

No. A11-705
**STATE OF MINNESOTA
IN COURT OF APPEALS**

City of Moorhead,
Appellant,
v.
Red River Cooperative Power Association, et al.,
Respondent.

**BRIEF OF MINNESOTA MUNICIPAL UTILITIES ASSOCIATION,
MISSOURI RIVER ENERGY SERVICES, WESTERN MINNESOTA
MUNICIPAL POWER AGENCY AND COALITION OF GREATER
MINNESOTA CITIES AS *AMICI CURIAE* IN SUPPORT OF APPELLANT**

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STATEMENT OF LEGAL ISSUE

When deciding damages in an eminent domain proceeding under Minn. Stat. § 216B.47 may evidence of fair market value or analysis of fair market value principles be considered? ¹

The District Court ruled in several motions that fair market value may not be considered in determining damages and excluded all evidence of fair market value.

¹ Pursuant to Minn. R. Civ. App.P. 129.03, Municipal Amici certify that this brief was not authored in whole or in part by counsel for either party to this appeal and that no other person or entity besides the Municipal Amici made a monetary contribution to its preparation or submission.

The Appellant City of Moorhead is a member of the CGMC. Moorhead Public Service is a member of MMUA, MRES, and Western Minnesota. Funds to pay for this brief came out of the general funds of each organization and were not paid specifically by the city or its public utility.

STATEMENT OF IDENTITY OF AMICI

The Minnesota Municipal Utilities Association (MMUA) represents the interests of Minnesota's municipal electric and gas utilities. There are 125 municipal electric and 31 municipal gas utilities in Minnesota. Established in 1931, MMUA's mission is to unify and serve as a common voice for municipal utilities and to provide them with the support they need to be able to improve service to their customers and community. MMUA has long supported the right of municipal electric utilities to grow with their cities, a right they have held since the inception of the electric utility industry more than a century ago.

Missouri River Energy Services (MRES) was established under Chapter 28E of the Iowa Code and exists under the intergovernmental cooperation laws of the states of Iowa, Minnesota, North Dakota and South Dakota. MRES is comprised of 61 municipally-owned utilities in those states, including 24 in Minnesota. Western Minnesota Municipal Power Agency (Western Minnesota) is a Minnesota political subdivision formed under Minn. Stat. §§ 453.51-.62 (2010). The current membership in Western Minnesota consists of 24 Minnesota municipal utilities, 23 of which are MRES members, each of which owns and operates a utility for the local distribution of energy. Western Minnesota's principal activity is the acquisition and ownership of generation and transmission facilities, both within Minnesota and elsewhere, and the sale of Western Minnesota's

entitlement to power, energy and transmission capabilities to MRES. MRES provides firm power and energy to its member cities to supplement the hydroelectric power and energy needs to its member cities. MRES and Western Minnesota offer the unique perspective of 24 Minnesota municipalities and a municipal power agency that could be directly affected by the outcome of this appeal.

The Coalition of Greater Minnesota Cities (CGMC) is a non-partisan association of 76 cities located throughout greater Minnesota. Its mission is to develop viable, progressive communities for businesses and families through strong economic growth and good local government. The CGMC supports good land use planning that promotes efficiency, protects the environment, and safeguards the interests of taxpayers. Many CGMC members own and operate municipal utilities and could be directly affected by the outcome of this case.

STATEMENT OF INTEREST OF AMICI

The Municipal Amici have a public interest in ensuring that the calculation of damages in eminent domain proceedings under Minn. Stat. § 216B.47 (2010) includes evidence or analysis of fair market value principles. The member cities and their utilities that comprise the Municipal Amici expect to grow (or expect their members to grow) through annexation in the future and further, to extend their electrical service as their city boundaries grow. The municipalities and their utilities expect to

pay fair compensation for any service territory they would acquire through eminent domain. Removing the concept of fair market value from the eminent domain analysis would mean that cities pay just compensation without any grounding in valuation theory or eminent domain jurisprudence. This new damages calculation will result in higher damages awards which in turn will impact the municipalities' decisions on whether to expand. Municipal power agencies will also be affected because their long range plans are based on the growth plans of member cities.

INTRODUCTION AND SUMMARY OF THE ARGUMENT

For more than a century, Minnesota has recognized the right of its citizens to form and develop cities and the accompanying right for the cities to create, operate and expand utilities to serve their citizens. Those legislatively protected rights are grounded in common sense and sound economic principles. As new commercial or residential areas are developed, placing the development near existing cities means lower infrastructure costs and the protection of rural farmlands. Creating a municipal utility allows citizens to exercise control over the services they receive and the rates charged. Allowing municipal utilities to expand as the cities develop means that everyone within those cities will receive equal service and will equally share the risks and benefits of owning a public utility.

The results of this case could undermine those rights and the underlying public policy. In 1974, when the Legislature divided the state into electric service territories it preserved the right of municipal electric utilities to use eminent domain to expand along with their municipalities in Minn. Stat. § 216B.47 (2010). This statute recognizes that municipal utilities may continue to use eminent domain and specifies that the calculation of damages must include four specific factors. *Id.*

Minnesota courts have consistently held that the calculation of damages in an eminent domain case must include consideration of the fair market value of the property. In this case, however, the District Court ruled in a series of orders that evidence of fair market value could not be considered when calculating damages under the four factors of § 216B.47. Municipal Amici believe that excluding fair market value in this manner not only contradicts the plain language of the statute, but also contradicts the public policy and legislative intent that undergird the statute.

Municipal Amici agree with the Appellant that interpreting the four factors does not preclude and may actually require consideration of fair market value. To exclude fair market value will lead to a damage calculation that is, in the words of Red River's expert, "inherently higher." The increasing cost of acquiring service territory is already deterring municipal utilities from expanding into annexed areas to serve all of their citizens. Further raising the cost will make it much more likely that

municipal utilities will be unable to exercise their legislatively guaranteed right to grow with their cities and will undermine the legislative preference for promoting growth within cities.

The current legislative provision that guarantees municipal utilities the right to use eminent domain to grow with their cities arose out of a legislative compromise between municipalities and the rural electric associations. Removing fair market value from just compensation analysis undermines that important compromise thereby significantly increasing the cost and making municipal utilities' exercise of their territory expansion rights less likely to occur.

STATEMENT OF THE CASE AND FACTS

Municipal Amici concur with the Appellant's statement of the case and facts.

ARGUMENT

I. **Excluding Fair Market Value From Compensation Calculation Discourages Sound Land Use Policies And The Associated Growth Of Municipal Services.**

The Minnesota Legislature has long recognized the important role that cities and municipal utilities play in the growth and development of our state. The District Court rulings excluding fair market value from the

eminent domain damages calculation² frustrate Minnesota's policy preferences for how cities should develop and grow by increasing the costs associated with annexation and territory service acquisition. This decision has negative implications not only for this parcel at issue, but for future development throughout the state by making these service expansions so expensive that they may not occur.

A. Municipal Services, Including Electric Utilities, Should Expand With Cities.

Sound land use policy plays an important role in the economic growth of the state. Minn. Stat. §414.01, subd. 1a(2010). In Minnesota, our land use policy favors development that is efficient and economic. Cities are preferred for intensive residential, industrial, and urban development because they are best situated to accommodate that growth.³

² The District Court ruled on the fair market value issue in several pre- and post-trial orders. The District Court ruled that fair market value may not be considered in determining damages and that no evidence of fair market value would be admissible in these pre- and post-trial motions as well as denying the City's requested jury instructions concerning fair market value. Appellant's Addendum ("Add") at 4, 15, 18-19.

The District Court also excluded evidence related to facility replacement largely on procedural grounds. Municipal Amici are not addressing this procedural issue and are focusing solely on the substantive issue of whether fair market value evidence or analysis may be considered when calculating just compensation in a utility eminent domain case brought under Minn.Stat. § 216B.47.

³ The Legislature also encourages the use of annexation to facilitate this growth. The Municipal Boundary chapter calls for annexation to be facilitated in unincorporated areas that lack services and encourages

Id. Case studies support this preference for growth within cities because “the fiscal impacts of new residential development tend to be enhanced when it occurs in cities, rather than in outlying rural areas.” Minnesota Department of Agriculture, Cost of Public Services Study (1997), p. 1, <http://www.mda.state.mn.us/news/publications/aboutmda/pubservcosts.pdf>

A city is not just a collection of homes and businesses that lie in close proximity. A city is, at its heart, a community with a comprehensive plan to provide for its citizens’ shared needs and aspirations. It is for these reasons that the Legislature granted cities the right to establish municipal utilities and extend water, sewer, electricity and other utility services to developing areas.⁴ State policy also recognizes that when a city extends a line from its sewer system and water system, it logically follows that, if the city also provides electricity to its citizens, new citizens rightly expect to receive that same service as well.⁵

Allowing municipal services to follow municipal growth serves broad public policy interests. Tying utility growth to city growth preserves the financial stability and fiscal integrity of the city’s overall financial structure

orderly annexation and mergers of cities and townships. Minn. Stat. §414.01 subd. 1a (4),(5) (2010).

⁴ *Cf.* Minn. Stat. Ch. 9, § 758.23 (1909 supp.) (repealed 1976 and superseded by Minn. Stat. §412.321 and Minn. Stat. §452.08 (2010) (granting cities the right to operate municipal utilities)

⁵ *Cf.* Minn. Stat. Ch. 9, § 758.24 (1909 supp.) (repealed 1976 and superseded by Minn. Stat. §412.321 subd. 3 and Minn. Stat. §452.08 (2010) (granting municipal utilities the right to expand.)

and credit ratings. It also ensures that all customers receive the same service and price throughout the city and reduces confusion among city residents. Moreover, municipal utilities are owned by the taxpayers of the city – all city residents should enjoy the benefits of this service as well as bear any risks or costs associated with that ownership. Two decades ago, Judge Davies explained these policy rationales that still apply today:

One of the reasons, certainly, that the legislature permitted municipalities to extend service to annexed areas was to permit it to keep all residents on an equal basis as both taxpayers and utility customers. Were a portion of the community to be left out of the benefit--or burden--of local power rates, political problems concerning rate setting and investment decisions could result.

In re People's Co-Operative Power Association, 470 N.W. 2d 545, 534 (Minn. Ct. App. 1991) (Davies, J., dissenting).

Minnesota's municipal utility growth policy also acknowledges the state's preference that commercial, residential, and industrial growth occur within cities. Minn. Stat. §414.01 subd. 1a (2) (2010). To attract and accommodate such new development, cities often make significant investments by extending municipal services based on comprehensive plans aimed at promoting city viability and, hopefully, progress.⁶ Part of

⁶ Municipal Power Agencies such as Western Minnesota routinely make planning and resource decisions based on cities' and their utilities'

the reason for this growth preference and the desire to attract development is the benefit that economies of scale provide in an array of ways via infrastructure placement. Tying municipal utility growth to city growth assures that those economic benefits of scale accrue to the city and its residents both as citizens and utility customers.

These important principles of economical and efficient land use, financial stability, equity and sound city management and investment are the types of factors that should inform how the court interprets the calculation of damages in utility eminent domain cases. Unfortunately, they have gone unnoticed in many service area cases, including this one, in favor of less sound principles that lack grounding in valuation principles or eminent domain jurisprudence.

B. Removing Fair Market Value Will Deter Municipal Utility Service Territory Expansion.

Excluding consideration of fair market value removes the constraint on the just compensation damages calculation that have long been present in eminent domain jurisprudence.⁷ Red River's expert has explained that his analysis was from the "seller's perspective." Affidavit of Kaela Brennan ("Brennan Aff"), Exh. A at 186 – 87. This analysis does not follow business

comprehensive growth plans. Judicial decisions that hinder municipal utilities' ability to grow with their cities also create uncertainty for these agencies.

⁷ See, e.g., *Minneapolis-St. Paul Sanitary District v. Fitzpatrick*, 277 N.W. 394, 398 (1937); *State by Spannaus v. Carney*, 309 N.W.2d 775, 776 (Minn. 1981).

valuation standards. T. 246. With no grounding in eminent domain law or valuation theory, there are no limits on what a seller might perceive its damages to be. Although Minn. Stat. § 216B.47 provides factors that must be included, the factors themselves, particularly the loss of revenue and the other appropriate factors, require interpretation. Fair market value provides the framework for that analysis.

Removing fair market value and relying solely on the seller's perspective will undoubtedly increase the costs to municipal utilities as illustrated by the expert opinions in this case. The appellant's expert made an offer of proof that the loss of revenue damages would have been significantly less if fair market value analysis were applied. Trial Transcript ("T.") at 381-82. The appellee's expert also stated that his calculation of damages is "almost inherently" higher than fair market value. Brennan Aff., Exh. A at 226 – 27. Cities such as Moorhead are willing to pay fair and reasonable compensation, but as these costs escalate with no reasonable limitation, cities will be less likely to exercise their right to extend to their citizens electrical utility service to annexed areas.

Anecdotally, it appears that this chilling effect on municipal service territory is already occurring. At least 27 MMUA member cities are not serving all of their residences and at least 9 of those have 50 or more residences served by a different utility. If the formula loses its grounding in basic eminent domain compensation theory, this problem will only worsen.

The electric cooperatives have recognized that increasing the compensation required for municipal territorial expansions will deter municipal utilities from exercising their statutory right to expand. For example, in a 2002 territory transfer case, staff at the Minnesota Public Utilities Commission (PUC) expressed the opinion that in a series of service area transfer dockets involving Rochester and the People's Electric Cooperative it appeared the Cooperative was seeking to make these transfers prohibitively expensive. PUC staff pointed out the "Cooperative's apparent strategy of making all facets of the City's acquisition of service rights be so cumbersome and costly that the City eventually would back off and let the Cooperative share in the City's growth." Staff Briefing Papers for MN PUC Docket E-275, I34/SA-02-1207, at p.3, Sept. 12, 2002.⁸

Another Minnesota electric cooperative explained in a resolution seeking CFC integrity funds⁹ that increasing the costs in eminent domain cases would provide service territory protection:

[A]sserting G&T losses on behalf of its other affected distribution cooperatives represents an opportunity to achieve virtual territorial protection by increasing the taking cost. Locally LCP's Request of

⁸ Reproduced at Amici Appendix ("Amici Apx") at 4.

⁹ The National Rural Utilities Cooperative Finance Cooperation has established a cooperative system integrity fund that funds litigation challenging municipal utilities that exercise their expansion rights. (<http://www.cooperativemunicipalutilities.org/cfc-will-not-see-contributions-to-integrity-fund-this-year/>). The resolution quoted above refers to a request for those integrity funds.

Integrity Funds will ensure that any future degradation of the co-op's service area by the municipal utility will be made more difficult.

Minutes of the Lake Country Power, November 27, 2001 Board meeting.¹⁰

In that same resolution, the cooperative noted that it was testing a novel compensation formula before the PUC that could dissuade future takings. "Besides challenging the PUC's taking, the co-op is intent on expanding the current compensation formula. . . . If successful, it could well set a precedent for future compensation cases and may well dissuade future taking by Minnesota's acquisitive municipal-owned utilities." *Id.* Although that particular attempt at expanding the compensation formula failed, it demonstrates that the cooperatives recognize that increasing the cost of eminent domain will deter municipal utilities from exercising their service territory expansion rights.

The economical and efficient expansion of cities through annexation and concomitant municipal electric growth should be encouraged. While the cooperatives deserve just compensation under Minn. Stat. §216B.47, this court should not interpret the four factors of that statute to remove the reasonable restraint that the concept of fair market value imposes. To do so could increase damage calculations so much that territory expansion realistically will not occur, frustrating the legislative goal of promoting

¹⁰ The minutes were entered as evidence, Exh. 28, in *In re Grand Rapids Public Utility Commission*, Minn. PUC Docket No.E-2483, 3-896 and are reproduced at *Amici* Apx. 6 – 7.

growth through municipalities and municipal utilities.

II. Excluding Fair Market Value Contradicts Legislative Intent Favoring Municipal Utilities' Right To Expand With City Boundaries.

Municipal utilities have always had the right to expand with their cities. The current statutory provisions were adopted as part of a legislative compromise between cooperatives, municipal utilities and investor-owned utilities enacted when the Legislature divided the state into service territories. The District Court's expansive interpretation of just compensation in utility eminent domain cases undermines that legislative compromise by removing the limits on fair compensation and making municipal territory expansion prohibitively expensive. Moreover, excluding fair market value from the eminent domain analysis represents another attempt at undoing the legislative recognition of municipal utilities' rights.

A. The Eminent Domain Procedure Reflects A Legislative Compromise To Protect Municipal Rights

The right of cities to extend their electric utility services as their boundaries grew existed long before the 1974 Public Utilities Act established service territories in Minnesota. At least as early as 1907, the state recognized the right of cities to establish municipal electric utilities, which included the power to expand or add to that utility using eminent domain. Minn. Stat. Ch. 9, § 758.23 (1909 supp.) (repealed 1976 and superseded by Minn. Stat. §412.321, §452.08 (2010)). The right of

municipal utilities to expand with their cities remains in place today as the result of a legislative compromise between municipalities and cooperatives.

Before 1974, the concept of service territory protection did not exist in Minnesota. A key objective of the 1974 Public Utilities Act was to develop a system that efficiently and cost-effectively served the public by creating service territories. Minn. Stat. § 216B.37 (2010) *see also In re People's Co-Op Power Association*, 470 N.W. 2d 525, 531 (Minn. Ct. App. 1991) (Davies, J., dissenting and reviewing the legislative history of the Public Utilities Act). This act divided the state into service territories giving investor owned utilities, rural electric associations (REAs) (*i.e.*, cooperatives) and municipal utilities the right to provide service to their existing customers and halfway to the adjacent utility's existing lines. 470 N.W. 2d at 532 (citing Minn. Stat. § 216B. 37 (1974)).

The rural electric cooperatives were the primary proponents of this change. They were planning to build a large new generating facility in North Dakota that would supply wholesale electricity to most cooperatives in Minnesota. To secure the loan for this facility, the cooperatives had to demonstrate to their lenders that they had protected service territory. "[O]ne of the principle reasons that the cooperatives talked about service territories in the '70's was because we were gonna commit a billion dollars

to that plant and we wanted to have some assurance, as our bankers did, that we were gonna be around to pay for it..." Harold LeVander Jr., counsel for the Minnesota Electric Cooperatives Association, Hearing of the Minnesota House Regulated Industries Committee on HF 619, Concerning Electric Utility Service Territories & Rates, February 20, 1989, Amici Apx. at 11-12.

The municipal utilities were willing to accept the proposed service territory law, provided that the law preserved the right of municipal electric utilities to grow with their cities following annexation. As Judge Davies explained, "The municipal utilities . . . insisted upon, *and obtained from the legislature, the buy-out right upon annexation.*" *In re People's Co-op Power Association*, 470 N.W. 2d 525, 533 (Minn. Ct. App. 1991) (Davis, J., dissenting) (italics in original).

Because they were receiving significant territorial protection the cooperatives agreed to this legislative compromise. During legislative testimony, Mr. LeVander affirmed that the Legislature was preserving this important right for municipalities, "In other words, we're preserving really, the right of the municipally-owned systems to continue to expand with their corporate borders, . . . should annexations occur." Hearing of the Minnesota House State Boards and Commissions Subcommittee of the House Government Operations Committee on H.F. 957 and H.F. 1835

concerning electric utility regulation and the establishment of electric utility service territories, April 19, 1973. Amici Apx. at 9.

It is in this context of a legislative compromise preserving the municipal utilities' right to grow with their cities that the language of Minn. Stat. § 216B.47 should be interpreted. Appellant has explained how the language of § 216B.47 requires that the constitutional and statutory principles regarding eminent domain apply to procedures involving utilities, thereby requiring consideration of fair market value principles. Municipal Amici agree and will not repeat those arguments. Municipal Amici also agree that the plain language of this statute does not conflict with consideration of fair market value.

Municipal Amici further argue, however, that the lower court's interpretation conflicts with the legislative intent supporting this compromise. The District Court suggests that the Legislature authorized an "enhanced measure of damages" through the language of § 216B.47 Add. 21-22. The language of the statute does not suggest that the damages necessarily should be enhanced above the amount the standard eminent domain calculation would provide.

Equally important, there is no evidence to show that the Legislature intended to establish a single new type of eminent domain case where fair market principles are supplanted. No evidence has been presented that

the Legislature was creating a new form of eminent domain analysis and none exists because it was not part of the compromise that led to the statute's enactment. Rather, the Legislature intended fair compensation using long established eminent domain principles, which include fair market value, to preserve the municipal utilities' right to grow with city boundaries, and the statute must be read with that in mind.

In addition, as stated above, by excluding the concept of fair market value the lower court's opinion removes any reasonable boundaries on the calculation of damages. In so doing, the court is expanding the definition so that in the future the right to grow that the Legislature intended to preserve will be prohibitively expensive for many municipal utilities to exercise.

B. Removing The Principle Of Fair Market Value From Just Compensation Analysis Is Another Attempt To Undo The Legislative Compromise

Although the cooperatives supported the territorial service compromise protecting municipal utilities' expansion rights, since then they have employed a variety of means to undermine this legislative compromise. Attempting to reformulate how damages are calculated in eminent domain cases represents another attack on municipal utilities' legislatively guaranteed rights.

For example, the Minnesota Rural Electric Association (MREA),

which represents the cooperatives, recommended to Minnesota's Legislative Electric Energy Task Force the outright repeal of municipal utilities' right to grow with their cities as set forth in Minn. Stat. § 216B.44 and § 216B.47. Amici Apx. at 15. And as noted earlier, the cooperatives have attempted to advance alternative theories of compensation in other cases precisely to slow down or stop service territory expansion and to achieve a virtual service territory freeze for multiple distribution utilities. Amici Apx. at 4, 6-7.

This case, which seeks to greatly expand the damages available to cooperatives by removing fair market value from the eminent domain calculation, is yet another attempt at undoing the legislative compromise of 1974. To date, the Legislature has rejected attempts to repeal § 216B.47. Removing the elements of fair market value from the eminent domain analysis would accomplish a similar result, increasing the cost of expanding service territory so that few municipal utilities will exercise their statutory right to expand.

CONCLUSION

Minnesota has long recognized the legislative right of municipalities to establish utilities and to grow the utilities as the city expands. Removing the concept of fair market value from the calculation of damages when a municipal utility exercises its rights to expand through eminent domain

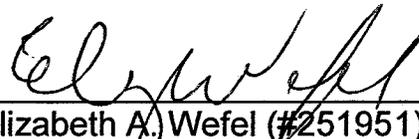
frustrates the public policy and legislative intent behind this long standing right. Municipal Amici urge this court to reverse the District Court's decisions that just compensation in this matter must not be based upon fair market value, that all evidence concerning fair market value should be excluded, and that any jury instructions referencing fair market value should be rejected.

Respectfully submitted,

FLAHERTY & HOOD, P.A.

Dated:

June 27, 2011



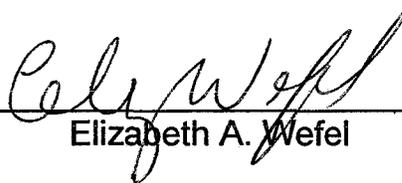
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CERTIFICATION OF COMPLIANCE WITH THE
REQUIREMENTS OF MINN. R. APP. P 132.01

I, Elizabeth A. Wefel, the attorney *for Amici Curiae* of Minnesota Municipal Utilities Association, Missouri River Energy Services, Western Minnesota Municipal Power Agency and Coalition of Greater Minnesota Cities, hereby certify that this brief complies with the form and length requirements of Minn R. App. P. 132.01, subds. 1 and 3. Counsel for *amici* prepared this brief using the word processing software Microsoft Word 2007. The *amici* brief was printed in 13-point type using the proportional font Arial. According to this software's word count utility, the brief contains 4,238 words, and hence is within the 7000 word limit set by Minn. R. App. P. 132.01, subd3. Pursuant to this Court's order dated May 17, 2011, this brief does not exceed 20 pages.

June 27, 2011


Elizabeth A. Wefel