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BCWMC  
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October 3, 2018

Nicole Clapp  
Grants Coordinator  
Board of Water and  
Soil Resources  
520 Lafayette Road N  
St. Paul, MN 55155

Re: Penalty Provision in the BWSR Watershed Based Funding Grants Program  
Grant Agreement

Dear Ms. Clapp:

This firm represents the Bassett Creek Watershed Management Commission ("Commission") and I was asked to write to express its concerns regarding the penalty provision the Minnesota Board of Water and Soil Resources ("BWSR") includes in its Watershed Based Funding Grants Program Grant Agreement ("Agreement"). The specific penalty language that is the cause of the concern is in paragraph 5 of the Agreement setting out the conditions of payment, which states in part as follows:

Minnesota Statutes §103C.401 (2014) establishes BWSR's obligation to assure program compliance. If the noncompliance is severe, or if work under the grant agreement is found by BWSR to be unsatisfactory or performed in violation of federal, state, or local law, BWSR has the authority to require the repayment of grant funds, or an additional penalty. Penalties can be assessed at a rate up to 150% of the grant agreement.

The Commission certainly understands the desire to ensure the services paid for with grant funds comply with the provisions of the Agreement and applicable laws. It is, however, the method employed to achieve assurance that is of concern.

The law has long recognized that penalty clauses in contracts are against public policy and are unenforceable. In situations where the damages resulting from a breach are clearly and readily susceptible of definite measurement and proof by ordinary rules, a provision in the contract that provides for damages in excess of that amount is a penalty and is unenforceable. *Gorco Const. Co. v. Stein*, 99 N.W.2d 69, 75 (Minn. 1959) (see also, *Priester Const. Co. v. Hansen*, No. A09-1845, 2010 WL 3000183 (Minn. Ct. App. Aug. 3, 2010)). Here, the amount of damages sustained by the state from a breach is susceptible to definite measurement and the penalty provision provides for the payment of an amount that is greatly disproportionate to those damages.

In most cases it is a question of whether a liquidated damages provision has gone too far and is actually a penalty provision. However, in this case there is no attempt to disguise the provision as anything other than a penalty. The Agreement expressly provides for BWSR's unilateral imposition of a penalty of up to 150% of the grant amount. Furthermore, the Agreement provides no basis on which BWSR would make that determination, it is simply left to BWSR to decide the amount of the penalty. There can be no debate that this is a penalty provision both under the common law analysis of it exceeding any reasonable determination of actual damages, and by its own terms threatening the imposition of a penalty if the entity receiving the grant does not perform.

BWSR's Grants Administration Manual asserts that "BWSR has the authority to require the repayment of grant funds, or an additional penalty. Penalties can be assessed at a rate up to 150% of the grant agreement." However, it cites no basis for that authority beyond reference to its obligation under Minn. Stat. § 103C.401, subd. 1(12) to "ensure compliance with statewide programs and policies established by the state board by advice, consultation, and approval of grant agreements with the districts." In regard to other provisions, the manual cites to the management policies of the Minnesota Department of Administration's Office as authority. However, neither the statute nor the Department's policies provide for the imposition of a penalty for breaching a grant agreement. However, even if they did, the state and its agencies may not develop or implement policies that are contrary to law.

There is also the concern that the penalty would have the effect of penalizing the grant recipient's taxpayers. The public policy behind prohibiting penalty provisions is bolstered by the fact that in this case it would involve one public entity exacting public funds from another public entity. Requiring the repaying of the grant funds is sufficient motivation for public entities to ensure the grant funds are properly used without the added threat of the state penalizing them for not performing.

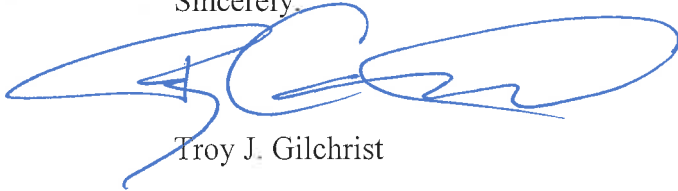
To be clear, the Commission appreciates the grants provided by BWSR and there is no question they are critical in carrying out the Commission's work to improve water quality in the watershed. Furthermore, this expression of concern is by no means a threat of legal action or other challenge to BWSR or its programs. Instead, the goal of this letter is to encourage BWSR to examine its policy and Agreement with the Office of Grants Management and the Attorney General's Office with respect to the imposition of a penalty on grant recipients. It is the

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Commission's position that the penalty provision is unreasonable, contrary to law, and is not enforceable.

Thank you for considering the Commission's concerns.

Sincerely,

A handwritten signature in blue ink, appearing to read 'TJG', with a large, stylized flourish extending to the right.

Troy J. Gilchrist

cc: Bassett Creek Watershed Management Commission  
Laura Jester, BCWMC Administrator