporation. If so, Bergen is unable to establish a benefit account, since there is no dispute that neither Sonnie nor BA Bergen LLC Investment elected coverage for Bergen.

This goes to the very question of who Bergen’s employer was. This issue is usually considered only in the independent contractor context, when this Court inquires into whether the applicant worked for herself or for the corporation that paid her. But this is an unusual case in which Sonnie and BA Bergen LLC functioned as a single entity, and thus raises the question of whether Bergen was an officer who owned 25 percent or more of the employer corporation under Minn. Stat. § 268.035, subd. 20. To the Department’s best knowledge, this issue has been briefed only once before, and this Court has not yet decided the matter.²⁵

Minn. Stat. § 268.035, defines the following terms:

Subd. 13. Employee.

"Employee" means:

- (1) every individual who is performing or has performed services for an employer in employment; or
- (2) each individual employed to perform or assist in performing the work of any agent or employee of the employer is considered to be an employee of that employer whether the individual was hired or paid directly by that employer or by the agent or

²⁵ The previous case, *Jennings v. Jennings State Bank*, A10-845, will be argued before this Court on January 19, 2011.

employee, provided the employer had actual or constructive knowledge of the work.

Subd. 14. Employer.

"Employer" means any person that has had one or more employees during the current or the prior calendar year including any person that has elected, under section 268.042, to be subject to the Minnesota Unemployment Insurance Law and a joint venture composed of one or more employers...

Subd. 15. Employment.

(a) "Employment" means service performed by:

- (1) an individual who is considered an employee under the common law of employer-employee and not considered an independent contractor;
- (2) an officer of a corporation...

Relator's brief argues that Bergen owns no stock in Sonnie, and that BA Bergen LLC is "a separate legal entity" from Bergen.²⁶ But there is no dispute that BA Bergen LLC is wholly owned by Bergen, that Bergen established the LLC in order to purchase Sonnie, and that the LLC owned nothing else. The Department is not obligated to treat BA Bergen LLC as Bergen's only employer simply because Sonnie and BA Bergen LLC were nominally separate. Indeed, in her first communications to the Department, Bergen described herself as the "president/100% owner" of Sonnie of St. Paul.²⁷ The Department's definitions of employer and employee do not obligate the Department to mindlessly accept or adopt the definitions set out by other discrete statutory schemes. In many cases, for example, an applicant's employer considers the worker to be an independent

²⁶ Relator's brief, p. 2.

²⁷ E-6.

contractor and uses a 1099 form for tax purposes; but the Department, which operates under a different statutory definition from the IRS', can properly consider the applicant to be an employee.²⁸ Corporations that are separate legal entities in some contexts are treated as a single combined entity in others; Minnesota's Department of Revenue, similarly operating under its own discrete statutory scheme, has devised a method to tax nominally discrete entities as a "unitary" business, for example.²⁹

The Department also makes futile a corporation's effort to escape a high tax rate by dissolving and reforming the corporation; the Department will tax such successor corporations at the predecessor corporation's rate, even though they are incorporated as two separate and unrelated businesses.³⁰ If a holding company were to shutter one wholly-owned subsidiary with a high tax rate and form a new subsidiary, for example, it could not avoid paying the higher unemployment taxes it would be assessed as a result of the benefits paid to employees of the original subsidiary. The Department would note that the true employer – the holding company – had remained unchanged, and would not allow the holding company to avoid the higher rate by engaging in a corporate reshuffling.

The Department's statutory definitions of employer, employee, and employment, make no reference or allowance for the nominal separations created

²⁸ Here, the IRS would offer no assistance to Bergen's case, as the IRS treated Bergen and BA Bergen LLC as a single entity for tax purposes. T. 16.

²⁹ Minn. Stat. § 290.17.

³⁰ Minn. Stat. § 268.051, subd. 4 (2009).

by the multi-level parents and subsidiaries. Instead, applicants seeking benefits paid from public money – the unemployment insurance trust fund – must show that they were an employee of an employer as defined by the Minnesota unemployment insurance statute. That statutory definition of “employer” specifically includes “a joint venture composed of one or more employers,”³¹ and the definition of employee makes no inquiry into whether the applicant would be considered an employee under any other statute or regulatory scheme. Instead, the statute specifically inquires into whether the applicant “is considered an employee under the common law of employer-employee...”³²

The common-law inquiry into employer-employee status is generally only undertaken in the independent contractor context. Nonetheless, the standards that the common-law rule lays out provide guidance in this case, as this Court considers who Bergen’s employer was. The common law is laid out in Minn. R. 3315.0555, subp. 1, which explains that:

When determining whether an individual is an employee or an independent contractor, five essential factors must be considered and weighed within a particular set of circumstances. Of the five essential factors to be considered, the two most important are those:

- A. that indicate the right or the lack of the right to control the means and manner of performance; and
- B. to discharge the worker without incurring liability. Other essential factors to be considered and weighed within the overall relationship are the mode of payment; furnishing of materials and

³¹ Minn. Stat. § 268.035, subd. 14 (2009).

³² *Id.*

tools; and control over the premises where the services are performed.

Thus, this Court may properly inquire into whether Bergen was a BA Bergen LLC employee under the definition of “employee” and “employer,” whether Bergen was also an employee of BA Bergen LLC under common law, and whether BA Bergen LLC and Sonnie can be considered a “joint venture” under the statute’s definition of employer.

First, there is no question that BA Bergen LLC wholly controlled Sonnie. It cannot be dismissed as coincidence alone that BA Bergen LLC’s sole owner and Sonnie’s sole officer consisted of only one person: Barbara Bergen. No one could plausibly argue that Bergen, as the owner of BA Bergen LLC, did not also control her own appointment to the position of president at Sonnie. Similarly, Bergen, as the sole owner of BA Bergen LLC, was ultimately the only one with the authority to close down Sonnie, thus discharging herself from her position as president. In considering the common-law factors that demonstrate employment – most importantly, control and the right to discharge without liability – there is no question that, at minimum, BA Bergen LLC controlled Sonnie and Bergen.

More importantly, though, there is a growing body of common law addressing situations in which one nominal corporate entity may be considered to be part of another, such that the two nominal entities are treated as one. Bergen cannot be found to have wages in covered employment simply by veiling one employer in multiple layers of corporate garb and calling it two; the common law

of employment looks past such artifice. Minnesota law, for example, has recognized both the “single employer” and “alter ego” doctrines in the labor relations context.³³ In general,

A “single employer” situation exists “where two nominally separate entities are actually part of a single integrated enterprise...” In such circumstances, of which examples may be parent and wholly-owned subsidiary corporations, or separate corporations under common ownership and management, the nominally distinct entities can be deemed to constitute a single enterprise. There is well-established authority under this theory that, in appropriate circumstances, an employee, who is technically employed on the books of one entity, which is deemed to be part of a larger “single-employer” entity, may impose liability for certain violations of employment law not only on the nominal employer but also on another entity comprising part of the single integrated employer.³⁴

This single employer analysis is often applied in cases of disputes under the National Labor Relations Act, as well as in ADEA and Title VII discrimination complaints, all of which – like the unemployment insurance statute - define “employer” broadly.³⁵ All are congruous with the unemployment insurance’s broad common-law definitions of employer and employee, and the UI law does

³³ *Local #49 Operating Engineers Health and Welfare Fund v. Swenke*, 2005 WL 1430315 (D. Minn. March 7, 2005) (Appendix, A21-A22).

³⁴ *Arculeo v. On-Site Sales & Marketing, LLC*, 425 F.3d 193, 198 (2d Cir. 2005) (citing *Clinton's Ditch Cooperative Co. v. NLRB*, 778 F.2d 132 (2d Cir. 1985); *NLRB v. Browning-Ferris Indus. of Pa., Inc.*, 691 F.2d 1117, 1122 (3d Cir. 1982); *Cook v. Arrowsmith Shelburne, Inc.*, 69 F.3d 1235, 1240-41 (2d Cir. 1995)).

³⁵ *South Prairie Construction Co. v. Operating Engineers Local 627*, 425 U.S. 800 (1976); *Baetzel v. Home Instead Senior Care*, 370 F. Supp. 2d 631 (N.D. Ohio 2005). See also AMERICAN JURISPRUDENCE - LABOR AND LABOR RELATIONS § 720 (July 2010) and CORPUS JURIS SECUNDUM – EMPLOYER/EMPLOYEE RELATIONSHIP § 9 (May 2010).

not have any inherent deference to the accounting or corporate structure that any given employer has chosen to adopt. Through Bergen's base period, BA Bergen LLC owned only Sonnie, and Sonnie was only owned by BA Bergen LLC. Neither had a purpose separate from the other. They functioned as a single employer, and while this arrangement could be called any number of names – be it a single employer, a joint venture, or something else – the reality of the situation is clear. Sonnie and BA Bergen LLC were functionally the same, and Bergen controlled a 100% stake of both while serving as the owner of BA Bergen LLC and the president of Sonnie. The wages she earned during her base period were not earned in covered employment, Bergen's employer did not elect coverage for her, and Bergen cannot establish a benefit account.

b. Bergen's employer did not elect coverage for her employment as an officer.

Unemployment benefits are a creation of legislative enactment, and benefits are payable only if the requirements of those legislative enactments are met. The legislature chose to exclude corporate officers/owners from covered employment but included the longstanding provision allowing an employer to – with the Department's approval - elect to have the noncovered employment of its officers considered covered. The law is very specific that there is no equitable entitlement to unemployment benefits.³⁶

³⁶ Minn. Stat. § 268.069, subd. 3 (2009).

Relator argues that she did not receive notice from the Department that she needed to elect coverage for herself, and that she could not have been expected to elect coverage without such notice.³⁷ But first, the decision was not Bergen's to make alone. The statute is clear that the Department's commissioner has the discretion to approve or deny an election of coverage.³⁸ There is no certainty that the Department would have approved an election of coverage even if one had been requested.

Second, the Department has no way of knowing whether an employer has properly classified or reported an employee when it files its wage detail reports or pays unemployment taxes. Over 2.7 million workers are reported by employers each quarter on filed wage detail reports, and some reports will improperly include employees who are not working in covered employment. For example, when an insurance company files a quarterly wage detail report, the Department has no way of detecting whether the employer has improperly included insurance agents compensated solely by way of commission (and who are therefore excluded under the law). In fact, the State of Minnesota, as an employer, continually misreports employees in policy or advisory positions – positions that are excluded from coverage.³⁹ This creates problems every time there is a change in administration, resulting in the overpayment of benefits to a number of individuals, and the

³⁷ Relator's brief, p. 2.

³⁸ Minn. Stat. § 268.042, subd. 3(a) (2009).

³⁹ Minn. Stat. § 268.035, subd. 20(15) (2009).

subsequent requirement that they repay those benefits.

The tax reporting and collection system is an imperfect one, and the Department is neither omniscient nor error-proof. But the remedy available for erroneous payment of unemployment taxes under the statute is a tax refund, not the payment of unemployment benefits to a particular individual.⁴⁰ Bergen has been informed of the availability of a tax refund. Just as in the income tax system, it is incumbent upon the taxpayer to report properly that which is taxable. Normally, only after an on-site audit can the Department confirm that reporting was done properly.⁴¹ The Department has no way of knowing whether an officer reported on an employer's quarterly wage detail report owned 25 percent or more of the employer during that calendar quarter.

The unemployment insurance taxation system functions as it does because the cost of benefits is not prepaid by the employer. While the term "insurance" has been labeled on the program, it is not like any other type of insurance. A common misconception is that taxes from an individual employer prepay the cost of unemployment benefits to that employer's later unemployed workers. In fact, the opposite is true. The cost of unemployment benefits are actually postpaid by an employer. The unemployment insurance trust fund pays out benefits to an unemployed worker, and his employer's experience rating then increases so that

⁴⁰ Minn. Stat. § 268.057, subd. 7 (2009).

⁴¹ Each year, the Department audits approximately two percent of the approximately 125,000 Minnesota employers.

the trust fund recoups, over a four-year period, the cost of the unemployment benefits paid out. The fund obviously never recoups such payments from a business that has shut down.

Every employer pays a base tax rate, in addition to its own calculated experience rating. The money raised by the base tax rate covers the costs of over 10,000 employers that go out of business each year (including Bergen's employer), where the trust fund cannot recoup the benefits paid out to workers unemployed as a result of the closure of that business. If Bergen were to be paid benefits, for example, the maximum benefits she could receive would likely exceed the taxes Sonnie paid during the course of her employment. Other Minnesota employers would pick up the tab, both for Bergen (and other former employees of defunct employers), and for the over 7,000 Minnesota employers that are at the maximum tax rate. For those employers at the maximum rate, the trust fund cannot recoup the cost of benefits paid to its unemployed workers. In fact, the trust fund pays out over \$100 million more each year to the unemployed workers of maximum-rate employers than those employers pay in taxes. This actuarial picture is neither an argument for nor against Bergen's ability to establish an account, but rather refutes Bergen argument that she seeks to recover benefits that she has already paid for. Instead, she seeks to receive benefits that will be paid for by other Minnesota employers.

In the unemployment insurance system, some employers pay more in taxes than their employees will ever recoup in benefits, and some pay far less. As the

Minnesota Supreme Court described in *State v. Industrial Tool and Die Works*, the unemployment tax is an excise tax, or a tax on the right to employ labor.⁴² It is a cost of doing business. The question of taxes on an employer corporation's payroll, and the payment of benefits to a worker are, as the Supreme Court indicated in *Seiz v. Citizens Pure Ice Co.*, "separate and distinct."⁴³

The fact that Sonnie paid taxes on the wages paid to Bergen and other employees does not automatically entitle Bergen to benefits, nor does it excuse Bergen from the requirement that her employer elect coverage for her. The Court of Appeals in *Jackson v. Global Marketing Opportunities, Inc.*, addressed an issue somewhat similar to Bergen's, in which an accountant failed to file an election of coverage for a particular officer.⁴⁴ The Court affirmed the Unemployment Law Judge's decision that Jackson was ineligible for unemployment benefits, because she had no covered wages with which to establish a benefit account. In *Truax v. CFT Communications, Inc.*, the Court of Appeals, addressing an argument that the Department should pay benefits because it accepted the taxes paid on the corporate officers' wages, held that the exclusive remedy available was a tax refund.⁴⁵

⁴² 21 N.W. 2d 31 (Minn. 1946).

⁴³ 290 N.W.2d 802 (Minn. 1940).

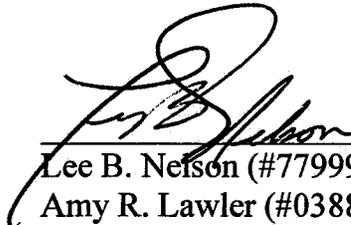
⁴⁴ 2007 WL 2993836 (Minn. App. October 16, 2007) (Appendix, A14-A16).

⁴⁵ 2009 WL 2746304 (Minn. App., September 01, 2009) (Appendix, A11-A13); see also *Reubendale v. Collaborative Solutions*, 2010 WL 3396915 (Minn. App. Aug. 31, 2010) (Appendix, A9-A10).

Conclusion

The employment Barbara Bergen performed for Sonnie and BA Bergen LLC during her base period was not considered covered employment under the unemployment insurance program, and no election of coverage was filed for Bergen. Therefore, Bergen is not entitled to establish a benefit account, and cannot receive unemployment benefits from the Minnesota unemployment insurance trust fund. The Department requests that the Court affirm the decision of Unemployment Law Judge Christine Steffen.

Dated this 27th day of December, 2010.



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