

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
(Damage Award Following Decision on Contract Matter Finding Breach)**

**Carol Berg O'Toole
Arbitrator**

Representatives:

For Hendricks:

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

For Ivanhoe:

**Joseph F. Lulic, Esq.
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700 Northstar East
608 Second Avenue South
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Preliminary Statement

The above entitled matter commenced following the decision issued by the arbitrator on August 24, 2013, finding a breach by Ivanhoe of the Interdistrict Cooperation Agreement (Agreement) between the parties. The parties involved are Hendricks Independent School District 402 (Hendricks) and Ivanhoe Independent

School District 403 (Ivanhoe). The arbitrator found a breach of the Interdistrict Cooperation Agreement by Ivanhoe. The parties were ordered in the Award to address the damages issue:

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 ... 2) additional financial detail as to the composition of the "lost revenue" for both years... 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.

The parties and arbitrator met in a telephone conference call on September 23, 2013.

This conference and an additional meeting by counsel for the parties resulted in an agreement regarding timelines for discovery and written arguments. That process was completed upon the submission of Ivanhoe's arguments regarding damages on November 15, 2013. Additional exhibits were offered and received.

Issue Presented

The arbitrator fashioned the issue as follows:

Issue One: What are the damages resulting from Ivanhoe's breach of the Interdistrict Cooperation Agreement between the parties?

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.

The arbitrator issued an award on the breach issue on August 24, 2013, finding that Ivanhoe breached the Agreement. The parties were ordered to provide additional current information on damages and afforded an opportunity to present testimony, evidence and argument related to the assessment. Hendricks sought public information from Ivanhoe. The arbitrator held a hearing with the attorneys for the parties on September 23, 2013. The parties indicated a willingness to devise a discovery and scheduling agreement and resolve the disagreement regarding provision of public information themselves and did so. The briefing and rebuttals have been carried out ending with the submission of a response by Hendricks on November 27, 2013, and the damage assessment is before the arbitrator.

Ivanhoe's Position on Damages:

Ivanhoe states Hendricks' damages equal the amount of revenue lost as a result of Ivanhoe students not attending Hendricks' schools, less the amounts Hendricks saved by not having to educate them. Specifically, Ivanhoe argues that requires determining the number of students that would have gone to Hendricks but for Ivanhoe's termination of the Agreement. That number is multiplied by the per student tuition amount. Then, Ivanhoe continues, the amount that Hendricks would save from not educating the extra students, as well as the tuition Hendricks doesn't pay for

educating Hendricks' students, are both subtracted from the first amount. Ivanhoe states that Hendricks refuses to provide Ivanhoe with a calculation of the above amount and their current assessment reflects that.

Ivanhoe characterizes Hendricks' assessment of damages as "a lot of figures ...without any detailed analysis as to what those figures represent." Ivanhoe's Post Arbitration Brief on Damages. Ivanhoe also provides an amended expert estimate, "the absolute maximum amount of loss that could have been sustained by Hendricks...of \$78,695 for fiscal year 2012, and \$58,633 for fiscal year 2012". Interest damages were \$11,092 and \$10,329. Ivanhoe's Post Arbitration Brief and Letter to Lulic from Hoogeveen, CPA, undated.

Ivanhoe also argues that Hendricks had no obligation to operate its own high school after the Agreement was terminated. Ivanhoe states that there is "no statutory obligation nor other legal obligation for school districts such as Hendricks to operate a high school". Ivanhoe's Post Arbitration Brief. Ivanhoe further argues that if there was an obligation to establish a high school and the costs of that are attributable to the breach, they would have been incurred anyway upon expiration of the Agreement. "Therefore their compensation for those damages, to the extent they are damaged, is only a matter of timing which an award of interest on the sum spent would accommodate...once the Agreement is terminated, Minnesota Section 123A.32 simply does not apply to require Hendricks to establish a high school." . Ivanhoe's Post Arbitration Brief. Ivanhoe concludes its argument by saying Hendricks "has merely thrown all of its expenses and revenue figures at the arbitrator without any explanation

or analysis as to what effect, if any, the termination of the Agreement has had upon the amounts listed.” . Ivanhoe’s Post Arbitration Brief.

Hendricks’ Position on Damages:

Hendricks’ submission on damages covered a two year period, the school year 2011-2012 and the school year 2012-2013. They argue that the Interdistrict Cooperation Agreement covered two years and because it was breached, the damages should cover two years. The damages include increased expenses in running a grade 7 through 12 program on short notice for two years and lost revenue from the fewer grades K-8 students who normally would have gone to Hendricks had the Interdistrict Cooperation Agreement been observed. Illustrative of the detriment that Hendricks suffered are the statutory operating debt figures.

Statutory Operating Debt

For the first time in its history Hendricks, following the breach, went into statutory operating debt. Although Hendricks attempted to lessen the statutory operating debt by using its designated severance fund, the unassigned fund balance still went negative to \$157,661 for the year 2012. The unassigned fund balance for 2013 shows a worsening condition, a negative \$357,452. Prior to the breach, Hendricks was not in statutory operating debt. Testimony and Affidavit of Mary Swenson.

Food Service Fund

Although Hendricks reduced its food service staff and benefits to attempt to ameliorate the repercussions from fewer students, the food services fund balance suffered. They lost revenue. The fund balance in the Food Service fund for fiscal 2011

was \$32,335. The ending fund balance for fiscal 2012 was \$16,995. The end balance for fiscal 2013 was \$15,325. Testimony and Affidavit of Mary Swenson.

Community (Service) Education Fund

Prior to the breach, Hendricks and Ivanhoe evenly split the costs of summer recreation programming. The fund balance in the Community (Service) Education Fund for fiscal 2011 was \$41,566. The ending fund balance for fiscal 2012 was \$12,967. The ending fund balance for fiscal 2013 was a negative \$13,513. Testimony and Affidavit of Mary Swenson.

Total Damages as a Result of the Breach

Hendricks lost revenue from Ivanhoe's students not attending the Hendricks' grades K-6, the attendant food service revenue and community education revenue and expense reimbursement. In addition, Hendricks incurred expenses in establishing its own grades 7-12 program, including interest and increased workers' compensation premiums,

For 2011-2012 the total loss was \$578,014.87, comprised of lost revenue of \$389,898.58 and costs of establishing a grades 7-12 program in the amount \$133,680.16, There were additional costs of increased interest and workers compensation premiums in the amount of \$4021.99 and lost revenue in the Food Service program of \$30,167.55 and loss of Community (Service) Education revenue and expense of \$20,273.59.

For 2012-2013, Hendricks' damages totaled \$647,459.99. This total consists of lost revenue of \$488,379.38 as well as costs incurred in establishing a grades 7-12 program in the amount of \$87,108.91. Increased interest and Workers Compensation

premiums totalled \$3117.10. There was also lost revenue to the Food Service program of \$32,939.83 and loss of revenue and expense reimbursement for Community (Service) Education/service of \$35,914.77.

Award

The Standard

In assessing damages for breach of a contract, one must consider damages that flow directly (not remotely) from the breach, that are neither speculative nor mere guesses. “It is noteworthy that broad remedial authority is granted to arbitrators under the Uniform Arbitration Act. 7 U.L.A. Section 5 (1955) as cited by Elkouri & Elkouri, *How Arbitration Works*, Bureau of National Affairs, Seventh Edition (2012) at 18-3. Monetary damages “normally correspond to monetary losses suffered”. Patterson-Sergent Co., 23 LA 21, 23 (Wilcox, 1954) as cited by Elkouri at 18-15.

Hendricks is correct in its characterization of the standard for damages. Damages repay actual losses or proven injury. Hendricks’ Rebuttal Brief at 2 citing *Poppler v. Wright Hennepin Co-op Electrical Association*, 834 N.W. 2d 527, 546, 2013 WL 3779185 (Minn. Ct. App. 2013), quoting *Ray v. Miller Meester Adver., Inc.*, 684 N.W. 2d 404, 407 (Minn. 2004).

Hendricks’ damages stemmed directly from the breach by Ivanhoe. The Agreement required the parties to notify each other if termination was desired, precisely to avoid the kinds of damage that Hendricks suffered. There was insufficient time to notify Hendricks’ faculty on contract who were no longer needed, let alone find another district to substitute for Ivanhoe. The parties had been cooperating for twenty years. Hendricks testified credibly that they expected the Agreement to continue absent any

notification. In fact, there was even evidence of discussions to merge the two school districts. When the breach occurred Hendricks determined that they had to operate a full K-12 system on very short notice.

The Duty to Provide a K-12 Education

There is no question that Hendricks had an obligation to provide K-12 education to the residents of its school district if Ivanhoe walked away from this obligation.

Ivanhoe again argues that this is not so. That issue was argued in the first hearing and decided. The Hendricks' Superintendent's credible testimony that he considered it a legal obligation was decisive. A plain reading of both Minnesota Statutes Sections 123 A.32 and 123 B.02 indicates that Hendricks has a legal obligation to provide an education to any child of school age, grades K-12, residing in its district through a cooperation agreement with another district or in the absence of an agreement like that, through its own operation.

The arbitrator concluded in the August 24, 2013, Award that Ivanhoe thought they also had the obligation provide a K-12 operation after the Agreement was terminated. Their actions speak loudly. Ivanhoe immediately choose to offer the grades Hendricks had previously provided before Ivanhoe breached the Interdistrict Cooperation Agreement so they would have a K-12 operation of their own. And, the long course of conduct of both parties 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 Agreement to provide what could best be done together rather than separately.

The Proof of Damage

In the proceedings, Hendricks provided volumes of background information justifying the numbers comprising its damage calculation. In addition, credible testimony was given from its long-term Business Manager, Mary Swenson and its Superintendent, Bruce Houck. Both officials from Hendricks' had experience and expertise in managing school finances. Superintendent Houck has superb educational credentials plus a good deal of experience in cooperation with other school districts. The figures comprising Hendricks' damage calculation are based on the school district 2011-2012 and 2012-2013 audit reports. Both Swenson's and Houck's testimony and the exhibits presented show a direct link between the breach and Hendricks' first time Statutory Operating Debt. I find Hendricks' descent into Statutory Operating Debt directly attributable to Ivanhoe's breach of the Interdistrict Cooperation Agreement.

Ivanhoe claims Hendricks has "thrown all of its expenses and revenue figures at the arbitrator without any explanation or analysis as to what effect, if any, the termination of the Agreement has had upon the amounts listed". Ivanhoe's Post Arbitration Brief at 6. They have supported the damage calculation with telling words: "would". "the most Hendricks' loss could possibly be", "would... have paid", "presumed that the cost...is at least relatively close to the amount", "potential maximum potential damage", Ivanhoe's Post Arbitration Brief. I find to the contrary. Hendricks proved their actual losses from the breach with certainty. Besides substantial data from the school district's audits, testimony was given from those who experienced the losses first-hand. Their proof was convincing.

Ivanhoe initially claimed that the damage amount should not include damages related to Hendricks' Food Service operation. In the Post Arbitration Brief Ivanhoe includes consideration of that operation, albeit with a different calculation. The Agreement covers Food Service and Community Education (Service) expenses and revenue and the twenty year practice of the parties requires that these operations be considered in the calculation of damages.

Based on all the testimony and exhibits as well as the argument of counsel, I find that Hendricks suffered damage in the amount of \$578,041.87 for the 2011-2012 school year and \$647,459.99 for the 2012-2013 school year attributable to Ivanhoe's breach of the Agreement. I award Hendricks a total of \$1,225,501.86 in damages payable by Ivanhoe.

Dated this thirteenth day of December, 2013

Carol Berg O'Toole