FAEGRE BAKER DANIELS

MEMORANDUM

PRIVILEGED AND CONFIDENTIAL

TO:	Kevin McCann, Gaylord City Administrator
FROM:	Stephen C. Rosholt
DATE:	September 4, 2012
RE:	Fiber Optic Broadband Communications Project

At your request I have reviewed the documents furnished by Kennedy & Graven relating to the financing of the project. I found the summary memorandum to be an accurate description of the documents and I believe the documents accomplish what they purport to do. That said, I believe the financing involves substantial risks which should be considered:

A. Shortfall Agreement. Subject to "nonappropriation" the agreement would commit the City to pay as much as 16.5% (150% of the 11% base amount) of the debt service on the up to $77 million of revenue bonds to be issued for the project. This nearly doubles the City's outstanding debt commitments. Potential consequences of nonappropriation are as follows:

1. Misrepresentation Lawsuits. Although nonappropriation is possible, Section 2.3 of the Shortfall Agreement contains a representation that the City "reasonably believes that moneys in an amount sufficient to pay [its share] of any and all Shortfall Amounts can and will be appropriated . . .". A number of years ago representations by municipalities regarding their intention to appropriate for shortfalls on housing projects resulted in misrepresentation lawsuits (which the cities lost or settled) when shortfall appropriations were not forthcoming. The City currently has a relatively large amount of outstanding debt. I am not sure what the basis is for saying that there is a reasonable expectation that an appropriation will be forthcoming. I am not sure there is a practical downside to nonappropriation. The Council should consider whether it actually has the expectation and fiscal capacity to make the full amount of the potential appropriations. I suggest this language be deleted from the Shortfall Agreement.

2. Bond Rating. Some have speculated that failure to appropriate under such an agreement would have an adverse impact on a city's bond rating or ability to access the financial markets. It may also be the case that the fact of entering into the sort of commitment

reflected by the Shortfall Agreement would have a negative impact. The City should seek expert financial advice on this subject.

B. Telephone Service. The business plan assumes that the project will include telephone service. Minnesota Statutes, Section 237.19 requires passage of a referendum in order for a municipality to construct a new telephone exchange. We understand the Joint Powers Board believes that the statute does not apply where the switching is handled elsewhere. We do not agree with that conclusion. The City should consider requesting that a legal opinion be directed to it addressing that issue. We would be happy to share the research we have done on that subject.

C. Derivative Liability. We are uncertain whether it is possible to fully insulate the City from potential liability in connection with litigation that could arise out of the offering of the bonds by the Joint Powers Board. Depending on the nature of the agreement, courts may look through the joint powers organization to hold members liable for actions of the joint powers entity. See e.g., In the Matter of Greater Morrison Sanitary Landfill, 435 N.W.2d 92. It may help to include language in the Joint Powers Agreement providing that members are not liable for actions of the entity.

D. City Charter. Minnesota Statutes, Chapter 238, requires that cable operators, including municipal entities, obtain a franchise. The City has entered an existing franchise and any new additional franchises may not be more favorable or less burdensome. Under the Charter, the new franchise must be adopted by ordinance with a 4/5ths vote and the ordinance is subject to referendum. I have not reviewed the existing cable franchise ordinance. I would think the Joint Powers Board should review the implications of these requirements. The City should have the right to withdraw from the Joint Powers Board without liability if the franchise is not granted.

E. Timing. We recommend the City not execute the Shortfall Agreement until it has seen all the documentation for the transaction such as the Official Statement, Net Operating Agreement, Continuing Disclosure Agreement and Bond Purchase Agreement. Accordingly, the resolution should provide an out if the City is unsatisfied after completing appropriate due diligence.

SCR:bjm
fb.us.9086946.01