

Arbitration

**In The Matter of Arbitration
Between:**

**Independent School District 402, Hendricks, MN
and
Independent School District 403, Ivanhoe, MN**

**BMS Case No. 13 VP 0770
(Contract Matter)**

**Carol Berg O'Toole
Arbitrator**

Representatives:

For Hendricks:

**James K. Martin, Esq.
Booth & Lavorato LLC
10520 Wayzata Boulevard
Minnetonka, Minnesota 55305**

For Ivanhoe:

**Joseph F. Lulic, Esq.
Hanson Lulic & Krall, LLC
700 Northstar East
608 Second Avenue South
Minneapolis, Minnesota 55402**

Witnesses

For Hendricks:

**Bruce Houck, Superintendent
Mary Swenson, Business Manager
Nick Citterman, School Board**

For Ivanhoe:

**Dennis Hoogeveen, CPA and Partner, CliftonLarsonAllen LLP
Steve Critterman, School Board Chair**

Preliminary Statement

The hearing in the above entitled matter commenced on July 23, 2013 at 10:00 A.M at the Lincoln High Public School, 421 North Rebecca Street, Ivanhoe, MN 56142. The parties involved are Hendricks Independent School District 402 (Hendricks) and Ivanhoe Independent School District 403 (Ivanhoe). The parties presented opening statements, oral testimony, oral argument and exhibits. All exhibits offered were received with the admonition that, depending on the exhibit, some would be given lesser weight. Post hearing briefs were filed by both parties. The arbitrator received the last brief on August 16, 2013, and issued an award on the question of breach on August 24, 2013, reserving the award on Issue Two, Damages. (See Award on page 17.)

Issue Presented

The arbitrator fashioned the issue as follows:

Issue One: Was there a breach of the Interdistrict Cooperation Agreement between the parties?

Issue Two: If so, what is are the damages?

Contractual and Statutory Jurisdiction

Hendricks and Ivanhoe are signatories to an Interdistrict Cooperation Agreement (Agreement) in effect for four years, July 1, 2007, through June 30, 2011. Hendricks Exhibit 1 and Ivanhoe Exhibits1. The Agreement provides in Article II, Section 4, Disputes, that, if preliminary efforts to have the dispute resolved are unsuccessful, the parties shall select a neutral arbitrator from a list provided by the Bureau of Mediation

Services. The Agreement also provides that unless agreed to by the school boards the arbitrator shall not be a resident or voter of any of the districts. The parties stipulated that the issue was properly before the neutral arbitrator from Minneapolis and that there were no procedural issues.

Opening Statement by Hendrickson

In the opening argument counsel for Hendricks described the dispute as a “very simple case” involving a twenty year relationship. Hendricks has educated all the kindergarten through sixth grade students and Ivanhoe has educated all the seventh through twelfth grade students. The contract governing this arrangement was a four year Agreement with an automatic renewal of two years if neither party notified the other by January 1 that the Agreement would not be extended or renewed. Hendricks, receiving no January 1, 2010, notice providing otherwise from Ivanhoe, proceeded to operate as before, assuming the Agreement was automatically renewed. On June 20, 2010, the Ivanhoe School Board voted to establish its own kindergarten through sixth grade program. Because of Ivanhoe’s actions, Hendricks had to quickly establish its own seventh through twelfth grade program. Hendricks lost all of the resources it would normally receive from Ivanhoe for running the kindergarten through sixth grade program for Ivanhoe students. This amounted to several hundred thousand dollars and forced Hendricks into statutory operating debt. The situation for the school year 2012 -2013 only worsened. Hendricks never got an explanation for the abandonment of the arrangement and considers Ivanhoe to have breached the Agreement. The provision pertinent to this is Article XV, Section 2.

Opening Statement by Ivanhoe

Counsel for Ivanhoe said that there is no prohibition against Ivanhoe doing what it did in 2010 and the action did not constitute a breach of the Agreement. Students from Ivanhoe go to other schools under the Open Enrollment statute. The allegation that Ivanhoe breached the Agreement is “ridiculous” and constitutes paying Hendricks for students they didn’t educate.

Hendricks’ Case in Chief

Witnesses:

Bruce Houck

The first witness for Hendricks was the Superintendent of Schools. He has been an educator since 1982. Following work as a teacher in Minnesota and North Dakota, he became a superintendent and began working in South Dakota. He has been Superintendent at Hendricks for eight years and currently is also the Russell, Tyler and Ruthton combined school district superintendent. His training includes a Bachelor’s, Masters and Specialist degree from North Dakota State University.

Houck described the enrollment at Hendricks as 100 students with a very high “free and reduced lunches” component, 75% of the high school students and 40+% of the elementary students received free or reduced lunch. He testified that until the breach, Hendricks had money in the bank and its reserves were building. Now they are borrowing and are in statutory operating debt. Since June, 2011, they have been operating a kindergarten through twelfth grade school district by themselves. Ivanhoe and Hendricks had routinely discussed issues in regard to curriculum and sports and

had split the cost of Community Education. Houck stated that, “We didn’t have enough students...” The Agreement had allowed them to get rid of duplication. Houck testified that the Agreement “made us cost-effective” and helped us to “expand our curriculum”. He stated that before the breach he thought it “would be suicide to the district” if the Agreement was terminated...and that is “what happened to Hendricks”.

Houck testified that Ivanhoe took action at the school board meeting in June, 2011, and sent a letter to Hendricks in July, 2011, saying they were going to run their own program. When asked if Hendricks had violated the Agreement he said “No”. He stated he assumed that the two year automatic renewal had occurred when the January 1, 2011, deadline for notice passed. Hendricks Exhibit 1, Article XIV, Duration. Houck explained that the notice provision was in the Agreement so the “school district who was given the notice...could put together properly the program”. When notified in July, 2011, that Ivanhoe was going to operate on its own, Houck testified that they were able to get it together but had to offer some on-line courses and incurred extra costs.

Houck was asked about the difference between “consolidation” and “cooperation”. He said that consolidation was where school districts agreed to become a new school district and that cooperation was where school districts agreed to take on certain grades and the tuition went back and forth between the districts. Hendricks had asked in the past to look at consolidation and they (both districts) decided not to pursue it. Hendricks Exhibit 2.

Houck was asked about the classifications allowed by the State Department of Education, including K-12, K-6, K-8, 9-12, etc. He testified that Hendricks made a District or School Site Change Request Form in May, 2011 to the Minnesota

Department of Education in preparation for getting an exception from the state to allow Hendricks to negotiate with South Dakota. Senator Kubley indicated to Houck that he would entertain the legislation. Houck testified that such an application “doesn’t change how you operate” a school district and that Lake Benton and Lynd were examples of that. Lake Benton and Lynd are classified as K-12 districts but do not provide K-12 instruction to students. Despite the classification Lynd has programming for K-8 and Lake Benton has programming for K-6. When Houck was asked if he received complaints about the request, he said “No”. He testified that if the school district had received complaints about the designation they would have “removed it”, but it was to Ivanhoe’s advantage also.

Houck testified about the effects of Ivanhoe’s decision in June, 2011, to operate its own K-6. He said Hendricks was put into statutory operating debt and they had to start their own 7-12 program which included hiring additional staff, buying texts, chairs and tables to fit older kids. They also had to establish more bus routes. Because there is a statutory time line for layoffs of teachers (called unrequested leave) they weren’t able to put the proper number of teachers on layoff. They had the expense of the teachers but no income from students. Houck described the school district’s attempts to deal with Ivanhoe’s action. He said they tried to limit the damage by holding a public meeting to describe the changes. They sent out a brochure and put an advertisement on a Brookings, South Dakota, radio station. Houck testified that they tried to be as cost effective as they could be, including putting elective classes on line.

On cross examination, Houck was asked if the Agreement said, “Ivanhoe is prohibited...” in Article IV, page 3 of the Agreement. He said that language was not

there. He was also asked if Hendricks continued to operate after June or July of 2011. He said they did and also said Ivanhoe did. In response to Counsel's question, Houck said that on July 26, 2011, Ivanhoe Superintendent Mortensen told him in a letter that the School Board approved the minutes of their June 20, 2011, meeting that provided Ivanhoe would be operating their own K-6 program. Hendricks Exhibit 2. Houck testified that there had been no notice that the Agreement was terminated, but he interpreted the July letter to mean it was. Counsel for Ivanhoe asked Houck about a number of neighboring school districts who sent students to Ivanhoe or Hendrick under the Open Enrollment statute. Houck agreed that you cannot guarantee kids go to Ivanhoe. He was asked if Hendricks could find another partner once the Agreement was terminated. Houck described his efforts and stated that it had been twenty year since Hendricks ran its own high school. Houck testified that he believed as a school district Hendricks was legally required to provide K-12 education for students if Ivanhoe was terminating the Agreement.

On redirect Houck was asked about the practice of the last twenty years. He replied that neither Ivanhoe nor Hendricks had operated any grades other than their designated ones; that is, Ivanhoe operated the high school and Hendricks operated the K-6 grades.

Mary Swenson

The business manager for the Hendricks School District was the second witness. She is a college graduate with a degree in Office Management. She had experience in the field working at a cooperative center in Springfield. At Hendricks she started as the bookkeeper, became the finance director and, then in May, 1995, her present position,

Business Manager. When asked if she had ever seen Ivanhoe provide K-6 classes, she said, "No" and said that Ivanhoe had provided 7-12 all the time she was there. She testified that the agreements prior to the Agreement in dispute took an extensive period of time to negotiate. Both boards signed the Agreement after a similarly "extensive" period of time to negotiate.

Swenson testified that the financial condition on June 30, 2011, for Hendricks included \$275,000 fund balance, \$244,000 restricted reserves and \$156,000 set aside for severance payments. On June 30, 2012, the unassigned revenue went from \$221,000 to \$55,000 and severance went from a plus figure to a minus \$157,000. Swenson explained what going into statutory operating debt meant. She testified that the fiscal year end for 2012 was June 30. She stated that the field audit was not yet finished but they expected a negative balance and attributed it to two things: adding a secondary school; not getting the students from Ivanhoe. She identified Hendricks Exhibit 6 and 7 and pointed out the contingency for staff, textbooks, etc. Swenson testified as to damages for Hendricks because of the breach of the Agreement. She estimated that if they had "remained together" Hendricks would had \$39,000 in the black "moving forward".

On cross examination, Swenson agreed that Ivanhoe didn't fail to pay Hendricks for students that attended Hendricks and that Hendricks neither educated nor got paid for Ivanhoe students that went to Ivanhoe schools. On redirect, Swenson testified that the damages were based on the loss of revenue for breach of the Agreement to educate each other's students.

Ivanhoe's Case in Chief

Witness:

Steve Citterman

Ivanhoe's first witness was Citterman, the Ivanhoe Board Chair, serving in his seventh year as head of the School Board. He testified that he has lived in Ivanhoe all his life, graduated from Ivanhoe high school and is a farmer. He testified that he was familiar with the Agreement and that "the money follows the student". Citterman stated that Ivanhoe has educated the 7-12 students since 1991. He said that in the past, the majority of the Ivanhoe elementary students went to Hendricks with some to other school districts. He testified that in June, 2011, the Ivanhoe Board voted for the first time since 1990 to restart the elementary program at Ivanhoe, but that he didn't consider it a breach of the Agreement or "prohibited" by the Agreement.

Citterman testified that he did not know about the District or School Site Change Request Form, Hendricks Exhibit 2. He said that Ivanhoe was never notified about the application. Citterman discussed Hendricks Exhibit 2, Ivanhoe's July 25, 2011, letter from Superintendent Mortensen indicating the July 25, 2011, Ivanhoe Board action to approve minutes of the June 20, 2011, board meeting. He explained that the Ivanhoe School Board approved the resolution to adopt a new elementary school site for the 2011-2012 school year and approved a resolution to rescind past consolidation resolutions. Citterman stated that the reason for the letter going out on June 25, 2011, was because "nothing was legal until minutes were approved". When asked if Ivanhoe had consulted legal counsel and was advised on "breach of the Agreement", he said

they had done so and were advised. Citterman indicated that a single attorney had drafted the Agreement and acted as the attorney for both Hendricks and Ivanhoe.

The Ivanhoe Board Chair testified that they were “heading down the wrong road” and the “town wanted elementary back”. He said that he thought there was no prohibition in the Agreement for Ivanhoe kids going Hendricks or Hendricks kids going to Ivanhoe and that some “people go to Hendricks elementary school and some stayed”.

On cross examination, Citterman described the discussion with Hendricks regarding the open enrollment and that Hendricks “did not support Lincoln HI”. He testified that on May 4, 2011, he thought that Hendricks was going to terminate them. “We did it to protect our people and our town.” He stated that their attorney told them Hendricks was prepared to terminate the Agreement and that “if we terminate the Agreement...there would be no financial bearing on us”. When shown the video of the meeting where the question was asked about the consequences of breaking the Agreement and counsel indicated there was nothing either one could do about it, Citterman said that the “Board was ready to breach the Agreement when I started”.

Dennis Hoogeveen

The second and last witness for Ivanhoe was Hoogeveen, a Certified Public Accountant with the firm CliftonLarsonAllen, L.L.P. He specializes in K-12 school districts, both traditional and charter. He was hired by Ivanhoe’s counsel to analyze the damages alleged by Hendricks for the “split by Ivanhoe from the Interdistrict Cooperation Agreement”, the description of the dispute in the engagement letter. Ivanhoe Exhibit 4. He testified that he had no direct contact with any Ivanhoe or

Hendricks personnel. Hoogeveen described the process he used and the assumptions he made. He testified that he did not include the cost of Hendricks running their own high school after the alleged breach. He questioned whether Hendricks was legally required to start a high school and stated he wasn't aware that Hendricks had to legally provide it. He calculated the loss Ivanhoe had from including the loss of sparsity aid but did not know nor calculate any losses that Hendricks incurred. On cross examination, Hoogeveen answered that he was paid by Ivanhoe and had made no calculation related to costs incurred by Hendricks. He agreed that he excluded the cost of community education and school lunch from his calculations.

Discussion

The inquiry includes whether there was a valid contract, whether a breach occurred, by whom and, if so, what the damages are. Minnesota Statutes 123A.32 authorizes school districts to enter cooperative agreements for the education of students in circumstances where the individual district has too few students to effectively operate a separate K-12 district. It provides:

The boards of two or more districts may, after consultation with the department, enter into an agreement providing for: (1) discontinuance by all districts except one of at least the 10th, 11th and 12th grades; and (2) instruction of the pupils in the discontinued grades in one of the cooperating districts. Each district must continue to operate a school with at least three grades. Before entering into a final agreement, the boards must provide a copy of this agreement to the commissioner.(Emphasis added.) Minnesota Statute 123A.32.

The statute allows exactly what Hendricks and Ivanhoe agreed to in their interdistrict cooperative agreements, the most recent of which is the Agreement in dispute. There was no testimony at the hearing disputing the validity of the Agreement as a contract. I find that a valid contract between the parties existed.

For twenty years, because neither school district had enough students for individual elementary and secondary operations, Hendricks operated the elementary program for both districts and Ivanhoe operated the high school program for both districts. Houck Testimony. The cooperation saved money and allowed each district to offer more extensive curriculum. Houck Testimony. The dispute centers about what the Agreement requires.

To determine the meaning of the Agreement, arbitrators look at the plain language of the Agreement, the intent of the parties, and the behavior of the parties. *The Restatement (Second) of Contracts*, Section 202 comment d (1981), as cited by Elkouri and Elkouri, *How Arbitration Works*, Bureau of National Affairs, Seventh Edition (2012) at 9-34, states, "Where the whole can be read to give significance to each part, that reading is preferred..." The Agreement covers all the issues Hendricks argues apply: purpose (Article IV); duration of the Agreement (Article XIV); termination of the Agreement (Article XV, Section 2); disputes both over each districts' reimbursement of tuition and other disputes arising under the Agreement including an alleged breach (Article II and XIV); Community Education (Article VII); transportation of students (Article III); tuition (Article II).

Ivanhoe argues that, only one part or rather the absence of language in the Agreement, applies. That is, the Agreement's failure to contain a provision that prohibits Ivanhoe from reestablishing a high school or grade school means it can. Ivanhoe's Post Hearing Brief.

To adopt Ivanhoe's interpretation would violate the well settled principle in interpretation of contracts that requires reading the whole contract and giving meaning to all parts of it. Ivanhoe's argument would ignore multiple parts of the Agreement in favor of a part of the Agreement that doesn't exist. Article IV, Attendance-Responsible District is clear:

The purpose of this Agreement shall be to cooperate in order to provide comprehensive education ...the placement of students on a transfer basis in the buildings of the two member districts shall be District 402 will be responsible for the operation of grades PK-6 Lincoln HI Elementary and District 403 will be responsible for the operation of 7-12 Lincoln HI Junior and Senior High School." Ivanhoe Exhibit 1 and Hendricks Exhibit 1.

Ivanhoe's interpretation and dependence on a clause that doesn't exist would negate the very purpose for the Agreement. Such a result would be absurd. When one interpretation would lead to, "harsh, absurd, or nonsensical results" while another plausible interpretation would lead to "just and reasonable results", the latter interpretation will prevail. Square D Co., 99 LA 879, 882 Goodstein, 1992), as cited by Elkourii at 9-41.

Ivanhoe's interpretation is also contradicted by the enabling legislation of the very statute under which the Agreement was made. Minnesota Statute 123A.32 states that the interdistrict agreement and the districts must provide two things: "(1) discontinuance by all districts except one of at least the 10th, 11th and 12th grades; and (2) instruction of the pupils in the discontinued grades in one of the cooperating districts. (Emphasis added.)"

Arbitrators look at the language crafted by the parties themselves when deciding whether a contract was breached. Both Hendricks and Ivanhoe introduced at the hearing as their first exhibit the Agreement named the "Interdistrict Cooperation

Agreement Hendricks and Ivanhoe School Districts". Hendricks Exhibit 1 and Ivanhoe Exhibit 1. This Agreement was the most recent Agreement into which the two school districts had entered on March 27, 2007. It covered the period from July 1, 2007, to June 30, 2011, and had an automatic extension if neither party gave notice of termination. The language of Article XIV, Duration reads:

It is mutually understood and agreed that this Agreement shall be effective for four years: July 1, 2007 through June 30, 2011. Fiscal years 2008, 2009, 2010 and 2011.

Any party not intending to renew or extend this Agreement shall provide, by January 1 of the year preceeding (sic) the expiration of the Agreement, written notice to the other party of its intention not to renew or extend the Agreement. If no such notice is received by January 1, the Agreement shall be extended for a period of two (2) years. Hendricks Exhibit 1 and Ivanhoe Exhibit 1.

The Agreement describes the manner of notice to terminate the Agreement in Article XIV of the Agreement, Section 1. Notice:

All notices required to be giving (sic) by the parties, unless specifically provided otherwise, shall be in writing and sent by registered or certified mail addressed to the chairperson of the district at the administrative office. All notices required to be provided on a specific day or date shall be considered timely if postmarked on or before the date due.

It is undisputed that Ivanhoe gave no notice of termination of the Agreement in January, 2011, when the Agreement required it. Ivanhoe took board action to terminate the Agreement on June 20, 2011, and approved the minutes of the action on July 25, 2011. The Ivanhoe superintendent sent a letter to Houck on the same day. Hendricks Exhibit 2.

Houck testified that in the absence any notice in January, 2011, he thought both districts would continue the cooperation with each other they had undertaken in the previous twenty years. Both Hendricks and Ivanhoe, at the time of Ivanhoe's School

Board action in the summer of 2011, were exploring the possibility of consolidation. Hendricks' Exhibit 2. This was a step beyond the cooperation they had engaged in for two decades. The intent was clearly to be cooperative to an even greater degree than they had done before. Hendricks was justifiably surprised when the July letter came which rescinded the consolidation resolutions under discussion and, most importantly, terminated the cooperation agreement.

Past practice is usually considered when language of the contract is unclear. Here we have clear language in the Agreement. "Unquestionably, the custom and past practice of the parties constitute one of the most significant evidentiary considerations...to indicate the proper interpretation of the contract language..." Elkouri at 12-1. Hendrick and Ivanhoe had two decades of this practice that Ivanhoe abruptly terminated.

Ivanhoe argues that an anticipatory breach occurred because Hendricks filed a District or School Site Change Request Form (Hendrick's Exhibit 2) in May, 2011, which breached the Agreement. This argument fails in light of the testimony given by both of the disputing parties, Houck and Citterman. Houck credibly testified that their application would not affect the Agreement and was simply preparatory to future cooperation with nearby South Dakota school districts for which they were seeking legislation at the state legislature. He also testified that if the application had been objected to by Ivanhoe, Hendricks would have withdrawn it. Houck Testimony.

Ivanhoe's School Board Chair Citterman testified, also credibly, that he did not know about the District or School Site Change Request Form, Hendricks Exhibit 2. He said that Ivanhoe was never notified about the application. He said he didn't know the

application had been made when the Ivanhoe Board took its action to terminate the Agreement in June and July, 2011. The testimony at the hearing defeats the claim that Hendricks breached the Agreement first and was the impetus for Ivanhoe's breach.

Ivanhoe also argues that their action was simply "open enrollment". Hendricks countered by pointing out the before-the-breach behavior of reporting student from Hendricks as "tuition" as opposed to the "after-the-breach" reporting of students as an "option", a designation commonly used for open enrollment. Hendricks Exhibit 7. I find Hendricks' argument persuasive.

Ivanhoe's only testimony and evidence regarding the financial impact of the decision by Ivanhoe to terminate the Agreement was a witness who worked as a Certified Public Accountant. The testimony and report, Ivanhoe Exhibit 4, were fatally flawed because of the assumptions made. In particular, the testimony that he didn't consider Hendricks legally obligated to start a 7-12 operation and the subsequent costs in providing it when the Agreement was breached, made the report incredible. The Hendricks Superintendent's credible testimony that he considered it a legal obligation was decisive. A plain reading of Minnesota Statute 123A.32 indicates that Hendricks had a legal obligation to provide a K-12 organization in the absence of an agreement to cooperate. Additionally, Ivanhoe must have thought the same. They immediately choose to offer the grades Hendricks had previously provided before Ivanhoe breached the Agreement so they would have a K-12 operation.

Finally, the parties own course of conduct over twenty years indicated that both Ivanhoe and Hendricks felt a legal obligation to provide K-12 education for residents of

their districts. That is precisely why they needed to have an Interdistrict Cooperation Agreement to provide what could best be done together rather than separately.

Award

I find that the Agreement was breached by Ivanhoe and Ivanhoe alone. I find no breach of the Agreement by Hendricks.

I reserve the right to assess damages against Ivanhoe for the breach after additional testimony and evidence is presented by either or both parties and provided to opposing counsel and the arbitrator including the following: 1) the results of the Hendricks' field audit for the 2012-2013 year that were not available at the hearing according to the testimony of Swenson; 2). additional financial detail as to the composition of the "lost revenue" for both years referred to in the Hendricks Post Hearing Brief. Such information shall be provided on or before September 30, 2013, at a time agreed upon by the arbitrator and counsel for each party. Such evidence and testimony may be provided in writing, or by testimony in person or by phone, or a combination of the above by both parties or by either party. The Hearing will be kept open until that date for the sole purpose of assessing damages against Ivanhoe.

Dated this 24 day of August, 2013

Carol Berg O'Toole