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June 12, 2013

The Honorable Gary Sturm
Mayor, City of St. James
P.O. Box 70
St. James, Minnesota 56081-0070

Dear Mayor Sturm:

The Office of the State Auditor (“OSA”) received concerns about the City of St. James (“City”). Specifically, the OSA received concerns about the City’s contracting procedures for the construction of an electrical storage building, possible conflicts of interest regarding the City’s Economic Development Authority (“EDA”) snow removal contracts, and the disposal of EDA property. The OSA discussed the concerns with the City Manager and reviewed related City documents.

Based upon its review, the OSA found that the City did not comply with Minnesota contracting law in the construction of the electrical storage building. This letter will provide the City with guidance to help the City comply with Minnesota law in the future.

Contracting Procedures

The OSA received concerns that the City did not re-bid a construction project for an electrical storage building after the building was changed from a concrete and steel structure to a concrete and wood-frame structure.

In September of 2011, the City hired an architectural firm to provide architectural, structural, civil, and engineering services for an electric department storage building project.¹ The City advertised for bids for the construction of a concrete and steel structure, and set the bid opening for January 25, 2012. At its February 7, 2012, meeting, the City Council was informed that all 13 bids received were over the City’s budget for the project.² City staff and the budget committee recommended that all of the bids be rejected.³ However, the City Council was told that RAM General Contracting, Inc. (“RAM”), who had submitted the low base bid of \$492,000,

¹ City Council meeting minutes, September 6, 2011.

² City Council meeting minutes, February 7, 2012.

³ See bid tabulation sheet, February 7, 2012. According to the bid tabulation sheet, City staff was working with the architect to develop an alternative type of building.

was trying to develop an alternative type of building.⁴ The City Council tabled any decision on the building until its February 21, 2012, meeting.⁵

At the February 21, 2012, meeting, RAM presented a re-designed concrete and wood-frame building and a “bid” of \$367,671.⁶ The City Council accepted the “bid” after being advised by the City Attorney that the City did not have to re-bid the project and could accept RAM’s “bid” because it was “based on the best value alternative.”⁷ The City entered into a “Design/Build Contract” with RAM on March 7, 2012 for \$370,861.

Minnesota’s Uniform Municipal Contracting Law requires a city to obtain competitive bids for the construction, alteration, repair or maintenance of real or personal property if the estimated cost of the contract exceeds \$100,000.⁸ Alternatively, a city may issue requests for proposals for these contracts, and award the contract to the contractor offering the best value.⁹ The City did not issue requests for proposals as required for the best value alternative. Instead, the City used the competitive bidding process.¹⁰

Minnesota courts have consistently held that a city must determine bid responsiveness at the time the bids are opened.¹¹ A successful bid must conform to the bid specifications, or the bid must be rejected.¹² No material change may be made to any bid after the bids have been opened.¹³ The test for determining whether a change is material is whether the change gives a bidder a substantial advantage or benefit not enjoyed by other bidders, such as price or other things that go into the actual determination of the amount of the bid.¹⁴ Similarly, no material change to contract terms may be made after a contract has been let to the lowest bidder.¹⁵

The base bid received from RAM was for \$492,000. The City had no authority to allow RAM to change its bid from \$492,000 to \$367,671. While RAM’s bid of \$492,000 may have conformed

⁴ See City Council meeting minutes and bid tabulation sheet, February 7, 2012. The bid tabulation sheet showed a base bid for the concrete and steel structure, and an alternate bid for geo-thermal heating/air conditioning. The City determined that geo-thermal heating/air conditioning was not cost effective.

⁵ City Council meeting minutes, February 7, 2012.

⁶ City Council meeting minutes, February 21, 2012.

⁷ *Id.*

⁸ Minn. Stat. § 471.345, subd. 3.

⁹ See Minn. Stat. § 471.345, subd. 3a. With best value, cities are able to consider performance factors with price when awarding construction project contracts.

¹⁰ Having adopted the competitive bidding method, the city was required to follow the competitive bidding requirements. See, e.g., *Griswold v. Ramsey County*, 242 Minn. 529, 535, 65 N.W.2d 647, 652 (1954).

¹¹ See, e.g., *Carl Bolander & Sons Co. v. City of Minneapolis*, 451 N.W.2d 204, 206 (Minn. 1990).

¹² See, e.g., *Coller v. City of St. Paul*, 223 Minn. 376, 385, 26 N.W.2d 835, 840 (1947).

¹³ *Id.*; *Griswold*, 242 Minn. at 536, 65 N.W.2d at 652.

¹⁴ *Bolander*, 451 N.W.2d at 207; *Foley Bros. v. Marshall*, 266 Minn. 259, 263, 123 N.W.2d 387, 390 (1963); *Coller*, 223 Minn. at 385, 26 N.W.2d at 840; *Lovering-Johnson, Inc. v. City of Prior Lake*, 558 N.W.2d 499, 502-503 (Minn. App. 1997).

¹⁵ See, e.g., *Griswold*, 242 Minn. at 536, 65 N.W.2d at 652.

to the bid specifications, RAM's "bid" of \$367,671 did not. Instead, the "bid" of \$367,671 was a new proposal that the City was required to reject.

When all bids the City received were over the City's budget for the project, the City should have rejected all bids and started over. The City had no authority to engage in negotiations with RAM for the design and construction of an alternative type of structure. Other contractors may have been interested in designing and/or constructing the alternative structure, but the City never solicited bids or issued a request for proposals for the new project. Instead, RAM was given a substantial advantage over the other bidders because it faced no competition for the newly designed structure.

Nor does the designation of the contract with RAM as a design-build contract relieve the City of the competitive bidding requirements. Minnesota case law has firmly established that "design/build contracts" are subject to competitive bidding requirements.¹⁶

Based upon its review, the OSA finds that the City did not comply with Minnesota contracting law in the construction of an electrical storage building. The OSA recommends that, in the future, the City comply with Minnesota contracting law. For additional guidance on competitive bidding requirements, the City may want to review the League of Minnesota Cities ("LMC") Information Memo on Competitive Bidding Requirements in Cities, available on LMC's website, www.lmc.org.

Conflicts of Interest – EDA Contracts

The OSA also received concerns that the City's EDA entered into snow removal contracts with a company that employs the EDA Executive Director's spouse. The EDA Executive Director received a letter in 2009 from the City Attorney stating the contracts did not raise conflict of interest concerns because: 1) the contracts did not have to be bid; and 2) the EDA Executive Director did not have a "direct" financial interest in the contracts since she did not have an ownership interest in the company and was not a shareholder, officer or director of the company.

Generally, a public officer authorized to take part in any manner in making a contract in official capacity may not voluntarily have a personal financial interest in the contract or personally benefit financially from the contract.¹⁷ An exception to the general rule exists for contracts for

¹⁶ *W.V. Nelson Construction Company v. City of Lindstrom*, 565 N.W.2d 434 (Minn. Ct. App. 1997) (city cannot circumvent the requirements of the competitive bidding statutes simply by including a design component in a contract for the construction of a public building).

¹⁷ Minn. Stat. § 471.87.

which competitive bids are not required by law.¹⁸ However, to use this broad exception, the interested officer must follow certain statutorily required resolution and affidavit procedures.¹⁹

In addition to the general conflict of interest statute, there is a conflict of interest statute that specifically applies to EDAs. Under the EDA statute, prior to taking action or making a decision which could substantially affect an EDA employee's financial interests or those of an organization with which the employee is associated, the employee must disclose the potential conflict in writing and must not participate in the action or decision that presents the potential conflict.²⁰

An EDA employee might have a personal financial interest in a contract between the EDA and a business that employs the employee's spouse. The Minnesota Attorney General's Office has taken the position that whether there is a conflict of interest in a contract is a matter that involves questions of fact that are appropriately determined by the governing body.²¹ Therefore, when contracting with the spouse of an EDA employee, the EDA Board should determine from all the circumstances whether a conflict of interest exists.²²

The OSA recommends that, in the future, the EDA Executive Director disclose any possible conflicts of interest to the EDA Board according to the requirements of the EDA conflict of interest statute.²³ The EDA Board should make a fact determination regarding the possible conflict of interest, including a possible conflict of interest involving the spouse of an EDA employee.²⁴ If the EDA Board determines that a conflict of interest exists, another EDA official or employee should review the quotations or bids, and the EDA employee should not supervise or otherwise be involved with the contract.²⁵ Additional guidance on conflicts of interest is

¹⁸ Minn. Stat. § 471.88, subd. 5. Due to the dollar value, competitive bidding was not required for the snow removal contracts. Under Minnesota law, the contracts could be awarded either upon quotation or in the open market. *See* Minn. Stat. § 471.345, subd. 5.

¹⁹ Minn. Stat. § 471.89. Under the statute, the governing body must approve a resolution in advance "setting out the essential facts and determining that the contract price is as low as or lower than the price at which the commodity or services could be obtained elsewhere" and the interested officer must file an affidavit stating, among other things, an "itemization of the commodity or services furnished," the "contract price," and the "reasonable value." *Id.*

²⁰ Minn. Stat. § 469.098, subs. 1 and 2. *See also* Op. Att'y Gen. 90 (June 9, 1994) (discussing similar disclosure and non-participation requirement found in the HRA conflict of interest statute).

²¹ *See, e.g.,* Ops. Att'y Gen. 90a-1 (October 7, 1976), 90-E-5 (November 13, 1969), 90e-5 (May 25, 1966), and 90-E-5 (August 25, 1955).

²² *See, e.g.,* Ops. Att'y Gen. (July 30, 1940) and (July 14, 1939). Generally, the Attorney General has advised that a personal financial interest may not exist if a public official is an employee of a business contracting with a local government, and: 1) does not have an ownership interest in the business; 2) is not an officer or a director of the business; 3) is compensated on a salary or hourly wage and receives no commission, bonus or other remuneration; and 4) is not involved in supervising the performance of the contract on behalf of the employer and has no other interest in the contract. *See* Op. Att'y Gen. 90a-1 (October 7, 1976).

²³ *See* Minn. Stat. § 469.098.

²⁴ The determination should be recorded in the EDA's meeting minutes.

²⁵ To avoid even the appearance of impropriety, the EDA may want to implement the disclosure and non-participation requirements even if the EDA Board determines that the contracts do not present a disqualifying conflict of interest.

The Honorable Gary Sturm
Mayor, City of St. James
June 12, 2013
Page 5

available in LMC's Information Memo on Official Conflict of Interest, available on LMC's website.

EDA Appliance Disposal

The OSA also reviewed concerns it received about the disposal of washer and dryer appliances from EDA apartments that were damaged in a flood in 2010. The EDA replaced the damaged appliances and moved the old appliances to an off-site location. The City informed the OSA that the insurance company advised the City that the items could not be sold. According to the City, some of the stored appliances, or their parts, were taken during the next year by City Departments and by "others." The EDA eventually gave what remained of the appliances to a local scrap metal dealer for disposal.

The sharing of damaged or unneeded items among city departments is commendable. However, the OSA knows of no authority for the City to simply let "others" take damaged or surplus city property.²⁶

The OSA recommends that the City amend its policy on the sale of abandoned and surplus property to cover the disposal of items that may not be sold or have only minimal value.

Conclusion

The OSA found that the City did not comply with Minnesota contracting law in the construction of an electrical storage building. The OSA also reviewed potential conflicts of interest involving EDA snow removal contracts and the EDA's disposal of damaged appliances. The OSA provided the City with guidance to help the City comply with Minnesota law in the future.

If you have any questions about any of the matters discussed in this letter, please feel free to contact me at (651) 297-7108 or by email at Terrilyn.Diamond@osa.state.mn.us.

Sincerely,

/s/ Terrilyn Diamond

Terrilyn Diamond, Attorney
Office of the State Auditor

cc: The Honorable Michael Banks, City Council Member
The Honorable Kathleen Hanson, City Council Member
The Honorable Paul Harris, City Council Member
The Honorable Joshua Haseman, City Council Member
The Honorable Don Mackey, City Council Member

²⁶ Additional guidance on disposing of city property is found in Chapter 23 of LMC's Handbook for Minnesota Cities, available on LMC's website.

The Honorable Gary Sturm
Mayor, City of St. James
June 12, 2013
Page 6

Mr. Joe McCabe, City Manager
Ms. Molly Westman, EDA/Community Development Director
Mr. Pete Eggen, Chair, EDA Board
Eide Bailly, City Auditor
Mr. Steven Sunde, City Attorney
The Honorable Stephen Lindee, Watonwan County Attorney