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August 30, 2011

The Honorable Ken Harycki
Mayor, City of Stillwater
216 – 4th Street North
Stillwater, Minnesota 55082-4807

Dear Mayor Harycki:

The Office of the State Auditor (“OSA”) received concerns about the City of Stillwater’s (“City”) donation of \$80,000 in tax increment to the Coalition for the St. Croix River Crossing (“Coalition”), a nonprofit corporation. In addition, concerns were raised about whether the Mayor, who is the Co-Chair of the Coalition, could participate in the vote regarding the donation. During our review of these concerns, the OSA learned that the City also paid the Coalition’s \$70 filing fee with the Minnesota Secretary of State, and that the City’s contract with The Conach Group did not accurately reflect the services The Conach Group was providing to the City.

The OSA knows of no authority for the City to make an \$80,000 donation to the Coalition or to pay the Coalition’s filing fee with the Minnesota Secretary of State. The OSA received no evidence showing that the Mayor was disqualified from voting on matters related to the Coalition. The OSA found that the City did not use effective contracting principles when it donated \$80,000 to the Coalition or when it contracted with The Conach Group. Indeed, the City had no contract with the Coalition. The OSA will handle any issues related to the use of tax increment for the \$80,000 donation through the procedures required under the tax increment financing (“TIF”) laws.

This letter provides the City with the OSA’s findings and recommendations.

Background

For several years, there have been discussions about the construction of a new bridge over the St. Croix River. The Coalition was formed to support the construction of a specific bridge that, on the Minnesota side of the River, would be located in the City of Oak Park Heights.¹ The Coalition describes itself as a bi-state alliance of local government, business, community, and labor leaders, whose purpose is to educate

¹ Other bridge designs and locations have been proposed. *See, e.g.*, Coalition’s presentation included in the City Council agenda packets for the July 5, 2011, City Council meeting, available on the City’s website.

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citizens and to advocate in Wisconsin, Minnesota, Washington, D.C., and the media for the new bridge.² The Mayor is the Co-Chair of the Coalition. The Coalition's registered office address on the Minnesota Secretary of State's website is City Hall.

The City Council unanimously approved the City's participation in the Coalition at its November 16, 2010, City Council meeting.³ The City Council also unanimously approved the payment of annual membership fees to the Coalition.⁴ While the City has not paid the Coalition's membership fees, the City Council unanimously approved payment of \$70 to the Minnesota Secretary of State for the filing of the Coalition's Articles of Incorporation at its January 4, 2011, meeting.⁵

The Coalition came to the City Council on July 5, 2011, and requested the City's financial support.⁶ In its presentation, the Coalition stated that its "message point" is that the current Lift Bridge (located on the Minnesota side of the River in the City of Stillwater) is obsolete, fracture-critical and unsafe, and the proposed bridge is "the right project in the right location." The Coalition described its purpose as allowing supporters of the new bridge to be organized, to speak with one voice, to make project decisions as public as possible, to lobby for congressional action and funding in Minnesota and Wisconsin, and to "win this time."⁷ If successful, the Coalition anticipated that the project would be ready to begin in July 2013.

The City approved a donation of \$80,000 to the Coalition in a 4 to 1 vote. The Mayor voted with the majority. More specifically, the City agreed that \$80,000 in tax increment would be paid from the City's TIF District No. 1, a redevelopment district established in 1985 that is required to be decertified at the end of 2011.⁸ According to the City Administrator, the funds were paid to the Coalition, but the City has no contract with the Coalition, and the City does not direct the Coalition's actions.

The City also entered into a contract on April 19, 2011, with The Conach Group "to obtain Legislative support" for, among other things, the new bridge and "[t]o secure the

² See Coalition's website (www.stcroixcrossing.org) and the Coalition's presentation included in the City Council agenda packets for the July 5, 2011, City Council meeting.

³ See City Resolution No. 2010-180 (November 16, 2010) and related City Council meeting minutes.

⁴ *Id.*

⁵ See City Resolution No. 2011-02 (January 4, 2011). The "manual" check for \$70, dated December 2, 2010, was approved as part of the consent agenda. The payment was made from the City's General Fund.

⁶ The presentation was made by the Coalition's Executive Director, who is also one of the Coalition's lobbyists.

⁷ See Coalition's presentation included in the City Council agenda packets for the July 5, 2011, City Council meeting.

⁸ See Minn. Stat. § 469.176, subd. 1b(a)(4) (2010). According to the report the City filed with the OSA, TIF District No. 1 had a tax increment balance of \$4,419,121 as of December 31, 2010. The City will be able to continue spending the tax increment from this District, in accordance with the TIF Plan and the approved budget, even after the District has been decertified.

required support of the Federal Government, State of Minnesota, and any administrative Department of either entity for the approval and funding of the pending St. Croix River Crossing at Stillwater.”⁹ The City agreed to pay The Conach Group \$1,500 per month or \$18,000 per year.¹⁰ The contract required that “the nature of the work done by” The Conach Group be reviewed at least quarterly “to determine whether work should be deleted or added based upon changed circumstances.”¹¹ The City did not use the request for proposal (“RFP”) process prior to hiring The Conach Group.

In response to a complaint received by the Minnesota Campaign Finance and Public Disclosure Board, The Conach Group’s attorney conceded that the contract was poorly drafted and significantly misrepresented the scope of the work The Conach Group was performing for the City.¹²

I. Unauthorized Expenditures

According to the City Administrator, the \$80,000 was a donation to the Coalition to help the Coalition pay its lobbyists.¹³ Although the City approved the payment of membership fees in the Coalition, the OSA understands the fees have not been paid. Instead, the City Council approved payment of the Coalition’s \$70 filing fee with the Minnesota Secretary of State.

A. The \$80,000 Donation

The OSA knows of no authority for the City’s \$80,000 donation to the Coalition.

The Minnesota Attorney General’s Office has repeatedly concluded that, “[a]bsent specific authority, local governments are not generally authorized to become members of, or donate funds to, independent organizations.”¹⁴ The Minnesota Attorney General’s Office has also distinguished between statutory authorization to appropriate and use money for a purpose, and authorization to contribute money to a body generally

⁹ See Legislative Consultant Contract 2011 between the City and The Conach Group (April 19, 2011).

¹⁰ *Id.* According to the City Administrator, payments under the contract were made from the City’s General Fund.

¹¹ See Legislative Consultant Contract 2011 between the City and The Conach Group (April 19, 2011).

¹² See Campaign Finance and Public Disclosure Board’s Findings and Order in the Matter of the Complaint by Karl Bremer regarding The Conach Group and Mike Campbell (August 16, 2011).

¹³ The Coalition has also described the \$80,000 payment as a “donation.”

¹⁴ See Letter from Assistant Attorney General Kenneth E. Raschke, Jr., to State Senators Keith Langseth and Dave Senjem, and State Representatives Morrie Lanning and Loren Solberg (June 30, 2006) (“2006 Raschke Letter”), at page 6, and authorities cited in the 2006 Raschke Letter. A link to the 2006 Raschke Letter is found in the OSA’s Statement of Position on Expenditure of Public Funds on Ballot Issue Advocacy, available on the OSA’s website (www.auditor.state.mn.us). See also OSA’s Statement of Position on Public Expenditures: Donations and Dues, and the League of Minnesota Cities (LMC) publication Public Purpose Expenditures, available on the LMC’s website (www.lmc.org).

committed to advancing a purpose.¹⁵ Statutory authorization for a local government to appropriate and use money for a certain purpose permits the local government to contract with an independent organization for that purpose.¹⁶ It does not permit the local government to donate funds to an independent organization for the organization to expend at its own discretion.¹⁷

Furthermore, even if a local government has specific statutory authority to be a member of or to contract with an independent organization, the Minnesota Attorney General's Office has concluded that "local government payments specifically to support or fund [advocacy taken by the independent organization on legal or political issues of interest to its members] would not likely be permitted."¹⁸

The OSA recognizes that cities have specific statutory authority to appropriate not more than \$50,000 annually out of the city's general revenue fund to be paid "to any incorporated development society or organization of this state for promoting, advertising, improving, or developing the economic and agricultural resources of the city."¹⁹ However, the City's \$80,000 donation is not authorized by this statute. The City relied on different authority to justify the \$80,000 donation to the Coalition, the donation was not limited to \$50,000, and the donation was not paid out of the City's general revenue fund.

The OSA concludes that the \$80,000 donation was an unauthorized expenditure.

B. Coalition Membership Fees

The OSA also knows of no authority for the City to pay membership fees to the Coalition.

The Minnesota Attorney General's Office has generally determined that local governments are not authorized to form or join private organizations absent specific statutory authority.²⁰

The OSA recognizes that cities have statutory authority to "appropriate necessary funds to provide membership . . . in county, regional, state, and national associations of a civic,

¹⁵ See Letter from Assistant Attorney General Kenneth E. Raschke, Jr., to Staples City Attorney Hans Borstad (June 27, 1997) (chamber of commerce) ("1997 Raschke Letter"). See, e.g., Op. Atty. Gen. 59a3 (January 15, 1959) (county historical society).

¹⁶ See 1997 Raschke Letter. The Minnesota Attorney General's Office has recognized that local governments may pay money to independent organizations in exchange for goods or services directly related to the local government's authorized governmental functions. See 2006 Raschke Letter, at page 3.

¹⁷ See 1997 Raschke Letter.

¹⁸ See 2006 Raschke Letter, at page 6, and authorities cited in the 2006 Raschke Letter.

¹⁹ See Minn. Stat. § 469.191 (2010). But see Minn. Stat. § 375.83 (2010) (counties).

²⁰ See 2006 Raschke Letter; 1997 Raschke Letter.

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educational, or governmental nature which have as their purpose the betterment and improvement of municipal governmental operations.”²¹ The City lacks authority to pay Coalition membership fees under this statute because the Coalition’s purpose is not “the betterment and improvement of municipal governmental operations.”²²

The OSA concludes that the City lacks authority to pay Coalition dues or membership fees.

C. Coalition’s Filing Fee

Finally, the OSA knows of no authority for the City to pay \$70 to the Minnesota Secretary of State for the Coalition’s filing fees.

The Coalition told the OSA that the \$70 should be considered another City donation to the Coalition. As discussed previously in this letter, the OSA knows of no authority for such a donation. The City explained to the OSA that the \$70 was paid at the Mayor’s request, based upon the City’s November 16, 2010, resolution authorizing the payment of the Coalition’s membership fees. The City said it planned to deduct the \$70 from the membership fees assessed by the Coalition. As discussed previously in this letter, the OSA knows of no authority for the City payment of Coalition membership fees.

In addition, Minnesota law specifically prohibits a city from creating a nonprofit corporation unless explicitly authorized to do so by law.²³ It would appear that paying a nonprofit organization’s filing fee with the Secretary of State would be part of “creating a nonprofit corporation” included in the statutory prohibition.

The OSA concludes that the City lacked authority to pay the Coalition’s filing fee with the Minnesota Secretary of State.

²¹ See Minn. Stat. § 471.96 (2010).

²² The 1997 Raschke Letter similarly concluded that this statute does not authorize the payment of chamber of commerce membership fees. See 1997 Raschke Letter, at page 3.

²³ See Minn. Stat. § 465.717, subd. 1 (2010).

II. Professional Services Contract Management

The City does not have a contract with the Coalition, and the City's contract with The Conach Group apparently does not accurately describe the services provided under the contract.

Like all public entities, the City should use effective contract management principles when hiring consultants with specific technical or professional training, such as lobbying expertise. Effective contract management principles seek to provide a process that is open, fair, and as objective as possible, to avoid actual or perceived favoritism or wrongdoing.²⁴ As with all public spending, government entities must be held to a high standard regarding the purpose and cost-effectiveness of contract expenditures.²⁵

Generally, competitive bids are not required for professional services contracts. More commonly, governmental entities use requests for proposals (RFPs) to find consultants. With an RFP, the entity advertises a request for services, and the interested professionals submit proposals describing what they will do and what it will cost.

General consensus exists regarding effective contract management principles that should be followed by public entities entering into contracts for professional services. For example, the Minnesota Legislative Auditor has identified effective contracting principles for state agencies entering into professional/technical contracts.²⁶ These include:

- Clearly define roles, responsibilities, and performance expectations of the contractor and agency staff.
- Identify a variety of tools to monitor contract and contractor performance.
- Link payment to the satisfactory completion of specific contract tasks or services, which should be spread throughout the life of the contract.
- Periodically evaluate the progress of the contract and determine if it is prudent to continue.²⁷

²⁴ See Office of Legislative Auditor, Evaluation Report #03-02 (Professional/Technical Contracting, January 2003), at page 28, available at: <http://www.auditor.leg.state.mn.us/ped/2003/pe0302.htm>. See also February 2005 Update to the 2003 Evaluation Report. The OSA has also reviewed contracts by local governmental units for legal, lobbying, and communication services. See, e.g., OSA's Northstar Corridor Project Special Review (February 2006).

²⁵ See Office of Legislative Auditor, Evaluation Report #03-02 (Professional/Technical Contracting, January 2003), at page 28.

²⁶ See Office of Legislative Auditor, Evaluation Report #03-02 (Professional/Technical Contracting, January 2003), at pages 28 - 31.

²⁷ State statutes incorporate many of these safeguards for state agencies entering into professional and technical services contracts. See, e.g., Minn. Stat. § 16C.08 (2010).

A. No Contract with the Coalition

The City did not have a contract with the Coalition, and therefore did not use effective contract management principles when it simply donated \$80,000 to the Coalition. If the City required lobbying or other services, the City should have entered into a contract with the Coalition, or some other entity, to obtain the required services. Without a contract, the City has no means to control how the money donated to the Coalition is actually used, and the City has no assurance that the payment is in exchange for services directly related to one of the City's authorized governmental functions.

In addition, the City's failure to enter into a written contract with the Coalition may be an attempt to circumvent statutory requirements designed to safeguard public funds. For example, Minnesota law requires all city contracts, or any city pass-through disbursement of public funds to a vendor of goods or services, to include an audit clause, either express or implied.²⁸ The audit clause must provide that the books, records, documents, and accounting procedures and practices of the vendor or other party, relevant to the contract or transaction, are subject to examination by the city and the State Auditor for at least six years.

Similarly, the City is governed by the Minnesota Government Data Practices Act ("MGDPA").²⁹ Generally, city contracts primarily consist of public data.³⁰ In addition, under the MGDPA, a city's contract with a nonprofit corporation hired to perform any of the city's functions, must include a term in the contract making it clear that all of the data created, collected, received, stored, used, maintained, or disseminated by the nonprofit corporation in performing those functions are subject to the requirements of the MGDPA.³¹ In short, the nonprofit corporation must comply with the requirements of the MGDPA as if it were a government entity.³²

There is no contract between the City and the Coalition for public review. Furthermore, the Coalition has claimed "non-public, trade secret" protection for documents that

²⁸ See Minn. Stat. § 16C.05, subd. 5 (2010).

²⁹ See Minn. Stat. ch. 13.

³⁰ Information about the data practices status of contracts between cities and private parties is found on the Minnesota Department of Administration's Information Policy Analysis Division's website at: <http://www.ipad.state.mn.us/docs/contracts.html>.

³¹ See Minn. Stat. § 13.05, subd. 11 (2010). For purposes of the Minnesota Government Data Practices Act, a "person" includes an individual, partnership, corporation, association, business trust, or a legal representative of an organization. See Minn. Stat. § 13.02, subd. 10 (2010). If the required language is not included in a contract, it is implied by law, and the private party must act in accordance with the MGDPA. See, e.g., *WDSI, Inc. v. The County of Steele*, 672 N.W.2d 617 (Minn. Ct. App. 2003).

³² See Minn. Stat. § 13.05, subd. 11 (a) (2010). This requirement does not create a duty on the part of the nonprofit corporation to provide the public with access to public data if the data are available from the governmental entity, except as required by the terms of the contract. See Minn. Stat. § 13.05, subd. 11 (b) (2010).

describe such things as the Coalition's plans, costs, and timeline, and the specific individuals or entities that will actually be providing services to the Coalition.³³ As a result, there is no opportunity for the City or the public to review any document explaining what, if anything, the City might receive for this \$80,000 expenditure of public funds.

B. The Conach Group Contract

The Conach Group's attorney has admitted that the contract between the City and consultant is "poorly drafted and significantly misrepresents the scope of what The Conach Group did and is doing for the City."³⁴

The OSA agrees that the City's contract with The Conach Group does not reflect effective contract management principles. In addition to apparently significantly misrepresenting the work being performed by the consultant, the contract does not clearly define the roles, responsibilities, or performance expectations of either the consultant or City staff. The only contract provision for monitoring the consultant's performance does not specify who will perform the quarterly review of the consultant's work, or whether the consultant is required to submit anything in writing to the City describing the work performed during the preceding quarter. The contract contains no link between payments and the satisfactory completion of specific contract tasks or services. The contract contains no data practices or audit clauses.

III. Conflict of Interest

The Mayor is the Co-Chair of the Coalition and voted in favor of the \$80,000 donation. According to the City Administrator and the City Attorney, the Mayor is not paid by the Coalition. The OSA received no evidence showing that the Mayor was disqualified from voting on these matters.

Minnesota's conflict of interest statutes generally prohibit public officers who are "authorized to take part in any manner in making any sale, lease, or contract in official capacity" from voluntarily having "a personal financial interest in that sale, lease, or contract or personally benefit financially therefrom."³⁵ The OSA was provided with no evidence showing that the Mayor had a personal financial interest in, or personally benefitted from, the City's donation to the Coalition.

³³ See Minn. Stat. § 13.37, subd. 1 (b) (2010). The Minnesota Commissioner of Administration has the authority to review questions related to public access to or the classification of government data. See, e.g., Minn. Stat. § 13.072 (2010) and www.ipad.state.mn.us.

³⁴ See Campaign Finance and Public Disclosure Board's Findings and Order in the Matter of the Complaint by Karl Bremer regarding The Conach Group and Mike Campbell (August 16, 2011), at page 2

³⁵ See Minn. Stat. § 471.87 (2010). Exceptions to the general prohibition are found in Minn. Stat. §§ 471.88 – 471.89 (2010).

The City Charter contains conflict of interest provisions that generally prohibit City officials from voting on any matter, including City payments, where the City official has a private financial interest separate from that of the general public.³⁶ In addition, the City Charter requires City officials to file written disclosures about potential conflicts of interest, including information about business relationships the officials may have with entities doing business with the City.³⁷

The City Charter also allows the City Attorney to provide advisory opinions regarding the Charter's conflict of interest provisions.³⁸ The City Attorney told the OSA that the Mayor had no conflict of interest under the City Charter regarding the City's payments to the Coalition. He also told the OSA that no written disclosure was required because the "relationship with the Coalition is not a business relationship, but a political relationship" and the purpose of the Charter disclosure provision is to insure that public office is not used for personal gain.

IV. Use of Tax Increment for \$80,000 Donation

The City Attorney advised the City that it could use tax increment from the City's TIF District No. 1 for the \$80,000 donation to the Coalition to support the Coalition's lobbying efforts.³⁹

TIF is a statutory financing tool used to promote economic development, redevelopment, and housing development in areas where the development would not otherwise occur.⁴⁰ Under Minnesota law, a TIF authority (such as the City) "captures" the revenues generated by the increase in net tax capacity resulting from new development within a designated geographic area called a TIF district. The captured tax increments are then used to finance public improvements and other qualifying costs related to the new development that generated the increase in net tax capacity. The captured revenues must

³⁶ See City Charter section 5.12.

³⁷ See City Charter section 5.12, subd. 3 (2) and (3). For example, with respect to "any non-ownership business relationship the official has with any company, partnership, firm, corporation, labor union, association or other entity doing business with the City," the following disclosure must be made: the name of the entity, the title of each position held in connection with the entity, and whether compensation is involved in connection with the position. See City Charter section 5.12, subd. 3 (2).

³⁸ See City Charter section 5.12, subd. 7. The City Charter provides that an advisory opinion issued by the City Attorney is generally nonpublic data and may provide a defense for any subsequent judicial proceeding involving that issue. See City Charter section 5.12, subd. 7(b) and (c).

³⁹ See Email dated June 9, 2011, from Dave Magnuson forwarded to City Administrator on June 18, 2011; City Council Meeting Minutes for July 5, 2011, at page 3.

⁴⁰ Additional general information about TIF is available on the OSA's website: <http://www.auditor.state.mn.us> (see, e.g., "All about Tax Increment Financing (TIF)" under the "For Local Officials" tab). The OSA's website also contains Statements of Position on various TIF issues and links to additional TIF information on the Minnesota House of Representatives House Research and Minnesota Department of Revenue websites.

be used in accordance with the district's TIF plan to finance or otherwise pay the capital and administration costs of the district.⁴¹

When reviewing compliance with the TIF laws, the OSA must follow certain procedures if the OSA finds that a TIF authority is not in compliance with the TIF laws.⁴² Therefore, the OSA will handle any issues related to the use of tax increment for the \$80,000 donation through the procedures required under the TIF laws.

Recommendations

In the future, the City should follow Minnesota law and refrain from making donations to nonprofit organizations absent specific statutory or charter authority. The OSA recommends that the City attempt to recover the money donated to the Coalition and the money the City expended for the Coalition's filing fee. If the City decides to contract with the Coalition for services directly related to one of the City's authorized functions, the City should use proper contract management procedures to protect public funds.

The OSA recommends that the City amend its contract with The Conach Group to clearly define the roles, responsibilities, and performance expectations of The Conach Group and City staff. The City should include in the amended contract all statutorily required clauses.

To avoid even the appearance of impropriety, the OSA recommends that City officials disclose any official position a City official may hold with any organization receiving City funds. The disclosure, at a minimum, should include whether the City official receives compensation for the position held in the organization.

⁴¹ See Minn. Stat. § 469.176 (2010). For example, a city may not use tax increment for such things as general city operating expenses. Because the captured tax increment includes taxes imposed by all levels of government (e.g., city, county, school, and special taxing districts), such a use of tax increment would simply shift city costs to the other taxing entities. See, e.g., "TIF: No Use for General Government Purposes," available on the Minnesota House of Representatives House Research website.

⁴² See Minn. Stat. § 469.1771 (2010). Any data relating to a TIF examination by the OSA are not public until the OSA has followed the required procedures and issued a final report. See Minn. Stat. § 6.715 (2010).

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Please notify the OSA no later than September 30, 2011, regarding any actions the City takes in response to this letter. If you have any questions, please feel free to contact me by telephone at 651-297-5853, or by email at Nancy.Bode@osa.state.mn.us.

Sincerely,

/s/ Nancy J. Bode

Nancy Bode
Assistant Legal Counsel

cc. The Honorable Micky Cook, City Council Member
The Honorable Doug Menikheim, City Council Member
The Honorable Mike Polehna, City Council Member
The Honorable James Roush, City Council Member
Mr. Larry Hansen, City Administrator
Mr. David Magnuson, City Attorney
Ms. Sharon Harrison, City Finance Director
LarsonAllen, LLP, City's Auditors
Mr. Michael Wilhelmi, Coalition's Executive Director