

CASE NO. A08-1928

STATE OF MINNESOTA
IN THE COURT OF APPEALS

Bridgewater Telephone Company, Inc,)
 a Minnesota corporation,)
)
 Plaintiff-Appellant,)
)
 v.)
)
 City of Monticello, Minnesota,)
)
 Defendant-Appellee.)

OPENING BRIEF OF APPELLANT
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STATEMENT OF ISSUES

A. Did the District Court err in its October 8, 2008 Findings of Fact, Conclusions of Law, and Order Granting Motion to Dismiss (“October 8 Order”) in holding that the City of Monticello was authorized by the words “utility or other public convenience” of the revenue bond statute to issue such bonds to build an internet/cable television/telephone business to compete with private enterprises?

The District Court erroneously held that the business was a “utility or other public convenience.”

Minn. Stat. § 475.52 subd. 1

B. Did the District Court err in its October 8 Order in holding that the City of Monticello did not exceed its authority to issue revenue bonds by its decision to use proceeds of revenue bonds to pay for current expenses?

The District Court erroneously held that the City of Monticello had not exceeded its authority under the revenue bond statute by its planned use of revenue bond proceeds to pay current expenses.

Minn. Stat. § 475.52 subd. 1

C. Did the District Court abuse its discretion in its Findings of Fact, Conclusions of Law and Orders Denying Leave to File First and Second Amended Complaints of October 9 and 10, 2008?

The District Court abused its discretion in denying Bridgewater’s Motions for Leave to File First and Second Amended Complaints.

Minn. R. Civ. P. 15.01

LaSalle Cartage v. Johnson Bros. Wholesale Liquor, 225 N.W.2d 233, 237-38 (Minn. 1974)

STATEMENT OF THE CASE

Bridgewater Telephone Company, Inc. (“Bridgewater”), through its parent TDS Telecom, provides telephone, high-speed internet, and satellite television¹ services to Monticello residents. Bridgewater and TDS have just completed a \$6.6 million project to install a high-speed fiber-optic network in Monticello. The City has issued \$26,445,000 of revenue bonds to build its own fiber optic internet/telephone/cable television system (the “Fiber Project”).

Bridgewater filed its Complaint on May 21, 2008. The Complaint alleged that Minn. Stat. § 475.52 does not authorize the use of proceeds of bonds issued under that statute for the purposes identified in the City’s bond offering documents. Specifically, the Complaint alleged that the Fiber Project is not a “utility or other public convenience” as those words are used in section 475.52. In addition, Bridgewater alleged that the bonds violated section 475.52 because \$1.25 million of the bond proceeds were to be used to pay “current expenses” of the Fiber Project. Section 475.52 does not authorize the use of revenue bonds for that purpose and the statute specifically prohibits the use of proceeds of revenue bonds to pay for “current expenses.”

On June 6, 2008, the City of Monticello filed motions (1) to require Bridgewater to post a surety bond under Minn. Stat. § 562.02, and (2) to dismiss the

¹ TDS provides satellite television service through its affiliation with the DISH Network.

Complaint. On June 13, 2008, the District Court, Honorable Jonathan H. Jasper, after finding that issues raised by Bridgewater in its Complaint “present a substantial issue of statutory construction,” ordered Bridgewater to post a surety bond of \$2.5 million.

Bridgewater timely posted the surety bond on June 17, 2008. On June 20, 2008, the City filed an amended motion to dismiss the Complaint under Minn. R. Civ. P. 12.02(e). The motion was fully briefed. The District Court heard argument on the motion to dismiss on July 18, 2008 and took the matter under advisement.

Before the District Court ruled on the amended motion to dismiss, Bridgewater twice came into possession of new information that caused it to file two motions for leave to file amended complaints. Bridgewater sought leave to file its First Amended Complaint on July 14, 2008, seeking to add factual allegations regarding new information and documents it received through discovery and requests under the Minnesota Government Data Practices Act. Specifically, the First Amended Complaint added the Official Statement (similar to a prospectus for corporate securities offerings) and the Bond Indenture for the revenue bonds at issue in the case. Both documents were created after the original Complaint was filed. These documents provided additional factual detail relating to the allegations in the original Complaint regarding the \$1.25 million of bond proceeds that were to be used to pay “current expenses.” This

information was not available to Bridgewater until it received copies of the Official Statement and the Bond Indenture from the City.²

In addition, the First Amended Complaint added factual allegations relating to the background of the Fiber Project. The First Amended Complaint added allegations relating to the fact that the City of Monticello failed to conduct an election under Minn. Stat. § 475.58 before issuing the revenue bonds. This allegation was in direct response to the City's alternative argument offered in its amended motion to dismiss stating that the Fiber Project was also an "authorized corporate purpose" under Minn. Stat. § 475.52. To issue revenue bonds under that section of the act, the City needed to hold a voter's referendum. Minn. Stat. § 475.58.

Finally, before argument on the motion for leave to amend, Bridgewater received a copy of the management agreement between the City and Hiawatha Broadband Communications, Inc., a for-profit corporation, as the operating "manager" of the City's Fiber Project. To address the City's desire for expedition, Bridgewater filed a revised First Amended Complaint alleging that the management agreement placed Hiawatha Broadband in a position to control the Fiber Project. Accordingly, the revised First Amended Complaint alleged that the revenue bond proceeds were not to be used by the City for a "public convenience" or an "authorized corporate purpose" as required by

² The Indenture also provided that the revenue bond proceeds would be escrowed and the bonds redeemed if Bridgewater prevailed in this litigation.

Minn. Stat. § 475.52.³ The District Court heard arguments on the motion for leave to file the First Amended Complaint on August 8, 2008.

Bridgewater sought leave to file its Second Amended Complaint on August 5, 2008. The Second Amended Complaint added a claim arising out of a variation to the Fiber Project that was announced by Monticello on July 29, 2008. This variation, called “Fiber Loop” by the City, would develop a portion of the Fiber Project for commercial high-speed internet service only, and would initially be funded by general revenue funds.⁴ The proposed Second Amended Complaint alleged that the City lacked the authority to sell internet services for profit in competition with established private businesses. The District Court heard arguments on the motion for leave to file the Second Amended Complaint on August 21, 2008.

In its October 8 Order, the District Court dismissed the original Complaint with prejudice. The District Court concluded that the Fiber Project was a “utility or other public convenience.” In addition, the District Court held that the proceeds of revenue bonds approved for a “public convenience,” or any other enumerated use in section 475.52, could be used to pay “current expenses.” Accordingly, the District Court held

³ The City, oddly, insisted that Bridgewater present a second motion for leave to amend rather than allowing it to expeditiously piggyback on the pending motion. The additional allegations regarding Hiawatha were also included in the proposed Second Amended Complaint.

⁴ The City plans to advance development costs from general revenue funds and then repay those advances from the revenue bonds if it secures access to the revenue bond proceeds.

that the City could set aside any amount of the revenue bond proceeds for “current expenses.” In the alternative, the District Court held that the City had the inherent authority to use revenue bond proceeds to fund current expenses of the Fiber Project as “start-up costs.” On October 9, 2008, the District Court denied Bridgewater’s motion for leave to file the First Amended Complaint and on October 10, 2008, it denied Bridgewater’s motion for leave to file the Second Amended Complaint.

STATEMENT OF FACTS

A. Facts Alleged In The Complaint

Bridgewater provides telephone and internet service in and around Monticello. App. 1 (Tab 1).⁵ It has provided local telecommunications services under the Bridgewater name since 1962. It also provides video service through an agreement with the DISH satellite network. *Id.* at 2.

On May 5, 2008 Monticello issued a Preliminary Official Statement regarding the proposed issuance of \$25,680,000 in revenue bonds. App. 2 (Tab 1). The revenue bond proceeds were to be used for the Fiber Project. *Id.* The Fiber Project was to compete directly with existing for-profit businesses, including Bridgewater. *Id.*⁶ According to the business plan of the Fiber Project, by 2012 it would control 60% of

⁵ Citations to the Appendix filed by Bridgewater will take the form “App. ____ (Tab ____).”

⁶ Another significant competitor is the incumbent cable television provider, Charter Communications, Inc.

residential and commercial telephone service and 35% of residential and commercial data service. *Id.* These services are currently provided by, *inter alia*, Bridgewater. *Id.*

The Fiber Project was to be managed by Hiawatha Broadband Communications, Inc. (“Hiawatha”). App. 36 (Tab 2). Hiawatha executed a three-year management agreement with the City. *Id.* The City agreed to pay Hiawatha “a monthly management fee and a monthly fee per customer” *Id.* at 45. Hiawatha was also allowed to charge hourly fees for various services. *Id.* Hiawatha was to hire the general manager, but “all other staff positions” were to be filled by “City employees.” *Id.* at 36. These positions included “two inside technicians to take care of electronics, two outside technicians to maintain the fiber network, two customer service representations . . . and one market/salesperson.” *Id.* at 104. Hiawatha was to be the cable franchisee for the television offerings. *Id.* at 45.

The Preliminary Official Statement identified various funds to be established for revenue bond proceeds. Among them was an Operating Reserve Fund, into which “[a]n initial deposit of \$1,250,000 will be made.” App. 24 (Tab 2). The fund could be used upon a request by the City for payment of “Operation and Maintenance Expenses.” *Id.* Such expenses were defined to include “all the City’s costs and expenses for operation, maintenance and ordinary repairs, renewals and replacement of the Facilities” but did not include “Debt Service or any allowance for depreciation or any costs and expenses for new construction or other capital improvements.” *Id.* at 66. The expenses payable from the Operating Reserve Fund thus included payroll and benefits for the seven City employees who were to work for the Fiber Project.

B. Additional Facts Alleged In The Proposed First Amended Complaint

After the Complaint was filed, the City issued an Official Statement for the bond offering as well as an Indenture of Trust between Monticello and Wells Fargo Bank, N.A. (“Indenture”). App. 259 (Tab 18). In addition, the City moved under Minn. Stat. § 562.02 to require Bridgewater to post a surety bond in order to continue to prosecute its claim. App. 111 (Tab 4). In that motion the City argued that a referendum held in late 2007 to permit the City to operate a telephone exchange needed to be considered by the District Court in connection with this action. App. 113-14 (Tab 5). Finally, in that same motion the City advanced a new argument regarding its legal authority to issue revenue bonds, pointing to the catchall any “authorized corporate purpose provisions” of Minn. Stat. § 475.52. *Id.* at 124-25. The City had earlier identified only the provisions of that statute authorizing revenue bonds “for any utility or other public convenience” in support of the revenue bonds.

On July 14, 2008 Bridgewater moved to file a First Amended Complaint. The proposed First Amended Complaint sought to add as exhibits the Official Statement and the Indenture.⁷ App. 262 (Tab 19); *id.* at 267-68, App. 274-371 (Tab 21) (Official Statement), App. 520-616 (Tab 25) (Indenture). The Indenture expanded on the definition of the Operation and Maintenance Expenses to be paid from the Operating Reserve Fund. As defined in the Indenture, these expenses include:

⁷ Bridgewater obtained those documents in response to a document request.

all the City's costs and expenses for operation, maintenance, and ordinary repairs, renewals and replacements of the Facilities, and shall include, without limiting the generality of the foregoing, programming costs, rents, administrative and general expenses, engineering expenses, legal and financial advisory expenses, required payments to pension, retirement, health and hospitalization funds, taxes, payments in-lieu-of taxes and other governmental charges, insurance premiums, *and any other current expenses or obligations required to be paid by the City* under the provisions of this Indenture or by law, all to the extent properly allocable to the Facilities, and the fees and expenses of the Trustee. Operation and Maintenance Expenses shall not include Debt Service or any allowance for depreciation nor any costs and expenses for new construction or other capital expenditures.

App. 540 (Tab 25) (emphasis added).

The proposed First Amended Complaint also added allegations regarding various misrepresentations made in connection with the referendum to offer telephone service, as well as alleging that the City had not conducted a referendum to issue the revenue bonds. App. 262-65 (Tab 19). These allegations were responsive to arguments advanced by the City in its motion to require Bridgewater to post a surety bond.

Finally, after the motion for leave to file the First Amended Complaint – but before argument on that motion – Bridgewater secured a copy of the management agreement between the City and Hiawatha pursuant to a Minnesota Government Data Practices Act request. Bridgewater revised its proposed First Amended Complaint to expand upon its allegations regarding the role of Hiawatha. It alleged that Hiawatha is to be responsible for recommending, training and supervising the City employees who operate the Fiber Project. App. 663 (Tab 31). It is also to provide the video head-end equipment needed to receive, process and distribute television signals. *Id.* It will make all regulatory filings for the television operation, manage video content and bill

subscribers. *Id.* at 663-64. Hiawatha's monthly fee, owed by the City, was \$15,000, with additional amounts up to \$10.75 per subscriber, per month. *Id.* at 664.

The District Court denied Bridgewater's motion for leave to file the First Amended Complaint on October 9, 2008. App. 692 (Tab 33). The Court held that the proposed amendment would "not change the Court's analysis of the underlying issue in the litigation" because the "new factual allegations merely question the political process by which the City undertook to issue bonds." *Id.* As noted above, this was only one of the changes in the proposed amendment. It also sought to add allegations based on the revenue bond documents – including the Indenture – that postdated the Complaint and to add allegations regarding the expansive role of Hiawatha. App. 262 (Tab 19); *id.* at 267-68; App. 274-371 (Tab 21) (Official Statement), App. 520-616 (Tab 25) (Indenture).

C. Additional Facts Alleged In The Proposed Second Amended Complaint

On July 29, 2008 the City announced that it was building a portion of the Fiber Project – which it called the Fiber Loop – to permit it to sell high speed data services to commercial customers. On August 5, 2008 Bridgewater moved for leave to file a Second Amended Complaint, adding a count challenging the City's authority to operate this business. App. 696 (Tab 35); App. 702-03 (Tab 37).⁸

On October 10, 2008 the District Court entered an Order denying Bridgewater's motion for leave to file a Second Amended Complaint. App. 787 (Tab

⁸ All of the new allegations raised in the First Amended Complaint, including those regarding the role of Hiawatha based on the Management Agreement, were included in the proposed Second Amended Complaint.

42). The only reason given for this order – which was issued over two months after Bridgewater’s motion for leave to file – was that time was of the essence and that the Court did not want to delay the appeal of its October 8 Order dismissing the original Complaint. *Id.* at 786-87.

ARGUMENT

I. **THE DISTRICT COURT ERRED IN DETERMINING THAT THE FIBER PROJECT WAS A UTILITY OR OTHER PUBLIC CONVENIENCE.**

A. **Standard of Review.**

The District Court granted the City’s motion to dismiss based upon its statutory construction of the revenue bond act. Minn. Stat. § 475.52 subd. 1. This Court reviews the October 8 Order *de novo*. *Becker v. Mayo Foundation*, 737 N.W. 2d 200, 207 (Minn. 2007); *Bodah v. Lakeville Motor Express, Inc.*, 663 N.W. 2d 550, 553 (Minn. 2003)

B. **The Fiber Project Is Not A Utility Or Other Public Convenience.**

The City, like all statutory cities, has “no inherent powers and possess[es] only such powers as are expressly conferred by statute or implied as necessary in aid of those powers which have been expressly conferred.” *State v. Kuhlman*, 729 N.W.2d 577, 580 (Minn. 2007) (*quoting Mangold Midwest Co. v. Village of Richfield*, 143 N.W.2d 813, 820 (Minn. 1966)). The City’s authority to issue revenue bonds is conferred by statute. Minn. Stat. § 475.52 subd. 1. That statute provides:

Any statutory city may issue bonds or other obligations for the acquisition or betterment of public buildings, means of garbage disposal, hospitals, nursing homes, homes for the aged, schools, libraries, museums, art galleries, parks, playgrounds, stadia, sewers, sewage disposal plants, subways, streets, sidewalks, warning systems;

for any utility or other public convenience from which a revenue is or may be derived; for a permanent improvement revolving fund; for changing, controlling or bridging streams and other waterways; for the acquisition and betterment of bridges and roads within two miles of the corporate limits; for the acquisition of development rights in the form of conservation easements under chapter 84C; and for acquisition of equipment for snow removal, street construction and maintenance, or fire fighting. Without limitation by the foregoing the city may issue bonds to provide money for any authorized corporate purpose except current expenses.

The subject statute does not expressly authorize a statutory city to issue revenue bonds to enter into the internet/cable television/telephone business. The City claims that the Fiber Project is supported by the words permitting bonds “for any utility or other public convenience from which a revenue is or may be derived,” and the District Court agreed.⁹ The Fiber Project, however, is not a “utility or other public convenience.”

Statutes are to be construed “according to their most natural and obvious usage.” *ILHC of Egan, LLC v. County of Dakota*, 693 N.W.2d 412, 419 (Minn. 2005). A statute is interpreted to give effect to all its provisions. *Amaral v. St Cloud Hosp.*, 598 N.W.2d 379, 384 (Minn. 1999). Read in the overall context of the revenue bond act –

⁹ The City had argued in the alternative that bonds could be issued for the Fiber Project under the “any authorized corporate purpose” provisions of the act. App. 197-98 (Tab 13); App. 266 (Tab 19). The District Court did not address this argument. This provision, however, is unavailing: a referendum to approve the bonds was required unless the bonds issued under the revenue producing convenience section of the statute. Minn. Stat. § 475.58(4). No referendum was held to approve the revenue bond issue. App. 266 (Tab 19); *id.* at 269.

and given its most natural meaning – the allowance “for any utility or other public convenience” cannot support the Fiber Project.¹⁰

1. The Fiber Project is Not Akin to a Utility

The City asserts that a public convenience is anything that is convenient to the public. As the District Court recognized, “[u]nder the City’s interpretation, the plain meaning of the term ‘public convenience’ is something that is available to the general public that is conducive to comfort or ease.” App. 249 (Tab 16). The District Court rejected this construction because it would “provide the authority to issue bonds for limitless purposes including funding a gas station or hair salon.” *Id.* at 250. However, after rightfully rejecting the City’s argument that the statute provided a grant of limitless authority, the District Court construed the statute in a way that provided no meaningful limitation on the City’s authority under the “other public convenience” language.

The District Court held that a “public convenience,” for purposes of the statute, is any enterprise that provides a service “of equal importance” to that provided by a traditional utility. App. 250 (Tab 16). The District Court purported to ground this holding in a grammatical analysis: stating that the statute uses “or” as “a coordinating conjunction,” when it speaks of “utility or other public convenience.” *Id.* But by

¹⁰ No court has construed the words “other public convenience” as used in the revenue bond statute. As the District Court noted, cases in which the words “public convenience” have been discussed are inapposite. (App. 248-49 (Tab 16)) Indeed, the City placed its primary reliance on an 1893 opinion involving the issue of whether an association of lumbar yards was illegally restraining trade, *Bohn Mfg. Co. v. Hollis*, 55 N.W. 1119 (Minn. 1893). That opinion is utterly irrelevant to the issues of statutory construction raised in this action.

focusing solely on the conjunction “or,” the District Court failed to give any meaning to the word “other.” The statute was construed as if it said “utility or public convenience.” However, the use of “other” is critical: it ties public convenience into utility not merely as matters of co-equal importance, but also of the same kind.¹¹ The more specific “utility” modifies the general “other public convenience,” and limits the latter to utility-like projects. Minn. Stat. § 645.08(3).

This narrowing construction is compelled by the plain language of the statute, as it is the only construction that gives meaning to the word “other” in the phrase “utility or other public convenience.” And it is compelled by the requirement that all provisions of the statute be given effect. There would be no need for the delineation of the specific uses for revenue bonds – no fewer than 27 – if public convenience meant anything that made life easier for the public (City’s construction) or anything that was important to the public (District Court’s construction). Certainly “hospitals, nursing homes, homes for the aged, . . . museums, art galleries” and numerous other explicitly mentioned uses for revenue bonds would be mere surplusage if “public convenience” had the virtually limitless meaning provided by the District Court. Each of these are important, and each can generate revenue. The legislature would not have expressly

¹¹ The District Court’s attempt to “limit” the unfettered discretion provided by the City’s interpretation through requiring a public convenience be of equal importance to a utility is wholly unworkable. While the District Court suggested that building a gas station is not an appropriate use for revenue bonds, the City could easily defend a gas station under the District Court’s equivalency test: people need gas stations every bit as much as they need electric companies. The limitation the statute provides relates to the type of enterprise, and not the more amorphous “importance” of the enterprise.

delineated these uses if they were already captured in the allowance for “other public convenience[s] from which a revenue is or may be derived.” The only way to avoid a limitless grant of authority from this provision is to read it – as the law requires – in context. “Other public convenience” is defined by virtue of the precedent “utility,” and thus encompasses only the issuance of revenue bonds for funding the acquisition or betterment of facilities that share characteristics with utilities.¹²

Commonly recognized utilities include waterworks, gas plants and power plants. *See, e.g.*, Minn. Stat. § 412.321 subd. 1. Utilities are businesses that, at least at one time, were viewed as natural monopolies that needed to be publicly owned or subject to rate regulations. They provide services that are essential and used by all members of a community.

The Fiber Project would provide three services: internet, telephone and cable television. A consumer could purchase only internet, only cable, only telephone, or some combination thereof. App. 38 (Tab 2). The revenue bonds are to be used to build the infrastructure for each of these offerings. Aside from the cost of the video head-end building, no allocation of infrastructure costs between the various businesses is possible. Because each offering uses the infrastructure that will be funded by the revenue bonds,

¹² The District Court erroneously asserted that Bridgewater argued that an “other public convenience” had to be a utility, rendering the phrase superfluous. App. 250 (Tab 16). This was a misstatement of Bridgewater’s position, which is that “other public convenience” expands on the word utility to include enterprises that share common characteristics with utilities, even if they are not utilities as traditionally defined.

and each is to be offered on a stand-alone basis, each line of business needs to be a “utility or other public convenience.”

The telephone business may be sufficiently like a utility to be a public convenience. Virtually every resident has telephone service, according to the City’s feasibility study,¹³ and the service has been subject to rate regulations. Cable television occupies a gray area, however, while internet service is not utility-like at all.

First, only about 57% of residents have cable television. App. 498 (Tab 23). (Another 17% have satellite television.) *Id.* Less than half have high-speed internet service, and total internet availability – including dial up – is about 70% . *Id.* at 500. Neither service has the near universal usage common to a utility. Second, while cable television has been subject to rate regulation, internet service has not. It has traditionally been provided by private businesses, and rates have been set by the marketplace. It shares no characteristics with a utility.

The District Court implicitly recognized that internet service did not fit within the statutory allowance for a utility or other public convenience. It, however, held that the City could build out the infrastructure for the telecommunications component and, thereafter, use that infrastructure to sell internet or other services, even if they were

¹³ The City’s Broadband Feasibility Study was an exhibit to the First and Second Amended Complaints. App. 263 (Tab 19); App. 379-508 (Tab 23); App. 704-05 (Tab 37). Because the District Court denied Bridgewater’s motions for leave to amend, it did not consider the study in concluding that the Fiber Project was a utility or other public convenience.

not a “utility or other public convenience.” App. 251-52 (Tab 16). This was justified as being “economically efficient.”

The economic efficiency rationale cannot be reconciled with the hornbook law that a statutory city only has such powers as are expressly granted. The authority to issue bonds to build a nursing home does not permit the City to use such bonds to build a structure that is half nursing home, half day-care center. The City plans to sell internet and cable television service separately, as well as bundled with telephone services. It cannot use revenue bonds for unauthorized purposes. Nor can the City support this use of revenue bonds under its implied authority. The City has such implied authority as is “a necessary aid to a specific grant in the statute or charter.” *Borgelt v. City of Minneapolis*, 135 N.W.2d 438, 441 (Minn. 1965). The City has no implied authority to issue revenue bonds for any purposes not enumerated in the statute, and the District Court’s contrary conclusion at paragraph 7 of the October 8 Order was wrong. App. 247 (Tab 16).

2. The Fiber Project is Not Public

Even if the District Court’s properly construed the statute by requiring that “utility” and “other public convenience” be only of equivalent importance, the Fiber Project would still not satisfy the “public” requirement. The City argues that the Fiber Project is public because it sells service to the public. The District Court agreed that any service offered to all residents was “public.” App. 252-53 (Tab 16).

Activities undertaken by a government are “public,” however, when they “serve as a benefit to the community as a body” and are “directly related to the functions of government.” *Borgelt*, 135 N.W.2d at 443 (quoting *Visina v. Freeman*, 89 N.W.2d

635, 643 (Minn. 1958)). Public purposes do not encompass “any private business enterprise or occupation such as is usually pursued by private individuals.” *Borgelt*, 135 N.W.2d at 443 (quoting *John Wright & Assocs., Inc. v. City of Red Wing*, 93 N.W.2d 660, 664 (Minn. 1958)).

The legislature can explicitly grant a statutory city the authority to enter a business even where it involves an area traditionally occupied by private enterprise. The grant of authority to offer cable television services is just such an example. Minn. Stat. § 238.08 subd. 3.¹⁴ But a grant of authority to offer a “public convenience” expressly incorporates the traditional limit on the ability of a statutory city to engage in activities not “directly related to the functions of government.” *Borgelt*, 135 N.W.2d at 443. This cannot be justification for the City’s attempted foray into the business of internet service provider. The revenue bond statute does not support the introduction of a statutory city into a functioning competitive marketplace where no express statutory authorization otherwise provides for such action.¹⁵

¹⁴ That the City can operate a cable franchise does not make the enterprise a “utility or other public convenience.” These are distinct issues. A liquor store is clearly not a “utility or other public convenience,” yet the City can operate such a business. Minn. Stat. § 340A.601. At most, the authority to operate a cable franchise permitted revenue bond financing under the “authorized corporate purpose” provision of the statute. But to proceed on that basis the City was required to hold a voter referendum on the bonds, and it did not do so.

¹⁵ The District Court wrongly read the express statutory authority to offer telephone exchange services as suggesting a broad reading of the revenue bond statute. To the contrary, the legislature would not have needed to authorize telephone exchange services if municipalities had the inherent right to engage in traditional private enterprises that the District Court found in construing the revenue bond statute.

Moreover, the central role of a private business in the Fiber Project also defeats any claim that it is a “public convenience.” Hiawatha is, *inter alia*, (a) the general manager, (b) the cable franchisee, and (c) the owner of the video head-end equipment that provides cable television service. With regard to the cable television business – which is forecast to be the primary revenue producer for the enterprise (App. 97 (Tab 2)) – the City has no role at all. The subsidy of a private cable television company is not a “public convenience.”

II. THE FIBER PROJECT INAPPROPRIATELY USES REVENUE BOND FUNDING TO PAY CURRENT EXPENSES.

The October 8 Order also erroneously concluded that the City could use proceeds of the revenue bonds to pay current expenses associated with the Fiber Project.¹⁶

The revenue bond proceeds will be parceled into various “funds,” including \$1,250,000 placed in an “Operating Reserve Fund.” App. 3 (Tab 1). This fund is used to pay “Operation and Maintenance Expenses,” which mean “all *the City’s* costs and expenses for operation, maintenance, and ordinary repairs, renewals and replacements of the Facilities.” App. 66 (Tab 2). “Operation and Maintenance Expenses shall not include Debt Service or any allowance for depreciation of any costs and expenses for new construction or other capital expenditures.” *Id.*

¹⁶ This issue is also subject to *de novo* review. *Becker v. Mayo Foundation*, 737 N.W. 2d 200, 207 (Minn. 2007); *Bodah v. Lakeville Motor Express, Inc.*, 663 N.W. 2d 550, 553 (Minn. 2003).

The expenditures from the Operating Reserve Fund will cover the City's obligations to Hiawatha as well as its payroll and benefit obligations to the seven City employees who will be performing services in connection with the Fiber Project. These are current expenses of the City.

Current expenses cannot be funded by revenue bonds. This is true for two reasons. First, they are not authorized anywhere in Minn. Stat. § 475.52. Second, they are expressly excluded by that statute. The District Court erred when it failed to apply the clear language of the statute.

The District Court searched the revenue bond statute for a unifying purpose. But the purpose it identified was so vague and generic as to be of no assistance in construction. The Court said "[t]he enumerated purposes elucidate the intent to permit cities to issue bonds to make a city a better place for its citizens to live." App. 248 (Tab 16). With this amorphous "purpose" as its guidepost, the District Court construed grants of power broadly while negating any limits on those grants.

The purposes listed in the statute have a more specific unifying principal than making "a city a better place." Revenue bonds are used to finance capital intensive projects that can be accomplished only with the long-term repayment options offered by such bonds without otherwise using a government's taxing authority. Had the District Court recognized this more specific goal common to all of the enumerated purposes, it could have given meaning both to the statutory grants of power and to the limitations on those grants.

Revenue bond proceeds are to be used for the purposes delineated.¹⁷ Those purposes all involve “acquisitions” or “betterments” of capital intensive facilities and enterprises. The proceeds can also be used for capitalized expenses – “startup costs” – including “the cost of necessary professional planning studies . . . legal, financial advisory, and other professional services, printing and publication, and interest to accrue on the obligations” Minn. Stat. § 475.65. In sum, revenue bonds are appropriate for significant capital improvements, including costs incurred to realize those improvements. Nothing in the statute authorizes revenue bonds to be used to pay the current expenses of a statutory city.

This is reinforced by the last sentence of § 475.52. This sentence provides the catchall allowance for revenue bonds, adding to the specifically listed uses: “Without limitation by the foregoing the city may issue bonds to provide money for any authorized corporate purpose except current expenses.” Current expenses – payment by a statutory city of its daily bills – is not an appropriate use of revenue bonds, even those authorized by referendum.

The District Court committed multiple errors in determining that the Operating Reserve Fund was not violative of the revenue bond statute. First, it isolated the second sentence of the statute, which contains the express prohibition on the use of proceeds for current expenses, by misreading the introductory clause of that sentence.

¹⁷ There is no authority for the City to repay itself from revenue bond proceeds for funds it advances from other sources, *i e.*, not an “acquisition or betterment.”

The sentence begins, “Without limitation by the foregoing” The “foregoing” is the list of expressly permitted uses for revenue bonds. The catchall provision in the second sentence is not limited by the prior delineation of specific proper uses. But the District Court read the language backwards: it said, “[t]his second sentence explicitly does not limit the prior sentence.” App. 253 (Tab 16). Through this fundamental misreading of the unambiguous language, the District Court turned a single, integrated statutory provision a mere two sentences long into two distinct and unrelated statutory provisions. According to the District Court, current expenses can be funded out of virtually all revenue bond offerings, so long as the bonds are tied into one of the 27 uses for bonds spelled out in the first sentence of § 475.52, and only bonds issued under the catchall “any authorized corporate purpose” are subject to this limit.

The District Court provided no reason why the legislature would have created this two-tiered revenue bond structure, in which current expenses can be funded in some instances but not others. Nor is there any reason. The District Court’s patently erroneous interpretation of the introductory clause of the second sentence caused it to bifurcate the statute, violating the maxim of construction that the statute be read to give effect to all provisions. *Amaral, supra*.

The statute did not need to include an express prohibition on current expenses prior to the 1947 amendment where the “any authorized corporate purpose” provision was added. That is because before that amendment the statute allowed revenue bonds only for the acquisition of various facilities, a limited use that clearly foreclosed current expense payments. It was only when the statute was broadened to allow revenue

bonds for “any authorized corporate purpose” that it was necessary to expressly exclude current expenses. But the statute – in all its incarnations – has never allowed revenue bonds to be used for current expenses, which are to be met by the City on a pay as it goes basis through tax revenues.

The District Court alternatively held that even if the prohibitory clause of the second sentence applied to the statute as a whole, current expenses could be funded. App. 254 (Tab 16). The District Court held that the City has implied power to do all that is necessary in support of its express authority to issue bonds for any “utility or other public convenience from which a revenue is or may be derived.” *Id.*

The City does not have the “implied” power to do that which the statute expressly prohibits. This is not statutory construction; it is statutory amendment and it can be accomplished only by the legislature.

The District Court cited to *Otter Tail Power Co. v. Village of Wheaton*, 49 N.W.2d 804 (Minn. 1951) as its support for the assertion that implied powers can trump express prohibitions. App. 254 (Tab 16). But *Otter Tail* says nothing of the sort. It did not even address the provisions of Minn. Stat. § 475.52 or its prohibition on current expenses. The court there merely held that certain startup costs were properly funded by the certificates at issue.

The District Court’s re-labeling of current expenses as startup costs cannot provide an end-run around the limitations and prohibitions in § 475.52. True startup costs – “professional planning studies . . . legal, financial advisory, and other professional services” – are a permissible use of the proceeds. Minn. Stat. § 475.65. The Operating

Reserve Fund goes well beyond those appropriate uses. The Operating Reserve Fund will pay, for example, the salaries and benefits of City employees working, to some unspecified degree, for the Fiber Project. App. 66 (Tab 2). And it will pay the amounts due from the City to Hiawatha under the management agreement. *Id.* These are not “startup” costs. Startup costs include items such as legal fees to bond counsel, or engineering fees to design the system. The Fiber Project will have employee expenses as long as it operates. Technicians working on the electronics, customer service representatives, general managers and others to be paid by the Operating Reserve Fund are not startup costs; they are current operating expenses.

The District Court supported its factual finding that the current expenses to be paid were startup costs by noting that the Operating Reserve Fund exists for only three years. App. 254 (Tab 16). But “startup” costs do not encompass every current expense incurred by the City during some judicially-defined “startup period” that has no statutory basis. Under the District Court’s interpretation salaries to City employees are startup costs for three years, and then are transformed into current expenses on the first day of the fourth fiscal year of the enterprise. The District Court’s ruling in this regard was not based on the allegations of the Complaint, nor upon conventional accounting definitions. To the contrary, the Court ignored the well-pleaded allegation that the Operating Reserve Fund paid current expenses (App. 3 (Tab 1)), instead holding that it covered only “startup costs” by using a definition of startup costs – anything incurred during the first three years of operation – that it created. The District Court was to accept as true the facts

alleged, and to construe all reasonable inferences in Bridgewater's favor. *Hebert v. City of Fifty Lakes*, 744 N.W.2d 226, 227 (Minn. 2008). It did the opposite.

The District Court's determination that the Operating Reserve Fund was "an essential step in the process" of developing the Fiber Project (App. 254 (Tab 16)) was, likewise, a factual determination on a disputed issue. As the District Court noted, "powers can only be implied when necessary to enable the entity to exercise its express powers." *Id.* at 247. There was no factual support for the determination that the City could not pay the operating expenses of the Fiber Project out of general revenue funds for any period before the project was generating positive cash flow. To the contrary, the facts alleged in the Second Amended Complaint—which the District Court refused to consider—showed that the City had ample resources to build and operate a significant portion of the project without using revenue bond proceeds. App. 713 (Tab 37). It could have paid the current expenses of the Fiber Project out of general revenue funds, and the use of revenue bond proceeds was not "necessary."

Bridgewater's claim that the Operating Reserve Fund covered current expenses presented material factual issues that required discovery and, almost certainly, expert testimony. The District Court made findings of fact that contradicted the well pleaded allegations of the Complaint and that were not supported in the record. This constitutes reversible error under Minn. R. Civ. P. 12.02. *See In re Milk Indirect Purchaser Antitrust Litig.*, 588 N.W.2d 772, 775 (Minn. App. 1999).

III. THE DISTRICT COURT ABUSED ITS DISCRETION IN DENYING BRIDGEWATER'S MOTION FOR LEAVE TO FILE THE FIRST AMENDED COMPLAINT.

A. Standard of Review.

This Court reviews the denial of Bridgewater's motion for leave to amend under an abuse of discretion standard. *Hempel v. Creek House Trust*, 743 N.W. 2d 305, 313 (Minn. App. 2007)

B. Bridgewater Properly Sought To Allege Newly Discovered Facts In The First Amended Complaint.

At the time of the filing of the Complaint, the City had not yet issued the final revenue bond documents. The Official Statement and Indenture both issued at the beginning of June. The First Amended Complaint included allegations based on the provisions of each of those documents. Especially germane to this appeal, the Indenture expanded on the definition of Operation and Maintenance Expenses to make it clear that such expenses were – by the City's admission – current expenses. It provided:

“Operating and Maintenance Expenses” means all the City's costs and expenses for operation, maintenance, and ordinary repairs, renewals and replacements of the Facilities, and shall include, without limiting the generality of the foregoing, programming costs, rents, administrative and general expenses, engineering expenses, legal and financial advisory expenses, required payments to pension, retirement, health and hospitalization funds, taxes, payments in-lieu-of taxes and other governmental charges, insurance premiums, *and any other current expenses or obligations required to be paid by the City* under the provisions of this Indenture or by law, all to the extent properly allocable to the Facilities, and the fees and expenses of the Trustee. Operation and Maintenance Expenses shall not include Debt Service or any allowance for depreciation or any costs and expenses for new construction or other capital expenditures.

App. 267-68 (Tab 19) (quoting App. 540 (Tab 25)). (emphasis added).

Because the District Court denied leave to amend, it did not consider this dispositive admission by the City in its October 8 Order, finding that Operation and Maintenance Expenses did not encompass current expenses.

The First Amended Complaint, as revised during briefing on the motion for leave to file, also added factual allegations regarding the central role of Hiawatha in the Fiber Project. The District Court's conclusion that the benefits to Hiawatha did not affect the legality of the revenue bond issue was based on the more skeletal allegation of the Complaint. App. 252 (Tab 16). The District Court should have considered the additional facts alleged in the First Amended Complaint.¹⁸ Moreover, even if the District Court had determined that Bridgewater could not revise the proposed First Amended Complaint during briefing on the leave to amend motion, the additional allegations regarding Hiawatha were before it in the motion for leave to file Second Amended Complaint.

The standard for leave to amend is permissive: leave should be granted "when justice so requires." Minn. Rule Civil Procedure 15.01. "[U]nless prejudice going to the merits has been established, the amendment should be permitted." *LaSalle Cartage v. Johnson Bros. Wholesale Liquor*, 225 N.W.2d 233, 237-38 (Minn. 1974). As Herr and Haydock note:

¹⁸ The First Amended Complaint also added an allegation that the City did not conduct the referendum required to issue bonds under the "any authorized corporate purpose" provisions of § 472.52 subd. 1. App. 266 (Tab 19). Because the District Court did not reach that fallback argument by the City, its failure to allow this addition was harmless. However, should this Court address that fallback claim it will need to do so with the full factual record as alleged in the First Amended Complaint.

[Rule 15.01] requires that amendments should be liberally allowed. This rule has repeatedly been given literal interpretation by the Minnesota Supreme Court and the trial courts, and amendments are liberally granted in practice. Unless parties opposing an amendment can establish prejudice, other than merely having to defend against an additional claim or defense, amendments will be allowed.

1 David F. Herr & Roger S. Haydock, *Minn. Prac., Civil Rules Ann.*, Rule 15.01, § 15.5 (4th ed. 2007).

The motion for leave to file the Amended Complaint was brought when this action was less than two months old. The City had initiated no discovery. The amendment sought to add facts based on documents the City generated after the filing of the Complaint and then only reluctantly provided to Bridgewater; obviously facts that could not have been included in that original pleading. Rather than immediately allowing amendment and considering the new facts in determining whether the revenue bonds were validly issued, the District Court waited over two-and-a-half months to rule, and then denied leave to amend because (1) time was of the essence, and (2) the First Amended Complaint, according to the District Court, only added factual allegations to “question the political process by which the City undertook to the [*sic*] issue bonds and not whether the City possesses the statutory authority to act in such a manner.” App. 691-92 (Tab 33). These “reasons” provide no basis to support the order of the District Court denying leave to amend.

This case required some expedition; a fact Bridgewater recognized from the outset. But the need to expedite does not trump the need for a correct resolution. Nor can it defeat Bridgewater’s right to bring to the Court’s attention relevant facts that could

not have been included in the Complaint. The District Court did not properly exercise its discretion by delaying ruling on a routine motion to amend for months, and then justifying denial of that motion by saying time was of the essence.

The District Court was clearly wrong in its conclusion that the amendment only sought to add complaints about the referendum held to offer telephone service and did not add facts going to the City's authority to issue revenue bonds. As shown above, the First Amended Complaint added allegations regarding current expenses and Hiawatha's role, both of which are relevant to the authority to issue revenue bonds. The importance of such facts to the issues of statutory construction was expressly identified by Bridgewater in briefing on its motion for leave to amend. App. 259 (Tab 18); App. 640-42, 644, 646-48 (Tab 28).

In short, Bridgewater was prevented from bringing before the District Court material facts, including the City's admission that Operation and Maintenance Expenses cover "current expenses or obligations required to be paid by the City." App. 267-268 (Tab 19) (quoting App. 540 (Tab 25)). These facts could not have been included in the initial Complaint. The Indenture containing these terms post-dated filing of the Complaint. The District Court's denial of leave to amend – leading to its failure to consider those matters – was an abuse of discretion.

C. The District Court Abused Its Discretion In Denying Bridgewater's Motion For Leave To File Second Amended Complaint.

The proposed Second Amended Complaint was necessitated by the City's announcement in late July that it was constructing a subset of the Fiber Project, called the

Fiber Loop, to offer high-speed data service to commercial customers. (Telephone and cable television services were not to be included in the Fiber Loop project.) The District Court determined that Bridgewater's claims involving the Fiber Loop were unrelated to the City's authority to issue revenue bonds and that leave to amend should be denied in order to permit prompt appeal of the dismissal of the revenue bond challenge. The District Court expressly noted it was not passing on the merits of the new claims, but merely sought to assure prompt appeal of the claims in the original Complaint. App. 786-87 (Tab 42).

It is true that the claim to be added by the Second Amended Complaint – while arising out of the same core of operative fact as the other claims in this action – did not seek to void the revenue bonds. It sought relief that was indirectly related to the revenue bonds, however. Bridgewater requested that the City be prohibited from entry into a private business. That business is eventually to be funded by the revenue bonds.

Joinder of all claims between the parties that relate to the same operative facts is encouraged. Indeed, had the Fiber Loop project been announced before the original Complaint was filed, Bridgewater would have been required to plead the claims contained in the Second Amended Complaint or suffer the merger and bar consequences or *res judicata*. See *Brown-Wilbert, Inc v. Copeland Buhl & Co., P.L.L.P.*, 715 N.W.2d 484, 488 (Minn. App. 2006) ("[A] plaintiff may not *split his cause of action* and bring successive suits involving the same set of factual circumstances.") (quoting *Hauser v. Mealey*, 263 N.W.2d 803, 807 (Minn. 1978)). By requiring that Bridgewater assert those claims in a newly-filed separate action, the District Court imposed a significant and

undue burden. Minnesota Statute § 562.02 provides that any action challenging a municipality may be conditioned on a surety bond. Bridgewater had to post a \$2,500,000 bond to bring this action. App. 162-64 (Tabs 8-9). To disallow normal joinder and require a new action – with another surety bond hearing – is to interpose an unnecessary procedural hurdle before Bridgewater.

This might have been defensible had there been a genuine concern about the immediate appealability of the District Court's dismissal of the revenue bond claims. But there was not. Rule of Civil Procedure 54.02 allows the District Court to enter Final Judgment on the revenue bond claims while permitting the continued prosecution of the claims added by the Second Amended Complaint. That judgment would be immediately appealable under Rule 103.03(a) of the Rules of Appellate Procedure. This procedure fully protects the City's interest in an expeditious appeal of the revenue bond ruling while not requiring Bridgewater to file a new lawsuit, and post a second surety bond.

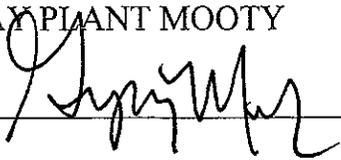
IV. CONCLUSION

For the foregoing reasons, plaintiff-appellant Bridgewater Telephone Company, Inc. requests that this Court reverse the District Court's Findings of Fact, Conclusions of Law and Orders of October 8, 9 and 10 and remand this action to permit the action to proceed on the merits of the proposed Amended or Second Amended Complaints.

Dated: December 15, 2008

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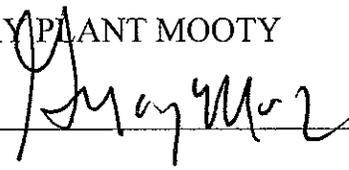
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