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Members of the Legislative Audit Commission

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In late November 2011, the Office of the Legislative Auditor (OLA) decided to review certain payments made by the Minnesota Department of Natural Resources (DNR) to the Middle-Snake-Tamarac Rivers Watershed District.¹ The payments were made under a grant agreement between DNR and the watershed district for the Agassiz Valley Flood Damage Reduction Project (Agassiz Valley Project).² Our review focused on reimbursements DNR made to the watershed district for attorney fees related to a lawsuit. The district brought the lawsuit against an individual who signed a settlement agreement by which the watershed district purchased land from the individual and others for the Agassiz Valley Project. In the lawsuit, the watershed district claimed that the individual had breached the settlement agreement and was, in contradiction to the agreement, attempting to obstruct the watershed district from completing the Agassiz Valley Project. However, because the grant agreement restricted state reimbursement of attorney fees, some legislators questioned whether it was appropriate for DNR to reimburse the watershed district for a share of the attorney fees related to the litigation. In response to their concern, we conducted this review.

Background Information

The Grant Agreement

In March 2001, DNR entered into a flood damage reduction grant agreement with the Middle-Snake-Tamarac Rivers Watershed District.³ The watershed district is located in northwestern Minnesota, mostly in Marshall County, with smaller areas in Polk, Pennington, Kittson, and Roseau counties. It covers the watershed areas of the Middle, Snake, and Tamarac rivers, which are tributaries of the Red River.

¹ Watershed districts are special-purpose local units of government authorized by *Minnesota Statutes* 2011, chapter 103D, and organized to address various water-related concerns. There are currently 45 watershed districts established in Minnesota. They are each governed by a board of managers appointed by the boards of commissioners of the counties that have land in the district.

² The project has also been referred to as the Agassiz-Audubon Project, Agassiz Valley Water Resource Management Project, Agassiz Valley Water Management Project, and Agassiz Valley Flood Damage Reduction Project.

³ In March 2001, the district's name was the Middle River-Snake River Watershed District. The district changed its name in August 2002 to the Middle-Snake-Tamarac Rivers Watershed District.

The Agassiz Valley Project is one of several flood damage mitigation projects proposed after a group of government and environmental organizations, known as the Red River Basin Flood Damage Reduction Work Group, reached a mediation agreement in December 1998 that set forth goals and a planning process to achieve flood damage reduction in that part of the Red River Basin that is within Minnesota.⁴ According to grant application documents submitted to DNR by the watershed district, the primary objective of the Agassiz Valley Project is flood control, and secondary objectives are wetland and prairie restorations and various research, education, and recreational opportunities. To achieve flood control, the watershed district proposed to purchase private land and construct a gated impoundment (reservoir) to hold water when there is a potential for overland flooding. Most of the private land the watershed district needed for the project was being used for crop production.

As authorized by state law, the grant agreement provided the watershed district with 75 percent of eligible costs related to the Agassiz Valley Project.⁵ Money for the grant was appropriated from bond proceeds, which is generally the source of funding for the state’s flood hazard mitigation grant program. Table 1 delineates the amounts authorized by the state to the Middle-Snake-Tamarac Rivers Watershed District under the grant agreement for the Agassiz Valley Flood Damage Reduction Project.

**Table 1
Grant Amendments and Amounts Added**

Grant Amendment #	Date Signed	Addition to Grant	Cumulative Total	Grant End Date
Original agreement	03/26/2001	—	\$1,515,000.00	12/31/2003
1	06/24/2002	\$234,000.00	\$1,749,000.00	12/31/2004
2	04/28/2003	\$460,178.20	\$2,209,178.20	12/31/2004
3	12/28/2004	—	\$2,209,178.20	12/31/2007
4	05/09/2006	\$400,000.00	\$2,609,178.20	12/31/2007
5	12/19/2007	—	\$2,609,178.20	12/31/2010
6	06/18/2008	\$3,000,000.00	\$5,609,178.20	12/31/2010
7	07/30/2009	\$2,500,000.00	\$8,109,178.20	12/31/2010
8	12/28/2010	—	\$8,109,178.20	09/30/2011
9	09/26/2011	—	\$8,109,178.20	12/31/2012

SOURCE: Minnesota Department of Natural Resources Flood Hazard Mitigation Grant Agreement with the Middle-Snake-Tamarac Rivers Watershed District and amendments.

According to DNR and the watershed district, the number of amendments and time span for the Agassiz Valley Project do not reflect significant changes in the project’s scope or purpose; rather, they reflect the common practice of staged funding from DNR for flood hazard mitigation projects and delays resulting from litigation. Because of those delays, major construction to achieve the project’s flood hazard reduction objective did not begin until June 2008, and it was completed in July 2010. According to the watershed district, other aspects of the project, such as establishing native grasses for natural resource enhancement, will likely require several more years to

⁴ For more information about the mediation agreement and the Red River Basin Flood Damage Reduction Work Group, go the Web site at: <http://www.rwmb.org/html/info.cfm?ID=10>.

⁵ *Laws of Minnesota* 2000, chapter 492, art. 1, sec. 41, authorized a 75-percent state share for a grant to implement a “flood hazard mitigation project in the Red River Basin that is consistent with the 1998 mediation agreement and approved by the Red River flood damage reduction work group,” and specifically cited the “Agassiz-Audubon” project and three other projects.

complete. Currently, the estimated total cost of the project is \$10.7 million. The 25-percent local share for the project was paid with money from the Middle-Snake-Tamarac Rivers Watershed District (8.33 percent) and the Red River Watershed Management Board (16.67 percent).⁶

Litigation

The Agassiz Valley Project has been subject to protracted litigation from the beginning. Shortly after the watershed district issued its first project-related order, owners of some land the district was seeking to purchase filed a lawsuit against the watershed district in Marshall County District Court.⁷ Their lawsuit raised several legal challenges to the project, including the watershed district's proposed compensation to the landowners. Under a process authorized in state law, the issues in the litigation were eventually referred to the Minnesota Board of Water and Soil Resources (BWSR) for resolution.⁸ BWSR sent the parties into mediation, which resulted in a settlement agreement that became effective in April 2006.⁹ The agreement provided for \$1,700,000 in payments to the landowners for their land and required the landowners to cooperate in implementing the agreement in various ways, including to "address no further challenges in litigation or otherwise against the establishment of the project."¹⁰ In addition, the watershed district and landowners pledged in the settlement agreement "that they will endeavor to establish a positive and collaborative relationship."¹¹

However, the settlement agreement did not end conflict or litigation over the Agassiz Valley Project. In July 2007, the watershed district filed a complaint in Marshall County District Court against James Stengrim, one of the landowners who had signed the settlement agreement. The complaint alleged that Mr. Stengrim had breached the settlement agreement and that his actions were intended to obstruct completion of the Agassiz Valley Project. Those actions were enumerated in the district's submission to the court as follows:

The Defendant [James Stengrim] has attempted to interfere with funding of the Agassiz Valley Project, has made statements with the intent of harming the

⁶ The Red River Watershed Management Board was authorized by law in 1976 and established under a joint powers agreement to provide a basin-wide perspective concerning flooding and flood mitigation projects in the Red River Basin. Its jurisdiction encompasses the area managed by the individual watershed districts that have membership on the board. Currently, they include the following eight watershed districts: Joe River, Two Rivers, Roseau River, Middle-Snake-Tamarac Rivers, Red Lake, Sand Hill River, Wild Rice, and Bois de Sioux. By law, the watershed districts that are members of the joint powers agreement are authorized an additional levy of 0.04836 percent on the market value of all taxable property in their district. Half of the resulting revenue is credited to the Red River Watershed Management Board for "construction and maintenance of projects of common benefit." See *Laws of Minnesota* 1976, chapter 162, sec. 1, as amended by *Laws of Minnesota* 1982, chapter 474, sec. 1, as amended by *Laws of Minnesota* 1983, chapter 338, sec. 1.

⁷ Marshall County District Court: C4-02-324, C0-02-326, C8-02-326, C6-02-325, C7-02-320, C3-02-329, C0-02-319, C9-02-321, C1-02-328, C2-02-323, and CX-02-327. For background information on the landowners' legal challenge against the watershed district and the Agassiz Valley Project, a 2004 opinion of the Minnesota Court of Appeals is useful. See *In the Matter of the Agassiz Water Management Project, State of Minnesota, Court of Appeals, Unpublished Opinion, A03-1841, July 20, 2004*; available at: <http://www.lawlibrary.state.mn.us/archive/ctapun/0407/opa031841-0720.htm>.

⁸ Under *Minnesota Statutes* 2011, 103D.535, orders of a watershed board of managers, such as the land acquisition order issued by the Middle-Snake-Tamarac Rivers Watershed District for the Agassiz Valley Project, may be appealed to a district court or the Minnesota Board of Water and Soil Resources.

⁹ *In the Matter of the Agassiz Valley Water Management Project, State of Minnesota, Marshall County District Court, Settlement Agreement, April 21, 2006*. While the settlement agreement was reached under a mediation process established by the Board of Water and Soil Resources, the settlement agreement itself was issued by the Marshall County District Court.

¹⁰ *Ibid.*, see particularly item 13. Conclusion of Dispute, p. 7.

¹¹ *Ibid.*, p. 2.

project, has continued to file repeated data practices requests designed to burden the Plaintiff's [watershed district's] staff from implementing their ordinary duties, has used the Data Practices Act as a weapon in an effort to stop the project and get his land back, has made complaints and engaged in other activities designed to delay or defeat implementation of the project, and has engaged in activities designed to make the conduct of the Plaintiff's business more acrimonious.¹²

Mr. Stengrim denied that he had breached the settlement agreement and asked the court to dismiss the watershed district's lawsuit against him based on Minnesota's anti-SLAPP law (Strategic Lawsuits Against Public Participation).¹³ Using the language of the anti-SLAPP law, Mr. Stengrim claimed that his actions and statements were "immunized from liability" because they were part of his right to participate in the public process. The district court denied Mr. Stengrim's motion for dismissal, finding that the state's anti-SLAPP statute was not intended to apply to the type of complaint brought against Mr. Stengrim.¹⁴

Mr. Stengrim appealed the district court's decision to the Minnesota Court of Appeals. In February 2009, the court held that the state's anti-SLAPP statute could be applied to the Stengrim case and remanded the case to the district court.¹⁵ However, in June 2010, the Minnesota Supreme Court reversed the decision of the Court of Appeals, finding that the district court had properly denied Mr. Stengrim's anti-SLAPP motion because "there were genuine issues of material fact concerning the effect of the settlement agreement on Stengrim's actions."¹⁶ The court said that a preexisting legal relationship, such as one established by a settlement agreement, can "legitimately limit a party's public participation."¹⁷ The Supreme Court remanded the case to the Marshall County District Court.

With the case back in district court, the watershed district moved to have its complaint against Mr. Stengrim dismissed, and the court granted the district's motion.¹⁸ According to the attorney handling the watershed district's case, the district asked for the dismissal because the litigation had become far more time consuming and costly than anticipated.¹⁹ In addition, according to the

¹² Middle-Snake-Tamarac Rivers Watershed District vs. James Stengrim, State of Minnesota, Marshall County District Court, Complaint, CV-07-428, July 27, 2007, p. 5.

¹³ *Minnesota Statutes* 2011, 554.03.

¹⁴ Middle-Snake-Tamarac Rivers Watershed District, State of Minnesota, Marshall County District Court, Order, CV-07-428, April 30, 2008.

¹⁵ Middle-Snake-Tamarac Rivers Watershed District v. James Stengrim, State of Minnesota, Court of Appeals, A08-0825, February 17, 2009. The Court of Appeals essentially said that before the district court could address the complaint that Mr. Stengrim's actions violated the settlement agreement he signed, the court would have to determine whether those actions were "immunized from liability" under Minnesota's anti-SLAPP law.

¹⁶ Middle-Snake-Tamarac Rivers Watershed District vs. James Stengrim, State of Minnesota, Supreme Court, Slip Opinion, June 30, 2010, available at: www.lawlibrary.state.mn.us/archive/supct/1006/OPA080825-0630.pdf. Also available at: *Minnesota Reporter*, Vol. 784, N.W. 2nd, p. 834.

¹⁷ *Ibid.* (slip opinion), p. 13.

¹⁸ Middle-Snake-Tamarac Rivers Watershed District vs. James Stengrim, State of Minnesota, Marshall County District Court, Findings of Fact, Conclusions of Law, and Order, 45-CV-07-428, February 3, 2011.

¹⁹ Office of the Legislative Auditor, Interview with Nick Drees, Executive Director, Middle-Snake-Tamarac Rivers Watershed District; Roger Hille, Chair, Middle-Snake-Tamarac Rivers Watershed District Board of Managers; and Jerry Von Korff, Attorney, Rinke Noonan Law Firm (representing the watershed district in the Stengrim litigation), pp. 34-41.

attorney, since flood control construction work had been completed, Mr. Stengrim's actions were no longer a risk to the watershed district's ability to complete the project's primary purpose.²⁰

However, Mr. Stengrim appealed the district court's dismissal of the case. In his appeal to the Court of Appeals, he claimed that the district court abused its discretion by granting the watershed district's motion for voluntary dismissal rather than granting dismissal based on Mr. Stengrim's anti-SLAPP claim, by which Mr. Stengrim was seeking a judgment for attorney fees and damages from the watershed district.²¹ On January 17, 2012, the Court of Appeals affirmed the district court's decision to grant the watershed district's motion for voluntary dismissal of the case.²² It is possible that Mr. Stengrim will appeal the decision to the Minnesota Supreme Court. According to the attorney for the watershed district in the case, if that occurs, the watershed district will continue to seek an end to the litigation.

We conducted this review not because we questioned the prerogative of the watershed district to file a complaint against Mr. Stengrim, nor because we questioned the district's management of the case. We conducted the review to determine whether DNR should have reimbursed the district for a share of the attorney fees associated with the district's lawsuit against Mr. Stengrim.

According to invoices submitted to the state by the watershed district, as of September 27, 2011, the total costs in attorney fees related to the district's lawsuit against Mr. Stengrim amounted to \$150,179, of which the state has reimbursed the watershed district \$112,634.

Objective and Methods

The objective of this special review was to answer the following question:

- Was there a reasonable basis for the Minnesota Department of Natural Resources to reimburse the Middle-Snake-Tamarac Rivers Watershed District for a share of the attorney fees related to litigation the watershed district brought against James Stengrim?²³

To answer this question, we reviewed the grant agreement, documents supporting payments under the grant agreement, court decisions and submissions related to the Middle-Snake-Tamarac Rivers Watershed District's lawsuit against James Stengrim, and various other documents related to the operation of the watershed district and the Agassiz Valley Flood Damage Reduction Project. We also interviewed, under oath, representatives of the Middle-Snake-Tamarac Rivers Watershed District and the Minnesota Department of Natural Resources.

²⁰ *Ibid.*

²¹ Middle-Snake-Tamarac Rivers Watershed District vs. James Stengrim, State of Minnesota, Court of Appeals, Unpublished Opinion, A11-1265, January 17, 2012, pp. 1-3.

²² *Ibid.*

²³ Since the grant agreement is funded with bond proceeds, we also considered the need to ask a specific question related to whether attorney fees or other litigation costs are eligible for payment with bond proceeds. We decided that it was not necessary to address that question. Attorney fees and other litigation costs are commonly paid from bond proceeds since many capital improvement projects financed with bond proceeds require land acquisition and construction, which often involve attorney fees and sometimes litigation. However, as we point out in the discussion that follows our conclusion, the Agassiz Valley Project grant agreement narrowed the eligibility of attorney fees beyond what could be allowed for the use of bond fund money generally. In short, it was the language of the grant agreement that caused this review, not a broader concern about the use of bond money for attorney fees.

Conclusion

Attorney fees related to a lawsuit the Middle-Snake-Tamarac Rivers Watershed District brought against James Stengrim were not clearly “eligible costs” under language in the grant agreement between the Minnesota Department of Natural Resources and the watershed district. The department could have—but did not—amend the grant agreement to broaden the type of attorney fees that were eligible costs. Nevertheless, the department had a reasonable basis to reimburse the watershed district a share of the attorney fees resulting from the Stengrim litigation. The litigation sought court assistance in requiring Mr. Stengrim to comply with the settlement agreement he had signed and by which the watershed district had purchased land from Mr. Stengrim for use in constructing the Agassiz Valley Flood Damage Reduction Project. The watershed district thought Mr. Stengrim was breaching the settlement agreement by actions intended to obstruct the district’s ability to complete the project.

The grant agreement between the Department of Natural Resources and the Middle-Snake-Tamarac Rivers Watershed District for the Agassiz Valley Project provides that the state will reimburse the watershed district its share of costs that are “solely related to and necessary for producing the objectives and work products specified in the project plan.” To this general requirement, the grant agreement provides more specific guidance by identifying certain costs as “eligible” or “noneligible.” An enumeration of the cost items listed in each of the two cost categories is shown in the Appendix on page 8. Most relevant for our review is the identification of “attorney fees” as noneligible, “except for acquisition and clearing title to land.”

The language in the grant agreement suggests that attorney fees for the Stengrim litigation were not eligible for reimbursement by DNR because the litigation was not needed to acquire or clear title to Mr. Stengrim’s land. The watershed district obtained the land it sought from Mr. Stengrim through the 2006 settlement agreement. The agreement contained a detailed section on “Conveyance of Property Rights,” which included, among other requirements, that the landowners who signed the agreement “shall execute and deliver the limited warranty deed in lieu of eminent domain, and all other documents and affidavits necessary to transfer fee title to the property to watershed district.” Marshall County’s property records indicate that title to Mr. Stengrim’s land was transferred to the watershed district on June 26, 2006.

We conducted this review to determine whether there were facts related to the litigation that could justify DNR going beyond the “eligible costs” language of the grant agreement and deciding to reimburse the watershed district for a share of the attorney fees resulting from the Stengrim litigation. As noted previously, the watershed district’s case was based on a belief that Mr. Stengrim had breached the settlement agreement and was taking action intended to obstruct the district’s ability to complete the Agassiz Valley Project. The district specifically alleged that Mr. Stengrim was aggressively using information requests as a way to disrupt the watershed district’s operations and that he was claiming the watershed district had obtained money from the state for the Agassiz Valley Project under false pretenses.

According to the attorney handling the watershed district’s lawsuit against Mr. Stengrim, the objective of the lawsuit was as follows:

Our original plan for the case was that the court would intervene in this dispute and resolve it efficiently. We wanted the court to act as a referee in this dispute and to do it at the very beginning of the case in the most economical way possible.

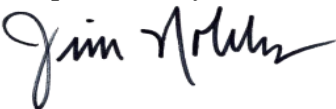
We urged the court to appoint a mediator, and then to instruct the parties on the meaning of the agreement. We said to the court, look, if you resolve this dispute so that everyone knows what they must do in the future, we don't care about the past. We want it clear that Stengrim cannot use this fraud theory to attack our right to build the project on his land.²⁴

Before seeking court intervention, representatives of the watershed district discussed their plan with representatives of DNR. While there is no record of DNR officials recommending or endorsing the district's proposed action, their decision to participate in the cost of the litigation affirmed to the district that the department considered the attorney fees associated with the litigation a reimbursable cost under the grant. In addition, in filing the lawsuit, the watershed district was following the process authorized in the settlement agreement.²⁵

Based on the interviews we conducted and the documents we reviewed, we think the watershed district's decision to seek court involvement through litigation was reasonable. In addition, we think DNR's reimbursement of the watershed district for attorney fees associated with the Stengrim litigation was justified. The Agassiz Valley Project is part of a comprehensive state program to mitigate flood damage in the Red River Basin. After years of delay, the state had a strong interest in supporting the watershed district's efforts to ensure that the project could finally be completed.

However, DNR should have done a better job documenting the basis for its decision to reimburse the watershed district a share of the attorney fees for the Stengrim litigation. In addition, the department should have amended its grant agreement with the watershed district to explicitly define as eligible, "attorney fees directly related to obtaining or enforcing agreements necessary for completing the Agassiz Valley Project." That simple action might have avoided the question that led to this review.

The Department of Natural Resources and the Middle-Snake-Tamarac Rivers Watershed District cooperated fully with this review.



James Nobles
Legislative Auditor



Cecile Ferkul, CPA, CISA
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Financial Audit Division

²⁴ Jerry Von Korff, Attorney, e-mail to James Nobles, Legislative Auditor, January 17, 2012.

²⁵ Item 19 of the settlement agreement says: "In the event any party breaches this agreement, any other party may commence an action to enforce the agreement as provided by law."

Appendix

Grant Agreement Eligible and Noneligible Costs

Eligible Costs:

Eligible costs are those costs directly incurred by the grantee that are solely related to and necessary for producing the work products described in the Project Plan. Eligible costs may include the following:

- Advertising costs for bids and proposals;
- Capital expenditures for facilities, equipment, and other capital assets as expressly approved in the Project Plan;
- Materials and supplies;
- Architectural and engineering services;
- Construction management and inspection services;
- Surveys and soil borings;
- Actual construction of the Project; or
- Travel, lodging, and meal expenses of persons involved in the Project in the same manner and in no greater amount than provided for in the current "Commissioner's Plan" promulgated by the Commissioner of Employee Relations.

Certain other types of costs may be eligible provided that they are (1) directly incurred by the Grantee; (2) are solely related to and necessary for producing the work products described in the Project Plan; and (3) have prior written approval of the State. Any cost not defined as an eligible cost or not included in the Project Plan shall not be paid from State funds committed to the Project.

Noneligible Costs:

Noneligible costs for reimbursement means all costs not defined as eligible costs, including but not limited to the following:

- Any costs incurred before the effective date of this Grant;
- Fund raising;
- Taxes, except sales tax on goods and services;
- Insurance, except title insurance;
- Attorney fees; except for acquisition and clearing title to land;
- Loans, grants, or subsidies to persons or entities for development;
- Bad debts or contingency funds;
- Interest;
- Lobbyists; and
- Political contributions.

SOURCE: Flood Hazard Mitigation Grant Agreement between the State of Minnesota and the Middle River-Snake River Watershed District.
