OAH 65-1300-30948

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE DEPARTMENT OF EDUCATION

In the Matter of:

Independent School District #271
(Bloomington)

and

Intermediate District #287

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND DECISION

This matter was referred to the Office of Administrative Hearings (OAH) by the Department of Education for a contested case proceeding and final decision, pursuant to Minn. Stat. § 14.57(a) (2014).[1]

An evidentiary hearing was held before Administrative Law Judge (ALJ) Ann O'Reilly on June 23, 24, 25, 26, 27, and 30, 2014.

David L. Holman, Holman Law Offices, appeared on behalf of Independent School District #271 (Bloomington). Sara Ruff, Attorney at Law, and Anne Becker, General Counsel, appeared on behalf of Intermediate School District #287 (Intermediate District or District). Daron Korte, Chief Legal Counsel, observed the proceedings on behalf of the Department of Education (Department).

After the hearing, the parties submitted post-hearing briefs. After reviewing the post-hearing briefs and arguments, the Administrative Law Judge requested additional information from the parties, including additional exhibits, which were marked by the judge as Exhibits A-Z and AA.

The hearing record closed on December 19, 2014, upon receipt of the last post-hearing correspondence and the issuance of an Order Supplementing the Hearing Record to include Exhibits A-Z and AA.

[1] *See* Notice and Order for Prehearing Conference and Hearing dated October 20, 2013.

STATEMENT OF THE ISSUES

1. Upon its withdrawal from the Intermediate District, what is Bloomington's proportionate share of the Intermediate District's assets and liabilities based upon Bloomington's enrollment, financial contribution, usage, or other factor or combination of factors?

2. How should the assets be disbursed to Bloomington so as to minimize financial disruption to the Intermediate District?

SUMMARY OF DECISION

Based upon Bloomington's enrollment, financial contribution, usage and other factors, Bloomington's proportionate share of the Intermediate District's assets and liabilities is **$525,297.00.** A portion of said amount can be paid by non-member tuition credits for Bloomington students to enroll in the Intermediate District. The parties are directed to agree to a payment schedule that minimizes financial disruption to the Intermediate District and its remaining Member Districts. If the parties cannot agree to a payment schedule by February 17, 2015, the Administrative Law Judge shall determine the payment schedule, payment type, and the interest, if any, to be applied to the balance owed, after allowing additional written argument by the parties.

Based upon an application of the law, the arguments of counsel, and the evidence in the hearing record, the Administrative Law Judge makes the following:

FINDINGS OF FACT

INTRODUCTION

1. This matter involves the withdrawal of Bloomington from the Intermediate District pursuant to Minn. Stat. § 123A.24 (2014), and the distribution of assets and the assignment of liabilities associated therewith.[2]

2. The Intermediate District is a consortium of member school districts created under Minn. Stat. § 136D.21 (2014), to provide special education and other services to students of participating districts.[3] Bloomington was a member of the Intermediate District for approximately 40 years: from the District's inception in 1968 until Bloomington's withdrawal on June 30, 2011.[4]

3. Neither the Intermediate District's Joint Powers Agreement with its members nor its Bylaws address the financial implications of a member district's withdrawal from the collective.[5]

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[2] *See id.*
[3] Testimony (Test.) of Sandra Lewandowski at Transcript (T.) 434-35, 437, 443-44.
[4] *Id.* at T. 437; Test. of Les Fujitake at T. 30; Exhibits (Ex.) 21, 102.
[5] Test. of S. Lewandowski at T. 451-52.

4. The parties agree that Minn. Stat. § 123A.24 governs Bloomington's withdrawal from the Intermediate District.[6] Section 123A.24 provides, in pertinent part:

> Subdivision 1. **Distribution of assets and liabilities.**
>
> (a) If a district withdraws from a cooperative unit defined in subdivision 2, the distribution of assets and assignment of liabilities to the withdrawing district shall be determined according to this subdivision.
>
> (b) The withdrawing district remains responsible for its share of debt incurred by the cooperative unit according to section 123B.02, subdivision 3. The district and cooperative unit may mutually agree, through a board resolution by each, to terms and conditions of the distribution of assets and the assignment of liabilities.
>
> (c) If the cooperative unit and the district cannot agree on the terms and conditions, the commissioner[7] shall resolve the dispute by determining the district's proportionate share of assets and liabilities based on the district's enrollment, financial contribution, usage, or other factor or combination of factors determined appropriate by the commissioner. The assets must be disbursed to the withdrawing district in a manner that minimizes financial disruption to the cooperative unit.

5. After its withdrawal, Bloomington and the Intermediate District were unable to agree on the terms and conditions of the distribution of assets and assignment of liabilities.[8]

6. As a result, on May 25, 2012, the Intermediate District and Bloomington participated in mediation.[9] That mediation was unsuccessful.[10]

7. On May 31, 2012, the Intermediate District advised the Commissioner that the District and Bloomington were unable to agree to the distribution of assets and assignment of liabilities required by Bloomington's withdrawal.[11] The Intermediate District made a formal request that the Commissioner resolve the dispute pursuant to Minn. Stat. § 123A.24.[12]

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[6] *See* the parties' respective Post-Hearing Briefs filed on August 25, 2014.
[7] The statute refers to the Minnesota Commissioner of Education. *See* Minn. Stat. §§ 123A.01, subd. 1, 120A.05, subd. 4 (2014).
[8] *See* the parties' Post-Hearing Briefs filed on August 25, 2014.
[9] Ex. 111.
[10] *Id.*
[11] *Id.*
[12] *Id.*

8. The Commissioner expressed that she had never been asked to exercise the authority granted by Minn. Stat. § 123A.24, and scheduled a meeting with the parties to discuss resolution.[13]

9. The Commissioner met with the parties on two occasions to resolve the matter informally.[14] Despite her efforts, the Commissioner was unable to resolve the matter with the parties. The Commissioner concluded, "The Minnesota Department of Education does not have the technical knowledge or expertise to make an appropriate determination of the correct valuation of Bloomington's share of the Intermediate's assets and liabilities."[15] As a result, the Commissioner referred the matter to the Office of Administrative Hearings for an evidentiary hearing and final decision pursuant to Minn. Stat. § 14.57(a).[16]

10. The parties agree that Bloomington is not prohibited by law or contract from withdrawing from the Intermediate District.[17] The parties disagree, however, on the value of Bloomington's share of assets and liabilities, as well as the manner in which disbursement should occur so as to minimize financial disruption to the Intermediate District.[18]

11. The parties stipulate to the following list of issues upon which disagreement exists: (1) the value of assets and liabilities associated with real estate in which the Intermediate District has a legal interest; (2) the amount of pension and other post-employment benefits for which Bloomington is responsible; and (3) Bloomington's proportionate share of the Intermediate District's assets and liabilities.[19]

12. Minnesota Statutes, section 123A.24, subdivision 1(c), vests the Commissioner of Education (Commissioner) with the authority to resolve the dispute between Bloomington and the Intermediate District. The Commissioner has submitted this dispute to the Office of Administrative Hearings for final determination pursuant to Minn. Stat. § 14.57 (2014).[20] The following constitutes the final agency decision in this matter.[21]

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[13] Ex. 113.
[14] *See* Notice and Order for Prehearing Conference and Hearing at 2.
[15] *Id*.
[16] *Id.*
[17] *Id*.
[18] *Id.*
[19] *Id.*
[20] *See id*.
[21] Minn. Stat. § 14.57.

CREATION AND FINANCING OF INTERMEDIATE DISTRICT #287

13. In the late 1960s, the Minnesota legislature passed legislation authorizing the creation of three "intermediate school districts," each to be comprised of two or more independent school districts in the Minneapolis/St. Paul metropolitan area.[22] The legislation, in its current form, allows individual school districts to "enter into agreements to accomplish jointly and cooperatively the acquisition, betterment, construction, maintenance, and operation of technical colleges and the provision of facilities for and instruction in special education, and driving of motor vehicles."[23]

14. An "intermediate school district" is defined in Minnesota law as "a district with a cooperative program…offering integrated services for secondary, postsecondary, and adult students in the areas of vocational education, special education, and other authorized services."[24]

15. Federal and state laws prescribe specific requirements on the type of programming public schools must offer, including the special education schools must provide to all eligible students.[25] Governmental funding to individual school districts, however, is often insufficient to cover all costs of providing the required services.[26]

16. The intended purpose and function of an intermediate school district is to enable independent school districts to combine their resources and offer technical and special education to their students in a more cost-effective manner.[27] By pooling resources and sharing expenses, individual school districts are able to offer their students specialized programming that the individual districts may be unable to fully or economically provide on their own.[28]

17. Intermediate School District #287 was first established in 1968.[29] Its original members included 13 Independent School Districts (ISD) in Hennepin and Wright Counties, including ISD #270 (Hopkins); ISD #271 (Bloomington); ISD #272 (Eden Prairie); ISD #273 (Edina); ISD #276 (Minnetonka); ISD #277 (Westonka); ISD #278 (Orono); ISD #279 (Osseo); ISD #280 (Richfield); ISD #281 (Robbinsdale); ISD #283 (St. Louis Park); ISD #284 (Wayzata); and ISD #286 (Brooklyn Center) (collectively referred to as the "Participating School Districts" or "Member Districts").[30]

18. There are three intermediate school districts in the State of Minnesota: (1) Intermediate District #287; (2) Intermediate School District #917, which serves independent school districts in Dakota and Goodhue Counties; and (3) Intermediate

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[22] 1967 Minn. Laws ch. 822; 1969 Minn. Laws ch. 775; 1969 Minn. Laws ch. 1060.
[23] *See* Minn. Stat. § 136D.21.
[24] Minn. Stat. § 136D.01 (2014).
[25] Test. of L. Fujitake at T. 28-29.
[26] *Id.*
[27] *Id.*
[28] *Id.*
[29] Ex. 102.
[30] Test. of S. Lewandowski at T. 442-44; Ex. 102.

District #916, which serves independent school districts in Anoka, Ramsey and Washington Counties.[31]

19. Intermediate School District #287 is the largest of the three intermediate school districts in Minnesota.[32] The District currently serves approximately 11,996 full- and part-time students from both its Member Districts and non-member districts.[33]

Memoranda of Agreement Establishing Intermediate District #287

20. To create the Intermediate District in 1968, the original Member Districts executed a Memorandum of Agreement setting forth the terms and conditions of the joint powers entity.[34] The Memorandum of Agreement was subsequently amended in 1972.[35]

21. In 2008, the Superintendent of the Intermediate District determined that it was advisable for the Member Districts to review the 1972 Memorandum of Agreement, and reconfirm their commitment to each other and to the Intermediate District.[36] As a result, the District drafted, and the Member Districts unanimously executed, a new Memorandum of Agreement, effective on January 1, 2009.[37] The 2009 Memorandum of Agreement is the most current joint powers agreement for the Intermediate District.[38] The Memoranda of Agreements executed in 1968, 1972, and 2009 are the only organizational documents detailing the terms and conditions of the Member Districts' joint powers arrangement.

22. The 2009 Memorandum of Agreement (Agreement) provides that each Member District shall have one representative on the Intermediate District School Board.[39] As such, each Member District has an equal voice in the management and operation of the Intermediate District, irrespective of the number of students enrolled in the District.[40]

23. The Agreement further provides that "Neither members nor member representatives shall have individual liability for the debts and obligations of the District. Member and member representative liability is determined by law."[41] Thus, debts and obligations incurred by the District remain the liabilities of the Intermediate District, and do not become liabilities of the individual Member Districts.[42]

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31 *See* Minn. Stat. § 136D.01-.94 (2014).
32 Test. of S. Lewandowski at T. 435.
33 http://www.district287.org/clientuploads/FACT_Sheets/District_287_Fact_Sheet%20Nov_21_2013.pdf.
34 Ex. 102.
35 *Id.*
36 Test. of S. Lewandowski at T. 446-49; Ex. 102.
37 Ex. 102.
38 *Id.*
39 *Id.*
40 *Id*.
41 *Id.*
42 *Id.*

24. With respect to the withdrawal of Member Districts from the collective, the Agreement states:

> Withdrawal of any Member. Any member may withdraw from the District and cause its representative to cease to function in such capacity upon written notice given to the Clerk of the Board before February 1 of any year, such notice to be accompanied by a certified copy of an appropriate resolution of the school board of such member authorizing and directing such withdrawal of the member from the Intermediate District. Any such withdrawal by a member shall be effective June 30 of the following fiscal year.[43]

25. The Agreement does not, however, address how the assets and liabilities of the Intermediate District should be distributed or allocated upon withdrawal of a Member District.[44] The Agreement is also silent as to a withdrawing Member District's liability for debts of the Intermediate District after withdrawal.[45]

26. While the Agreement does not give direction as to how assets and liabilities shall be distributed upon the withdrawal of a Member District, the Agreement does address the distribution of assets and liabilities upon dissolution of the collective.[46] The Agreement provides:

> Dissolution of Intermediate District. The District shall continue in existence until two-thirds of its membership agree upon dissolution at an annual meeting or special meeting called for the purpose of considering dissolution.
>
> Distribution of Assets upon Dissolution. Upon dissolution of the District, any assets remaining after payment or reservation for debts and liabilities shall be divided among all members of the District as a majority of the members of the Board at the time of dissolution may determine in their discretion. To the extent possible all assets of the District shall be converted to cash prior to dissolution.[47]

Financing of Intermediate School Districts

27. Intermediate school districts in Minnesota do not have the authority to issue bonds or levy taxes to pay for school facilities.[48] The legislature only vests such powers in independent school districts, not intermediate districts.[49] Thus, to subsidize

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[43] *Id*. The fiscal year for the Intermediate District runs from July 1 to June 30 of each year.
[44] Ex. 102.
[45] *Id.*
[46] *Id*.
[47] *Id.*
[48] *See* Minn. Stat. § 136D.281, subd. 8; *see also* Test. of Mae Hawkins at T. 874.
[49] Test. of M. Hawkins at T. 874.

the operation of programs, the payment of staff, the acquisition of real estate, and the construction of school facilities, intermediate districts must rely on the tax and levy authority of their member districts.[50] Member districts tax their residents and then pay the intermediate district for programming and facilities.[51]

28. Intermediate District #287 is primarily funded by two main sources: (1) "tuition costs" charged to Member Districts and non-member districts; and (2) lease levies imposed on Member Districts.[52] The income from tuition is used to pay operating costs, staff costs, and programming costs.[53] The income from lease levies is used to pay for capital costs, such as real estate leases and acquisitions.[54]

29. The District's daily operations are primarily funded by the tuition payments made by Member Districts and non-member independent school districts that enroll their students in the programs offered by the Intermediate District.[55] The tuition amount is different for each of the programs offered by the Intermediate District [i.e., special education, technical education, educational services provided through an Area Learning Center (ACL), education provided to English Language Learners (ELL), etc.].[56]

30. Each year, as part of the establishment of various education funding formulas, the Commissioner sets the per-pupil tuition for each of the Intermediate District's programs.[57] The tuition amount is based upon the Intermediate District's funding requirements and obligations, less any federal subsidies or grants received.[58] The same tuition amount is charged to Member Districts and non-member districts.[59]

31. Non-member districts, however, are also charged an access fee on a per-pupil basis.[60] While non-member school districts are able to enroll their students in the programs offered by the Intermediate District, space is often limited and preference is given to students from Member Districts.[61]

32. Because the Intermediate District does not have the authority to issue bonds and levy taxes, it must rely on other mechanisms to finance its facility costs.[62] To finance capital expenses, such as the District's interests in real estate, each Member District is assessed a lease levy.[63] The lease levy is used to pay the costs of the

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[50] *Id.*
[51] *Id.* at T. 874, 926-29.
[52] *Id.* at T. 925; Test. of S. Lewandowski at T. 437. Other sources of funding include the Safe School Levy and Health and Safety Levy. Test. of S. Lewandowski at T. 437.
[53] Test. of M. Hawkins at T. 925-27; Test. of S. Lewandowsi at T. 437.
[54] Test. of M. Hawkins at T. 925; Test. of S. Lewandowski at T. 625-26.
[55] Test. of M. Hawkins at T. 925-29.
[56] *Id.*
[57] *Id.* at 885-86.
[58] Test. of S. Lewandowski at T. 437.
[59] Test. of M. Hawkins at T. 927-28.
[60] *Id.*
[61] Test. of S. Lewandowski at T. 633
[62] Test. of M. Hawkins at T. 907.
[63] *Id*. at T. 925-29.

contractual agreements that the Intermediate District enters into to acquire interests in real estate and facilities.[64]

33. The amount of the lease levy is based upon the amount of the District's lease obligations divided among the Member Districts based upon the Average Daily Membership of each Member District (i.e., the average number of students each Member District sends to the Intermediate District).[65]

34. Non-member districts do not share in the cost of the lease levies.[66]

INTERMEDIATE DISTRICT'S REAL ESTATE INTERESTS

35. For over 40 years, Bloomington was an active member of the Intermediate District.[67] During that time, the Intermediate District acquired legal interests in six real properties:

(1) The District Service Center, located in Plymouth, MN;

(2) A residential condominium in Robbinsdale, MN;

(3) The Edgewood Education Center, located in Brooklyn Park, MN;

(4) The South Education Center, located in Richfield, MN;

(5) The West Education Center, located in Minnetonka, MN; and

(6) The North Educational Center, located in New Hope, MN.[68]

36. From its inception in 1968 until approximately 2005, the Intermediate District owned one building: the District Service Center (DSC Property), located in Plymouth.[69] The District purchased the DSC Property in 1972, and has used the building for administrative offices and storage space since that time.[70]

37. The District owns the DSC Property free and clear of any mortgages or other encumbrances.[71] As a result, the District has a fee simple interest in the DSC Property.[72]

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[64] *Id.* at T. 925.
[65] *Id.* at T. 926.
[66] *Id*. at T. 927-28.
[67] Test. of L. Fujitake at T. 30; Test. of S. Lewandowski at T. 437.
[68] Exs. 1-13, 104-07, A-Z; *see also* Test. of L. Fujitake at T. 56-58.
[69] Test. of S. Lewandowski at T. 445-46, 626-29; Ex. 4 at 49.
[70] Ex. 4 at 1, 10, 49.
[71] Test. of Robert Lutz at T. 228; Ex. AA.
[72] Ex. AA.

38. The market value of the DSC Property is disputed by the parties in this action.

39. From 1968 until 2005, the District was operating all of its educational programs out of leased retail space and unused facilities owned by Member Districts.[73] Beginning in approximately 2004, under the direction of then Assistant Superintendent Sandra Lewandowski (Lewandowski), the Intermediate District decided that its former practice of renting facility space to conduct its programming was inefficient and inadequate.[74]

40. According to Lewandowski, the leased facilities were no longer providing safe or effective educational environments for their special needs students, and often required extensive retrofitting or remodeling to meet the District's requirements.[75] Remodeling the rented facilities to meet the District's needs was expensive, and, because the District did not own the properties, the District could not recoup its investment in the improvements at the end of the lease terms.[76]

41. Consequently, the District embarked on a long-term facilities planning process to investigate whether it was more efficient or economical for the District to purchase facilities rather than rent space.[77] After much study, the District decided that it wanted to purchase real estate and build its own facilities to suit the District's unique needs.[78]

42. As an intermediate school district, the District does not have the legal authority to levy taxes or issue bonds to pay for the construction of new facilities.[79] Therefore, unless the District was able to purchase a property in cash, creative financing was required to acquire real property.[80] The District found such creative financing in the use of certificates of participation and lease purchase agreements, which will be more specifically described below.

43. In 2005, the Intermediate District purchased a residential condominium in Robbinsdale, Minnesota (Robbinsdale Condo or Condo) to use for educational programming. The District owns the Condo free and clear of any mortgages. As a result, the District has a fee simple interest in the Condo. The parties do not dispute that the market value of the Robbinsdale Condo is $50,000.[81]

44. Between 2004 and 2010, the District acquired legal interests in four other real properties: the West Education Center (WEC Property) in 2004; the South

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[73] Test. of S. Lewandowski at T. 445-46, 626-29.
[74] *Id*.
[75] *Id.*
[76] *Id.*
[77] *Id.*
[78] *Id.*
[79] *Id.* at T. 437.
[80] *Id.*
[81] *See* Bloomington's Post-Hearing Brief.

Education Center (SEC Property) in 2006; the Edgewood Education Center (EEC Property) in 2010; and the North Education Center (NEC Property) in 2010.[82] The District's legal interest in each of these properties was acquired using financing vehicles involving certificates of participation and long-term lease agreements.[83]

45. During the time that the Intermediate District was acquiring its interests in all of these real properties, Bloomington was a full, participating Member District of the Intermediate District.[84] Bloomington voted in favor of the Intermediate District acquiring a legal interest in the Robbinsdale Condo, the EEC Property, the SEC Property, and the WEC Property.[85] Bloomington ultimately opposed the Intermediate District's decision to acquire a legal interest in the NEC Property.[86]

46. A detailed explanation of the District's real estate transactions is set forth below.

Financing of Real Estate Acquisitions by the Intermediate District

47. Because the Intermediate District does not have the legal authority to levy taxes or issue bonds, it must rely on other methods to finance the acquisition of real property and the construction of school facilities. In recent years, the Intermediate District has used certificates of participation and various forms of leases to finance its real estate acquisitions.[87]

48. To establish these types of financing arrangements, the Intermediate District worked with a lender to finance the purchase of real property and the construction of facilities.[88] The lender generally purchased the real property and paid for the construction or remodeling of the facilities.[89] The District, however, determined how the facilities should be constructed and used, in the same manner as a build-to-suit transaction involving an owner-occupant.

49. Rather than entering into promissory notes and mortgages with the lender, as is done in typical financial arrangements, the District and the lender entered into long-term leases in which the lender serves as the lessor and the District becomes the lessee of the property.[90] Title to the property generally remains with the lender and the District obtains a possessory interest via the lease agreement.[91]

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[82] *See* Exs. A, B, D, E, I, J, K, L, R, S, T.
[83] *See* Exs. A-W.
[84] Test. of L. Fujitake at T. 30; Test. of S. Lewandowski at T. 437.
[85] The parties do not dispute that Bloomington voted in favor of the District acquiring legal interests in the Robbinsdale Condo, EEC Property, SEC Property, and SEC Property.
[86] Ex. 22.
[87] *See* Exs. A-W; Test. of M. Hawkins at T. 907-08.
[88] Exs. A-W.
[89] Exs. A-W.
[90] Exs. A-W.
[91] Exs. A-W.

50. Unlike traditional commercial leases, the District's leases all contain non-appropriation provisions, as required by state law.[92] These non-appropriation clauses permit the District to terminate the lease at the end of any fiscal year without further liability.[93] According to the Intermediate District's real estate expert, this type of financing allows the Intermediate District to "circumvent" the legal restrictions that limit the amount of debt that a school district may acquire, and serves a function similar to school bonding but without the need for public approval of a referendum.[94]

51. Under the lease agreements, the District and lender agree to a fixed interest rate which is applied to the principal amount paid by the lender for the acquisition and construction of the property.[95] The principal and interest are then amortized over a period of years and divided into a "lease payment" or "rent payment," payable once or twice yearly by the District to the lender.[96]

52. Under the terms of these lease agreements, the lender generally remains the owner of record until the last lease payment is made, at which time legal title to the property is conveyed to the District.[97] As a result, the District does not own or have title to the property until: (1) all lease payments are made at the end of the lease term; or (2) the District exercises its option to purchase the property and prepays the lease prior to the expiration of the lease term.[98] Thus, during the lease term and until the District exercises its option to purchase the property, the District holds only possessory and leasehold interests in the property. Title remains vested in the lender.[99]

53. What distinguishes these leases from typical commercial leases is that, under the required non-appropriation clauses of the lease agreements, the District may terminate the lease at the end of any fiscal year without further liability.[100] Upon early termination, the District forfeits all rent payments made prior to termination and the lender retains all right and title to the property, similar to a contract for deed.[101]

54. To recoup the cost of the property and construction and to minimize its financial risk, the lender issues certificates of participation to outside investors in amounts equal to the amount paid by the lender for the acquisition and construction of the property.[102] Thus, the investors, not the lender, carry the financial risk of the District's early termination or default.

[92] *See, e.g.,* Minn. Stat. §§ 126C.40, subd.1(d), 465.71 (2014); s*ee also* Exs. A, D, F, I, J, N, R, U.
[93] Exs. A, D, F, I, J, N, R.
[94] Ex. 107 at cover letter; *see also* Finding of Fact No. 55 related to Certificate of Participation financing.
[95] Exs. A-W.
[96] Exs. A-W.
[97] Exs. A, D, F, I, J, N, R.
[98] Exs. A, D, F, I, J, N, R.
[99] Exs. A, D, F, I, J, N, R.
[100] Exs. A, D, F, I, J, N, R.
[101] Exs. A, D, F, I, J, N, R.
[102] Exs. A-W.

55. A certificate of participation is a financing vehicle by which an investor purchases a share of an income stream arising out of an agreement, in this case, lease revenues.[103] According to the Municipal Securities Rulemaking Board, a certificate of participation is defined as:

> An instrument evidencing a pro rata share in a specific pledged revenue stream, usually lease payments by the issuer that are typically subject to annual appropriation. The certificate generally entitles the holder to receive a share, or participation, in the payments from a particular project. The payments are passed through the lessor to the certificate holders. The lessor typically assigns the lease and the payments to a trustee, which then distributes the payments to the certificate holders.[104]

56. Certificates of participation are an alternative to bond financing, in that they allow a governmental entity the ability to avoid legal restrictions on the amount of debt that the entity may acquire.[105]

57. In conjunction with the issuance of certificates of participation, the lender enters into trust agreements whereby the lender acts as the trustee for all lease payments made by the District.[106] The lender collects the District's lease payments

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[103] *See* http://www.investopedia.com/terms/c/certificateofparticipation.asp. The Administrative Law Judge takes judicial notice of the definition of "certificate of participation" contained in Investopedia.com. *See* Minn. Stat. § 14.60 (2014); Minn. R. 1400.8100, subp. 2 (2013).

[104] *See* http://www.msrb.org/Glossary/Definition/CERTIFICATE-OF-PARTICIPATION-_COP_.aspx. The Administrative Law Judge takes judicial notice of the definition of "certificate of participation" published by the Municipal Securities Rulemaking Board. *See* Minn. Stat. § 14.60; Minn. R. 1400.8100, subp. 2.

[105] *See* http://www.investopedia.com/terms/c/certificateofparticipation.asp. According to Electronic Municipal Statistics (eMuni), an organization that provides information relating to the U.S. municipal bond market, a certificate of participation is explained as:

> A form of lease revenue bond that permits the investor to participate in a stream of lease payments, installment payments, or loan payments relating to the acquisition or construction of specific equipment, land, or facilities. In theory, the certificate holder could foreclose on the equipment or facility financed in the event of default, but so far no investor has ended up owning a piece of a school house or a storm drainage system. A very popular financing device in California since Proposition 13 because COP issuance does not require voter approval. **COPs are not viewed legally as "debt" because payment is tied to an annual appropriation by the government body. As a result, COPs are seen by investors as providing weaker security and often carry ratings that are a notch or two below an agency's general obligation rating.**

http://www.emuni.org/glossary.php (emphasis added). The Administrative Law Judge takes judicial notice of the definition of "certificate of participation" published by Electronic Municipal Statistics (emuni.org). *See* Minn. Stat. § 14.60 (2014); Minn. R. 1400.8100, subp. 2 (2013).

Unlike municipal or school bonds, certificates of participation are taxable, meaning that the holders/investors must pay taxes on the return from the investment. Test. of M. Hawkins at 907-08. As a result, the interest charged to the District on certificates of participation is higher than with bonds because the income to the investors is taxable and the financing arrangement has a higher risk than do bonds. *Id.*

[106] Exs. B, G, L, O, S, V.

each year and pays off the certificates of participation as they mature and as interest comes due.[107] In this way, the lender acts as an administrator and intermediary between the investors and the District.

58. Under this complex arrangement of lease agreements and certificates of participation, all parties seek to benefit. The certificate of participation holders hope to receive a return on their investment, which, because the investment involves a public school district, often has low risk of default. The lender receives administrative fees for its services as the facilitator and intermediary for the transaction without risk. The Intermediate District is able to finance the acquisition of property over time without a mortgage, without the issuance of bonds, and without its own tax levy. The practical effect is that this type of financing arrangement allows an intermediate school district to avoid state laws that restrict an intermediate school district's authority to purchase real property or enter into long-term debts or contracts.[108]

59. The difference between an independent school district and an intermediate district is an important one for understanding why the Intermediate District used this type of financing. When an independent school district seeks to acquire new facilities, it must seek voter approval through a referendum authorizing it to issue bonds to finance the purchase and to levy taxes to pay for the bonds.[109] Intermediate districts do not have their own voters or the authority to levy taxes.[110] Therefore, Intermediate District #287 looked to more creative financing, using a combination of certificates of participation and long-term leases in lieu of bonds to finance their acquisitions.[111]

60. When the Intermediate District decided to acquire interests in real property and build new facilities, it did not have to go to taxpayers for passage of a referendum granting it authority to issue bonds and levy taxes.[112] Instead, the District's Board simply voted to approve a lease-purchase agreement and accompanying certificates of participation, and then, once approved, imposed lease levies on its Member Districts to cover the costs of the leases.[113] Thus, by using lease-purchase agreements and certificates of participation, the Intermediate District was able to acquire real estate without the authority to levy taxes and without the public scrutiny of bond referenda.[114] While the taxpayers in Member Districts are ultimately responsible for these capital costs, they are not provided any opportunity to vote on or approve (or disapprove) the obligations like they would if an independent school district was acquiring the same facilities.

[107] Exs. B, G, L, O, S, V.
[108] *See generally* Exs. A-W; *see also* Ex. 107 at cover letter.
[109] Test. of M. Hawkins at T. 907.
[110] *Id.*
[111] *Id.*
[112] *Id.*
[113] *Id.* at T. 907-08.
[114] *See id*.

West Education Center (WEC)

61. In approximately 2004, the Intermediate District Board unanimously voted on a resolution to acquire an interest in real property located at 11140 Bren Road West, Minnetonka, Minnesota, and to remodel the existing building so that it could be used as a school facility by the District.[115] This property is referred to as the West Education Center or WEC Property.

62. To finance the purchase, the District entered into various agreements with Wells Fargo Brokerage Services, LLC (Wells Fargo Brokerage) and Wells Fargo Bank, N.A. (Wells Fargo Bank).[116]

WEC Lease

63. On August 31, 2004, the District and Wells Fargo Brokerage executed a Lease Agreement (WEC Lease), whereby Wells Fargo Brokerage, as lessor, agreed to purchase the WEC Property and lease it to the District, as lessee.[117] To fund the purchase of the land and building costs, Wells Fargo Brokerage agreed to deposit $9,000,000 in a construction fund held it in escrow.[118]

64. On August 31, 2004, Wells Fargo Brokerage purchased the WEC Property for $4,500,000.00.[119] Said amount was deducted from the construction fund, leaving the remainder of the $9,000,000.00 in the fund, from which the District drew and paid the construction costs.[120]

65. Under the WEC Lease, the District agreed to pay rent to Wells Fargo Brokerage in 40 bi-annual installments in an amount equal to $9,000,000.00 plus interest, amortized over 20 years.[121]

66. The WEC Lease permitted the District to terminate the lease at the end of each year if the District Board failed to appropriate funds sufficient to pay the rent.[122] In addition, the WEC Lease allowed for the prepayment of rental payments and an option to purchase the WEC Property before the end of the lease term.[123]

67. The WEC Lease provided that upon payment of the final rent payment, or upon the exercise of the option to prepay and purchase the property, legal title to the

[115] Ex. 106 at 3-4.
[116] Exs. D-H.
[117] Ex. D.
[118] *Id.* at 9; Ex. E.
[119] Ex. 106 at 4.
[120] Ex. E.
[121] Ex. D at Schedule 1.
[122] *Id.* at 11.
[123] *Id.*

property and its improvements would be conveyed to the Intermediate District for one dollar.[124]

WEC Refunding Lease and WEC Ground Lease

68. In 2009, the District decided to refinance the WEC Lease to obtain a more favorable interest rate.[125] On July 15, 2009, the District entered into a series of agreements with the Wells Fargo Bank, which combined in a Refunding Lease Agreement (WEC Refunding Lease).[126]

69. To fund the refinance, Wells Fargo Bank issued Certificates of Participation (COP) Series 2009A, in the principal amount of $8,570,000.00 (COP Series 2009A), to pay off the amount remaining under the WEC Lease.[127] Once the option to purchase was exercised under the original WEC Lease using the COP funds, legal title to the land was conveyed to the District.[128]

70. To provide security to Wells Fargo Bank for refinancing the WEC Lease, however, the District conveyed an interest in the WEC land back to the bank using a long-term Ground Lease Agreement (WEC Ground Lease), which vested a possessory interest in the WEC Property in the bank.[129]

71. At the same time, the District and Wells Fargo Bank entered into a Trust Agreement (WEC Trust Agreement), whereby the District conveyed its interest in the WEC Ground Lease to Wells Fargo Bank, allowing the bank to lease the WEC Property back to the District via the WEC Refunding Lease Agreement.[130]

72. Pursuant to the WEC Refunding Lease, Wells Fargo Bank is leasing the property back to the District for $8,570,000.00, plus interest, payable in 31 lease payments, due bi-annually from February 1, 2010, through February 1, 2025.[131] Unless earlier terminated as provided for in the lease, the lease term is from July 15, 2009, to February 1, 2025.[132] Upon payment of the final lease payment on February 1, 2025, Wells Fargo Bank shall convey all of its interest in the WEC Property back to the District, allowing the District to have clear title to the property.[133]

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[124] *Id.* at 11, 26.
[125] Ex. F at iv.
[126] Exs. F, G, H.
[127] Ex. F.
[128] Ex. X.
[129] Ex. H.
[130] Ex. G.
[131] Ex. F at Ex. B.
[132] *Id.* at 12.
[133] *Id*.

73. According to the WEC Refunding Lease, "The School District has determined that the Lease Payments hereunder during the Agreement Term represent the fair value of the use of the Premises."[134]

74. Under the WEC Trust Agreement, Wells Fargo Bank, as trustee for the owners of the COP Series 2009A, receives all lease payments due from the District under the WEC Refunding Lease, and shall use those payments to pay interest on and satisfy the COP Series 2009A, as they mature.[135]

75. The WEC Refunding Lease allows the District to purchase the WEC Property for an amount sufficient to pay off the COP Series 2009A, or prepay the unpaid lease payments before the expiration of the lease term.[136] The WEC Refunding Lease provides:

> **Section 4.3 Trustee's Interest in the Premises**. Upon payment or prepayment of the Lease Payments and Additional Lease Payments[137] due hereunder or discharge of the School District's obligation to make the Lease Payments and Additional Lease Payments in accordance with Article VIII hereof [Option to Purchase or Prepay], and in either event upon defeasance of the Certificates in accordance with the Trust Agreements, full and unencumbered legal title to the Premises shall pass to the School District, and the Trustee shall have no further interest therein. In such event, the Trustee and its officers shall take all actions necessary to authorize, execute, and deliver to the School District any and all documents necessary to vest in the School District, all of the Trustee's right, title, and interest in and to the Premises, free and clear of all liens, leasehold interests, encumbrances (other than Permitted Encumbrances), including, if necessary, a release of any and all interests or liens created under the provisions of this Agreement and the Ground Lease.[138]
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> **Section 4.5 Purchase Option; Conveyance of Title.** At any time when the purchase price for the Premises, together with any unpaid or delinquent interest, has been fully paid or provided for, whether by (i) payment of all Lease Payments and Additional Lease Payments, or (ii) payment or provision for payment of the Purchase Price provided in Article VIII [Option to Purchase or Prepay] hereof, then the purchase of the Premises by the School District shall be deemed to have occurred. The Trustee shall thereupon deliver to the School District such instruments of conveyance or release as, in the opinion of the School District, may be

[134] *Id.* at 5.
[135] Ex. G.
[136] Ex. F at 13, 22; Ex. B
[137] Additional Lease Payments include fees and expenses incurred by the Trustee, costs incident to the payment of the COP Series 2009A, and other costs. Ex. F at 10-11.
[138] *Id.* at 12.

> necessary to release any interests of the Trustee in the Premises and to convey title to the School District.[139]

76. Thus, upon the full payment or prepayment of the lease payments, or upon the payment of the purchase price set forth in the WEC Refunding Lease, full and unencumbered title to the WEC Property will be conveyed to the District.[140] However, until all lease payments are made, or until the District exercises its option to prepay the lease or purchase the property, the District's title to the WEC Property remains fully encumbered by the bank's interest in the property under the WEC Ground Lease.[141]

77. Consequently, while the District may have record title to the WEC Property, such title is fully encumbered by the WEC Refunding Lease and WEC Ground Lease, preventing the District from selling or otherwise conveying the property to a third party.[142] To that end, the WEC Refunding Lease expressly provides that the District "will not mortgage, sell, assign, transfer or convey the Premises or any portion thereof during the Term of this Agreement."[143]

78. The District, nonetheless, may still terminate the WEC Refunding Lease at the end of any fiscal year without further liability to the bank or COP Series 2009A holders.[144] Pursuant to the non-appropriation clauses in the WEC Refunding Lease:

> **Section 4.7 Nonappropriation by School District.** If the School Board of the School District (the "School Board") does not appropriate or budget moneys sufficient to pay the Lease Payments and reasonably estimated Additional Lease Payments coming due in the next Fiscal Year, as determined by a specific provision in the School District's budget for the Fiscal Year in question so stating, the School District shall be deemed to have terminated this Agreement… In the event of termination of this Agreement as provided in this Section, the School District shall surrender possession of the Premises to the Trustee in accordance with Section 4.4 hereof and convey to the Trustee or release its interest in the Premises within ten (10) days after the expiration of the current Fiscal Year.[145]
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> **Section 4.4. Surrender of Premises.** Upon termination of the Term of this Agreement pursuant to [non-appropriation] or [default]…the School District shall surrender the Premises to the Trustee in the condition in which they were originally received from the Trustee, except as repaired, rebuilt, restored, altered or added to as permitted or required hereby, ordinary wear and tear excluded….

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[139] *Id.* at 13.
[140] *Id.* at 12-13, 22.
[141] *Id.*
[142] *Id.; see also* Ex. X.
[143] Ex. F at 23.
[144] *Id.* at 13.
[145] *Id.*

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> **Section 4.9 Effect of Termination.** Upon termination of this Agreement as provided in Section 4.7, the School District **shall not be responsible for the payment of any Lease Payments or Additional Lease Payments coming due with respect to succeeding Fiscal Years**....[146]

79. More importantly, the WEC Refunding Lease does not obligate the District to appropriate funds necessary to continue the lease.[147] According to Section 2.1(i) of the WEC Refunding Lease:

> Except to the extent specifically provided herein, the School District is not obligated to appropriate or otherwise provide moneys for the payment of the Lease Payments or any other amounts coming due hereunder, and in the event the School District terminates this Agreement in accordance with Section 4.2(a) thereof, the School District shall not be liable for general, special[,] incidental, consequential or other damages resulting therefrom. This Agreement does not constitute a general obligation of the School District, and the full faith and credit and taxing powers of the School District is not pledged for the payment of the Lease Payments or other amounts coming due, or other actions required to be performed herein.[148]

80. The WEC Refunding Lease further provides:

> Nothing in this Agreement, the Ground Lease Agreement, the Trust Agreement or the Certificates [of Participation] shall be deemed to obligate the School District to continue this Agreement beyond any then-current Fiscal Year or to obligate the School District to budget or appropriate moneys or to pay Lease Payments or Additional Lease Payments due following the end of the then-current Fiscal Year.[149]

81. Thus, as long as the District pays rent through the end of the fiscal year, it can terminate the lease at any time without default or further obligation to Wells Fargo Bank beyond that fiscal year.[150] Upon either termination or default, the Intermediate District's entire liability is for the rent owed for the then-current fiscal year and no more, so long as the District vacates the property within 10 days.[151]

82. If the District were to terminate or default on the WEC Refunding Lease, the District would continue to have legal title to the WEC Property, but it would not be

[146] *Id.* (emphasis added).
[147] *Id.* at 6.
[148] *Id*.
[149] *Id*. at 8.
[150] *Id*.
[151] *Id.* at 6-8, 13-14, 24-25.

able to use, possess, or occupy the property due to the WEC Ground Lease with Wells Fargo Bank, which would continue to fully encumber the property until 2035.[152]

83. Under the Ground Lease, Wells Fargo Bank maintains a leasehold/possessory interest in the WEC Property until February 1, 2035, or until: (1) full payment or prepayment of rent is made under the WEC Refunding Lease; (2) the District exercises its option to purchase the property under the WEC Refunding Lease; or (3) the bank receives repayment of all of its administrative costs and expenses, plus an amount equal to the principal component of the rent due under the WEC Refunding Lease as of February 1, 2025.[153] Thus, unless the WEC Refunding Lease is paid in full, the District's title to the property is entirely encumbered by the WEC Ground Lease.[154]

84. With respect to future liability or indebtedness, the WEC Refunding Lease expressly provides:

> **Section 3.4 Source of Lease Payments.** Notwithstanding any other provision apparently to the contrary, this Agreement shall not constitute a general obligation of the School District, and the full faith and credit of the School District are not pledged for the payment of the Lease Payments or Additional Lease Payments or the performance by the School District of its other obligations hereunder. The Lease Payments and Additional Lease Payments shall be paid, and other obligations of the School District hereunder shall be met, solely from the amount appropriated by the School Board of the District for such purpose in the School District's annual budget, **and shall constitute a current expense of the School District for the Fiscal Year then in effect. This Agreement shall not constitute an indebtedness, liability or mandatory payment obligation of the School District within the meaning of the Constitution or the laws of the State of Minnesota**.[155]

85. Under the express terms of the WEC Refunding Lease, the lease shall not constitute a long-term debt or liability of the District, and shall only be considered a current yearly expense for the District.[156]

86. As of June 30, 2011, the District continued to occupy the WEC Property and had not terminated the WEC Refunding Lease. Nor had the District exercised its option to prepay the WEC Refunding Lease. In addition, the WEC Ground Lease

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[152] *See* Exs. F, H, X.
[153] Ex. H at 4. The WEC Refunding Lease term expires on February 1, 2025. Ex. F. The WEC Ground Lease term is through February 1, 2035, but allows early termination upon payment of all administrative costs and expenses, plus an amount equal to the principal component of the rent due under the WEC Refunding Lease through February 1, 2025. Ex. H.
[154] Ex. H.
[155] Ex. F. at 7-8 (emphasis added).
[156] *Id.*

continued to encumber the WEC Property, prohibiting the District from conveying, selling, or otherwise disposing of the property.[157]

87. According to the Certificate of Title for the WEC Property, the Intermediate District is the "owner of an estate in fee simple" in the WEC Property, subject to Wells Fargo Bank's interest in the WEC Ground Lease.[158]

88. As of June 30, 2011, the principal amount outstanding on the WEC Refunding Lease was $7,590,000.00.[159]

South Education Center (SEC)

89. In late 2005, the Intermediate District Board unanimously voted to acquire an interest in real property located at 7450 Penn Avenue South, Richfield, Minnesota, and to construct a new school facility on the property.[160] This property is referred to as the South Education Center or SEC Property.

90. To finance the purchase, the District entered into various agreements with Wells Fargo Brokerage and Wells Fargo Bank.[161]

SEC Land Lease

91. On January 6, 2006, the Intermediate District and Wells Fargo Brokerage executed a Lease Agreement (SEC Land Lease), whereby Wells Fargo Brokerage, as lessor, agreed to purchase land, and lease it to the District, as lessor.[162] The intended purpose of the acquisition was to enable the District to construct a new building (the SEC) on the property and ultimately purchase the SEC Property (land and building) from the bank.[163]

92. The purchase price for the land was $7,500,000.00.[164] At the time of purchase, the land contained an existing building which the District intended to demolish and replace with a new facility.[165]

93. The SEC Land Lease provided for rent to be paid by the District in 42 bi-annual installments, in an amount equal to $7,600,000.00, plus interest, amortized over

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[157] Exs. H, X.
[158] Ex. X.
[159] Ex. 108 at 41.
[160] Ex. P.
[161] Exs. I-O.
[162] Ex. I.
[163] *Id.* at 2.
[164] Ex. 107 at 3. Strachota's Appraisal states that the purchase price was $7,500,000.00. *Id*. However, the SEC Land Lease is for $7,600,000.00. Ex. I.
[165] Ex. 107 at 3-4.

21 years.[166] The term of the SEC Land Lease was from January 6, 2006,[167] to January 1, 2028, unless earlier terminated by the District, with the last rent payment due on January 1, 2028.[168]

94. Like the WEC Lease, the SEC Land Lease permitted the District to terminate the lease at the end of each year if the District Board failed to appropriate funds sufficient to pay the rent.[169] In addition, the SEC Land Lease allowed for the prepayment of rent and an option to purchase the SEC Property before the end of the lease term.[170]

95. The SEC Land Lease provided that upon tender of the final rent payment, or upon the exercise of the option to prepay and purchase the property, legal title to the SEC Property would be conveyed to the Intermediate District for one dollar.[171] Until that time, however, title remains with Wells Fargo Brokerage.

SEC Building Lease

96. On October 10, 2006, the District and Wells Fargo Brokerage entered into a second Lease Agreement (SEC Building Lease), whereby Wells Fargo Brokerage, as lessor, agreed to fund the construction of a new building on the SEC Property and to lease the building to the District, as lessee.[172]

97. The construction costs funded by Wells Fargo Brokerage totaled $25,400,000.00.[173] Under an Escrow Agreement dated October 10, 2006, Wells Fargo Brokerage deposited $25,400,000.00 into an escrow account against which the District could draw to pay the construction costs of the new building.[174]

98. Wells Fargo Brokerage then issued Certificates of Participation Series 2006A (COP Series 2006A) to investors in the principal amount of $25,400,000.00, with a maturity date of November 1, 2032.[175]

99. To provide security for the COP Series 2006A, Wells Fargo Brokerage, Wells Fargo Bank, and the District entered into a Trust Agreement dated October 10, 2006 (SEC Building Trust), whereby Wells Fargo Bank was appointed as trustee.[176]

[166] Ex. I at Schedule 1.
[167] The first payment of the rent was not due until July 1, 2007. *Id.*
[168] *Id.*
[169] *Id.* at 11.
[170] *Id*. at 11, 26.
[171] *Id.* at 26.
[172] Ex. J.
[173] *Id.* at Schedule 1.
[174] Ex. K.
[175] Ex. L at Ex. A.
[176] Ex. L.

Wells Fargo Brokerage then assigned its interest in the SEC Building Lease to Wells Fargo Bank, as the trustee.[177]

100. As trustee, Wells Fargo Bank holds in trust, for the benefit of the COP Series 2006A owners, Wells Fargo Brokerage's interest in the SEC Building Lease, as well as the rents received from the Intermediate District under the SEC Building Lease.[178] From the rents received, Wells Fargo Bank pays interest on, and will eventually pay off, the COP Series 2006A.[179]

101. The SEC Building Lease provides that rent be paid by the District in 52 bi-annual installments, in an amount equal to $25,400,000.00, plus interest, amortized over 26 years.[180] The term of the lease is from October 10, 2006,[181] to November 1, 2032, unless earlier terminated, with the last rent payment due on November 1, 2032.[182]

102. While the District represents that it will maintain its existence during the term of the lease or assure the assumption of its obligations by its successor, there is nothing in the SEC Building Lease that prevents the Intermediate District from terminating the lease at any time.[183] Indeed, the SEC Building Lease expressly provides:

> **Section 4.06 <u>Termination by Lessee upon Non-appropriation</u>**. The Lessee shall have the right to terminate this Lease, in whole but not in part, at the end of any Fiscal Year of the Lessee, in the manner and subject to the terms specified in this Section, in the sole event that the Governing Body fails to appropriate money sufficient for the continued performance of this Lease by the Lessee after the end of such Fiscal Year, as evidence by the passage of a resolution specifically prohibiting the Lessee from performing its obligations under this Lease and from using any moneys to pay the Rent due under this Lease in the next succeeding Fiscal Year and all subsequent Fiscal Years. The Lessee may effect such termination by giving the Lessor a written notice of termination as provided in this Section and by paying to the Lessor any Rent and other amounts which are due and have not been paid at or before the end of its then current Fiscal Year….In the event of termination of this Lease as provided in this Section, the Lessee shall deliver possession of the Leased Property to the Lessor and shall convey to the Lessor or release its interest in the Leased Property with ten (10) days after termination of this Lease.

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[177] *Id.*
[178] *Id.*
[179] *Id.*
[180] Ex. J at Schedule 1.
[181] The first rent payment was not due until May 1, 2007. *Id.*
[182] *Id.*
[183] *Id.* at 10, 18.

Upon termination of this Lease as provided in this Section, the Lessee shall not be responsible for the payment of any Rent coming due with respect to succeeding Fiscal Years….

…Therefore, an event of non-appropriation under this Lease or the aforementioned Lease Agreement dated January 6, 2006 [SEC Land Lease], under which the Land and the Building are being financed, will be considered by Lessee and Lessor an event of non-appropriation under both.[184]

103. Upon termination of the SEC Building Lease by default or non-appropriation, the District must surrender possession of the SEC Property.[185] As long as the District properly exercises it right to terminate the contract and possession of the property is surrendered to the bank within 10 days, the District's financial liability is limited to the rent due in the fiscal year of termination.[186] All rent paid prior to termination, however, is forfeited, and title to the property does not transfer to the District.[187]

104. A 2006 Amendment to the SEC Building Lease further clarifies that a termination of either the SEC Building Lease or SEC Land Lease shall be considered a termination of both leases.[188] Moreover, the Amendment expressly states that legal title to the SEC Property shall not transfer to the District until full payment is made under both the SEC Building Lease and the SEC Land Lease.[189]

105. In addition to allowing the District to terminate the lease at any time, the SEC Building Lease also allows for the prepayment of rent and an option to purchase the SEC Property before the end of the lease term.[190] According to the agreement:

Section 4.05 <u>Prepayment of Rents</u>. There is expressly reserved to the Lessee the right, and the Lessee is authorized and permitted, on any Payment Date on or after November 1, 2016, to prepay in whole but not in part[,] the Rent payable under Section 2.01 hereof as described in Section 10.01 hereof, and the Lessor agrees to accept such prepayment of Rent when the same is tendered by the Lessee.

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Section 10.01 <u>Option to Purchase Lease Property</u>. On any Payment Date, on or after November 1, 2016, during the Lease Term, the Lessee may elect to terminate this Lease upon payment of the Total Payment Due plus the Termination Value set forth in Schedule 1 hereto with respect to

[184] *Id*. at 10.
[185] *Id.* at 27.
[186] *Id*. at 10, 22-23; s*ee also* Ex. M.
[187] Ex. J at 10, 22-23.
[188] Ex. M.
[189] *Id.*
[190] Ex. J. at 10, 25.

> such date, and on such termination date, the Lessee may exercise its option to purchase the New Leased Building….The Lessee shall have, and is hereby granted, an option to purchase the New Leased Building for One Dollar ($1.00) at the expiration of the Lease Term if full payment or prepayment of all Rent has been made in accordance with the provisions hereof ….
>
> **Section 10.02** **<u>Conveyance on Exercise of Option to Purchase</u>**. On the exercise of any option to purchase granted herein, the Lessor will upon payment of the purchase price deliver or cause to be delivered to the Lessee documents conveying to the Lessee all of the right, title and interest of the Lessor in and to the real and personal property being purchased ….

106. Thus, upon remittance of the final rent payment, or upon the exercise of the option to prepay and purchase the property, legal title to the SEC Property will be conveyed to the Intermediate District for one dollar.[191] Until this happens, however, legal title remains with Wells Fargo Bank.[192]

107. With respect to future liability or indebtedness, the SEC Building Lease expressly provides:

> **Section 4.07** **<u>Not General Obligation</u>**. Notwithstanding any other provision of this Lease Agreement, this Lease Agreement shall not constitute a general obligation of the Lessee, and the full faith and credit of the Lessee are not pledged for the payment of the Rent or the performance by the Lessee of its other obligations hereunder. The Rent shall be paid, and the other obligations of the Lessee shall be met, solely from the amount appropriated by the Governing Body for such purpose in the Lessee's annual budget **and shall constitute a current expense of the Lessee for the Lessee's Fiscal Year then in effect. Nothing in this Lease Agreement shall be deemed to obligate the Lessee to budget or appropriate moneys or to pay Rent due following the end of its then-current Fiscal Year. This Lease Agreement shall not constitute an indebtedness of the Lessee** within the meaning of the Constitution or the Laws of the State of Minnesota.[193]

108. Thus, according to the SEC Building Lease, the lease does not constitute a long-term debt or liability of the District, and shall only be considered a current yearly expense for the District.[194]

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[191] *Id*.
[192] *Id.*
[193] *Id*. at 10-11 (emphasis added).
[194] *Id.*

109. This is confirmed in the COP Series 2006A, which expressly warns the investors:

> THE OBLIGATION OF THE INTERMEDIATE DISTRICT TO MAKE LEASE PAYMENTS UNDER THE LEASE IS NOT A GENERAL OBLIGATION OF THE INTERMEDIATE DISTRICT TO WHICH ITS FULL FAITH AND CREDIT AND ABILITY TO LEVY AD VALOREM TAXES WITHOUT LIMITATION AS TO RATE OR AMOUNT ARE PLEDGED. THE INTERMEDIATE DISTRICT IS OBLIGATED ONLY TO MAKE LEASE PAYMENTS FOR MONEYS APPROPRIATED FOR SUCH PURPOSE BY THE SCHOOL BOARD OF THE INTERMEDIATE DISTRICT. THE INTERMEDIATE DISTRICT IS NOT OBLIGATED TO MAKE ANY SUCH APPROPRIATION, AND IN THE EVENT THAT THE INTERMEDIATE DISTRICT'S SCHOOL BOARD FAILS TO APPROPRIATE MONEY TO PAY SUCH LEASE PAYMENTS IN ANY FISCAL YEAR OF THE INTERMEDIATE DISTRICT, THE LEASE WILL TERMINATE AT THE END OF THE LAST FISCAL YEAR FOR WHICH SUCH FUNDS WERE SO APPROPRIATED AND THE LESSEE WILL HAVE NO FURTHER OBLIGATION TO MAKE LEASE PAYMENTS UNDER THE LEASE.[195]

110. As of June 30, 2011, the District continued to occupy the SEC Property and had not terminated the SEC Building Lease.[196] Nor had the District exercised its option to purchase the property or prepay the SEC Building Lease.[197]

111. As of June 30, 2011, the principal amount outstanding on the SEC Building Lease was $25,753,734.00.[198]

SEC Lease Purchase Agreement/Refunding Lease

112. In 2010, the Intermediate District decided to refinance the SEC Land Lease to make the SEC Land Lease and SEC Building Lease "parity obligations."[199] By this time, however, Bloomington had already noticed its withdrawal from the Intermediate District.[200]

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[195] Ex. L at Ex. A (emphasis in original).
[196] Ex. 107.
[197] *Id.*
[198] Ex. 108 at 40.
[199] Ex. N at 1. As "parity obligations," a default under the SEC Refunding Lease would result in a default under the SEC Building Lease and vice versa. *Id.* According to the SEC Refunding Lease, "the [SEC] Refunding Lease and the [SEC] Building Lease are secured equally and ratably and on a parity basis with respect to the Land and all improvements thereon[.]" *Id.*
[200] Ex. 21. Bloomington's Notice of Withdrawal was served on the District on January 29, 2010. *Id.*

113. On June 30, 2010, Wells Fargo Bank and the Intermediate District entered into a Lease-Purchase Agreement (SEC Refunding Lease) for the purpose of refinancing the SEC Land Lease.[201]

114. As part of the SEC Refunding Lease, Wells Fargo Bank and the District entered into a Trust Agreement dated June 30, 2010 (SEC Land Trust).[202] Under the SEC Land Trust and SEC Refunding Lease, Wells Fargo Bank exercised the District's option to prepay the rent and terminate the 2006 SEC Land Lease.[203] This refinance did not impact the District's obligations under the SEC Building Lease.[204]

115. Upon prepayment of the 2006 SEC Land Lease, Wells Fargo Securities, LLC, as successor to the lessor, Wells Fargo Brokerage, deeded title to the SEC Property to Wells Fargo Bank.[205] Unlike the transaction involving the WEC Property, title to the SEC Property was not conveyed to the District.[206]

116. At the same time, the District agreed to lease the SEC Property from Wells Fargo Bank under the new SEC Refunding Lease terms.[207] The SEC Refunding Lease provides that the District will pay rent in an amount equal to $7,405,000.00, plus interest, amortized over 17 years and paid in 35 bi-annual installments from January 1, 2011 to January 1, 2028.[208] The term of the lease is from June 30, 2010, to January 1, 2028, unless earlier terminated, with the last rent payment due on January 1, 2028.[209]

117. In turn, Wells Fargo Bank issued and sold Certificate of Participation Series 2010 (COP Series 2010) in the principal amount of $7,405,000.00 to investors.[210]

118. Under the SEC Land Trust, Wells Fargo Bank, as trustee for the owners of the COP Series 2010, receives all lease payments due from the District under the SEC Refunding Lease.[211]

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[201] Ex. N at 1.
[202] Ex. O.
[203] Exs. N, O.
[204] Ex. J.
[205] Ex. N at 7; Ex. O.
[206] Ex. N at 7; Ex. O*; see also* Ex. Y.
[207] Ex. N.
[208] *Id.* at 10, Ex. B.
[209] *Id.* at 8, 10.
[210] *Id.* at Debt Service Schedule.
[211] Ex. O.

119. During the term of the SEC Refunding Lease, legal title to the SEC Property remains with Wells Fargo Bank.[212] As expressly stated in Article IX of the SEC Refunding Lease:

> Section 9.1. <u>Title</u>. During the Term of this Lease, legal title to the Land and any and all replacements, substitutions and modifications thereto shall be in the Lessor….[213]

120. The SEC Refunding Lease provides that "[t]he District shall be deemed to have purchased Lessor's interest in the Land upon payment of all Rental Payments and other amounts due hereunder…."[214]

121. In addition, the SEC Refunding Lease allows the District to prepay the lease and purchase the property prior to the date of the last rental payment in 2025.[215] The SEC Refunding Lease provides:

> Section. 11.2 <u>Purchase Option</u>. Unless the District is then in default hereunder, the District may purchase the interest in the Land subject hereto on any business day on or after February 1, 2020, by depositing with Lessor all Rental Payments and other amounts then due hereunder, the application Purchase Option Price shown in <u>Exhibit B</u>, and additional interest, if any accrued to the date of exercise of the payment option. In such event the provisions of Section 11.3 shall apply. Lessee may exercise its rights under Article XI only if it simultaneously exercises its rights under Article X of the Building Lease.[216]

> Section 11.3 <u>Release of Lessor's Interest</u>. Upon payment by Lessee of all Rental Payments and other amounts due hereunder, Lessee shall have no further obligations under this Lease and Lessor and its officers shall take all actions necessary to authorize, execute and deliver to Lessee any and all documents necessary to vest in Lessee, all of Lessor's right, title and interest in and to the Land, free and clear of all liens, leasehold interest and encumbrances arising under the provisions of this Lease.[217]

122. According to the SEC Refunding Lease:

> Section 4.3. <u>Trustee's Interest in the Land</u>. Upon payment of all Rental Payments due hereunder…or exercise of the option to purchase pursuant to Article XI hereof, full and unencumbered legal title to the Land shall

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[212] Ex. N at 20; Ex. Y.
[213] Ex. N at 18.
[214] *Id.* at 20.
[215] *Id.*
[216] *Id*. (emphasis in original).
[217] *Id.*

> pass to the District, and the Trustee shall have no further interest therein.[218]
>
> ***
>
> Section. 4.7. Purchase; Conveyance of Title. At any time when all Rental Payments and all other amounts due hereunder have been paid…or upon exercise of the option to purchase pursuant to Article XI hereof, then the purchase of the Land by the District shall be deemed to have been completed. The Trustee shall thereupon deliver to the District such instruments of conveyance or release as, in the opinion of counsel, may be necessary to release any interests of the Trustee in the Land.[219]
>
> ***
>
> Section 9.1. Title. …Upon the payment by the District of all Rental Payments as indicated in Exhibit B…or exercise of the option to purchase pursuant to Article XI hereof, full and unencumbered legal title to the Land shall pass to the District, and the Lessor shall have no further interest therein; and the Lessor shall execute and deliver to the District such documents as the District may request to evidence the passage of legal title to the Land to the District and the termination of the Lessor's interest therein.[220]

123. Thus, upon the full payment of rent or upon the exercise of the option to purchase, title to the property shall be conveyed to the District.[221] However, until all lease payments are made, or until the District exercises its option to prepay and purchase the property, legal title to the SEC Property remains with Wells Fargo Bank.[222]

124. According to the SEC Refunding Lease, while the District "presently intends" to continue the lease for the entire term; plans to "take all actions necessary" to approve budgets with appropriations sufficient to pay the rent; and "reasonably believes" that moneys can and will be lawfully appropriated, the District may nonetheless terminate the SEC Refunding Lease at the end of any fiscal year without further liability.[223] According to the Lease:

> Section 4.5. Termination by the District. The District shall have the right to terminate this Lease, in whole but not in part, at the end of any Fiscal Year of the District, in the manner and subject to the terms specified in this Section and Section 4.7, if the governing body does not appropriate or budget moneys sufficient to pay the Rental Payments coming due in the next Fiscal Year. The District may effect such termination by giving the Trustee a written notice of termination, as evidenced by a resolution of the

[218] *Id.* at 8.
[219] *Id.* at 9.
[220] *Id*. at 18 (emphasis in original).
[221] *Id.* at 8, 18, 20.
[222] *Id.*
[223] *Id.* at 5.

> governing body specifically determining not to provide moneys to pay Rental Payments for the succeeding Fiscal Year and all future Fiscal Years, and stating the governing body's determination to terminate this Lease, and by paying to the Trustee any Rental Payments which are due and have not been paid at or before the end of its then current Fiscal Year.…An event of non-appropriation under this Lease will be deemed a failure to appropriate money sufficient for continued operation of the Land and improvements thereon. Therefore, an event of non-appropriation under this Lease or the [SEC] Building Lease will be considered by the Lessee and Lessor an event of non-appropriation under both.[224]
>
> Section 4.6. <u>Effect of Termination</u>. Upon termination of this Lease as provided in Section [4.5], the District shall not be responsible for the payment of any additional Rental Payments coming due with respect to the succeeding Fiscal Years.…[225]
>
> ***
>
> Section 4.4. <u>Surrender of Land</u>**.** Upon termination of the Term of this Lease pursuant to Section 4.2(a) [non-appropriation] or (c) [default],…the District shall surrender the Land to the Trustee in the condition in which it was originally received from the Trustee, except as repaired, rebuilt, restored, altered or added to as permitted or required hereby, ordinary wear and tear excluded.[226]
>
> ***
>
> Section 13.3. <u>Return of Land</u>. Upon the expiration or termination of this Lease prior to the payment of all Rental Payments in accordance with <u>Exhibit B</u>, the District shall return the Land to the Lessor in the condition, repair, appearance and working order required in Section 8.2.…[227]

125. Thus, as long as the District pays rent through the end of the fiscal year, it can terminate the lease at any time without default or further obligation to Wells Fargo Bank beyond that fiscal year.[228] Upon either termination or default, the Intermediate District's entire liability is for the rent owed for the then-current fiscal year and no more, so long as the District vacates the property within 10 days.[229]

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[224] *Id.* at 8-9.
[225] *Id.* at 9.
[226] *Id.* at 8.
[227] *Id.* at 24 (emphasis in original).
[228] *Id.* at 8-9, 10, 22-24.
[229] *Id.*

126. With respect to future liability or indebtedness, the SEC Refunding Lease expressly provides:

> Section 5.2. <u>Current Expense</u>. The obligations of the District under this Lease, including its obligation to pay the Rental Payments, in any Fiscal Year for which this Lease is in effect, **shall constitute a current expense of the District for such Fiscal Year and shall not constitute an indebtedness of the District within the meaning of the Constitution and laws of the State.** Nothing herein shall constitute a pledge by the District of any taxes or other moneys, other than moneys lawfully appropriated from time to time by or for the benefit of the District in the annual budget of the School Board and the proceeds or Net Proceeds to the Land, to the Payment of any Rental Payment or other amount coming due hereunder.[230]

127. Under the express terms of the SEC Refunding Lease, the lease obligations do not constitute a long-term debt or liability of the District, and shall only be considered a current yearly expense for the District.[231]

128. As of June 30, 2011, the District continued to occupy the SEC Property and had not terminated the SEC Refunding Lease.[232] Nor had the District exercised its option to purchase the property or prepay the SEC Refunding Lease.[233]

129. As of June 30, 2011, the principal amount of rent outstanding under the SEC Refunding Lease was $7,290,000.00.[234]

130. According to the Certificate of Title for the SEC Property, Wells Fargo Bank is currently the "owner of an estate in fee simple" in the SEC Property.[235]

Edgewood Education Center (EEC)

131. In approximately 2008 or 2009, the Intermediate District Board unanimously voted on a resolution to acquire an interest in the Edgewood Elementary School in Brooklyn Park, Minnesota, referred to herein as the Edgewood Education Center or EEC Property.[236]

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[230] *Id.* at 10 (emphasis added).
[231] *Id.*
[232] Ex. 107.
[233] *Id.; see also* Ex. Y.
[234] Ex. 108 at 41.
[235] Ex. Y.
[236] The parties did not present evidence on when the District's Board approved a resolution to acquire an interest in the EEC Property. However, the fact that all Members Districts supported the District's acquisition of an interest in the EEC Property is not disputed by the parties.

132. To finance the purchase, the District entered into two agreements with Wells Fargo Bank: a Lease Purchase Agreement and a Trust Agreement.[237]

133. On January 1, 2010, the District and Wells Fargo Bank executed a Lease Purchase Agreement (EEC Lease), whereby Wells Fargo Bank, as lessor, agreed to purchase the EEC Property and facility and lease it to the District, as lessee.[238] The term of the EEC Lease is from July 20, 2010, through January 20, 2025, unless earlier terminated by the District.[239] The EEC Lease expires upon the final scheduled rent payment on January 20, 2025.[240]

134. On or about January 7, 2010, Wells Fargo Bank purchased the EEC Property for a net sale price of $5,211,436.00.[241] To finance the purchase, Wells Fargo Bank issued two certificates of participation to investors: COP Series 2010A totaling $3,200,000.00, and COP Series 2010B, totaling $2,050,000.00.[242] COP Series 2010A matures on February 1, 2020, and COP Series 2010B matures on February 1, 2025.[243]

135. Contemporaneous with the execution of the EEC Lease, Wells Fargo Bank and the Intermediate District entered into a Trust Agreement whereby the bank serves as trustee for the owners of the COPs.[244] As trustee, Wells Fargo Bank holds in trust the EEC Property, the bank's interest in the EEC Lease, and all rental payments made by the District under the EEC Lease.[245] The owners of the COPs are the sole beneficiaries of the trust.[246] The corpus of the trust is Wells Fargo Bank's interest in the EEC Lease and all rental payments made by the District under the EEC Lease.[247]

136. The rental payments set forth in the EEC Lease are paid separately for each of the two COPs.[248] The rental payments due equal the sum of the COPs issued plus interest, amortized over the term of the COPs (10 or 15 years, respectively).[249] Bi-annual rental payments are due from the Intermediate District to Wells Fargo Bank: from July 2010 to January 2020, for COP Series 2010A; and from July 2010 to January 2025, for COP Series 2010B.[250]

[237] Exs. A, B.
[238] Ex. A.
[239] *Id.* at Ex. B.
[240] *Id.*
[241] Ex. 3 at 48; Ex. 105 at 4. The exact purchase date is different in the two appraisals.
[242] Ex. B at Ex. B. Series 2010A is tax exempt and Series 2010B is taxable. *Id*. Under the COPs, interest payments are made every six months and principal is paid annually. *Id*.
[243] Ex. C.
[244] Ex. B.
[245] *Id.* at 5.
[246] *Id.*
[247] *Id.*
[248] Ex. A at Ex. B.
[249] *Id.*
[250] *Id.*

137. Upon the full payment of all rental payments, title to the property shall be conveyed to the District.[251] However, until full payment is made, legal title to the property remains with Wells Fargo Bank, not the District.[252] The District's only legal interest in the property during the lease term is possessory and that of a lessee.[253] Accordingly, until the full payment of the purchase price (i.e., all rental payments are made), the District maintains only a leasehold (i.e., possessory) interest in the property.[254]

138. Section IX of the EEC Lease expressly provides:

> Section 9.1. Title. During the Term of this Lease, legal title to the Land and Facilities and any and all repairs, replacements, substitutions and modifications thereto shall be in the Lessor [Wells Fargo Bank], subject to the District's interest under this Lease. Upon the payment by the District of all Rental Payments as indicated in Exhibit B, or prepayment by the District thereof pursuant hereto, full and unencumbered legal title to the Land and Facilities shall pass to the District, and the Lessor shall have no further interest therein; and the Lessor shall execute and deliver to the District a quitclaim deed to evidence the passage of legal title to the Land and Facilities to the District and the termination of the Lessor's interest therein.[255]

139. According to the EEC Lease, while the District "presently intends" to continue the lease for the entire term; plans to "take all actions necessary" to approve budgets with appropriations sufficient to pay the rent; and "reasonably believes" that moneys can and will be lawfully appropriated, the District may nonetheless terminate the EEC Lease at the end of any fiscal year without further liability.[256]

140. Like all the other lease agreements described above, the EEC Lease contains the following non-appropriation provisions:

> Section 4.5. Termination by the District. The District shall have the right to terminate this Lease, in whole but not in part, at the end of any Fiscal Year of the District, in the manner and subject to the terms specified in this Section and Section 4.6, if the governing body does not appropriate or budget moneys sufficient to pay the Rental Payments coming due in the next Fiscal Year, as determined by the District's budget for the Fiscal Year in question….In the event of termination of this Lease as provided in this Section, the District shall surrender possession of the Land and Facilities to the Trustee in accordance with Section 4.4 and convey to the Trustee

[251] *Id.* at 8, 19.
[252] *Id.* at 19.
[253] *Id.*
[254] *Id.*
[255] *Id.* (emphasis in original).
[256] *Id.* at 5-6, 8-9.

> or release its interests in the Land and Facilities under this Lease within ten (10) days after the expiration of the then-current term of this Lease.[257]
>
> Section 4.6. Effect of Termination. Upon termination of this Lease as provided in Section 4.5, the District shall not be responsible for the payment of any additional Rental Payments coming due with respect to succeeding Fiscal Years….[258]

141. In addition, the EEC Lease does not obligate the District to appropriate funds necessary to continue the Lease.[259] According to Section 2.1(h) of the EEC Lease:

> Except to the extent specifically provided herein, the government body is not obligated to appropriate or otherwise provide moneys for the payment of the Rental Payments or any other amounts coming due hereunder; and in the event of Non-Appropriation[260] by the governing body, **the District shall not be liable for general, special, incidental, consequential or other damages resulting therefrom**, except as provided in Section 4.6 hereof.[261]

142. Consequently, the District may terminate the Lease at the end of any fiscal year if the District's Board does not appropriate or budget moneys sufficient to pay the rental payments coming due in the next fiscal year.[262] Moreover, such early termination would not result in any liability for the District beyond the current fiscal year.[263] As expressly stated in the EEC Lease:

> …This Lease does not constitute a general obligation of the District, and the full faith and credit and taxing powers of the District are not pledged for the payment of the Rental Payments or other amounts coming due, or other actions required to be performed.[264]

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[257] *Id.* at 8-9.
[258] *Id*. at 9.
[259] *Id*. at 5-6.
[260] "Non-appropriation" is defined in the EEC Lease as:

> The failure of the School Board of the District to appropriate moneys for any Fiscal Year of the District sufficient for the continued performance of this Lease by the District, as evidenced by the passage of a resolution specifically prohibiting the District from performing its obligations under this Lease, and from using any moneys to pay the Rental Payments due under this Lease for a designated Fiscal Year and all subsequent Fiscal Years.

Id. at 2.
[261] *Id.* at 5-6 (emphasis added).
[262] *Id*.
[263] *Id.*
[264] *Id*. at 5.

> Section 5.2 Current Expense. The obligations of the District under this Lease, including its obligation to pay the Rental Payments, in any Fiscal Year for which this Lease is in effect, **shall constitute a current expense of the District for such Fiscal Year and shall not constitute an indebtedness of the District within the meaning of the Constitution and laws of the State.** Nothing herein shall constitute a pledge by the District of any taxes or other moneys other than moneys lawfully appropriated from time to time by or for the benefit of the District in the annual budget of the School Board and the proceeds of Net Proceeds of the Land and Facilities, to the payment of any Rental Payment or other amount due hereunder.[265]

143. Accordingly, the EEC Lease does not constitute a long-term debt, and shall only be considered a current yearly expense or "appropriation" for the District.[266]

144. Upon early termination of the EEC Lease, the District must pay the rent remaining due for the current fiscal year and surrender possession of the property.[267] The EEC Lease states:

> Section 4.4 Surrender of Land and Facilities. Upon termination of the Term of this Lease pursuant to Section 4.2., clauses (a) or (c), or upon exercise by the Trustee of its rights to take possession of the Land and Facilities under Section 13.2, the District shall surrender the Land and Facilities to the Trustee in the condition in which they were originally received from the Trustee, except as repaired, rebuilt, restored, altered or added to as permitted or required thereby, ordinary wear and tear excepted.[268]
>
> ***
>
> Section 13.3. Return of Land and Facilities. Upon the expiration or termination of this Lease prior to the payment of all Rental Payments in accordance with Exhibit B, the District shall return the Land and Facilities to the Lessor….[269]

145. All rental payments made prior to termination are, thus, forfeited to Wells Fargo Bank, and do not represent any equity in the property as to the Intermediate District.[270] Wells Fargo Bank, as trustee for the COP investors, would then be able to re-let the property to another lessee or sell it to pay off the COPs.[271]

146. Under the EEC Lease, the Intermediate District would not be liable for the remainder of the rental payments, for any deficiency upon sale or re-letting, or for any

[265] *Id.* at 10 (emphasis added).
[266] *Id.*
[267] *Id.*
[268] *Id.* at 8.
[269] *Id.* at 25 (emphasis in original).
[270] *Id.* at 23-25.
[271] *Id.*

other damages as a result of early termination.[272] This is true whether the EEC Lease is terminated by the District or the District defaults on its obligations.[273] The remedies available to Wells Fargo Bank on the District's default are limited to the rent due for the current fiscal year, unless the District fails to vacate the property within 10 days.[274]

147. According to the Certificate of Title for the EEC Property, Wells Fargo Bank is the "owner of an estate in fee simple" in the EEC Property.[275]

148. As of June 30, 2011, the District continued to occupy the EEC Property and had not terminated or prepaid the EEC Lease, and had not exercised its option to purchase the property.

149. As of June 30, 2011, the principal amount outstanding for rent payments under the EEC Lease was $4,975,000.00: $2,925,000.00 for COP Series 2010A; and $2,050,000.00 for COP Series 2010B.[276]

North Education Center (NEC)

150. On December 17, 2009, the Board of the Intermediate District voted on a resolution to purchase land and construct a new facility in New Hope, Minnesota, called the North Education Center (NEC or NEC Property).[277] Bloomington was the only Member District that voted against this acquisition.[278] The resolution nonetheless passed, and the Intermediate District proceeded with its plan to purchase land and construct the NEC, over Bloomington's objection.[279]

151. Approximately one month after the Intermediate District voted to acquire an interest in land and construct the NEC -- over Bloomington's objection -- Bloomington voted to withdraw from the Intermediate District.[280]

152. Despite Bloomington's withdrawal, on November 18, 2010, the Intermediate District and U.S. Bank National Association (U.S. Bank) entered into a Lease Purchase Agreement (NEC Lease), Trust Agreement, and Ground Lease and Easement Agreement (NEC Ground Lease) related to the NEC Property and the construction of a building thereon.[281]

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[272] *Id.; see also* Ex. B at Ex. B (COP).
[273] Ex. A at 23-25.
[274] *Id.*
[275] Ex. Z.
[276] Ex. 108 at 41.
[277] Ex. 22.
[278] *Id.*
[279] *Id.*
[280] Ex. 21. Bloomington's Notice of Withdrawal was served on the Intermediate District on January 29, 2010.
[281] Exs. R, S, T.

153. A First Supplemental Lease Purchase Agreement (NEC Supplemental Lease), First Supplemental Trust Agreement, and First Supplemental Ground Lease Agreement and Easement Agreement (NEC Supplemental Ground Lease) were executed by the Intermediate District and U.S. Bank on May 19, 2011.[282] The NEC Lease and the NEC Supplemental Lease shall be collectively referred to as the "NEC Lease, as supplemented."[283]

154. The total cost for U.S. Bank to purchase the property and build the NEC facility was $33,865,000.00[284]

155. Like the WEC, SEC, and EEC Properties, the purchase and construction of the NEC Property was financed through U.S. Bank's issuance of two Certificates of Participation: COP Series 2010E in the amount of $29,790,000.00, financing the cost of the land purchase and the construction of the initial building; and COP Series 2011A in the amount of $4,075,000.00, financing the cost to construct a third floor addition to the building.[285]

156. Like the other lease agreements described above, the NEC Lease provides that the District is "not obligated to appropriate or otherwise provide moneys for the payment of the Rental Payments or any other amounts coming due" under the lease in any fiscal year; and "in the event of Non-Appropriation by governing body, the District shall not be liable for general, special, incidental, consequential or other damages resulting therefrom."[286]

157. Similarly, the District has the right to terminate the lease at the end of any fiscal year if the District's Board "does not appropriate or budget moneys sufficient to pay the Rental Payments coming due in the next Fiscal Year."[287] In the event of termination, "the District shall not be responsible for the payment of any additional Rental Payments coming due with respect to succeeding Fiscal Years," unless the District fails to vacate the premises.[288]

158. The rent payments due under the NEC Lease are also not considered "debt" by the District.[289] The NEC Lease expressly provides:

> Section 5.2. <u>Current Expense</u>. The obligations of the District under this Lease, including its obligation to pay the Rental Payments, in any Fiscal Year for which this Lease is in effect, shall constitute a current expense of the District for such Fiscal Year and shall not constitute an indebtedness

[282] Exs. U, V, W.
[283] The NEC Supplemental Lease provides for the construction of a third floor addition to the NEC Property at a cost of $4,075,000. *See* Ex. U.
[284] Ex. 108 at 41.
[285] Exs. R, S, U, V.
[286] Ex. R at 5-6.
[287] *Id*. at 8.
[288] *Id.* at 8-9.
[289] *Id*. at 10.

> of the District within the meaning of the Constitution and laws of the State. Nothing herein shall constitute a pledge by the District of any taxes or other moneys, other than moneys lawfully appropriated from time to time by or for the benefit of the District in the annual budget of the School Board and the proceeds or Net Proceeds of the Facilities, to the payment of any Rental Payment or other amounts coming due hereunder.[290]

159. If the District does not terminate the NEC Lease, as supplemented, and completes all rental payments due under the leases, the District will eventually acquire an unencumbered interest in the NEC property.[291] However, during the term of the lease, "legal title to the Facilities and any and all repairs, replacements, substitutions, and modifications thereto shall be in the Lessor [U.S. Bank];" and the District shall "not mortgage, sell, assign, transfer or convey the Facilities or any portion thereof."[292]

160. To provide additional security for the bank, the NEC Property is also fully encumbered by the NEC Ground Lease and NEC Supplemental Ground Lease, which give U.S. Bank a full possessory interest in the NEC Property in the case of the District's default or early termination of the NEC Lease, as supplemented.[293] The NEC Ground Lease and NEC Supplemental Ground Lease fully encumber the NEC Property until February 2039, unless the District completes all payments due under the NEC Lease, as supplemented, or exercises its option to prepay all rent due prior to the completion of the full lease term.[294]

161. As of June 30, 2011, the Intermediate District had not terminated the NEC Lease, as supplemented, and had not exercised its option to prepay the lease to obtain clear title to the NEC Property.

162. As of June 30, 2011, the principal amount outstanding on the NEC Lease and NEC Supplemental Lease was $33,865,000.00: $29,790,000.00 under the NEC Lease; and $4,075,000.00 under the NEC Supplemental Lease.[295]

EMPLOYEE BENEFIT AND PENSION PLAN OBLIGATIONS OF THE DISTRICT

163. In addition to the value of real estate interests held by the Intermediate District, the parties disagree as to the amount and allocation of liability related to pension and other post-employment benefits owed to employees of the District.

164. The Intermediate District offers its employees various employment benefits, including: a flexible benefit cafeteria plan; a multi-employer-funded retirement plan administered by the Teachers' Retirement Association (TRA) or the Public

[290] *Id.*
[291] *Id.* at Ex. B; Ex. U at Ex. B.
[292] Ex. R at 18, 21.
[293] Exs. T, W.
[294] Exs. T, W.
[295] Ex. 108 at 41.

Employees' Retirement Association (PERA); post-employment insurance benefits (referred to herein as other post-employment benefits or OPEB); and a District-funded, defined benefit pension plan (Pension Benefits Plan).[296]

165. The District's contributions to the retirement plans administered by the TRA and PERA are established by statute and are paid by the District to these plans each year as the benefits are earned.[297] The amounts paid are calculated to cover the future benefits owed.[298] Accordingly, these benefits, and the amount paid to these plans, are not in dispute.

166. Similarly, the flexible benefit cafeteria plan is paid on a monthly basis by the District to an outside plan administrator.[299] These amounts are paid in full each year and are not future obligations of the District.[300] Therefore, they are not in dispute.

167. In contrast, the District's self-funded OPEB and Pension Benefits Plan are unfunded future obligations of the District.[301] The parties disagree as to: (1) whether these benefits are liabilities that should be included in the calculation of assets and liabilities for purposes of distribution upon Bloomington's withdrawal from the District; and (2) if these benefits constitute liabilities owed, how they should be calculated and allocated to Bloomington.

Other Post-Employment Benefits

168. All employees who retire from the Intermediate District have the option under state law[302] to continue their medical insurance coverage through the District from the time of retirement until the employee reaches the age of eligibility for Medicare.[303] As a benefit to some of its employees, the Intermediate District pays all or part of the employee's medical and/or dental insurance premiums from the date of retirement until the date the retiree is eligible for Medicare.[304] Eligibility for this benefit is based on years of service, minimum age requirements, and membership in certain employee groups.[305]

169. Post-employment insurance benefits paid by the District differ by collective bargaining unit and are established in the collective bargaining agreements.[306] Therefore, they are contractual obligations for the District.[307]

[296] *Id.* at 44-51.
[297] *Id*. at 48-51.
[298] *Id.*
[299] *Id.* at 51.
[300] *Id.*
[301] Ex. 23; Ex. 108 at 45-46.
[302] Minn. Stat. § 471.61 (2014).
[303] Ex. 23; Ex. 108 at 45-46.
[304] Ex. 23; Ex. 108 at 45-46.
[305] Ex. 23; Ex. 108 at 45-46.
[306] Ex. 23; Ex. 108 at 45-46.
[307] Ex. 23; Ex. 108 at 45-46.

170. As of June 30, 2011, there were 730 active OPEB plan participants and 43 retired OPEB plan participants.[308] The number of employees receiving the benefits and the cost of the insurance premiums change year-to-year.[309] Therefore, the District's contribution obligation changes each year, and its future obligations can only be estimated, not concretely determined.[310]

171. While the District is contractually obligated to pay these on-going benefits, the Intermediate District does not set aside funds to cover these future expenses, and there are no invested plan assets earmarked to pay for these future benefits.[311] As a result, the District's future OPEB obligations are unfunded in advance and are paid on an annual basis, as costs, as they arise.[312]

172. The District's actual cost of OPEB differs year-to-year depending on how many retirees receive the benefit that year and what type of insurance benefits those retirees receive.[313] Each year during the budgeting process, the District projects how many retired employees will receive OPEB for the next fiscal year.[314] The District then calculates the estimated cost of OPEB for the year and budgets accordingly to pay for the costs as they come due (i.e., as eligible retirees receive the benefit).[315] Payments are then made out of the District's general operating fund as an employee expense.[316] This is referred to as "pay-as-you-go" financing.[317] It means that OPEB are treated as costs when the benefit is paid, as opposed to recognizing OPEB as a vested obligation at the time the benefit is earned by the employee.[318] There is risk in this type of financing because no funds are being saved to pay for the future benefits that are accruing.

173. In 2009, the Intermediate District began following Governmental Accounting Standards Board (GASB) Statement No. 45. GASB Statement No. 45 establishes standards for measuring, recognizing, and displaying OPEB values on financial statements.[319]

174. Prior to 2009, the District did not include any calculation of future obligations for OPEB on the District's financial statements.[320] Because the District finances its OPEB obligations on a "pay-as-you-go" basis, OPEB were only recognized on the financial statements when the promised benefits were paid, not as they accrued

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[308] Ex. 23; Ex. 108 at 45-46.
[309] Ex. 23; Ex. 108 at 45-46.
[310] Test. of Mark Schulte at T. 852.
[311] *Id.* at T. 839, 844.
[312] *Id.*
[313] *Id.* at T. 851-53.
[314] *Id.*
[315] *Id.*
[316] *Id*.
[317] Ex. 108 at 44.
[318] *Id*.
[319] Ex. 109.
[320] Test. of M. Schulte at T. 847-48.

or were earned.[321] As a result, the District's future obligations to pay OPEB were not noted on financial statements as future liabilities.[322]

175. GASB Statement No. 45 changed that practice to ensure that future OPEB obligations are estimated and recognized on financial statements.[323] This ensures that government entities recognize their future obligations and assess potential demands on future cash flow.[324] Without recognizing the accruing liability, a government entity risks being unable to fund the obligation when it is due for payment, many years after it was earned by the employee.[325]

176. Under GASB Statement No. 45, the District's financial statement must include the annual required contribution (ARC) required to meet the District's future OPEB liability.[326] The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal OPEB costs each year and amortize any unfunded actuarial liabilities over a period not to exceed 30 years.[327]

177. Professional accounting standards promulgated by GASB require that school districts prepare an actuarial report to estimate OBEB liabilities every two years.[328] The actuarial figures are then included in the District's audited financial statements as footnotes.[329]

178. In compliance with the GASB requirements, the District hired the actuarial firm of Van Iwaarden and Associates (Van Iwaarden) to calculate its estimated liability for OPEB so that the District's OPEB ARC could be included in the District's 2011 Audited Financial Statement.[330]

179. To calculate the value of the OPEB, Van Iwaarden actuaries reviewed the District's collective bargaining agreements to establish the employees' entitlements to benefits and the scope of those benefits.[331] Next, the actuaries reviewed census data, insurance data, and employee data.[332] From there, the actuaries estimated how many employees will elect to receive the OPEB benefits; when the employees are likely to receive the benefits; and the amount that the employees are likely to receive in the future.[333]

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[321] *Id.*
[322] *Id.*
[323] Ex. 109.
[324] *Id.*
[325] *Id.*
[326] Ex. 108 at 45.
[327] *Id.*
[328] Test. of M. Schulte at T. 825.
[329] *Id.*
[330] *Id*. at T. 828.
[331] *Id.* at T. 836.
[332] *Id.* at T. 837.
[333] *Id.* at T. 838.

180. From this data, the actuaries calculated the District's actuarial accrued liability (AAL): the estimated liability associated with the OPEB that has been accrued or earned by employees up to the valuation date.[334] In this case, the date of valuation is July 1, 2011.[335] The District's AAL does not include any liability for benefits that will be accrued in the future or based on future service.[336]

181. The actuaries then compared the AAL with the funds set aside by the District to pay future OPEB liabilities, and determined the District's unfunded actuarial accrued liability (UAAL).[337] Because the District does not set aside funds to cover future OPEB obligations, the AAL and the UAAL are the same amounts.[338]

182. AAL and UAAL figures are not definite.[339] They are only estimates, based upon actuarial assumptions, of what the District's future liability may be based upon current conditions.[340] What the District will actually pay in the future for these benefits could be significantly different, depending on future changes in health care laws, insurance laws, employee mortality, employee attrition, etc.[341]

183. Van Iwaarden estimated that the District's AAL and UAAL for OPEB earned by employees as of July 1, 2011, was $9,532,459.00.[342]

184. Bloomington offered no evidence to dispute the District's calculation of AAL and UAAL for OPEB earned by employees as of July 1, 2011. Instead, Bloomington argues that it is not liable for any of this amount because the District pays its pension liabilities on a "pay-as-you-go" basis. In the alternative, Bloomington disputes its proportionate share of this amount.

Severance Benefits Payable and Compensated Absences Payable

185. Van Iwaarden actuaries also determined the District's estimated future liability for accrued compensated absences[343] as of July 1, 2011.[344] The District's auditors splits these "accrued compensated absences" into two types: "compensated absences payable," meaning accrued vacation payable at years end; and "severance

[334] *Id*.
[335] *Id.*
[336] *Id.*
[337] *Id.* at T. 839.
[338] *Id.*
[339] *Id.* at T. 858.
[340] *Id.*
[341] *Id.*
[342] Ex. 129
[343] Compensated absences are absences for which employees are entitled to be paid, such as earned vacation, sick leave, severance, and sabbatical leave. *See* GASB Statement No. 16 at http://www.gasb.org/st/summary/gstsm16.html. Accordingly, "accrued compensated absences" means paid time off that employees have earned but have not yet taken. *Id.* The Administrative Law Judge takes judicial notice of GASB Statement No. 16, pursuant to Minn. R. 14.60, subd. 4 and Minn. R. 1400.8100, subp. 2.
[344] Test. of M. Schulte at T. 842; Ex. 129.

benefits payable," meaning early retirement incentive benefits payable to former employees.[345] Both benefit liabilities are paid by the District out of its general fund each year.[346]

186. As of July 1, 2011, the estimated future liability for "severance benefits payable" was $5,758,291.00.[347] This amount, when discounted to 2011 dollars, is estimated to be $4,731,848.00.[348] According to the Intermediate District's expert actuary, the discounted amount for severance benefits payable is closer to $4.5 million.[349] However, Bloomington does not dispute the Intermediate District's accountant's calculation of $4,731,848.00.[350] Bloomington only disputes its proportionate share of this liability.[351] Accordingly, the stipulated amount for severance benefits payable by the District as of June 30, 2011, is $4,731,848.00.

187. With respect to compensated absences payable (i.e., accrued vacation payable) to employees as of June 30, 2011, the District's accountants and actuaries calculated the amount to be $375,937.00.[352] Bloomington did not present evidence to dispute this amount or Bloomington's liability therefor.

Pension Benefits Plan

188. The Intermediate District also offers a self-funded Pension Benefits Plan to certain of its eligible employees.[353] The pension benefits offered under the plan are set forth in the collective bargaining agreements between the District and its employee units.[354] Therefore, like OPEB, the pension benefits are contractual obligations of the District.[355] In addition, because the District's pension liability has already been earned by its employees as part of their total compensation for past service, as promised in the collective bargaining agreements, it cannot be lawfully reduced once an employee retires.[356]

189. Eligibility for pension benefits is based upon years of service, minimum age requirements, and membership in certain employee groups.[357] The amount of the pension benefit differs by individual and bargaining unit.[358] The District's payment

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[345] Ex. 23, Ex. 108 at 41.
[346] Ex. 23, Ex. 108 at 41.
[347] Ex. 129 at 11; Test. of M. Schulte at T. 841-42, 854-57 (comments by Bloomington's attorney David Holman).
[348] Ex. 129 at 11; Test. of M. Schulte at T. 841-42, 854-57*; see also* Ex. 103 at 9.
[349] Test. of M. Schulte at T. 842.
[350] *See id.* at T. 854-57 (comments by Bloomington's attorney David Holman).
[351] *Id.*
[352] Ex. 23, Ex. 108 at 40.
[353] Ex. 108 at 46-48.
[354] *Id.*
[355] *Id.*
[356] *See, e.g., Housing and Redevelopment Authority of Chisholm v. Norman*, 696 N.W.2d 329, 337-38 (Minn. 2005).
[357] Ex. 108 at 46-48.
[358] *Id.*

obligations under the Pension Benefits Plan differ year-to-year based upon the number of retirees receiving the benefit that year and the amount of the recipients' individual benefits.[359]

190. As of June 30, 2011, there were 730 active participants in the District's Pension Benefits Plan.[360]

191. While the District is contractually obligated to pay these pension benefits on an on-going basis, the Intermediate District does not escrow funds to cover these future expenses, and there are no invested plan assets earmarked to pay for these future benefits.[361] In other words, the District's Pension Benefits Plan is unfunded, and the benefits are paid when recipients collect the benefit (i.e., receive their pensions). An amount to cover the promised benefit is not set aside by the District when the benefits are earned or as they accrue.[362]

192. Each year, the District projects the amount of the pension benefits it will be required to pay for the next fiscal year and budgets accordingly to pay for that year's costs.[363] Like the District's OPEB obligations, financing of the District's Pension Benefit Plan is on a "pay-as-you-go" basis.[364] The expenses are paid out of the District's general operating fund as costs, and there is no escrowing of funds as the benefits are earned by the employees.[365]

193. According to the District's actuarial expert, the AAL for the District's pension as of July 1, 2011, was $409,117.00.[366] Because the District's employee pension obligations are paid on a "pay-as-you-go" basis each year, there is no amount set aside for payment of this future obligation.[367] Therefore, the UAAL for the District's employee pension plan as of July 1, 2011, was the same as the ALL, $409,177.00.[368]

194. Bloomington offered no evidence to dispute the calculation of the Intermediate District's long-term pension liability. Instead, Bloomington argues that it is not liable for any of this amount because the District pays its pension liabilities on a "pay-as-you-go" basis.[369] In the alternative, Bloomington disputes its proportionate share of this amount.[370]

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[359] *Id*.
[360] Ex. 23, Ex. 108 at 46.
[361] Ex. 108 at 46-47.
[362] *Id.*
[363] *Id*.
[364] *Id.* at 46.
[365] *Id.*
[366] Ex. 129 at 12.
[367] Ex. 108 at 46.
[368] Ex. 129 at 12.
[369] *See* Bloomington's Post-Hearing Brief.
[370] *Id.*

WITHDRAWAL OF BLOOMINGTON FROM INDEPENDENT DISTRICT

195. In 2006, Les Fujitake (Fujitake) was appointed as the Superintendent of the Bloomington Public Schools.[371] Upon his appointment, Fujitake discovered that the Bloomington School District (ISD #271) was "very unstable".[372] Since approximately 1995, Bloomington had been cutting programs and staff, increasing class sizes, closing schools, and not maintaining its facilities.[373] As a result, residents of the district were losing confidence in the quality of the educational services being provided.[374]

196. As Superintendent, Fujitake determined that Bloomington had to cut costs to remain competitive.[375] Among other things, Fujitake began to evaluate Bloomington's membership in the Intermediate District.[376]

197. A review of Bloomington's use of the services provided by the Intermediate District showed that Bloomington was the highest consumer of special education services of all Member Districts.[377] Fujitake discovered that only 10 percent of Bloomington students required special education services, but that 20 percent of Bloomington's budget was spent on those services.[378]

198. Fujitake set out to determine whether Bloomington could provide its students with the same services in-house that the Intermediate District provided; or whether either of the other two metropolitan independent districts could provide the same services to Bloomington more economically.[379]

199. Fujitake concluded that Bloomington could save a significant amount of money by withdrawing from the Independent District and joining Independent School District 917.[380]

200. Fujitake then reviewed the 2009 Memorandum of Agreement and determined that Bloomington had a right to withdraw from the Intermediate District.[381] The Agreement was silent, however, as to how the Intermediate District's assets and liabilities would be calculated and attributed to Member Districts upon withdrawal.[382]

201. Fujitake thus looked to Minn. Stat. § 123A.24, which provides that if an intermediate district and withdrawing member district cannot agree on the distribution of

[371] Test. of L. Fujitake at T. 27.
[372] *Id.* at T. 27-28.
[373] *Id.*
[374] *Id.*
[375] *Id*. at T. 28, 33.
[376] *Id.* at T. 28.
[377] Ex. 103 at 8.
[378] Test. of L. Fujitake at T. 28.
[379] *Id.* at T. 28-32.
[380] *Id*. at T. 34, 36, 53. Ultimately, Bloomington concluded that its withdrawal from the Intermediate District saved Bloomington approximately $200,000 per year. *Id*. at T. 34.
[381] *Id*. at T. 37.
[382] *Id.* at T. 37-38; s*ee also* Ex. 101.

assets and liabilities, the Commissioner shall resolve the dispute by determining the withdrawing "district's proportionate share of assets and liabilities based on the district's enrollment, financial contribution, usage, or other factor or combination of factors determined appropriate by the commissioner."[383]

202. Guided by the Agreement and Minn. Stat. § 123A.24, Fujitake set out to determine Bloomington's financial exposure if it opted to withdraw from the cooperative.[384] To estimate the financial implications of Bloomington's withdrawal, Fujitake reviewed the Intermediate District's audited financial statements, which showed that the District had assets exceeding its liabilities.[385] As a result, Fujitake concluded that Bloomington would not owe money to the Intermediate District if Bloomington withdrew.[386] Indeed, Fujitake determined that the Intermediate District would be required to pay out assets to Bloomington.[387]

203. Relying upon the information set forth in the Intermediate District's audited financial statements, Fujitake recommended to the Bloomington School Board that Bloomington withdraw from the Independent District.[388] Notably, Bloomington's decision to withdraw occurred just one year after reconfirming its commitment to the Intermediate District by executing the 2009 Memorandum of Agreement.[389]

204. On January 28, 2010, the Bloomington School Board passed a resolution to withdraw from the Intermediate District effective July 1, 2011.[390] A Notice of Withdrawal and a certified copy of the resolution were served on the Intermediate District on January 29, 2010.[391]

205. Prior to 2011, no Member District had ever withdrawn from the Intermediate District.[392]

206. The parties stipulate that Bloomington's Notice of Withdrawal was valid and timely, and that Bloomington had the legal right to withdraw from the Intermediate

[383] Test. of L. Fujitake at T. 41.
[384] *Id.* at T. 41-42
[385] *Id.* at T. 41, 55. It appears that Fujitake is referring to the financial statement for fiscal year 2011, but such financial statement would not have been available to him until after June 30, 2011. The Intermediate District's audited financial statements for fiscal year 2009 and fiscal year 2010 were not admitted into evidence. The audited financial statement for 2011 states that the Intermediate District had net assets of $4,584,233.00 in fiscal year 2010 and net assets of $13,768,147.00 in fiscal year 2011. *See* Ex. 108 at 16. The record is silent as to whether the Intermediate District had net assets in fiscal year 2009. According to his testimony, Fujitake was evaluating whether Bloomington should withdraw from the Intermediate District in 2009. Therefore, Fujitake would have had to rely upon financial information from fiscal year 2009 or earlier, not the audited financial statement from fiscal year 2011.
[386] Test. of L. Fujitake at T. 41.
[387] *Id.*
[388] *Id.*
[389] *See* Exs. 21, 101, 102.
[390] Ex. 21.
[391] *Id.*
[392] Test. of S. Lewandowski at T. 437.

District.[393] The Intermediate District's fiscal year runs from July 1 to June 30 each year. Accordingly, Bloomington gave notice of its withdrawal mid-way through fiscal year 2010, but the withdrawal was not effective until the end of fiscal year 2011, giving the District approximately one-and-a-half years to prepare for Bloomington's withdrawal.[394]

2011 AUDITED FINANCIAL STATEMENT

207. Pursuant to Minn. Stat. § 123B.77, subd. 3 (2014), by December 31 of each year, the Intermediate District must file an audited financial statement with the Commissioner for the preceding fiscal year.

208. In 2011, the certified public accounting firm of Malloy, Montague, Karnowski, Radosevich & Co., P.A. (MMKR) prepared an audited financial report for the Intermediate District for the fiscal year ending June 30, 2011 (hereafter referred to as the "2011 Audited Financial Statement").[395]

209. The Intermediate District filed the 2011 Audited Financial Statement with the Commissioner on or before December 31, 2011, as required by Minn. Stat. § 123B.77, subd. 3 (2010).[396] The 2011 Audited Financial Statement showed that the Intermediate District had assets in the amount of $117,152,119.00 and liabilities in the amount of $103,383,972.00.[397] As a result, the 2011 Audited Financial Statement declared that the Intermediate District had net assets (i.e., assets in excess of liabilities) in the amount of $13,768,147.00.[398]

210. The assets included in the 2011 Audited Financial Statement included the land and buildings used for the NEC, SEC, WEC, DSC, and EEC Properties, as well as the Robbinsdale Condo.[399] The asset value attributed to the land and buildings associated with the SEC, WEC, DSC, and EEC Properties and Robbinsdale Condo was $52,665,400.00.[400] The asset value attributed to the NEC Property, which was then in the early process of construction, was $5,458,349.00.[401]

211. The values attributed to the properties in the 2011 Audited Financial Statement were determined on a cost basis: the value of the land was the original purchase price paid by the bank for the property, and the value of the buildings was the actual cost of construction. [402]

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[393] *See* the parties' Post-Hearing Briefs filed on August 25, 2014.
[394] The 2009 Memorandum of Agreement provides that notices of withdrawal received by February 1 are effective June 30 of the following fiscal year. *See* Ex. 101 at 2. This is also consistent with Minn. Stat. § 123B.02, subd. 3(c) (2014).
[395] Exs. 23, 108.
[396] Exs. 23, 108.
[397] Ex. 23 at 16; Ex. 108 at 16.
[398] Ex. 23 at 16; Ex. 108 at 16.
[399] Ex. 23 at 40-41; Ex. 108 at 40-41.
[400] Ex. 23 at 39; Ex. 108 at 39.
[401] Ex. 23 at 39; Ex. 108 at 39. As of June 30, 2011, the NEC was still under construction and $5,458,349 was the amount paid as of that date for construction of the building. *See* Test. of Gary Dosdall at T. 704.
[402] Test. of G. Dosdall at T. 665-66.

212. The liabilities set forth in the 2011 Audited Financial Statement included "long-term liabilities" related to the financing of the SEC building ($25,753,734.00) and the Certificates of Participation issued by the banks to finance the Intermediate District's interest in the WEC, SEC, EEC, and NEC Properties (totaling $53,720,000.00).[403] The amounts included as "liabilities" were the principal amounts remaining to be paid after June 30, 2011, provided that the lease-purchase agreements or refunding leases associated with those properties were not terminated, and the contracts were paid to completion.[404] Because interest had not yet been accrued, interest was not included in the determination of the "liabilities."[405]

213. The break-down of "liabilities" for each property, as set forth in the 2011 Audited Financial Statement, was as follows:

Property	Original Amount	Principal Outstanding
WEC	$ 8,570,000.00	$ 7,590,000.00
SEC (building)	$25,400,000.00	$25,753,734.00
SEC (land)	$ 7,405,000.00	$ 7,290,000.00
EEC (COP 2010A)	$ 3,200,000.00	$ 2,925,000.00
EEC (COP 2010B)	$ 2,050,000.00	$ 2,050,000.00
NEC	$29,790,000.00	$29,790,000.00
NEC (addition)	$ 4,075,000.00	$ 4,075,000.00
Total:		$79,473,734.00[406]

214. The 2011 Audited Financial Statement's Statement of Net Assets did not include as liabilities the total cost of OPEB and pension benefits accrued by, but yet unpaid to, employees.[407] Rather, the Statement of Net Assets included as liabilities only the estimated Annual Required Contribution (ARC) for OPEB ($960,472.00) and the ARC for pension benefits ($185,433.00) (referred to as the "net OPEB obligation" and "net annual pension costs").[408] As a result, the 2011 Audited Financial Statement's calculation of net assets did not include the AAL or UAAL (i.e., the long-term liability) attributable to the OPEB and pension obligations.[409] This is because the District does not set aside monies to pay these future liabilities and, instead, pays them yearly on a pay-as-you-go basis.[410]

215. The 2011 Audited Financial Statement also included figures for Severance Benefits Payable and Compensated Absences Payable.[411] Severance Benefits Payable consist of early retirement incentive benefits payable to former employees.[412]

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403 Ex. 108 at 41.
404 *Id.*
405 *Id.*
406 *Id.* at 40-41.
407 *Id.* at 16.
408 *Id.* at 40, 45-51.
409 *Id.* at 16, 40.
410 *Id.* at 44-48
411 *Id.* at 40-41.
412 *Id*. at 41.

Severance benefit liabilities are paid from the General Fund.[413] According to the 2011 Audited Financial Statement, "Annual payments to retire the severance benefit liabilities have not been determined and will depend on actual employee turnover."[414] The parties do not dispute the District's liability for, or the amount of, the Severance Benefits Payable set forth in the 2011 Audited Financial Statement ($4,731,848.00).[415]

216. Similarly, the parties do not dispute the amount stated for Compensated Absences Payable to employees. Compensated Absences Payable represent accrued vacation payable at year-end.[416] Compensated absences are paid from the General Fund.[417] According to the 2011 Audited Financial Statement, "Annual payments to retire compensated absences payable have not been determined and will depend on employee turnover and actual employee absences."[418] Nonetheless, the parties do not dispute the District's liability for, or the amount of, Compensated Absences Payable set forth in the 2011 Audited Financial Statement ($375,937.00).[419]

217. Based upon the figures in the District's 2011 Audited Financial Statement, Bloomington concluded that the District had assets exceeding liabilities in the amount of $13,768,147.00.[420]

218. Bloomington then calculated the number of students that it had enrolled in the District in the 2010-2011 school year in relation to the total number of students enrolled in the District.[421] Bloomington calculated that it had 6.52 percent of the students enrolled in the Intermediate District in 2010-2011.[422] Using this percentage (6.52%), Bloomington opined that it was entitled to 6.52 percent of the net assets stated on the District's 2011 Audited Financial Statement, plus a percentage of any monies received by the District arising out of a pending Minnesota Department of Education Special Education appeal.[423]

VALUATIONS OF THE REAL ESTATE INTERESTS

219. Unlike Bloomington, the Intermediate District did not rely on its 2011 Audited Financial Statement to determine Bloomington's proportionate share of assets and liabilities under Minn. Stat. § 123A.24.

220. Instead, the Intermediate District hired a real estate appraiser to prepare appraisals of the real properties in which the District holds a legal interest, as well as an

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413 *Id.*
414 *Id.*
415 *Id*. at 40.
416 *Id.* at 41.
417 *Id.*
418 *Id.*
419 *Id.* at 40.
420 *Id.* at 16.
421 *Id.* at 16-18.
422 *Id.*
423 *Id.*

actuarial expert to determine the AAL and UAAL attributable to the OPEB and pension liabilities.[424]

221. The District initially advised its real estate appraisers that the intended use of the appraisals was for "internal planning" so as to obtain the most fair and "unbiased" valuation of the properties[425] The District did not explain to the appraiser initially that the purpose of the appraisals was to determine Bloomington's share of the District's assets and liabilities as a result of Bloomington's withdrawal.[426] The District merely directed the appraiser to determine the fair market value of the properties in 2010 and 2011.[427]

222. It was not until 2012 that the District advised its real estate appraiser of the full intended use of the real estate appraisals.[428] After that, the appraiser drastically reversed his initial valuation conclusions and reduced his valuation conclusions by millions of dollars (in the case of the SEC Property, by over $20,000,000.00).[429] The progression of the changes to value made by the Intermediate District's appraiser is set forth below.

2010 Appraisals of SEC and WEC Properties

223. On or about August 12, 2010, the Intermediate District first retained Shenehon Company (Shenehon) to prepare appraisals on the DSC, SEC, and WEC Properties.[430] According to the retainer agreement, Shenehon agreed to prepare a "Restricted Use Appraisal Report" for each of the properties.[431] The retainer agreement between the District and Shenehon states:

> Shenehon Company will prepare the appraisals presented in a restricted use report format using the sales comparison and income approaches to value to estimate the market value of each subject property….The appraisal reports will comply with Uniform Standards of Professional Appraisal Practice (USPAP) guidelines.[432]

224. The retainer agreement further provides:

> Shenehon Company will preserve the confidential nature of information received from the client, in accordance with established professional standards. The client agrees to preserve the confidential format and content of the appraisal report. The report and the appraiser's identity are

[424] Exs. 129, 134, 135.
[425] Exs. 5, 6; Test. of M. Hawkins at T. 907.
[426] Exs. 5, 6; *see also* Test. of Robert Strachota at T. 490, 494-96; Test. of S. Lewandowsi at T. 479-84.
[427] Exs. 5, 6; *see also* Test. of Robert Strachota at T. 490, 494-96; Test. of S. Lewandowsi at T. 479-84.
[428] Ex. 118.
[429] Exs. 104-07.
[430] Ex. 135.
[431] *Id.*
[432] *Id.*

> not to be used in whole or in part, outside the client's organization, without prior written approval, except for review by auditors and legal counsel, and by the representatives of taxing authorities.[433]

225. A "Restricted Use Appraisal Report" is a written appraisal report prepared under the Uniform Standards of Professional Appraisal Practice Rules 2-2(c), 8-2(c), or 10-2(b).[434] A Restricted Use Appraisal Report is permitted to contain the minimal detail required under the USPAP and is intended to be relied upon only by the client, not any other party.[435] The 2014-2015 edition of the USPAP changed the name of this type of report to a "Restricted Appraisal Report."[436]

226. According to the Appraisal Standards Board of the Appraisal Foundation, which develops, interprets, and amends the USPAP, the scope of work required to prepare a value conclusion articulated in a Restrict Appraisal Report and full Appraisal Report remains the same:

> The scope of work required to develop credible assignment results is independent of the report format. The research and analysis required for credible results in an assignment would be the same whether the appraiser prepared an Appraisal Report or a Restricted Appraisal Report to communicate the results. Similarly, the scope of work is unaffected if the assignment results are presented in an oral appraisal report.[437]

227. Therefore, while a Restricted Use Appraisal Report is not prepared for anyone other than the intended user (i.e., the client hiring the appraisal), the reliability and methods used to arrive at a value conclusion should be no different whether that conclusion is articulated in a Restricted User Appraisal Report or a full Appraisal Report.[438] The only difference between the two types of reports is the intended user and the amount of supporting detail contained in the report.[439]

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[433] *Id.*
[434] APPRAISAL INSTITUTE, THE DICTIONARY OF REAL ESTATE APPRAISAL 170 (5th ed. 2010).
[435] *See* Uniform Standards of Professional Appraisal Practice 2012-2013 Edition. The Administrative Law Judge takes judicial notice of the USPAP pursuant to Minn. Stat. § 14.60, subd. 4 and Minn. R. 1400.8100, subp. 2.
[436] *See* Uniform Standards of Professional Appraisal Practice 2014-2015 modifications; *see also* http://www.appraisers.org/Disciplines/Appraisal-Review-Management/arm-news-and-events/2014/01/07/2014-15-uspap-modifications-released, explaining the changes.
[437] *See* The Appraisal Foundation Appraisal Standards Board 2014-2015 USPA Q&A issued October 9, 2013 (reprinted in http://www.ok.gov/oid/documents/123113_USPAP%20Doc.pdf). The Administrative Law Judge takes judicial notice of the Appraisal Standards Board's interpretations of USPAP, pursuant to Minn. Stat. § 14.60, subd. 4 and Minn. R. 1400.8100, subp. 2.
[438] *Id.*
[439] *Id.* ("The use of an Appraisal Report is appropriate for any appraisal assignment in which the client may need to understand the appraiser's rationale, or for an assignment in which the client may not have specialized knowledge about the subject property. When there are any intended users other than the client, an Appraisal Report is the only written option that is allowed under USPAP. [π] The Standard Rules for an Appraisal Report establish the minimum level of information that must be included in the report. The appraiser must decide if additional detail or explanation is required, given the intended use and intended users of the report.").

228. On August 13, 2010, Shenehon prepared Restricted Use Appraisal Reports on the SEC and WEC Properties.[440] Christopher Stockness and John Flaherty, licensed real estate appraisers, prepared the appraisal reports on behalf of Shenehon.[441]

229. In its 2010 appraisals for the WEC and SEC Properties, Shenehon determined the "estimated market value" of each property. "Market value" is defined as:

> The most probable price that the specified property interest should sell for in a competitive market after a reasonable exposure time, as of a specified date, in cash, or in terms equivalent to cash, under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably, for self-interest, and assuming that neither is under duress.[442]

230. In both of its 2010 appraisal reports, Shenehon appraised the market value of the leased fee interest and the fee simple interest of the WEC and SEC Properties.[443]

231. A "leased fee interest" is defined as "[a] freehold (ownership interest) where the possessory interest has been granted to another party by creation of a contractual landlord-tenant relationship (i.e., a lease)."[444] A leased fee interest is held by the owner of the property, who is then the lessor.

232. A "fee simple interest" is defined as "[a]bsolute ownership [of a property] unencumbered by any other interest or estate, subject only to the limitations imposed by the governmental powers of taxation, eminent domain, police power, and escheat."[445] A fee simple estate "is one in which the owner is entitled to the entire property, with unconditional power of disposition…."[446]

233. In both of its 2010 appraisal reports, Shenehon concluded that the highest and best use for the WEC and SEC Properties, as improved, is for the continued use of the properties as school buildings.[447]

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[440] Exs. 5, 6. Bloomington did not offer into the hearing record copies of the Restricted Use Appraisal Reports for the DSC Property, although the retainer agreement between the District and Shenehon states that Shenehon would prepare appraisal reports for that property as well. *See* Ex. 135.
[441] Exs. 5, 6.
[442] APPRAISAL INSTITUTE, THE DICTIONARY OF REAL ESTATE APPRAISAL 122-23 (5th ed. 2010); *see also* Ex. 5 at 5; Ex. 6 at 5; Ex. 7 at 5; Ex. 8 at 5; Ex. 9 at 5; and Ex. 10 at 4.
[443] Exs. 5, 6.
[444] APPRAISAL INSTITUTE, THE DICTIONARY OF REAL ESTATE APPRAISAL 111 (5th ed. 2010).
[445] *Id.* at 78.
[446] BLACK'S LAW DICTIONARY 427 (Abridged 6th ed. 1991).
[447] Ex. 5 at 13; Ex. 6 at 14.

234. Shenehon evaluated three approaches to determine market value: the cost approach; sales comparison approach; and the income capitalization approach.[448] The three valuation approaches are described by Shenehon as follows:

> **Cost Approach**
> The cost approach is based upon the principle that a prudent buyer will not pay more for a property than the cost to develop a new or substitute property with the same utility. This approach is useful in valuing new or proposed construction, special-purpose properties, and properties that are not frequently exchanged in the market.
>
> In the cost approach, the value of the property is derived by adding the estimated land value to the cost of constructing a reproduction or replacement improvement and then subtracting the amount of depreciation from all causes (that is, wear and tear on the property, design and plan deficiencies, or neighborhood and market influences). This technique can also be employed to derive information needed in the sale comparison and income capitalization approaches to value.
>
> **Sales Comparison Approach**
> The sales comparison approach is based upon the principle of substitution. In other words, a buyer will not pay more to acquire a substitute property of similar utility and desirability within a reasonable timeframe. The sales comparison approach is useful when a number of similar properties have recently sold or are currently for sale in the subject's market. This method is often used for properties that are not usually purchased for their income-producing capability such as owner-occupied properties.
>
> In the sales comparison approach, similar properties are compared to the subject property. Adjustments are made to the known sale price for the various differences between the comparable property and the subject property, and the adjusted prices are used to estimate the probable price at which the subject property would sell if offered on the open market.
>
> **Income Capitalization Approach**
> The income capitalization approach is based upon the principle of anticipation. Any property that generates income can be valued using the income capitalization approach. When more than one approach to value is used to develop an opinion of value for an income-producing property, the value indication produced by the income capitalization approach might be given greater weight than that of the other approaches in the final reconciliation of value indications.

[448] Exs. 5, 6.

> In the income capitalization approach, rental income of the property is calculated and deductions are made for vacancy and collection loss, and expenses. The prospective net operating income of the property is then estimated. To support this estimate, historical operating statements for the subject property and comparable properties are reviewed. An applicable capitalization method and appropriate capitalization rate are developed and used in computations that result in an indication of value.[449]

235. Shenehon used only the sales comparison and income capitalization approaches to estimate the value of the WEC Property.[450] Under the sales comparison approach, Shenehon determined that the market value for a fee simple interest in the property was $6,875,000.00.[451] Using the income capitalization approach, Shenehon estimated that the market value for a fee simple interest in the property was $4,100,000.00, and the market value for a leased fee interest in the property was $7,750,000.00.[452] Reconciling these figures, Shenehon concluded that the overall estimated market value of the WEC Property as of August 13, 2010, was $7,700,000.00.[453]

236. Shenehon conducted a similar analysis for the SEC Property.[454] Again, Shenehon used only the sales comparison and income capitalization approaches to estimate the value of the property.[455] Under the sales comparison approach, Shenehon determined that the market value of the fee simple interest in the SEC Property was $32,700,000.00.[456] Using the income capitalization approach, Shenehon estimated that the market value of the fee simple interest was $8,000,000, and the market value for the leased fee interest was $34,300,000.00.[457] Reconciling these figures, Shenehon concluded that the overall estimated market value of the SEC Property as of August 13, 2010, was $34,000,000.00.[458]

2011 Appraisals of WEC, SEC, DSC, and EEC Properties

237. In August 2011, after Bloomington had officially withdrawn from the District, the Intermediate District retained Shenehon to conduct new appraisals of the WEC, SEC, DSC, and EEC Properties, using a valuation date of June 30, 2011, the effective date of Bloomington's withdrawal.[459]

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[449] Ex. 6 at 15; *see also* Ex. 5 at 14; Ex. 7 at 15; Ex. 8 at 15; Ex. 9 at 15; Ex. 10 at 14; Ex. 104 at 31; Ex. 105 at 30; Ex. 106 at 30; Ex. 107 at 39.
[450] Ex. 6.
[451] *Id.* at 20.
[452] *Id.* at 22-26.
[453] *Id.* at cover letter, 26.
[454] Ex. 5.
[455] *Id.*
[456] *Id.* at 21.
[457] *Id.* at 23-28.
[458] *Id.* at cover letter, 28.
[459] Ex. 134.

238. Again in its retainer letter, Shenehon agreed to prepare Restricted Use Appraisal Reports for each of the properties.[460] The intended use of the appraisals was "to conclude a market value of the subject propert[ies] for [the District's] internal planning purposes."[461]

239. Restricted Use Appraisal Reports were prepared on the WEC, SEC, DSC, and EEC Properties by licensed real estate appraisers Christopher Stockness and Robert Strachota on behalf of Shenehon.[462]

240. In each of the 2011 appraisals, Shenehon utilized only the sales comparison and income capitalization approaches to value.[463] The cost approach was not used or considered.[464]

241. In its reports, Shenehon incorporated the newer definition of "market value," set forth in the *Uniform Standards of Professional Appraisal Practice* (USPAP), 2010-2011 Edition, as:

> The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition are the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:
>
> 1. Buyer and seller are typically motivated;
> 2. Both parties are well informed or well advised and acting in what they consider their own best interests;
> 3. A reasonable time is allowed for exposure in the open market;
> 4. Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
> 5. The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.[465]

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[460] *Id.*
[461] Ex. 7 at 3; Ex. 3; Ex. 9 at 3; Ex. 10 at 3.
[462] Exs. 7-10.
[463] Exs. 7-10.
[464] Exs. 7-10.
[465] *See* Ex. 7 at 5; Ex. 8 at 5; Ex. 9 at 5; Ex. 10 at 4.

2011 Appraisal of DSC Property

242. Unlike the EEC, SEC, or WEC Properties, the Intermediate District owns the DSC Property in fee simple. Therefore, the only interest appraised by Shenehon was the fee simple interest in the property.[466] Using the sales approach, Shenehon determined that the market value of the DSC Property was $2,750,000.00.[467] Using the income capitalization approach, Shenehon estimated that the market value of the property was $2,675,000.00.[468] Reconciling the two approaches to value, Shenehon concluded that the estimated market value of the DSC Property as of June 30, 2011, was $2,700,000.00.[469]

2011 Appraisal of EEC Property

243. Next, Shenehon appraised the EEC Property.[470] Because the EEC Property is subject to a lease agreement, Shenehon valued both the fee simple and leased fee interests.[471] Shenehon did not value the District's leasehold interest[472] in the property.[473]

244. Under the sales comparison approach, Shenehon determined that the market value for a fee simple interest in the EEC Property was $4,050,000.00.[474] Using the income capitalization approach, Shenehon estimated that the market value for a fee simple interest in the property was $4,675,000.00, and the market value for a leased fee interest was $4,575,000.00.[475]

245. Shenehon's appraisal report states, "The fee simple and leased fee values fall within a relatively tight range, *but we believe a buyer would focus on the lease fee value*."[476] Reconciling these approaches to value, Shenehon concluded that the estimated market value of the EEC Property as of June 30, 2011, was $4,500,000.00.[477]

2011 Appraisal of WEC Property

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[466] Ex. 7.
[467] *Id*. at 19.
[468] *Id.* at 23.
[469] *Id.* at cover letter, 24.
[470] Ex. 9.
[471] *Id.*
[472] A "leasehold interest" is defined as "[t]he tenant's possessory interest created by a lease." APPRAISAL INSTITUTE, THE DICTIONARY OF REAL ESTATE APPRAISAL 111 (5th ed. 2010).
[473] Ex. 9.
[474] *Id*. at 20.
[475] *Id.* at 22-29.
[476] *Id.* at 29 (emphasis added).
[477] *Id*. at cover letter, 30.

246. Shenehon appraised the WEC Property in a similar fashion.[478] Again, Shenehon valued both a fee simple interest and a leased fee interest in the property.[479] Shenehon did not appraise the District's leasehold interest in the property.[480]

247. Under the sales comparison approach, Shenehon determined that the market value for a fee simple interest in the WEC Property was $6,550,000.00.[481] Using the income capitalization approach, Shenehon estimated that the market value for a fee simple interest was $4,050,000.00, and the market value for the leased fee interest was $7,675,000.00.[482] The report states:

> *It is our opinion that a potential buyer would purchase the subject [WEC Property] on its leased fee value*. We conclude the value of the subject property as indicated by the income capitalization approach is $7,675,000.[483]

248. Reconciling the valuation approaches, Shenehon concluded that the estimated market value of the WEC Property as of June 30, 2011, was $7,600,000.00.[484]

2011 Appraisal of SEC Property

249. In a like fashion, Shenehon appraised the SEC Property.[485] Although the District does not hold a leased fee or ownership interest in the SEC Property, Shenehon valued both a fee simple interest and a leased fee interest in the property.[486] Shenehon did not value the District's leasehold interest in the property.[487]

250. In valuing the interests, Shenehon employed only the sale comparison and income capitalization approaches to valuation.[488] Shenehon did not use the cost approach even though the SEC Property had recently been constructed in 2008.[489] This was true despite the fact that Shenehon describes the cost approach as, "useful in valuing new or proposed construction, special-purposes properties, and properties that are not frequently exchanged in the open market."[490]

[478] Ex. 8.
[479] *Id.*
[480] *Id.*
[481] *Id*. at 20.
[482] *Id.* at 22-28.
[483] *Id.* at 28 (emphasis added).
[484] *Id.* at cover letter, 30.
[485] Ex. 7.
[486] *Id.*
[487] *Id.*
[488] *Id.*
[489] Id.
[490] *Id.* at 15.

251. Using the sales comparison approach, Shenehon determined that the market value of the SEC Property was $34,835,000.00: $535,000.00 for excess land and $34,300,000.00 for the remaining land and school facility.[491]

252. Using the income capitalization approach, Shenehon estimated the value of both a fee simple and leased fee interest.[492] Shenehon estimated that the market value for the fee simple interest under the income capitalization approach was $7,625,000.00; whereas, the market value for the leased fee interest was $31,250,000.00.[493] Although the valuations for the fee simple and leased fee interests were wildly divergent, Shenehon concluded that the value of the leased fee interest was the most accurate for purposes of determining the property's value on the open market.[494] Shenehon's report states:

> *It is our opinion that a potential buyer of the subject [SEC Property] would purchase the subject [property] based on its leased fee value.* We conclude the value of the subject property as indicated by the income capitalization approach is $31,250,000.[495]

253. Shenehon's report continues, "Since [sic] the real estate under appraisal is income[-]producing property, the leased fee income capitalization approach is given primary consideration in concluding the final value conclusion."[496]

254. Reconciling the valuation approaches, Shenehon concluded that the estimated market value of the SEC Property as of June 30, 2011, was $31,300,000.00.[497]

Intermediate District Changes its Opinions as to the Properties' Values

255. In 2012, Bloomington and the Intermediate District engaged in extensive settlement discussions, including a mediation session and facilitated discussions with the Commissioner.[498] During the negotiations, the Intermediate District voluntarily disclosed to the Commissioner and Bloomington the 2010 and 2011 restrict appraisal reports prepared by Shenehon.[499]

256. After negotiations with Bloomington broke down, the District, its legal counsel, and its financial experts, met with the real estate appraisers from Shenehon who had prepared the 2010 and 2011 appraisals of the DSC, EEC, WEC, and SEC.[500]

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[491] *Id.* at 23.
[492] *Id.* at 24-33.
[493] *Id.*
[494] *Id.* at 33.
[495] *Id.* (emphasis added).
[496] *Id.* at 34.
[497] *Id.* at cover letter, 34.
[498] Exs. 111-13, 119-22; *see also* Notice and Order for Prehearing Conference and Hearing at 2.
[499] Ex. 117 at 6.
[500] Test. of M. Hawkins at T. 904-07.

257. On October 2, 2012, the District met with Robert Strachota (Strachota), the President of Shenehon Company and one of the signatories of the 2011 appraisals.[501] Shenehon is a licensed real estate appraiser, a Member of the Appraisal Institute (MAI), a Master Certified Business Appraiser (MCBA), a Counselor of Real Estate (CRE), and a Fellow of the Institute of Business Appraisers.[502]

258. During the October 2, 2012 meeting, the District advised Strachota of the exact reason that the District had requested the appraisals to be conducted in 2010 and 2011: that is, to determine Bloomington's share of the assets and liabilities associated with the various properties.[503]

259. The next day, October 3, 2012, Strachota wrote a letter to Sara Ruff, legal counsel for the Intermediate District.[504] In his letter, Strachota reversed his professional opinions articulated in the appraisals he prepared for the EEC, SEC, and WEC Properties in 2010 and 2011.[505]

260. Rather than using the valuation of the leased fee interest, Strachota asserts that the values of the fee simple interests are the more accurate estimate of the properties' fair market values.[506] To justify his abrupt reversal, Strachota asserts, for the first time, that the lease agreements encumbering the EEC, WEC, and SEC Properties are actually "mortgage obligations" for the District, and that when such "mortgages" are paid off, the properties will be conveyed to the District for one dollar.[507]

261. As a result, Strachota makes an about-face and concludes that the fee simple interest is the legal interest that should be valued for purposes of allocating the District's assets and liabilities, because that is the legal interest that the District holds in the properties.[508] Strachota's analysis, however, ignores the fact that the District did not, in fact, have an alienable fee simple interest in the EEC, WEC, or SEC Properties as of June 30, 2011.

2014 Appraisals of the DSC, EEC, WEC, and SEC Properties

262. In preparation for the hearing in this matter, the Intermediate District retained Shenehon to prepare all new appraisals for the DSC, EEC, WEC, and SEC Properties.[509] Strachota prepared each of these new appraisals.[510] Strachota's 2014

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[501] *Id.*
[502] Ex. 104 at D-1; Ex. 105 at D-1; Ex. 106 at D-1; Ex. 107 at E-1.
[503]Ex. 104 at D-1; Ex. 105 at D-1; Ex. 106 at D-1; Ex. 107 at E-1; Test. of R. Strachota at T. 498-99; 584-85.
[504] Ex. 118.
[505] *Id.*
[506] *Id.*
[507] *Id.;* Test. of R. Strachota at T. 498-501.
[508] E, 118; Test. of R. Strachota at T. 498-501
[509] Exs. 104-07.
[510] Exs. 104-07.

appraisals erroneously assume that the Intermediate District held an existing and fully alienable fee simple interest in all of the properties as of June 30, 2011.[511]

2014 Appraisal of DSC Property

263. On or about March 5, 2014, Strachota prepared a new appraisal for the DSC Property.[512] Because the Intermediate District owns the DSC Property in fee simple, Strachota only valued the District's fee simple interest in the property.[513]

264. Strachota appraised the DSC Property using both the cost approach and income capitalization approach to value.[514] Using the cost approach, Strachota opined that the value of the property was $3,000,000.00.[515] Using the income capitalization approach, Strachota opined that the value of the property was $2,900,000.00.[516] Reconciling these two approaches, Strachota concluded that the fair market value of the DSC Property as of June 30, 2011, was $3,000,000.[517] This amount was $300,000.00 higher than Strachota's 2011 appraisal of the same property.[518]

2014 Appraisal of EEC Property

265. On or about March 5, 2014, Strachota prepared a new appraisal for the EEC Property.[519] In his appraisal, Strachota erroneously states that the "Intermediate District 287 purchased the property on January 7, 2010."[520] In reality, as of June 30, 2011, the District had not exercised its option to purchase the property under the EEC Lease Agreement and held had only a leasehold interest in the EEC Property.[521] Wells Fargo Bank was the only party holding title to, and having a fee simple interest in, the property.[522]

266. In support of his erroneous assumption, Strachota asserts that the EEC Lease Purchase Agreement and related COPs are the functional equivalent to a sale and mortgage transaction, and that the District's interest in the EEC Property is that of a fee simple owner, not a lessee.[523] Strachota erroneously states:

> The current payments made by the Intermediate District 287 to Wells Fargo Bank represent the repayment of a mortgage. They do not

[511] Exs. 104-07.
[512] Ex. 104.
[513] *Id*.
[514] *Id*.
[515] *Id.* at 46.
[516] *Id.*
[517] *Id.*
[518] *Id.; see also* Ex. 7 at 24.
[519] Ex. 105.
[520] *Id.* at 4.
[521] *See* Exs. A, B.
[522] *See* Exs. A, B.
[523] Ex. 105 at cover letter, 3-4.

> represent market rent negotiated between two arm's-length parties. It is our opinion that there is no leased fee interest for a lease payment that is a function of a mortgage note.[524]

267. As a result, Strachota abandoned his previous opinion that a reasonable buyer in the open market would purchase the EEC Property based upon the value of a leased fee interest.[525] Instead, Strachota appraised only a fee simple interest in the EEC Property.[526]

268. Strachota's 2014 appraisal of the EEC Property adopts the definition of "fee simple estate" contained in the Appraisal Institute's DICTIONARY OF REAL ESTATE APPRAISAL, as:

> Absolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by the government powers of taxation, eminent domain, police power, and escheat.[527]

269. As of June 30, 2011, however, the Intermediate District did not have a fee simple estate in the EEC Property.[528] The District's interest in the EEC Property was that of a lessee with an unexercised option to purchase the property in the future.[529]

270. Nonetheless, Strachota concluded that the value of a fee simple interest in the EEC Property as of June 30, 2011, was $4,000,000.00.[530] Strachota's 2014 appraisal of the EEC Property was $500,000.00 less than his 2011 appraisal of the same property.[531] In his 2011 appraisal, Strachota opined that the estimated market value of the EEC Property as of June 30, 2011, was $4,500,000.00.[532]

2014 Appraisal of WEC Property

271. On or about March 5, 2014, Strachota prepared a third appraisal of the WEC Property.[533] Unlike Shenehon's previous two appraisals of the WEC Property conducted in 2010 and 2011, Strachota concluded this time that there was no "leased fee interest" in the property to be valued, and that the WEC Lease Agreement and related COP financing resulted in the District having the functional equivalent to a fee simple interest in the property.[534]

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[524] *Id.* at cover letter.
[525] *See* Ex. 9 at 29-30.
[526] Ex. 105
[527] APPRAISAL INSTITUTE, THE DICTIONARY OF REAL ESTATE APPRAISAL 78 (5th ed. 2010).
[528] *See* Exs. A, B.
[529] Exs. A, B.
[530] Ex. 105 at 43.
[531] Ex. 9 at 30.
[532] *Id.*
[533] Ex. 106.
[534] *Id.* at cover letter, 3-4.

272. As a result, Strachota abandoned his previous opinion that a reasonable buyer in the open market would purchase the WEC Property based upon the value of a leased fee interest.[535]

273. However, the Intermediate District did not have an alienable ownership interest in the WEC Property as of June 30, 2011.[536] Instead, the District's interest in the WEC Property was fully encumbered by the WEC Ground Lease and WEC Trust Agreement, under which the District conveyed its interests in the property to Wells Fargo Bank to hold in trust, subject to the terms of the WEC Refunding Lease Agreement.[537] Under the WEC Refunding Lease Agreement, Wells Fargo Bank is leasing back the property to the District.[538] Thus, the District's true interest in the WEC Property as of June 30, 2011, was merely possessory.[539]

274. Without addressing the complexities of the District's interest in the WEC Property, Strachota concluded that the value of a fee simple interest in the WEC Property as of June 30, 2011, was $3,650,000.00.[540] Strachota's 2014 appraisal of the WEC Property was $3,950,000 less than his 2011 appraisal of the same property and $4,050,000.00 less than his 2010 appraisal of the same property.[541] In his 2011 appraisal, Strachota opined that the estimated market value of the WEC Property as of June 30, 2011, was $7,600,000.00.[542] In his 2010 appraisal, Strachota's company opined that the estimated market value of the WEC Property as of August 13, 2010, was $7,700,000.00.[543]

2014 Appraisal of SEC Property

275. On or about March 5, 2014, Strachota prepared a third appraisal for the SEC Property.[544] Unlike Shenehon's previous two appraisals of the SEC Property conducted in 2010 and 2011, Strachota concluded this time that there was no leased fee interest in the property to be valued, and that the SEC Refunding Lease Agreement and related COP financing resulted in the District having the functional equivalent to a fee simple interest in the property.[545] As a result, Strachota abandoned his previous opinion that a reasonable buyer in the open market would purchase the SEC Property based upon the value of a leased fee interest.[546]

[535] See Ex. 8 at 28.
[536] *See* Exs. F, G, H.
[537] Exs. F, G, H.
[538] Ex. F.
[539] Exs. F, G, H.
[540] Ex. 106 at 43.
[541] *Id; see also* Ex. 8 at 29; Ex. 6 at 26.
[542] Ex. 8 at 29.
[543] Ex. 6 at 26.
[544] Ex. 107.
[545] *Id.* at cover letter, 3; s*ee also* Exs. 5, 7.
[546] Ex. 107 at cover letter, 3; s*ee also* Exs. 5, 7.

276. Contrary to Strachota's erroneous assertions regarding the District's ownership interest in the property, as of June 30, 2011, the Intermediate District did not have a fee simple interest in the SEC Property.[547] The District's only legal interest in the SEC Property was that of a lessee with an unexercised option to purchase the property in the future.[548]

277. Nonetheless, Strachota concluded that the value of a fee simple interest in the SEC Property as of June 30, 2011, was $9,000,000.00.[549] Strachota's 2014 appraisal of the SEC Property was $22,300,000.00 less than his 2011 appraisal of the same property, and $25,000,000.00 less than his 2010 appraisal of the same property.[550] In his 2011 appraisal, Strachota opined that the estimated market value of the SEC Property as of June 30, 2011, was $31,300,000.00.[551] In its 2010 appraisal, Strachota's company opined that the estimated market value of the SEC Property as of August 13, 2010 was $34,000,000.00.[552]

Bloomington's Expert Real Estate Appraisals and Reviews

278. To counter Strachota's appraisals of the DSC, EEC, WEC, and SEC Properties, Bloomington hired its own expert real estate appraiser, Robert Lunz (Lunz) of Nicollet Partners, Inc., to conduct an evaluation of the properties[553] Lunz is a licensed real estate appraiser and broker, a Member of the Appraisal Institute (MAI), and a Counselor of Real Estate (CRE).[554]

279. Lunz conducted his own appraisals of the DSC and EEC Properties, but conducted only "appraisal reviews" of Shenehon's 2011 appraisals of the WEC and SEC Properties to reach his valuation conclusions.[555]

Lunz's Appraisal of the DSC Property

280. On or about February 28, 2014, Lunz completed a full, "retroactive" appraisal on the DSC Property.[556] Because the District owns the DSC Property in fee simple, Lunz appraised only the fee simple interest in the property as of June 30, 2011.[557]

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[547] *See* Exs. I, O, Y.
[548] Exs. I, O, Y.
[549] Ex. 107.
[550] Ex. 7 at 34; Ex. 5 at 28.
[551] Ex. 7 at 34.
[552] Ex. 5 at 28.
[553] Exs. 1-4.
[554] Exs. 1-4.
[555] Exs. 1-4.
[556] Ex. 4.
[557] *Id.* at 20.

281. Like Shenehon, Lunz determined that the highest and best use of the DSC Property, as improved, is the continued use as a general office building.[558] Lunz used both a sales comparison approach, as well as an income (direct capitalization) approach to value.[559] Lunz did not apply a cost approach to value, due to the property's age.[560]

282. Under the sales comparison approach, Lunz opined that the market value of the property as of June 30, 2011, was $4,100,000.00.[561] Using the income approach, Lunz estimated that the market value of the property as of June 30, 2011, was $3,630,000.00.[562] Overall, Lunz determined that "the most probable buyer" of the DSC Property would be "an owner-user who would rely heavily" on the sale comparison approach to value.[563] Reconciling the figures from the two valuation approaches, Lunz concluded that the "retrospective market value" of the DSC Property as of June 30, 2011, was $4,000,000.00.[564]

Lunz Appraisal of the EEC Property

283. On or about February 28, 2014, Lunz conducted a full, "retroactive" appraisal of the EEC Property as of June 30, 2011.[565]

284. Like Shenehon, Lunz determined that the highest and best use of the EEC Property, as improved, is the continued use as a school or other type of public service or educational facility.[566]

285. Based upon the highest and best use of the property as improved, Lunz set out to determine market value based upon comparable sales and income-producing opportunities involving school properties in the area.[567] Lunz was not provided with a copy of the EEC Lease or other financing documents related to the property. Therefore, Lunz could not evaluate any existing leased fee interest in the property.[568]

286. Nor could Lunz identify enough comparable school leases in the area to make an accurate value opinion using the income approach to value.[569] Because of the lack of sufficient rental data to develop an income approach to value, Lunz concluded that "the most probable buyer" of the EEC Property would be "an owner-user who would rely heavily" on comparable school sales in the area.[570]

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[558] *Id.* at 88.
[559] *Id.* at 89.
[560] *Id.*
[561] *Id.* at 90-102.
[562] Ex. 4 at amended appraisal.
[563] *Id.*
[564] *Id.*
[565] Ex. 3.
[566] *Id.* at 73.
[567] Test. of R. Lunz at T. 217-28.
[568] *Id.* at T. 218-19.
[569] *Id.*
[570] Ex. 3 at 84.

287. Using six comparable sales of school properties in the Twin Cities metropolitan area occurring between February 2009 and August 2012, Lunz concluded that the "retrospective market value" of a fee simple interest in the EEC Property as of June 30, 2011, was $4,010,000.00.[571] Lunz's value opinion was based solely on the sales comparison approach to value and the six sales analyzed in his report.[572]

Lunz's Appraisal Review of Shenehon's 2011 Restricted Use Appraisal of the SEC Property

288. With respect to the SEC Property, Lunz conducted only an appraisal review of the 2011 Restricted Use Appraisal Report prepared by Shenehon of the SEC Property (Exhibit 7).[573] An appraisal review is "[t]he act or process of developing and communicating an opinion about the quality of another appraiser's work that was performed as part of an appraisal, appraisal review, or appraisal consulting assignment."[574] An appraisal review is not an independent appraisal.[575]

289. Overall, Lunz concurs with the final market value reached by Strachota in his 2011 appraisal of the SEC Property.[576]

290. Unlike Strachota, Lunz acknowledges that the Intermediate District does not have a fee simple or leased fee interest in the SEC Property.[577] Nonetheless, Lunz concludes that, for purposes of estimating the market value of the property in this matter, the leased fee interest is the most accurate indication of value because it best represents the "value-in-use" of the property, as well as what a potential buyer would pay for the specialized property in the marketplace.[578]

291. "Value-in-use" is defined as "[t]he value of a property assuming a specific use, which may or may not be the property's highest and best use on the effective date of the appraisal."[579] "Value-in-use may or may not be equal to the market value but is different conceptually."[580]

292. According to Lunz, because both he and Strachota find that the highest and best use of the property, as improved, is for continued use as a school building, an

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[571] *Id.* at 75-84.
[572] Ex. 3.
[573] Ex. 1.
[574] APPRAISAL INSTITUTE, THE DICTIONARY OF REAL ESTATE APPRAISAL 11 (5th ed. 2010); s*ee also* Uniform Standards of Professional Appraisal Practices (USPAP) 2010-2011 Edition.
[575] *Cf.* APPRAISAL INSTITUTE, THE DICTIONARY OF REAL ESTATE APPRAISAL 11 (5th ed. 2010).
[576] Ex. 1
[577] *Id*.
[578] *Id.*
[579] APPRAISAL INSTITUTE, THE DICTIONARY OF REAL ESTATE APPRAISAL 206 (5th ed. 2010).
[580] *Id.*

appraisal of the property for the District must consider the value of the property in relation to its current use -- as a school property under lease by the District.[581]

293. Lunz explains that the value of the leased fee interest is the most accurate reflection of the true market value because it captures the property's value as it is currently being used -- as a school building leased by a highly credit-worthy governmental entity under a long-term, income-producing lease.[582] According to Lunz, Strachota's valuation of a fee simple interest ignores the existing lease arrangement and does not capture the value-in-use of the property.[583]

294. Lunz explains that any valuation of the SEC Property must necessarily include an evaluation of the SEC lease agreements, which establish an agreed-upon rent amount and income-producing stream. This amount can then be used in the income approach to determine the fee simple value of the property.

295. According to Lunz, Strachota's value opinion of the fee simple interest completely ignores the value of the existing lease agreements. However, Lunz explains, Strachota ultimately captures that lease income value in his value opinion of the leased fee interest. Accordingly, Lunz ultimately agrees with Strachota's final valuation.

296. Thus, while the District does not actually hold the leased fee interest, Lunz concurs with Strachota's original opinion that the leased fee value is the most accurate reflection of the market value of the property to the District, as well as to a probable buyer.[584] According to Lunz, this leased fee value is really the market value of the property itself.

297. While Lunz and Strachota go about valuing the property in different ways, they ultimately agree that the final market value is best represented by what Strachota refers to as the value of the leased fee interest.

298. Lunz asserts that Strachota was correct in his 2011 appraisal of the SEC Property, in which Strachota opined that a potential buyer would purchase the SEC Property based upon its leased fee value.[585] Ultimately, Lunz concurs with Strachota's methods of valuing the leased fee interest in the property, and agrees with Strachota's reconciled market value of $31,300,000.00.[586]

299. Lunz maintains, however, that Strachota's final valuation inadvertently failed to include the value of the excess parcel of land, which Strachota valued at $535,000.00.[587] Accordingly, Lunz concludes that the estimated market value of the

[581] Ex. 1.
[582] *Id.*
[583] *Id.*
[584] *Id.*
[585] *Id.*
[586] *Id.*
[587] *Id.*

SEC Property as of June 30, 2011, based upon Strachota's valuation approach and reconciliation, was actually $31,835,000.00, not $31,300,000.00.[588]

Lunz's Appraisal Review of Shenehon's 2011 Restricted Use Appraisal of the WEC Property

300. In a similar fashion, Lunz conducted an appraisal review of the 2011 Restricted Use Appraisal Report prepared by Shenehon of the WEC Property (Exhibit 8).[589] Overall, Lunz concurs with the final market value reached by Strachota in his 2011 appraisal of the WEC Property.[590]

301. Lunz concludes that, although the District does not have a leased fee interest in the WEC Property, the leased fee interest is the correct interest to be valued when determining the District's real estate assets.[591] This is because the leased fee interest best represents the property's value-in-use for the District.[592] According to Lunz, when valuing a specialized property like a school building for the user of the property, the value-in-use must be considered and given substantial weight.[593]

302. Lunz asserts that the value of the leased fee interest is the most accurate reflection of the value-in-use to the District, as well as the overall market value, because it captures the WEC Property's value as it is currently being used as a school building.[594] Lunz, therefore, agrees with Strachota's conclusion in the 2011 Shenehon appraisal, in which Strachota opined that a potential buyer would purchase the WEC Property based upon its leased fee value.[595]

303. In addition, Lunz concurs with Strachota's valuation approaches and methods of valuing the leased fee interest in the property.[596] As a result, Lunz accepts Strachota's reconciled market value of $7,600,000.00 for the WEC Property.[597] According to Lunz, Strachota's market valuation of the property at $7,600,000.00 is an accurate reflection of what the property is actually worth to both to the Intermediate District in a value-in-use basis, as well as to a potential buyer on a market value basis.[598]

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[588] *Id.*
[589] Ex. 2.
[590] *Id.*
[591] *Id.*
[592] *Id.*
[593] *Id.*
[594] *Id.*
[595] *Id.*
[596] *Id.*
[597] *Id.*
[598] *Id.*

Summary of Competing Real Estate Appraisals

304. A summary of the various valuation conclusions reached by the parties' respective appraisers is set forth below:[599]

Property	Shenehon 2010 Appraisal	Shenehon 2011 Appraisal	Shenehon 2014 Appraisal	Lutz Appraisal/Review
SEC Property	$34,000,000.00	$31,300,000.00	$9,000,000.00	$31,835,000.00
WEC Property	$7,700,000.00	$7,600,000.00	$3,650,000.00	$7,600,000.00
EEC Property	N/A	$4,500,000.00	$4,000,000.00	$4,010,000.00
DSC Property	N/A	$2,700,000.00	$3,000,000.00	$4,500,000.00

BLOOMINGTON'S ENROLLMENT IN THE DISTRICT FROM 2000-2011

305. The parties generally agree that Bloomington is only entitled to receive its fair and proportionate share of the District's assets, and that Bloomington remains liable for its fair and proportionate share of the District's liabilities. The parties, however, disagree as to how Bloomington's proportionate share should be calculated.

306. Based upon the value opinions made in the 2014 Shenehon Appraisals, and the inclusion of Van Iwaarden's estimate of the District's unfunded actuarial accrued liability for OPEB and pension benefits, the Intermediate District calculates that as of June 30, 2011, the District's liabilities exceeded its assets in the amount of $28,928,690.00.[600] As a result, the District asserts that Bloomington owes the District payment for its proportionate share of the District's net liabilities.

307. In contrast, Bloomington argues that the District's assets exceeded its liabilities as of June 30, 2011, in the amount of $117,152,119.00, as represented on the District' 2011 Audited Financial Statement.[601] As a result, Bloomington asserts that it is entitled to a lump sum payout from the District for Bloomington's proportionate share of the District's net assets.

308. The parties' respective calculation methods for determining Bloomington's "proportionate share" is described below.

Intermediate District's Calculation of Bloomington's Proportionate Share of Net Liabilities

309. To determine Bloomington's proportionate share of the assets and liabilities, the Intermediate District calculated the total amount of tuition payments invoiced to Member Districts each year from the 2000-2001 school year through the

[599] *See* Exs. 1-10; 104-07.
[600] Ex. 103 at 9.
[601] Ex. 108 at 16.

2010-2011 school year.[602] Next, the District calculated the amount that each Member District was invoiced for tuition each of those same years.[603] Using these two figures, the District determined the percentage of the overall tuition that each Member District was invoiced (and presumably paid) each of the 11 years. The District deems these percentages as the "ratio of tuition paid" by each Member District.

310. According to the Intermediate District's calculations, Bloomington's percentage of Member District tuition paid from 2001 to June 30, 2011 (i.e., the "11-year weighted average ratio of tuition paid") was 9.105 percent (9.105%).[604] The percentages for each fiscal year (FY) are as follows:

2000-2001 (FY 2001)	11.5681%
2001-2002 (FY 2002)	11.6244%
2002-2003 (FY 2003)	10.7503%
2003-2004 (FY 2004)	11.6522%
2004-2005 (FY 2005)	11.6887%
2005-2006 (FY 2006)	10.0864%
2006-2007 (FY 2007)	8.5570%
2007-2008 (FY 2008)	8.1960%
2008-2009 (FY 2009)	7.5642%
2009-2010 (FY 2010)	6.6381%
2010-2011 (FY 2011)	4.8241%
11-Year Average	9.1050%[605]

311. As these numbers indicate, starting in 2005 Bloomington began to steadily decrease the number of students it was sending to the Intermediate District.[606] By the 2010-2011 school year, Bloomington's share of the total Member District tuition received was only 4.8 percent.[607]

312. Because the number of students sent to the Intermediate District steadily declined after 2005, the Intermediate District argues that each real estate asset should be allocated in relation to the year that the property was placed in service; and that Bloomington's proportionate share of that asset should correspond to the percentage that Bloomington contributed to the District's tuition that year.[608] For example, for a building that was "put into service" by the District in fiscal year 2006, Bloomington's proportionate share of that asset should be 10.08 percent.[609] For a building that was "put into service" by the District in fiscal year 2011, Bloomington's proportionate share

[602] Test. of G. Dosdall at T. 698-99; Ex. 103 at Tables 1, 2.
[603] Test. of G. Dosdall at T. 698-99; Ex. 103 at Tables 1, 2.
[604] Ex. 103 at Tables 1, 2.
[605] *Id.*
[606] *Id.*
[607] *Id.*
[608] Test. of G. Dosdall at T. 698-707; Ex. 103 at 9.
[609] Test. of G. Dosdall at T. 698-707; Ex. 103 at 9.

should be 4.82 percent, etc.[610] For all other assets, the District uses the percentage of tuition paid by Bloomington for the last year of its membership in the District (i.e., the 2010-2011 year).[611]

313. The Intermediate District argues for a similar calculation with respect to liabilities.[612] For general liabilities, the District argues that Bloomington's proportionate share should correspond to the percentage of tuition paid by Bloomington for the last year that Bloomington was a Member District (i.e., 2010-2011).[613] For real estate liabilities, however, the District argues that Bloomington's percentage of tuition paid for the year each property was "put into service" should apply.[614] For all other long-term liabilities, the District argues that Bloomington's 11-year weighted average of tuition paid should apply (9.10%).[615]

314. The Intermediate District argues that this calculation results in an overall tuition paid average for Bloomington of 9.08 percent.[616] The District contends that this percentage (9.08%), when applied to the net liabilities that the District asserts it had in 2011 ($28,928,690.00), results in Bloomington owing the Intermediate District $2,625,534.00.[617]

315. Accordingly, the Intermediate District seeks recovery from Bloomington in the amount of $2,625,534.00.

Bloomington's Calculation of its Proportionate Share of Net Assets

316. Bloomington's calculation of its proportionate share of assets and liabilities is much simpler and easier to apply. Bloomington bases its percentage calculations solely on the last year that it was a member of the Intermediate District (i.e., the 2010-2011 school year).[618]

317. In addition, rather than use tuition paid as the basis to determine Bloomington's proportionate share, Bloomington relies on the Average Daily Membership (ADM) (i.e., the average number of students enrolled) in each of the District's programs during the 2010-2011 school year.[619] According to Bloomington, the ADM data for 2010-2011 was as follows:

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[610] Test. of G. Dosdall at T. 698-707; Ex. 103 at 9.
[611] Test. of G. Dosdall at T. 698-707; Ex. 103 at 9.
[612] Test. of G. Dosdall at T. 698-707; Ex. 103 at 9.
[613] Test. of G. Dosdall at T. 698-707; Ex. 103 at 9.
[614] Test. of G. Dosdall at T. 698-707; Ex. 103 at 9.
[615] Test. of G. Dosdall at T. 698-707; Ex. 103 at 9.
[616] Test. of G. Dosdall at T. 698-707; Ex. 103 at 9.
[617] Test. of G. Dosdall at T. 698-707; Ex. 103 at 9.
[618] Exs. 16, 18.
[619] Ex. 16; Ex. 18 at 6; Test. of Rod Zivkovich at T. 109.

Program Category	District Total	Bloomington Total	Bloomington %
ALC /ELL[620]	467.92	43.03	9.20%
Career & Technology	141.00	10.21	7.24%
Special Education	594.29	25.17	4.24%
TOTAL:	**1,203.21**	**78.41**	**6.52%**[621]

318. Based upon this data, Bloomington asserts that its percentage of the Intermediate District's total enrollment for the 2010-2011 school year was 6.52 percent (6.52%).[622] Consequently, Bloomington asserts that it is entitled to 6.52 percent of the Intermediate District's net assets.[623]

319. Bloomington did not provide ADM data for any years prior to fiscal year 2011.[624] Therefore, while Bloomington's calculation method is simpler, it does not include data from previous years or provide a long-term enrollment average, which would take into account Bloomington's varying enrollment figures over the course of the last 40 years.

320. Nonetheless, Bloomington asserts that if its 2010-2011 ADM percentage is applied to the net assets stated on the District's 2011 Audited Financial Statement ($13,768,147.00), less $5,711,435.00 in stipulated adjustments,[625] it is entitled to a payment from the Intermediate District of $585,549.00 [$13,768,147.00 net assets, less $5,711,435.00 in adjustments = $8,056,712.00 multiplied by a "usage factor" of .0652 = $525,297.62].[626]

321. Accordingly, in sum, Bloomington seeks recovery from the Intermediate District in the amount of $525,297.62.

[620] Area Learning Center/ English Language Learner.
[621] Exs. 16, 18.
[622] Exs. 16, 18.
[623] Exs. 16, 18.
[624] Exs. 16, 18.
[625] *See* Bloomington's Post-Hearing Brief at 2-3. Bloomington stipulates to the testimony of Mae Hawkins, in which she explained that the Intermediate District reimbursed a total of $5,711,435 to Member Districts for tuition reimbursements and Medical Assistance for overpayments. *Id.; see* Test. of M. Hawkins at T. 885-89. In fact, the District reimbursed Medical Assistance over $1,700,000, but only deducted $823,329 from the balance sheet. Test. of M. Hawkins at 887-88. Accordingly, the adjustment of $5,711,435 is undisputed.
[626] Ex. 18.

DISPUTED AND UNDISPUTED FIGURES IN THE DISTRICT'S 2011 ADJUSTED BALANCE SHEET

322. To simplify the parties' arguments, and to decipher between disputed and undisputed line items, the following adjusted balance sheet was used by the parties at the hearing to identify the figures in dispute:

ASSETS			
	Stipulated Value	**Stipulated Adjustment**	**Subtotal**
Cash and Investments	$3,764,13500		$3,764,135.00
Accts Receivable	$628,731.00		$628,731.00
Due from other units	$28,256,161.00	($5,711,435.00)	$22,544,726.00
Inventory	$1,850.00		$1,850.00
Prepaid Items	$113,611.00		$113,611.00
Restricted cash/invest.	$28,652,100.00		$28,652,100.00
Real Estate:			
South Educ. Center	Disputed		Disputed
West Educ. Center	Disputed		Disputed
District Service Center	Disputed		Disputed
Edgewood Educ. Center	Disputed		Disputed
Robbinsdale Condo	$50,000.00		$50,000.00
North Educ. Center (Construction in Progress)	$5,458,349.00[627]		$5,458,349.00
Other Capital Leases:			
Equipment	$2,823,913.00		$2,823,913.00
Assets under Cap Lease	$1,820,432.00		$1,820,432.00

[627] Despite its vote in opposition to the acquisition of the NEC Property, Bloomington did not dispute its obligations under the NEC lease agreements. *See* Bloomington's Post-Hearing Brief. Bloomington and the Intermediate District agree that the "asset" value of the NEC Property is the book value of the construction-in-progress as of June 30, 2011.

LIABILITIES			
	Stipulated Value	**Amount Remaining on Future Obligation as of June 30, 2011 (Assuming No Termination of Real Estate Leases)**	**Subtotal**
Aid Anticipation Cert.	$3,590,000.00		$3,590,000.00
Salaries and Comp.	$2,157,696.00		$2,157,696.00
Accts and Contracts Payable	$2,495,498.00		$2,495,498.00
Due to other Govt Units	$2,124,866.00		$2,124,866.00
Unearned Revenue	$7,231,493.00		$7,231,493.00
Accrued Interest	$706,489.00		$706,489.00
Unamortized Premiums	$0		$0
Capital Leases:			
North Vector	$76,600.00		$76,600.00
Technology	$450,064.00		$450,064.00
Real Estate Leases			
SEC Building Lease		$25,753,734.00	
WEC Refunding Lease COP 2009A		$7,590,000.00	
SEC Land Lease COP 2010C		$7,290,000.00	
EEC Lease COP 2010A		$2,925,000.00	
EEC Lease COP 2010B		$2,050,000.00	
NEC Building Lease COP 2010E		$29,790,000.00	
NEC Land Lease COP 2011A		$4,075,000.00	
Premium on Liabilities	$96,177.00		$96,177.00
Deferred Charges	($1,272,335.00)		($1,272,335.00)
Long Term EE Costs			
Severance Payable	$4,731,848.00		$4,731,848.00
Compensated Absences	$375,937.00		$375,937.00
Net OPEB Obligation	Disputed	$9,532,459.00	
Net Pension	Disputed	$409,117.00	

IMPACT OF WITHDRAWAL ON OTHER MEMBER DISTRICTS

323. The Intermediate District presented several witnesses to testify to the financial disruption to the District that resulted from Bloomington's withdrawal, and to explain why Bloomington should not be released from its obligations under the District's long-term real estate leases.

324. Dennis Peterson, Ph.D. (Peterson), the Superintendent of the Minnetonka School District (ISD #276), explained that as a result of Bloomington's withdrawal the 12 remaining Member Districts have had to absorb Bloomington's share of the Intermediate District's long-term obligations.[628] These long-term obligations include the rent payments due under the real estate leases, as well as the ongoing OPEB and pension costs for employees who accrued the benefits during the 40 years Bloomington was a member of the District.[629]

325. Peterson explained that if Bloomington is not held responsible for its share of the on-going costs related to the long-term leases and the employee-accrued OPEB and pension benefits, other Member Districts will be encouraged to withdraw from the District to avoid future obligations.[630] Peterson warned that, potentially, a few remaining school districts could be left "holding the bag" for all of the rental payments due under the various real estate leases, as well as all future liability for benefits accrued by employees in prior years.[631] According to Peterson, these risks present a "potential for rapid succession" and result in a high amount of uncertainty for the remaining Member Districts.[632]

326. Peterson noted that the Member Districts have not approved an agreement to address member withdrawal and the distribution of assets and liabilities because they are waiting for the resolution of this matter.[633] Nonetheless, Peterson expressed Minnetonka's support for the asset and liability calculations and distribution method proposed by the Intermediate District in this action.[634] Overall, Peterson stated that the Member Districts seek a valuation and distribution process that is fair to the remaining Member Districts, as well as repeatable in the future.[635]

327. Jeff Priess (Priess), the Executive Director of Business Services for the Robbinsdale School District (ISD #281), testified to the impact that Bloomington's withdrawal has had on his school district.[636] According to Priess, Robbinsdale experienced a $50,000.00 increase in its lease levy in the first year after Bloomington's

[628] Test. of Dennis Peterson at T. 751-52
[629] *Id.*
[630] *Id.* at T. 753-55.
[631] *Id*. at T. 755.
[632] *Id.*
[633] *Id.* at T. 753.
[634] *Id.* at T. 754.
[635] *Id.* at T. 752-53.
[636] Test. of Jeff Priess at T. 761-81.

withdrawal.[637] Priess expressed concern about the amount of time this process has taken, but did not indicate that the Member Districts were in agreement as to how assets and liabilities should be allocated in the event of future withdrawals by other Member Districts.[638]

328. Kelly Benusa (Benusa) is the Director of Business Services for the Osseo School District (IDS #279). Benusa stated that Osseo experienced an $85,000.00 annual increase in its lease levy as a result of Bloomington's withdrawal because its proportionate share of the lease levy went from 24.4 percent to 25.9 percent.[639] According to Benusa, all remaining Member Districts have been forced to assume a greater percentage of the Intermediate District's costs and obligations after Bloomington's departure.[640] Benusa acknowledged that enrollment in the Intermediate District did not decrease after Bloomington's withdrawal, meaning that Member Districts (or non-member districts) are sending more students to the Intermediate District to take the place of Bloomington's student population.[641]

329. Benusa expressed support for the calculation of assets and liabilities, as well as the allocation methods proposed by the Intermediate District in this case.[642] Benusa noted that, to date, the Member Districts have not been able to agree on a method for valuation and disbursement of assets and liabilities upon Member District withdrawal.[643]

330. Mae Hawkins (Hawkins), the Intermediate District's Director of Finance, testified that the lease levies for the remaining 12 Member Districts increased after Bloomington's departure.[644] According to Hawkins, Bloomington paid approximately $280,000.00 per year towards the lease payments.[645] After Bloomington withdrew, the remaining Member Districts had to absorb that amount unless the District terminated the leases.[646] The range of increase for the remaining Member Districts each year was between $1,150.00, for districts with fewer students, to $85,100.00 each year, for districts with the most students attending the Intermediate District.[647]

331. Because only Member Districts are responsible for lease levies, non-member districts that send students to the Intermediate District do not directly share in the cost of facilities.[648] Thus, even if non-member school district students take the

[637] *Id*. at T. 765.
[638] *Id.* at T. 765-67, 769-70
[639] Test. of Kelly Benusa at T. 789.
[640] *Id.* at T. 789-90
[641] *Id.* at T. 798.
[642] *Id.* at T. 791-92, 801.
[643] *Id*. at T. 800.
[644] Test. of M. Hawkins at T. 891-92.
[645] *Id.*
[646] *Id.*
[647] *Id.*
[648] Test. of K. Benusa at T. 798-99.

place of Bloomington students, it does not reduce the impact on the remaining Member Districts' lease levy payments resulting from Bloomington's withdrawal.[649]

332. In contrast, tuition is paid by both Member Districts and non-member districts.[650] The amount received in tuition is used by the Intermediate District to pay employee costs, including OPEB and pension benefits.[651] Thus, both non-member and new member districts will absorb the on-going cost of OPEB and pension benefits because these costs are paid each year on a "pay-as-you-go" basis.[652] Hence, if Bloomington continues to send its students to the Intermediate District as a non-member district as it is currently doing for some students, then Bloomington will continue to pay for OPEB and pensions even if it is required to contribute to these costs in this proceeding.[653]

333. Hawkins explained that Member Districts seek a withdrawal valuation and distribution process that is repeatable and does not leave the remaining school districts liable for all of the District's future expenses, including future lease payments.[654] Therefore, the Intermediate District and its Member Districts support, for purposes of this hearing, the valuation and distribution method proposed by Gary Dosdall, the District's accounting expert from Froehling Anderson.[655]

334. To the extent any Finding of Fact are more properly deemed Conclusions of Law, or to the extent any Conclusion of Law is more properly deemed a Finding of Fact, such findings or conclusions are hereby adopted as such.

Based upon the foregoing Findings of Fact, the Administrative Law Judge makes the following:

CONCLUSIONS OF LAW

1. The Commissioner of Education (Commissioner) has jurisdiction to decide this matter pursuant to Minn. Stat. §§ 123A.24, subd. 1 and 14.57(a).

2. The Office of Administrative Hearings has the authority to decide this matter pursuant to the authority delegated by the Commission and acknowledged by the parties, pursuant to Minn. Stat. § 14.57(a).

3. To cease participating in, or providing financial support for, any of the services or activities related to an agreement with an intermediate district, or to

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[649] *Id.*
[650] Test. of M. Hawkins at T. 927-28.
[651] *Id.* at T. 929.
[652] *Id.* at T. 928.
[653] *Id.* at T. 919. Hawkins acknowledged that if Bloomington is required to contribute its proportionate share toward the UAAL for the OPEB and pension benefits as of June 30, 2011, then Bloomington should receive a reduction in tuition for any students that it enrolls as a non-member district. *Id.*
[654] *Id.* at T. 893.
[655] *Id*. at T. 898.

terminate participation in the cooperative unit itself, a school district's board must adopt a resolution and notify the other parties to the agreement of its decision on or before February 1 of any year.[656] The cessation or withdrawal shall be effective June 30 of the following fiscal year.[657]

4. Bloomington properly served its Notice of Withdrawal from the Intermediate District on January 29, 2010. Accordingly, Bloomington's withdrawal from the Intermediate District was proper and effective on June 30, 2011.

5. Minnesota law provides that if an independent school district withdraws from an intermediate school district, the distribution of assets and assignment of liabilities to the withdrawing district shall be determined by Minn. Stat. § 123A.24.

6. According to Minn. Stat. § 123A.24, the withdrawing school district and the intermediate district may mutually agree to terms and conditions of the distribution of assets and the assignment of liabilities.[658] If, however, the intermediate district and the withdrawing district cannot agree on the terms and conditions, the Commissioner shall resolve the dispute.[659]

7. The Commissioner shall resolve the dispute by determining the withdrawing district's "proportionate share" of assets and liabilities based on the withdrawing district's enrollment, financial contribution, usage, or other factor or combination of factors determined appropriate by the Commissioner.[660] In addition, the assets must be disbursed to the withdrawing district in a manner that minimizes financial disruption to the cooperative unit.[661]

VALUATION OF ASSETS AS OF JUNE 30, 2011

8. According to BLACK'S LAW DICTIONARY, an "asset" is:

> Property of all kinds, real and personal, tangible and intangible, including *inter alia*, for certain purposes, patents and causes of action which belong to any person including a corporation and the estate of a decedent. The entire property of a person, association, corporation, or estate that is applicable or subject to the payment of his or her or its debts.[662]

9. More specifically for purposes of this case, an "asset" is defined by the DICTIONARY OF REAL ESTATE APPRAISAL as:

[656] Minn. Stat. § 123B.02, subd. 3(c).
[657] *Id.*
[658] Minn. Stat. § 123A.24, subd. 1(b).
[659] *Id.* (c).
[660] *Id.*
[661] *Id.*
[662] BLACK'S LAW DICTIONARY 78 (Abridged 6th ed. 1991).

(1) Generally, something that can be converted to cash and other economic equivalent.

(2) Any owned property that has economic value, including financial assets (cash or bonds), business interests, intangible assets (copyrights and trademarks), and physical assets (real and personal property).

(3) In general business usage, something owned by a business and reflected in the owner's balance sheet.[663]

Robbinsdale Condominium

10. The Intermediate District holds title to the Robbinsdale condominium in fee simple, free and clear of any financial encumbrances. Therefore, it is an asset that must be distributed as part of Bloomington's withdrawal from the District.

11. The parties stipulate that the value of this asset is $50,000.00.[664]

District Service Center

12. The Intermediate District owns the DSC Property in fee simple and free and clear of any encumbrances. Therefore, it is an asset that must be distributed as part of Bloomington's withdrawal from the District.

13. The Administrative Law Judge adopts the appraisal of the DSC Property conducted by Robert Strachota on March 5, 2014. According to that appraisal, the fair market value of the DSC Property as of June 30, 2011, was $3,000,000.00.

Edgewood Education Center

14. Under the express terms of the EEC Lease, the Intermediate District has no title or equity in the EEC Property unless and until the District makes all rent payments due under the lease through 2025, or exercises its option to purchase the property prior to the end of the lease term.[665]

15. As of the date of Bloomington's withdrawal from the District on June 30, 2011, the District had not paid all rent due under the contract, nor had it exercised its option to purchase the property. Therefore, title to the EEC Property had not transferred to the District, and was held by Wells Fargo Bank. The Intermediate District's interest in the property was that of a tenant or lessee holding a leasehold estate, with an unexercised option to purchase the property.

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[663] APPRAISAL INSTITUTE, DICTIONARY OF REAL ESTATE APPRAISAL 13 (5th ed. 2010).
[664] *See* Bloomington's Post-Hearing Brief at 7.
[665] Ex. A at 19.

16. A “leasehold” is defined as “a tenant/lessee’s possessory estate in land, granted by a landlord/lessor who holds an estate of larger duration in the same land.”[666] A “leasehold interest” is “a tenant’s possessory interest created by a lease.”[667]

17. As of June 30, 2011, the Intermediate District had no ownership interest in, and held no title to, the EEC Property. As a result, the District did not have a fee simple interest in the property, and any valuation of a fee simple interest in the property is irrelevant for determining the value of the District’s legal interest in the property.[668]

18. In addition, as of June 30, 2011, the Intermediate District did not hold a leased fee interest in the EEC Property. A “leased fee interest” is defined as “[a] freehold (ownership interest) where the possessory interest has been granted to another party by creation of a contractual landlord-tenant relationship (i.e., a lease).”[669] As a result, the District did not have a leased fee interest in the EEC Property, and any valuation of a leased fee interest in the property is irrelevant for determining the value of the District’s interest in the property.[670]

19. As of June 30, 2011, only Wells Fargo Bank held the fee simple and leased fee interests in the EEC Property.

20. The “asset” that the Intermediate District held as of June 30, 2011, was the District’s interest in the EEC Property, not the bank’s interest. The District’s legal interest was limited to a leasehold interest and nothing more. Consequently, the District’s leasehold interest is the asset to be valued as of June 30, 2011.

21. The value of a leasehold interest is “the difference between the total remaining rent under the lease, and the rent [a] lessee would currently pay for similar space for the same time period.”[671] Thus, if the total rent remaining under a lease is $100,000.00, and the rent the lessee would currently pay for similar space for a similar term is $200,000.00, the value of the lessee’s leasehold interest would be $100,000.00 – a positive leasehold.[672] Conversely, if the total rent remaining under a lease is $100,000.00, and the rent the lessee would currently pay for similar space for the same term is $50,000.00, the value of the lessee’s leasehold interest would be a *negative* $50,000.00 – resulting in a “negative leasehold.”[673] In the latter example, there would be no value in the lessee’s leasehold interest.[674]

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[666] BLACK’S LAW DICTIONARY 616 (Abridged 6th ed. 1991).
[667] APPRAISAL INSTITUTE, DICTIONARY OF REAL ESTATE APPRAISAL 111 (5th ed. 2010).
[668] According to property records, Wells Fargo Bank maintained a fee simple interest in the EEC Property as of June 30, 2011, subject to the District’s possessory interest arising out of the EEC Lease. *See* Ex. Z.
[669] APPRAISAL INSTITUTE, DICTIONARY OF REAL ESTATE APPRAISAL 111 (5th ed. 2010).
[670] Under the EEC Lease, Wells Fargo Bank held the leased fee interest in the EEC Property as of June 30, 2011. *See* Ex. A.
[671] BLACK’S LAW DICTIONARY 616-17 (Abridged 6th ed. 1991).
[672] A “positive leasehold” is “[a] lease situation in which the market rent is greater than the contract rent.” APPRAISAL INSTITUTE, THE DICTIONARY OF REAL ESTATE APPRAISAL 147 (5th ed. 2010).
[673] A “negative leasehold” is “a lease situation in which the market rent is less than the contract rent.” *Id.* at 132.
[674] *Id.*

22. No expert testified as to the value of the Intermediate District's leasehold interest in the EEC Property. However, because the rent paid under the EEC Lease was approximately market rent or greater, there was no positive value in the District's leasehold interest.[675] Thus, the Intermediate District held a negative leasehold interest.

23. By withdrawing from the collective, Bloomington forfeited its rights and interest in the EEC Property after June 30, 2011. Thus, Bloomington can claim no interest in the EEC Property should the District someday exercise its option to purchase the property.

24. If the District eventually tenders its final rent payment or earlier exercises its option to purchase the EEC Property, all rent previously paid will be applied toward the final purchase price, similar to a contract for deed. Until that occurs, however, all amounts paid under the EEC Lease are simply rent payments for which no equity in the property is earned. The same is true if the District terminates the EEC Lease prior to the end of the lease term -- all monies paid are forfeited and title to the EEC Property is never conveyed to the District.

25. Because the Intermediate District had not exercised its option to purchase the EEC Property or paid all rent due under the EEC Lease prior to June 30, 2011, the value of the District's interest in the EEC Property as of June 30, 2011, is limited to the value of the District's leasehold interest at the time of withdrawal and no more. As of June 30, 2011, the District held a negative leasehold interest in the EEC Property, causing the District's interest in the property to be of no current value. Therefore, Bloomington's proportionate share of this asset is zero.

South Education Center

26. Under the express terms of the SEC Building Lease and SEC Refunding Lease, the Intermediate District has no title or equity in the SEC Property unless and until the District makes all rent payments due under the respective leases, or exercises its option to purchase the property prior to the end of the lease terms.[676]

27. As of the date of Bloomington's withdrawal from the District on June 30, 2011, the District had not paid all rent due under the SEC Building Lease or SEC Refunding Lease, nor had the District exercised its option to purchase the property. Therefore, title to the SEC Property had not transferred to the District, and was held by Wells Fargo Bank. The Intermediate District's interest in the property was that of a tenant or lessee holding a leasehold estate, with an unexercised option to purchase the property.

28. As of June 30, 2011, the Intermediate District had no ownership interest in, and held no title to, the SEC Property. As a result, the District did not have a fee

[675] Ex. 3 at 82; Ex. 105 at 39-40.
[676] Exs. J, M, N.

simple interest in the property, and any valuation of a fee simple interest in the property is irrelevant for determining the value of the District's legal interest in the property.[677]

29. In addition, as of June 30, 2011, the Intermediate District did not hold a leased fee interest in the SEC Property."[678] Wells Fargo Bank held the leased fee interest in the SEC Property.[679] Consequently, any valuation of a leased fee interest in the SEC Property is irrelevant for determining the value of the District's interest in the property.[680]

30. The asset that the Intermediate District held as of June 30, 2011, was the District's interest in the SEC Property, not the bank's interest. The District's legal interest was limited to a leasehold interest and nothing more. Consequently, the District's leasehold interest is the asset to be valued as of June 30, 2011.

31. No expert testified as to the value of the Intermediate District's leasehold interest in the SEC Property. However, because the rent paid under the SEC Lease was approximately market rent or greater, there was no real positive value in the District's leasehold interest.[681] Thus, the Intermediate District held a negative leasehold interest.

32. By withdrawing from the collective, Bloomington forfeited its rights and interest in the SEC Property after June 30, 2011. Bloomington can claim no interest in the SEC Property should the District someday exercise its option to purchase the property.

33. If the District eventually tenders its final rent payment or exercises its option to purchase the SEC Property, all rent previously paid will be applied toward the final purchase price, similar to a contract for deed. Until that occurs, however, all amounts paid under the SEC Building Lease and SEC Refunding Lease are simply rent payments for which no equity in the property is earned. The same is true if the District terminates the SEC Building Lease and SEC Refunding Lease prior to the end of the leases' terms -- all monies paid are forfeited and title to the property is never conveyed to the District.

34. Because the Intermediate District had not exercised its option to purchase the SEC Property, and had not paid all rent due under the SEC Building Lease and SEC Refunding Lease, the value of the District's interest in the SEC Property as of June 30, 2011, is limited to the value of the District's leasehold interest at the time of withdrawal and no more. As of June 30, 2011, the District held a negative leasehold interest in the

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[677] According to property records, Wells Fargo Bank maintained a fee simple interest in the SEC Property as of June 30, 2011, subject to the District's possessory interest arising out of the SEC Building Lease and SEC Refunding Lease. *See* Ex. Y.
[678] *Id.*
[679] *Id.*
[680] Under the SEC Building Lease and SEC Refunding Lease, Wells Fargo Bank held a leased fee interest in the SEC Property as of June 30, 2011. *See* Exs. J, M, N.
[681] Ex. 7 at 31; Ex. 107 at 61-62.

SEC Property, causing the District's interest in the property to be of no current value. Therefore, Bloomington's proportionate share of this asset is zero.

West Education Center

35. Unlike the EEC Property and SEC Property, the Intermediate District technically holds title to the WEC Property.[682] Such title was conveyed to the District upon the refinance of the WEC Lease. The District's ownership interest in the WEC Property, however, is fully encumbered by the WEC Ground Lease under which Wells Fargo Bank has a possessory interest in the property.[683]

36. The WEC Ground Lease gives Wells Fargo Bank a possessory interest in the SEC Property until February 1, 2035, or until the District: (1) pays all rent due under the WEC Refunding Lease; (2) exercises its "option to purchase" the property and prepay the rent; or (3) defaults under the WEC Refunding Lease, in which case the trustee, Wells Fargo Bank, takes possession of the property.[684]

37. By the express terms of the WEC Refunding Lease, the Intermediate District cannot mortgage, sell, assign, transfer, or convey the SEC Property or any portion thereof during the lease term.[685] Thus, the District's title to the WEC Property is fully encumbered by the WEC Refunding Lease and WEC Ground Lease until the District fulfills all of its payment obligations under the WEC Refunding Lease.

38. As of June 30, 2011, the Intermediate District had not paid all rent due under the WEC Refunding Lease, nor had it exercised its "option to purchase" the property by prepaying rent in accordance with the WEC Refunding Lease. Therefore, the WEC Property was fully encumbered by the WEC Refunding Lease and Ground Lease, and was not saleable to a third party.

39. Because title to the WEC Property is held by the District, subject to the terms of the WEC Ground Lease and WEC Trust Agreement, the Intermediate District's actual interest in the property is that of a fee simple defeasible interest[686] or

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[682] Ex. X.
[683] Ex. H.
[684] Ex. F at 24-25.
[685] *Id.* at 23.
[686] According to BLACK'S LAW DICTIONARY 427 (Abridged 6th ed. 1991), a "fee simple defeasible" is:

> Title created in trustees where legal title in fee simple to active trust estate is by will placed in trustees who are required to distribute property in fee simple upon happening of an event. Also called a 'determinable fee,' 'base fee,' or 'qualified fee.'
>
> ***
>
> Type of grant which may be defeated on the happening of an event. An estate which may last forever, but which may end upon the occurrence or nonoccurrence of a specified event, is a 'fee simple defeasible."

determinable fee.[687]

40. Nonetheless, because the Intermediate District holds paper title to the WEC Property, its asset value should be measured by the value of a fee simple interest in the property.

41. The Administrative Law Judge concludes that the most reasonable appraised value of the WEC Property is $7,600,000.00, as determined by real estate experts Robert Lunz and Robert Strachota (in his more reliable 2011 Appraisal).

42. The total amount outstanding on the WEC Refunding Lease as of June 30, 2011, was $7,590,000.00.[688] Consequently, the WEC Property, even if considered an asset, has a net value to the District of only $10,000.00.

North Education Center

43. On December 17, 2009, the Intermediate District Members passed a resolution to acquire an interest in the NEC Property and construct a new facility.[689] Bloomington was the only Member District that opposed the measure.[690]

44. On January 28, 2010, the Bloomington School Board passed a resolution withdrawing from the Intermediate District.[691] The Intermediate District was notified of Bloomington's withdrawal on January 29, 2010.[692]

45. Minnesota law provides that before incurring "debt," the governing body of an intermediate district must adopt a resolution proposing to incur debt and articulating the proposed financial effect of the debt upon each participating district.[693] Within 120

[687] BLACK'S LAW DICTIONARY 427 (Abridged 6th ed. 1991), defines "determinable fee" as:

> One which has a qualification subjoined to it, and which must be determined whenever the qualification annexed to it is at an end. An estate in fee which is liable to be determined by some act or event expressed on its limitation to circumscribe its continuance, or inferred by law as bounding its extent. An estate which may last forever is a 'fee,' but if it may end on the happening of a merely possible event, it is a 'determinable' or 'qualified fee.'
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> A 'fee simple determinable' is created by conveyance which contains words effective to create a fee simple and, in addition, a provision for automatic expiration of estate on occurrence of stated event.

[688] Ex. 103 at 9; Exs. 2, 6, 8, 106.
[689] Ex. 22.
[690] *Id.*
[691] Ex. 21.
[692] *Id.*
[693] Minn. Stat. § 123B.02, subd. 3(d) (2014). This provision also addresses the issuance of bonds, but because intermediate districts do not have the legal authority to issue bonds, this clause of the statute is not applicable. *See also* Minn. Stat. § 123A.24, subd. 1(b).

days of receiving the resolution of the governing body, the school board of the participating district shall adopt a resolution stating:

(1) Its concurrence with incurring other debt;

(2) Its intention to cease participating in or providing financial support for the service or activity related to the debt; or

(3) Its intention to terminate participation in the cooperative agreement.[694]

46. If a school district concurs with the debt while it is a member of the intermediate district, it remains liable for the debt even after its withdrawal from the intermediate district.[695]

47. However, if, within 120 days of the intermediate district's resolution to incur the debt, a member district notices: (1) its intention to cease participating in or providing financial support for the debt; or (2) withdraws from the district, the member district shall not be liable for the debt.[696]

48. While the Intermediate District concedes that the NEC Lease, as supplemented, does not create a "debt" for which Bloomington is liable, the clear intent of Minn. Stat. § 123B.02, subd. 3 (2014), is to enable a member school district to withdraw from a cooperative unit if it disagrees with a debt or liability that the cooperative unit incurs over its objection.

49. By opposing the resolution to acquire the NEC Property, and timely noticing its withdrawal from the Intermediate District, Bloomington is not subject to the NEC Lease, as supplemented, or any of the other agreements related to the NEC Property.

50. The Intermediate District knew of Bloomington's opposition to the NEC acquisition, and it knew of Bloomington's withdrawal from the District before it executed the NEC Lease, NEC Supplemental Lease, and related agreements. Notwithstanding Bloomington's opposition and withdrawal, the Intermediate District Members decided to continue with the acquisition and construction of the NEC Property without Bloomington's continued contribution to the project.

51. Because Bloomington opposed the acquisition of the NEC Property, and immediately withdrew from the District after the District voted to acquire an interest in the NEC Property, it would be inequitable for Bloomington to share in the value of the NEC Property as an asset, or be subject to the liabilities associated with the NEC Lease, as supplemented.

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[694] Minn. Stat. § 123B.02, subd. 3(d).
[695] Minn. Stat. § 123B.02, subd. 3(d), (e) (2014).
[696] *Id.*

52. Therefore, the NEC Property and the obligations under the NEC Lease, as supplemented, shall be removed from the calculation of the District's assets and liabilities subject to disbursement and allocation in this case.

Other Assets

53. Aside from the EEC Property, SEC Property, WEC Property, and NEC Property, the Intermediate District and Bloomington stipulate to the value of all other assets listed on the 2011 Audited Financial Statement.[697] Those assets include:

- cash and temporary investments totaling $3,764,135.00;
- accounts receivable and interest totaling $628,731.00;
- amounts due from other governmental units totaling $28,256,161.00;
- inventory totaling $1,850.00;
- prepaid items totaling $113,611.00;
- restricted cash and investments totaling $28,652,100.00;
- equipment valued at $2,823,913.00; and
- assets held under capital leases valued at $1,820,432.00.[698]

CALCULATION OF LIABILITIES AS OF JUNE 30, 2011

54. Upon withdrawal, the withdrawing school district remains responsible for its share of "debt" incurred by the cooperative unit "according to Minn. Stat. § 123B.02, subd. 3."[699]

Real Estate Leases and Agreements

55. The Intermediate District stipulates that the rent obligations set forth in the EEC Lease, WEC Refunding Lease, SEC Building Lease, SEC Refunding Lease, and NEC Lease, as supplemented, do not constitute "debt" and do not contribute to the District's debt limit set forth in Minn. Stat. § 475.53 (2014).[700]

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[697] *See* Exs. 23, 108; Ex. 109 at 9.
[698] Exs. 23, 108; Ex. 109 at 9.
[699] Minn. Stat. § 123A.24, subd. 1(b).
[700] *See* e-mail correspondence from Anne Becker, legal counsel for the Intermediate District, dated December 8, 2014, on file and of record in this case. Note also that the 2009 Memorandum of Agreement provides that "Neither members nor member representatives shall have individual liability for the debts and obligations of the District." *See* Ex. 102.

56. Minnesota Statutes, section 475.53, subdivision 4, provides that no school district shall be subject to net debt in excess of 15 percent of the estimated market value of all taxable property situated within its corporate limits.

57. To that end, each lease agreement at issue in this case expressly exempts the rent due under the leases from the Intermediate District's "debt" limit. To wit:

- The EEC Lease expressly provides that the obligations under the lease, including the obligation to pay rent, "shall constitute a current expense of the District for such Fiscal Year and shall not constitute an indebtedness of the District….[701]"

- The WEC Refunding Lease expressly provides that the obligations under the lease, including the obligation to pay rent, "shall constitute a current expense of the District for the Fiscal Year then in effect" and "shall not constitute an indebtedness, liability or mandatory payment obligation" of the District.[702]

- The SEC Refunding Lease expressly provides that the obligations under the lease, including the obligation to pay rent, "shall constitute a current expense of the District for such Fiscal Year and shall not constitute an indebtedness of the District….[703]

- The SEC Building Lease expressly provides that the obligations under the lease, including the obligation to pay rent, "shall constitute a current expense" of the District for the fiscal year then in effect and "shall not constitute an indebtedness" of the District.[704]

- The NEC Land Lease expressly provides that the obligations under the lease, including the obligation to pay rent, "shall constitute a current expense" of the District for the fiscal year then in effect and "shall not constitute an indebtedness" of the District.[705]

58. As a result, the obligations to pay rent under the EEC Lease, WEC Refunding Lease, SEC Building Lease, SEC Refunding Lease, and NEC Lease, as supplemented, are not "debts" for which Bloomington has a continued obligation under Minn. Stat. § 123A.24, subd. 1(b), after its withdrawal on June 30, 2011.

[701] Ex. A. at 10.
[702] Ex. F. at 7-8.
[703] Ex. N. at 10.
[704] Ex. J at 10-11.
[705] Ex. R at 10.

59. A "liability" is broader in scope than a "debt." BLACK'S LAW DICTIONARY defines "liability" to include "all character of debts and obligations."[706]

60. Minnesota Statutes section 123B.02, subdivision 3(f), expressly provides that an independent school district that is part of an intermediate district may not obligate itself to participate in and provide financial support for an agreement with a cooperative unit to provide building space for a term of more than two years.[707] Therefore, Bloomington cannot be liable for any rent or lease payments due under real estate leases, agreements, or contracts that exceed two years.

61. In compliance with Minn. Stat. § 123B.02, subd. 3(f), the EEC Lease, WEC Refunding Lease, SEC Building Lease, SEC Refunding Lease, and NEC Lease, as supplemented, are all year-to-year leases terminable at will by the Intermediate District upon its non-appropriation of funds.[708] The leases all permit the Intermediate District to terminate the leases at the end of any fiscal year if the Intermediate District's Board decides not to appropriate moneys sufficient to pay the rent in its budget for the next fiscal year.[709]

62. The leases further provide that upon non-appropriation and termination, the Intermediate District's liability is limited to the rent due for the current fiscal year, and no other damages or liabilities are owed.[710]

63. The Intermediate District is in full control of whether to continue the leases or terminate them by non-appropriation. If the District decides to terminate the leases prior to the end of the lease term, the District has no on-going liability to pay rent or other damages. The District simply loses its interest in the properties. And all amounts paid in rent prior to termination are forfeited.

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706 BLACK'S LAW DICTIONARY 631 (Abridged 6th ed. 1991).

707 The statute provides that an agreement may allow the district an option to renew for an additional two years. Minn. Stat. § 123B.02, subd. 3(f).

708 *See* Ex. A at 8-9 (EEC Lease); Ex. F at 6, 8, and 13 (WEC Refunding Lease); Ex. J at 10 (SEC Building Lease); Ex. N at 8-9 (SEC Refunding Lease); Ex. R at 5, 8-9 (NEC Lease).

709 Ex. A at 8-9 (EEC Lease); Ex. F at 6, 8, and 13 (WEC Refunding Lease); Ex. J at 10 (SEC Building Lease); Ex. N at 8-9 (SEC Refunding Lease); Ex. R at 5, 8-9 (NEC Lease).

710 Ex. A at 5-6, 8-9; Ex. F at 6, 13; Ex. J at 10, 22-23; Ex. N at 8-9, 10, 22-24; Ex. R at 5.

64. The Intermediate District's obligations under the leases are similar to those arising under a contract for deed.[711] If a contract for deed is terminated prior to the end of the contract term or payment of the full purchase price, the property reverts back to the vendor and all amounts paid by the vendee are forfeited.[712]

65. The obligations created under the EEC Lease, WEC Refunding Lease, SEC Building Lease, SEC Refunding Lease, and NEC Lease, as supplemented, are incurred on a year-to-year basis when the District votes to appropriate funds to pay the rents due for the next year. By tying the rent obligation to appropriations, and limiting the damages that the bank may seek upon the District's early termination and default, the Intermediate District affirmatively limited its liabilities under the leases to the current fiscal year. Consequently, the EEC Lease, WEC Refunding Lease, SEC Building Lease, SEC Refunding Lease, and NEC Lease, as supplemented, do not represent long-term liabilities of the District, but rather annual expenses which are appropriated in the budgeting process.

66. Bloomington gave its notice of withdrawal from the District on January 29, 2010. Its withdrawal was not effective until June 30, 2011. The Intermediate District had the opportunity to terminate the EEC Lease, WEC Refunding Lease, SEC Building Lease, SEC Refunding Lease, and NEC Lease, as supplemented, by not appropriating moneys for the leases for fiscal year 2011 (and beyond), and by not proceeding with the acquisition of the NEC Property.

67. Instead, the remaining Member Districts continued with the acquisition and construction of the NEC Property; and voted each year after Bloomington's withdrawal to appropriate the moneys to pay rent under the EEC Lease, SEC Building Lease, SEC Refunding Lease, WEC Refunding Lease, and NEC Lease, as supplemented. The remaining Member Districts did this to preserve the District's interest in the properties, with the intent of someday acquiring clear and unencumbered title to the properties. However, by appropriating the funds each year after Bloomington's withdrawal, the remaining Member Districts accepted new liabilities each year for which Bloomington is not responsible.

68. The clear intent of Minn. Stat. § 123B.02, subd. 3(f) is to limit an independent school district's liabilities for facility leases to no more than two years. The additional intent of the statute is to allow school districts to withdraw from a cooperative

[711] A "contract for deed" is defined as "[a]n agreement by a seller to deliver the deed to the property when certain conditions have been met, such as completion of payments by purchaser." BLACK'S LAW DICTIONARY 227 (Abridged 6th ed. 1991).

[712] As succinctly explained in *In re Butler*, 552 N.W.2d 226, 230 (Minn. 1996):

> In Minnesota, one remedy available to a vendor upon the vendee's defaulting under the terms of the contract for deed is the vendor's ability to cancel the contract pursuant to Minnesota Statutes section 559.21. A statutory cancellation of a contract for deed results in the vendee's forfeiture of all payments made and restoration of full legal and equitable title in the property to the vendor. This result is different from that in a mortgage foreclosure sale, where the defaulting party may receive proceeds of a mortgage foreclosure sale above the amount owed on the property.

unit, and "cease participating in and providing financial support for the activities of" the cooperative.[713]

69. Minnesota Statutes, section 123A.24, subdivision 1(b), provides that a withdrawing district remains liable for its share of "debt" incurred by the cooperative, subject to Minn. Stat. § 123B.02, subd. 3. The Intermediate District specifically structured its real estate acquisitions to avoid the debt limitations imposed by law. As a result, each of the leases expressly provides that the obligation to pay rent is not a debt for the District – or a continuing liability for which damages may be sought – but rather a yearly appropriation or expense. Consequently, the rental obligations arising under the leases must be treated as yearly expenses, not long-term liabilities, upon the withdrawal of a Member District.

70. Bloomington paid its share of rent for the real estate leases through June 30, 2011, and owes no further obligation under the EEC Lease, WEC Refunding Lease, SEC Building Lease, SEC Refunding Lease, and NEC Lease, as supplemented. All obligations of the Intermediate District arising out of appropriations for rent payments made after June 30, 2011, are the obligations of the Intermediate District, not Bloomington.

71. The District specifically structured its real estate acquisitions as year-to-year leases to avoid debt limitations imposed by the legislature. As a result, the leases permit the District to terminate the contracts at any time and avoid continued liability in the event that the District decides not to appropriate funds for rent in any fiscal year. The District cannot now claim that the leases impose a greater obligation on its withdrawing member than the leases impose on the District itself.

72. The Administrative Law Judge, therefore, concludes that Bloomington has no liability for, and owes no debt on, obligations arising under the EEC Lease, WEC Refunding Lease, SEC Building Lease, SEC Refunding Lease, and NEC Lease, as supplemented, after June 30, 2011. Each time that the District appropriated moneys to pay the EEC Lease, WEC Refunding Lease, SEC Building Lease, SEC Refunding Lease, and NEC Lease, as supplemented, after June 30, 2011, it resulted in a new annual expense/liability for which Bloomington is not responsible. Accordingly, the "liabilities" of the District as of June 30, 2011, shall not include amounts attributable to these leases.

Other Post-Employment Benefits (OPEB) and Pension Benefits

73. The Other Post-Employment Benefits and Pension Benefits owed to the Intermediate District's employees are contractual obligations which arise under the collective bargaining agreements the District has entered into with its unions.

74. Once earned, these benefits are part of the employees' total compensation for past service and cannot be lawfully reduced once an employee

[713] Minn. Stat. § 123B.02, subd. 3.

retires.[714] As a result, the OPEB and Pension Benefits are debts, obligations, and/or liabilities[715] of the District from the dates that the benefits are earned, regardless of when or how they are paid or accounted for in the District's financial reports.

75. By accepting the services and labor of the District's employees and being a member of the District when these collective bargaining agreements were executed, Bloomington is responsible for its proportionate share of the total liability related to the OPEB and Pension Benefits earned but not received by the District's employees as of June 30, 2011.

76. Bloomington has been a member of the Intermediate District since its inception in 1968. Therefore, it has an obligation to pay its proportionate share of all OPEB and Pension Benefits earned by employees from 1968 to June 30, 2011.

77. The fact that the Intermediate District pays its OPEB and Pension Benefit obligations on an annual "pay-as-you-go" basis does not negate the District's on-going debt and liability for the amounts earned but unpaid as of June 30, 2011.

78. Bloomington did not present any evidence to contradict the District's calculation of its unfunded actuarial accrued liability or the OPEB and Pension Benefits. The UAAL is the amount required to pay all OPEB and Pension Benefits accrued by, but yet unpaid to, District employees as of the date of valuation (June 30, 2011). While the UAAL is an actuarial estimate and may differ from the amount the District will actually pay in the future, the UAAL is the best calculation of the future obligation available to the Administrative Law Judge at this time.

79. Bloomington did not present any testimony or evidence of how the OPEB and Pension Benefits can be "trued up" or reconciled in the future to ensure that the amount attributed to Bloomington in this hearing is consistent with the total amount actually paid by the District in the future.

80. At this time, a final determination is necessary to allocate the District's liabilities. Minnesota Statutes, section 123A.24, requires that the assets and liabilities of an intermediate district be determined upon a district's withdrawal. Therefore, the determination cannot be deferred until the District's exact liability is known, which could take decades.

81. By withdrawing from the Intermediate District, Bloomington subjected itself to payment of the future liability in a lump sum, rather than over time as they become

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[714] *See Norman*, 696 N.W.2d at 337-38.

[715] A "debt" is "[a] fixed and certain obligation to pay money or some other valuable thing or things, either in the present or in the future." BLACK'S LAW DICTIONARY 279 (Abridged 6th ed. 1991). A "liability" is "all character of debts and obligations…any kind of debt or liability, either absolute or contingent, express or implied…." *Id*. at 631. An "obligation" is "any duty imposed by law, promise, contract, relations of society, courtesy, kindness, etc." *Id.* at 740.

due. Therefore, an actuarial calculation is necessary to determine the District's accrued liability for these obligations as of June 30, 2011.

82. The unrefuted evidence presented at hearing establishes that the value of the Intermediate District's UAAL for OPEB earned but not yet paid to District employees as of June 30, 2011, is $9,532,459.00. Bloomington is liable for its proportionate share of this amount, as set forth below.

83. The unrefuted evidence presented further establishes that the current value of the Intermediate District's UAAL for Pension Benefits earned but not yet paid to District employees as of June 30, 2011, is $409,117.00. Bloomington is liable for its proportionate share of this amount, as set forth below.

Undisputed Liabilities

84. The parties do not dispute the calculation of the Intermediate District's liabilities as of June 30, 2011, for the following items:

- aid anticipation certificates totaling $3,590,000.00;
- salaries and compensated absences payable in the amount of $2,157,696.00;
- accounts and contracts payable totaling $2,495,498.00;
- amounts due to other governmental units totaling $2,124,866.00;
- unearned revenue totaling $7,231,493.00;
- accrued interest payable totaling $706,489.00;
- capital lease payable for North Vector in the amount of $76,600.00;
- capital lease payable for technology in the amount of $450,064.00;
- premium on liabilities issued totaling $96,177.00;
- deferred charges on liabilities issued totaling -$1,272,335.00;
- severance benefits payable to employees in the amount of $4,731,848.00; and
- compensated employee absences payable totaling $375,937.00.[716]

[716] *See* Exs. 23, 208; Ex. 109 at 9.

85. Bloomington is liable for its proportionate share of these amounts, as set forth below.

BLOOMINGTON'S PROPORTIONATE SHARE OF THE DISTRICT'S ASSETS AND LIABILITIES

86. Minnesota law provides that if an intermediate district and a withdrawing member district cannot agree on the terms and condition of the district's withdrawal, the Commissioner "shall resolve the dispute by determining the district's proportionate share of assets and liabilities based on the district's enrollment, financial contribution, usage, or other factor or combination of factors determined appropriate" by the Commissioner.[717]

87. Pursuant to Minn. R. 1400.7300, subp. 5 (2013), the party proposing that action be taken must prove the facts at issue by a preponderance of the evidence. In addition, a party asserting an affirmative defense shall have the burden of proving the existence of the defense by a preponderance of the evidence.[718]

88. As the party initiating this action through its withdrawal from the Intermediate District, Bloomington has the burden to establish, by a preponderance of the evidence, the amount of its proportionate share of the assets it claims to be owed from the Intermediate District, less its proportionate share of liabilities owed to the District, based upon Bloomington's enrollment, financial contribution, usage, and other factors.[719]

89. As set forth above, Bloomington has established by a preponderance of the evidence that the District's assets exceed its liabilities and that Bloomington is entitled to a proportionate share of those assets.

90. Bloomington has further established by a preponderance of the evidence that its proportionate share of the District's assets and liabilities is 6.52 percent, representing the percentage of Bloomington students enrolled in the Intermediate District programs in the 2010-2011 school year, the last school year in which Bloomington was a Member District.

91. The 6.52 percent multiplier is representative of Bloomington's enrollment in the District and its usage of all of the District's services in the year immediately preceding withdrawal. As a result, it is consistent with the factors that the Commissioner must apply when determining a withdrawing district's proportionate share of an intermediate district's assets and liabilities under Minn. Stat. § 123A.24, subp. 5(c).

[717] Minn. Stat. § 123A. 24, subd.1(c).
[718] Minn. R. 1400.7300, subp. 5.
[719] Minn. Stat. § 123A.24, subd. 1(c); Minn. R. 1400.7300, subp. 5; s*ee also* Order Allocating Burdens of Proof dated February 10, 2014.

FINAL RECONCILIATION AND DECISION

92. The following represents the Administrative Law Judge's final reconciliation of the Intermediate District's assets and liabilities and Bloomington's proportionate share thereof:

ASSETS	
	Value as of June 30, 2011
Cash and Investments	$3,764,135.00
Accts Receivable	$628,731.00
Due from other units	$22,544,726.00
Inventory	$1,850.00
Prepaid Items	$113,611.00
Restricted cash/invest.	$28,652,100.00
Real Estate:	
South Educ. Center	$0
West Educ. Center	$10,000.00
District Service Center	$3,000,000.00
Edgewood Educ. Center	$0
Robbinsdale Condo	$50,000.00
North Educ. Center (Construction in Progress)	$0
Other Capital Leases:	
Equipment	$2,823,913.00
Assets under Cap Lease	$1,820,432.00
SUBTOTAL:	**$63,409,498.00**

LIABILITIES	
	Owing as of June 30, 2011
Aid Anticipation Cert.	$3,590,000.00
Salaries and Comp.	$2,157,696.00
Accts and Contracts Payable	$2,495,498.00
Due to other Govt Units	$2,124,866.00
Unearned Revenue	$7,231,493.00
Accrued Interest	$706,489.00
Unamortized Premiums	$0
Capital Leases:	
North Vector	$76,600.00
Technology	$450,064.00
Real Estate Leases	
SEC Building Lease	$0
WEC Refunding Lease COP 2009A	$0
SEC Land Lease COP 2010C	$0
EEC Lease COP 2010A	$0
EEC Lease COP 2010B	$0
NEC Building Lease COP 2010E	$0
NEC Land Lease COP 2011A	$0
Premium on Liabilities	$96,177.00
Deferred Charges	($1,272,335.00)
Long Term EE Costs	
Severance Payable	$4,731,848.00
Compensated Absences	$375,937.00
Net OPEB Obligation	$9,532,459.00
Net Pension	$409,117.00
SUBTOTAL	**$32,705,909.00**

Assets	Less Liabilities	= Net Assets	Multiplied by Bloomington's Proportionate Share	TOTAL
$63,409,498.00	$32,705.909.00	$30,703,589.00	.0652 (6.52%)	**$2,001,874.00**

Distribution to Minimize Financial Disruption

93. Minnesota Statutes, section 123A.24, subdivision 1(c), provides that the Intermediate District's assets must be disbursed to Bloomington in a manner that minimizes financial disruption to the Intermediate District.

94. As the party proposing that certain action be taken, Bloomington carries the burden to establish, by a preponderance of the evidence, that a disbursement of assets to Bloomington will not impose a financial disruption to the Intermediate District.[720]

95. The Administrative Law Judge concludes that requiring the Intermediate District to pay Bloomington a lump sum amount of $2,001,874.00 would be a financial hardship, as well as a financial disruption to the Intermediate District.

96. The amount requested by Bloomington in this action was $525,297.62, representing 6.52 percent[721] of the Intermediate District's net assets set forth in the Intermediate District's 2011 Audited Financial Statement ($8,056,712.00).[722]

97. Bloomington acknowledges that this amount represents a fair and reasonable disbursement of the District's assets, less its liabilities.[723]

98. While Bloomington has established that the Intermediate District had assets exceeding its liabilities, and that Bloomington has a right to recover a proportionate share of those net assets, Bloomington has not established it is entitled to any more than $525,297.62. Nor has Bloomington proven that a recovery in excess of $525,297.62 could be paid to Bloomington without causing significant financial disruption to the District.

99. Minnesota Statutes, section 123A.24, subdivision 1(c), gives the Commissioner discretion to disburse assets and allocate liabilities in a manner that is

[720] *See* Minn. Stat. § 123A.24, subd. 1(c); Minn. R. 1400.7300, subp. 5.
[721] Until its Post-Hearing Brief, Bloomington was advocating for a 6.52 percent "usage factor," not the 9.105 percent factor determined by the Intermediate District's financial expert, Gary Dosdall. All evidence presented by Bloomington at the hearing was in support of the 6.52 percent usage factor.
[722] In its Post-Hearing Brief, Bloomington acknowledges that the District repaid $5,711,435 in tuition refunds and Medical Assistance overpayments, reducing the District's net assets from $13,768,147 (as set forth in the 2011 Audited Financial Statement) to $5,711,435. *See* Bloomington's Post-Hearing Brief at 2-3.
[723] *See* Bloomington's Post-Hearing Brief.

just and reasonable based upon the withdrawing district's enrollment, financial contribution, usage, *or any other factor or combination of factors determined appropriate by the Commissioner*.[724]

100. Because of Bloomington's active support for and involvement in the District's decisions to enter into real estate contracts that continue to impact the District's continued operation and its ability to pay Bloomington a lump-sum amount, it is fair and reasonable to limit Bloomington's proportionate share of the assets to the amount that Bloomington has requested in this action – an amount that Bloomington has acknowledged is the amount duly owed.

101. Accordingly, the Intermediate District shall pay Bloomington **$525,297.62,** representing the amount Bloomington acknowledges is its fair and proportionate share of the Intermediate District's net assets as of June 30, 2011.

102. A portion of said amount can be paid by non-member tuition credits for Bloomington students to enroll in the Intermediate District, as determined by the parties.

103. The parties are directed to agree to a payment schedule that minimizes financial disruption to the Intermediate District and its remaining Member Districts.

104. If the parties are unable to agree to a payment schedule by **February 17, 2015,** the Administrative Law Judge shall determine the payment schedule, payment type, and the amount of interest, if any, to be applied to the balance owed, after allowing additional written argument by the parties.

Dated: January 7, 2015

s/Ann C. O'Reilly

ANN C. O'REILLY
Administrative Law Judge

Reported: Digitally Recorded; Transcript Prepared

NOTICE

Pursuant to Minn. Stat. § 14.57(a), the Commissioner of the Department of Education has, by Order dated October 20, 2013, declared that the Report of the Administrative Law Judge in this proceeding constitutes the final decision in the case.

[724] Emphasis added.

MEMORANDUM

The rules applicable to administrative hearings set forth which party carries the burden of proof in an administrative action, as well as the standard of proof to be applied in this proceeding. Minnesota Rule 1400.7300, subpart 5, provides:

> The party proposing that certain action be taken must prove the facts at issue by a preponderance of the evidence, unless the substantive law provides a different burden or standard. A party asserting an affirmative defense shall have the burden of proving the existence of the defense by a preponderance of the evidence….

Prior to the hearing and based upon this Rule, the Administrative Law Judge determined that Bloomington, as the party withdrawing from the Intermediate District, was the party initiating the case and, thus, the party proposing that certain action be taken.[725] Consequently, the Judge ruled that Bloomington, like a plaintiff in a civil action, had the burden to prove, by a preponderance of the evidence, its entitlement to recovery from the Intermediate District.[726]

In the Order Allocating Burdens of Proof, the Administrative Law Judge ruled:

> 1. Bloomington shall have the initial burden of production in this matter to establish by a preponderance of the evidence: (1) its right to withdraw from the Intermediate District; (2) the amount of its proportionate share of assets it claims to be owed from the Intermediate District, less the proportionate share of liabilities owed to the Intermediate District; and (3) that its proposed manner of disbursement of assets will minimize the financial disruption to the Intermediate District.
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> 2. If Bloomington meets its burden of production of evidence, then the burden of production shall shift to the Intermediate District to establish that: (1) the amount of assets and liabilities claimed by Bloomington is in error and that a different amount is due to Bloomington; and/or (2) the manner of distribution proposed by Bloomington would cause undue financial disruption and that an alternative method for disbursement would better minimize financial disruption.
>
> 3. With respect to Bloomington's claims for monetary recovery from the Intermediate District, the ultimate burden of persuasion will be borne by Bloomington.
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> 4. To the extent that the Intermediate District is seeking a monetary recovery from Bloomington, such claim shall be treated as a counterclaim. For such counterclaim, the Intermediate District shall have the burden to

[725] *See* Order Allocating Burdens of Proof dated February 10, 2014.
[726] *Id.*

establish, by a preponderance of the evidence: (1) its right to a monetary recovery from Bloomington; and (2) the amount it is entitled to recover. The Intermediate District shall have the ultimate burden of persuasion on its counterclaim.

5. As the party initiating this action through its withdrawal from the cooperative unit, Bloomington shall proceed first with its case-in-chief at the contested case hearing.[727]

From the beginning of this action nearly three years ago, Bloomington has argued that the 2011 Audited Financial Statement, which valued all real estate as assets on a cost basis, should be used to determine the Intermediate District's assets and liabilities. Based upon the 2011 Audited Financial Statement, Bloomington argued that the District had net assets of $13,768,147.00 as of June 30, 2011.

After unrefuted evidence was presented at hearing to show that the District paid $5,711,435.00 in tuition reimbursements and Medical Assistance repayments, Bloomington conceded that the District's net assets, as stated in the 2011 Audited Financial Statement, were actually $8,056,712.00, not $13,765,147.00.[728]

At the hearing, Bloomington presented evidence that its "proportionate share" of the District's net assets was 6.52 percent, representing the proportionate number of students that Bloomington enrolled in the Intermediate District in the 2010-2011 school year -- the last year that Bloomington was a Member District. Bloomington presented no other evidence related to its "proportionate share" of the District's assets and liabilities.

In its Post-Hearing Brief, Bloomington continued to argue that the 2011 Audited Financial Statement, less a $5,711,435.00 deduction for tuition reimbursements and Medical Assistance repayments, should be used to value the District's assets and liabilities. Using these numbers, Bloomington concluded that it was entitled to recovery in the amount of $525,297.62, representing 6.52 percent of $8,056,712.00.

It is accepted in Minnesota law that a "plaintiff's recovery is not limited to the amount stated in the complaint unless the defendant is prejudiced."[729] In *Stephenson v. F.W. Woolworth Co.*, the Minnesota Supreme Court discussed the prejudice exception to the general rule.[730] The Court noted the importance of protecting a defendant who is led to believe that recovery will not exceed a certain amount.[731] The Court held that "where a party chooses to sue for an amount that will or may deprive another party of a

[727] *Id.*
[728] Bloomington's Post-Hearing Brief at 2-3.
[729] *Ahrenholz v. Hennepin County*, 295 N.W.2d 645, 647 (Minn. 1980); *see also Wallace v. Nelson*, 287 Minn. 438, 445, 178 N.W.2d 698, 703 (1970) ("It is settled law in this state that under our liberalized rules of pleading plaintiff is not limited to the amount stated in the complaint in the absence of extenuating circumstances which might prejudice defendant.")
[730] 277 Minn. 190, 196, 152 N.W.2d 138, 144 (1967).
[731] *Id.*

right he may have, the plaintiff is bound by such choice unless he takes action to amend his complaint within such time as will enable the defendant to assert the right which he has."[732]

While there was no "complaint" in this case, based upon: (1) the arguments made by Bloomington prior to hearing; (2) the evidence presented by Bloomington at the hearing; and (3) the arguments made by Bloomington after the hearing, the Intermediate District was led to believe that Bloomington's recovery would not exceed $525,297.62.

To recover in this case, Bloomington must prove, by a preponderance of the evidence, not only that it is entitled to recovery from the District, but that the assets it seeks can be disbursed to Bloomington in a manner that minimizes financial disruption to the Intermediate District. Bloomington did not present any legal theories to exclude the values of the SEC, EEC, and NEC Properties and leases from the calculation of assets and liabilities. Nor did Bloomington present any evidence that its proportionate share was more than 6.52 percent.[733] The only evidence that Bloomington established was that the District's assets exceeded its liabilities, and that Bloomington's proportionate share of those assets was 6.52 percent, totaling, according to Bloomington, $525,297.62.

While Bloomington has established that the District had assets exceeding its liabilities, and that Bloomington has a right to recover a proportionate share of those net assets, Bloomington has not established that it is entitled to any more than $525,297.62. Nor has Bloomington proven that a recovery in excess of $525,297.62 could be paid to Bloomington without causing financial disruption to the District.

Bloomington was one of the highest users of the Intermediate District's services during the 40+ years that the District has been in existence. Throughout that time, Bloomington received the benefits of the joint endeavor, as well as decades of labor and services from the District's employees.

During Bloomington's years as an active participant in the Intermediate District, the District entered into numerous contracts to acquire interests in six real properties. In the course of just seven years, from 2004 to 2011, the Intermediate District executed contracts for over $149,515,000.00 in real estate. This is a significant amount of real estate investment for an intermediate district that has no taxing or levying authority, and no obligation to seek voter approval for such acquisitions and expenditures.

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[732] *Id.* at 197, 152 N.W.2d at 145.

[733] *See State v. Pearson*, 775 N.W.2d 155, 164 (Minn. 2009) (stating that the district court instructed the jury that "counsels' arguments are not evidence"); *see also In re Welfare of Children of M.A.W.*, No A06-2159, 2007 WL 1599655, at *5 (Minn. Ct. App. June 5, 2007) (stating that "a lawyer's arguments are not evidence"); *Johnson v. 1999 Silver BMW Convertible*, No. C0-01-840, 2001 WL 1570278, at *3 (Minn. Ct. App. Dec. 11, 2001) (stating that a lawyer's argument regarding value is not evidence).

With the exception of the NEC Property, Bloomington fully supported the District's execution of the contractual agreements to acquire a legal interest in all of the properties. Now, as a result of Bloomington's withdrawal, the remaining 12 Member Districts must shoulder a greater share of the District's yearly expenses and contractual obligations unless they decide to discontinue appropriations for the leases. This presents a significant dilemma and financial burden to the remaining Member Districts – a burden not anticipated by the Member Districts when the majority of the real estate contracts were executed.

Allowing Bloomington to recover significantly more than it has ever requested in this proceeding, based upon legal theories that Bloomington never presented during the pendency of this action, would unfairly prejudice the Intermediate District and cause financial disruption to the District. It would also subject the District to a result that the District did not reasonably anticipate. Accordingly, Bloomington's recovery in this action is properly limited to **$525,297.62,** the amount that Bloomington has sought in this proceeding and the only amount that Bloomington presented evidence to establish at the hearing.

A. C. O.