

IN THE SUPREME COURT OF OHIO

HOPE ACADEMY BROADWAY CAMPUS,)	CASE NO. 2013-2050
et al.,)	
)	
Appellants,)	On Appeal from the Franklin County
)	Court of Appeals, Tenth Appellate
v.)	District – Case No. 12-APE-496
)	
WHITE HAT MANAGEMENT, LLC, et al.)	
)	
Appellees.)	

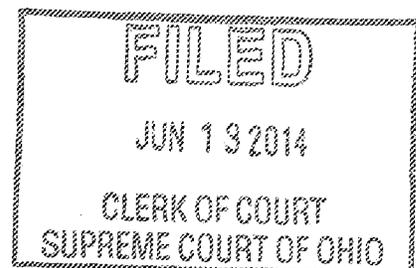
AMICUS BRIEF OF OHIO SCHOOL BOARDS ASSOCIATION IN SUPPORT OF
APPELLANTS HOPE ACADEMY BROADWAY CAMPUS, ET AL.

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I. INTRODUCTION

More than 120,000 of Ohio public school students now attend “Community Schools”. About 54% of that total attend community schools operated by for-profit management company “operators” like Defendants – Appellants, White Hat Management, LLC, et al. (“White Hat”).¹ Of the \$903 million in Ohio education funds spent on community schools in the 2013-14 fiscal year, it can be estimated that more than \$450 million now goes to such for-profit “operators.” White Hat operated schools have reportedly received more than \$1 Billion in Ohio education funds since 1998².

The issue before this Court is whether Ohio’s public education funds, used to purchase and take title to school buildings, books, computers, desks or other capital equipment can be kept by White Hat if management contracts are cancelled or schools are shut down. Such a scheme effectively “launders” that public money, turning it into just another private asset of White Hat. Appellants, the Ohio Department of Education, and Amicus Ohio School Boards Association argue that such assets belong to the public, not to White Hat. To preserve those public assets for public benefit, this Court should rule that community schools have no legal authority to transfer capital funds to for-profit “operators,” and that any contract providing otherwise is unenforceable as unconscionable and against public policy. The Court should also hold that White Hat is a fiduciary of the schools it operates, and cannot lawfully take title to property bought with Ohio school funds.

¹ 2012-13 Ohio Community Schools Annual Report, Ohio Department of Education, <http://education.ohio.gov/topics/school-choice/community-schools>, pdf p. 2.

² Stephen Dyer, 10 Period Blog, <http://10thperiod.blogspot.com/2014/03/white-hat-exemplifies-ohio-charter.html> (accessed June 10, 2014).

II. INTERESTS OF THE AMICUS CURIAE OHIO SCHOOL BOARDS ASSOCIATION

The Ohio School Boards Association (“OSBA”), represents nearly 100% of the elected and appointed board members in all of the various city, local, exempted village, educational service center and joint vocational school districts throughout the State of Ohio.

The OSBA advocates for a strong, reliable and effective system of public schools, not simply to prepare Ohio children for their future, but also to keep and attract the employers and families who judge a state by the quality of education provided to its children. The primacy of public education for Ohio was recognized in Article VI, § 2 of Ohio’s Constitution, requiring the General Assembly to provide for a “thorough and efficient system of common schools.” OSBA’s members are the stewards of that system.

The OSBA favors interpretations of Ohio law that foster the protection and preservation of Ohio’s public education funds, and full transparency on how those funds are expended – whether by traditional public schools or by Ohio’s community schools. While OSBA and its members have not typically aligned with the governing authorities of Ohio’s community schools, OSBA urges this Court to reverse the Court of Appeals’ decision. Ohio law requires all public schools – whether traditional or community schools – to retain any hard assets purchased with Ohio education funds, rather than enrich their for-profit “operators.”

Whether elected, like traditional Ohio Boards of Education, or appointed, like the members of the Appellant community school boards, those who have the ultimate fiduciary responsibility for Ohio’s “public” schools must retain control of and be held accountable for any property purchased with the scarce Ohio education funds allocated to their schools.

III. FACTUAL AND STATUTORY BACKGROUND

This dispute is between the independent governing authorities (also referred to as

“community school boards”) of ten (10) Ohio community schools, all located in Cleveland and Akron (“The HOPE Schools”), and the private, for-profit “operators” of those schools (the “White Hat Companies” or “White Hat”). The parties came into conflict when consistently poor student performance caused several community school boards to question the quality of the management provided by White Hat and the adverse impact on their schools’ students. The poor performance of White Hat’s “Hope” and “Life Skills” schools has been broadly reported.³ Throughout, White Hat has fiercely resisted disclosing how it has burned through more than \$1 Billion in Ohio education money that its schools have received since the late 1990’s. Now White Hat claims, and the Court of Appeals has held, that property purchased with that money belongs to White Hat, not to the public, or even to the schools it has so poorly managed.

1. Community Schools Are “Public Schools” Funded By Public Education Dollars.

In 1997, the Ohio General Assembly adopted Chapter 3314 of the Ohio Revised Code, authorizing a system of “community schools,” sometimes referred to as charter schools, as an option for parents and children residing in Ohio’s largest cities and most challenged school districts.⁴ As summarized by the Ohio Department of Education (ODE) in its 2012-13 “Ohio Community School Annual Report.”⁵

“Community Schools are public, nonprofit, nonsectarian schools operating independently of any school district, but under a contract with a sponsoring entity that is established by statute or approved by the Ohio

³ See, e.g., *Privatizing Government Services in the Era of ALEC and The Great Recession*, 43 U. Tol. L. Rev. 503, p. 11 (2012) (“Of the 51 schools White Hat managed in 2010, only one met a key standard established by the No Child Left Behind Law – called ‘Adequate Yearly Progress.’ According to the Report that is by far the worst performance of any large for-profit management company.”)

⁴ Starting in 2013, Ohio law allows lower income students residing in even the highest performing school districts to attend a community school with tuition paid from state tax dollars. 2013 Am.Sub.H.B. No. 59.

⁵ Ohio Community School Annual Report, 2012-13 available at <http://education.ohio.gov/topics/school-choice/community-schools>

Department of Education. While community schools receive state and federal funds, they are purposefully designed to have greater operational autonomy and provide greater flexibility in programs.”

Chapter 3314 has been amended and revised in almost every session of the General Assembly since 1997. But the basic framework for the organization, management and accountability of community schools remains the same. R.C. 3314.01(B), provides in part that

A community school created under this chapter is a public school, independent of any school district, and is part of the state’s program of education. A community school may sue and be sued, acquire facilities as needed, contract for any services necessary for the operation of the school, and enter into contracts with the sponsor pursuant to this chapter. The governing authority of a community school may carry out any act and ensure the performance of any function that is in compliance with the Ohio Constitution, this chapter, other statutes applicable to community schools, and the contract entered into under this chapter establishing the school. (Emphasis added)

In State Ex Rel. Ohio Congress of Parents & Teachers v. State Bd. of Edn., 111 Ohio St. 3d 568, 2006-Ohio-5512, 857 N.E.2d 1148, (*Ohio PTA*). This Court accepted as constitutional the General Assembly’s designation of community schools as *public schools* which are “state funded,” but “privately run.” *Id.* at ¶7.

A community school must be organized as either “a nonprofit corporation” or “a public benefit corporation established under Chapter 1702 of the Revised Code” depending on whether they were established before or after April 8, 2003. R.C. 3314.03(A). A nonprofit corporation or a public benefit corporation must have a board of directors, which becomes the “governing authority” or “school board” of a community school. *See* R.C. §1702.26. Community schools (if not opened by traditional school districts) operate under a contract with a “sponsor,” which monitors the school’s performance with applicable state laws and regulations. R.C. 3314.02(A)(1) and (C)(1). All of the community school Plaintiffs in this case are non-profit corporations.

2. Many of Ohio's Community Schools are "Operated" by For-Profit Management Companies.

Community school boards are authorized by law to enter into contracts for any "services" that are "necessary for the operation of the school." R.C. 3314.01(B). Like the Appellant's Boards, many community school boards have entered into management agreements with for-profit community school "operators," like White Hat, to manage their schools. The General Assembly amended R.C. Chapter 3314 to define "Operator" as "an organization that manages the daily operations of a community school pursuant to a contract between the operator and the school's governing authority." R.C. 3314.02(A)(8)(a). But the General Assembly provided no specific requirements for the content of management contracts, other than as allowed or limited by R.C. 3314.01(B).

There were approximately 367 community schools operating in Ohio in the 2012-13 school year.⁶ They enrolled about 120,000 students, or 6.5% of Ohio's approximately 1.8 million public school students.⁷ Community schools received about \$903 million in state funds for the 2013-14 fiscal year.⁸ In recent years, management companies operated about 30% of Ohio's community schools, but because such schools tend to be larger, privately operated schools enroll about 54% of Ohio's community school students. Those privately managed schools collected more than \$373 million in state funds during the 2011-12 school year,⁹ and significantly more state funds in 2013-14.

⁶ Ohio Ed. Assn., "A Brief Update on Charter Schools, May, 2012"; www.ohea.org/a-brief-update-on-charter-schools (hereinafter "OEA update").

⁷ 2012-13 Ohio Department of Education Ohio Community School Annual Report, pp. 2, 5.

⁸ Ohio Dept. of Edn. website, <http://education.ohio.gov/topics/school-choice> "School Choice" spread sheets (accessed June 10, 2014).

⁹ OEA update, providing data for the 2011-12 school year.

White Hat affiliated companies, including the Defendants-Appellees, currently operate 31 Ohio community schools,¹⁰ and enrolled approximately 9400 students in 2011-12, at schools that receive about \$70 million annually in Ohio education funds.¹¹ White Hat has been the dominant community school “operator” in Ohio since the program began operation in 1998. It has been reported that White Hat managed schools have received \$1.07 Billion in state education funds over those years, about 15% of the \$7.3 Billion directed to all of Ohio’s Charter Schools since 1998.¹²

3. The White Hat Form Management Agreements.

White Hat drafted the form management agreements, as shown by the nearly identical agreements executed in 2005 by the Plaintiff school boards. The Agreements all give a White Hat affiliate the right to receive virtually all state and federal funds received by the school.¹³ White Hat’s expansive role includes the purchase or lease of all furniture, equipment, computers or other personal property; selection of the school location or any re-location; the development and maintenance of education records; “training of employees, including the school’s principal, teachers and assistants....”; hiring “all personnel necessary to implement the educational model,” who are White Hat employees; the selection, evaluation, hiring, discipline, transfer and termination of all personnel, including the school principal; and the establishment of “the number and function of support staff.”¹⁴ In return, the school pays White Hat a monthly “continuing fee” amounting to 96% of the revenue received by the school from the State of Ohio, and 100% of federal funds and any state and local government grants.¹⁵ Taking into account the 2-3% of all

¹⁰ <http://whitehatmgmt.com/SCHOOLS> (accessed June 10, 2014).

¹¹ *OEA Update*.

¹² 10th Period Blog, Stephen Dyer, *infra*, fn. 2.

¹³ Agreed Stipulations, 2/14/2012, Ex. A (hereinafter “Management Agreement”), p. 1.

¹⁴ White Hat Management Agreement, p. 2-5.

¹⁵ *Id.* at p. 9.

revenue community schools pay to “sponsors,” the agreements give virtually all of a school’s state funds to White Hat.

The White Hat management agreement does allow the manager’s termination by the school board “for cause,” including insufficient academic progress. (Management Agreement, pp. 11-12). However, in the event of termination, the Court of Appeals interprets the contract as providing that any “personal property used in the operation of the school and owned by the Company,” is retained by White Hat unless the school buys it all back at its current depreciated value. (Management Agreement, pp. 9-10).

4. State Funding of Community Schools

In *Ohio PTA*, 111 Ohio St.3d 568, 2006-Ohio-5512, 857 N.E.2d 1148, at ¶¶53, 56, this Court described the funding formula used to pay for the education of public school students in Ohio – whether they enroll in traditional school districts or in community schools:

Funding formulas for traditional and community schools are complex although we may summarize them by saying that state money follows the student. In general, under both formulas, the state guarantees a basic minimum level of funding for each student called the ‘formula amount.’ R.C. 3317.02

* * *In using the formula for community schools, the ODE multiplies the number of students enrolled in a community school times a base formula amount times the cost of doing business factor. R.C. 3314.08(D).

Community schools do not receive separate capital funds, for such things as buildings, desks, computers and books. From its per student formula allocation, a community school must pay both its operating costs, for such items as teachers, other staff and administrative expense; and its capital costs, for buildings, classrooms, furniture and computers.¹⁶ In 2013-14, the base

¹⁶ Per-pupil funding is “intended to cover operating costs as well as capital purchases[.]” ODE Community Schools Operational Review (AOS 2002) p. 45 (“Operational Review”).

per pupil allocation to community schools, before other adjustments, was \$5,745/student.¹⁷ As a result, by signing the White Hat management agreement, the Plaintiff community school boards surrendered not only any meaningful day-to-day management decisions, but also all resources available to acquire the hard assets necessary to provide a public education.

5. The Community School Boards' Frustrating Attempts to Hold White Hat Accountable

The management agreement allows termination of White Hat by the school board for "failure to meet the material terms of the contract," and also provides that "the Company shall be responsible and accountable to the School's Board of Directors* * *."¹⁸ The schools' performance under White Hat's management was abysmal. Two were shut down by the ODE for "academic failure." Four were on "academic watch" or "academic emergency," the lowest ratings on the state's "report cards". Only one received a rating of "continuous improvement."¹⁹

Disappointed in poor student achievement under White Hat's management, the Plaintiff school boards began questioning White Hat's spending and performance. In response, White Hat refused to disclose how it spent the money it received from the schools, and announced that under the terms of the management agreement, all of the schools' physical assets -- computers, books, furniture, etc. -- actually belonged to White Hat, and not to the schools. If the schools wanted to continue in business without White Hat, they would have to "buy back" all of those assets. Of course, since the schools had funneled virtually all of their state payments to White Hat, as required by the management agreement, there were no reserves available to "buy back" the assets those state dollars had been used to acquire. This lawsuit sought to resolve that dilemma.

¹⁷ ODE Community Schools Annual Report, p. 30.

¹⁸ Management Agreement, p. 7.

¹⁹ 2010-2011 ODE Annual Report Cards and Chart, 2/2/2012 Hearing, Ex. 3.

IV. ARGUMENT

A. THE WHITE HAT MANAGEMENT AGREEMENT IS UNCONSCIONABLE, CONTRARY TO PUBLIC POLICY AND BEYOND THE AUTHORITY OF A COMMUNITY SCHOOL BOARD

AMICUS OSBA's ARGUMENT IN FAVOR OF APPELLANTS'

Proposition of Law Number 1:

Public Funds paid to a private entity exercising a government function, such as the operation of a community school, retain their character as public funds even after they are in the possession and control of the private entity.

and; Proposition of Law Number 2:

When a private entity uses funds designated by the Ohio Department of Education for the education of public-school students to purchase furniture, computers, software, equipment, and other personal property to operate a community school, the private entity is acting as a purchasing agent and the property must be titled in the name of the community school.

The Court of Appeals erred by treating this dispute as simply a matter of interpreting White Hat's form management agreement. *See Hope Academy Broadway Campus v. White Hat Mgt., LLC*, 10th Dist. Franklin No. 12 AP-496, 2013-Ohio-911, ¶12. The Plaintiffs persuasively argue that the management agreements' plain language does not allow White Hat to retain the school equipment, furniture and other property purchased with public funds. But the Court of Appeals disagreed. If the Court of Appeals' interpretation of the contract language is correct, then the key provisions of the agreement are unenforceable as unconscionable, as against public policy and as beyond the authority of a community school board.

1. The White Hat Management Agreements Are Unconscionable.

"Unconscionable" contracts are not enforceable. "Unconscionability" includes two elements: an absence of meaningful choice on the part of one of the parties ("procedural unconscionability"); and contract terms that are unreasonably favorable to the other party ("substantive unconscionability"). *See e.g. Hayes v. Oakridge Home*, 122 Ohio St.3d 63, 2009-

Ohio-2054, 908 N.E.2d 408. “The issue of unconscionability is a question of law,” and review on appeal is “plenary,” and *de novo*, with no need to defer to the discretion of the lower courts. *Eagle v. Fred Martin Motor Co.*, 157 Ohio App.3d 150, 2004-Ohio-829, 809 N.E.2d 1161, ¶11-13 (9th Dist.) (citations omitted).

a. The White Hat Management Agreements are “Substantively Unconscionable”

“Substantive unconscionability” includes whether the terms of the contract are unfair or unreasonable in the context of a particular transaction. *Caley v. Glenmoor Country Club, Inc.*, 2013-Ohio-4877, N.E.3d 471 (5th Dist.). The one-sided nature and inherent unfairness of White Hat’s form management agreement is manifest from the facts that gave rise to this case:

- White Hat received virtually all state and federal funds designated for the schools, regardless of its actual expenses in operating the schools, or the poor educational outcomes.
- While the Community School Boards had the hypothetical right to terminate White Hat for poor performance, in the event of cancellation, White Hat would keep all assets it had purchased with the schools’ funds.
- While the schools had the right to “buy back” the assets needed to run a school without White Hat, by virtue of the obligation to pay virtually all of its State and Federal revenue to White Hat, the schools would have no reserves to accomplish such a “buy back.”

The contract’s “buy back” requirement is the ultimate “poison pill.” As a practical matter, the management agreement deprives the school boards of any meaningful opportunity to *ever* cancel White Hat for poor performance and to operate the schools on their own. This one-sided

and fundamentally unfair form contract evidences the lack of mutuality, prohibitive costs and unfair limitation on the schools' remedies for poor management performance that are the hallmark of "substantive unconscionability." See *Hayes v. Oakridge Home*, 122 Ohio St.3d 63, 2009-Ohio-2054, 908 N.E.2d 408 and *Harrison v. Winchester Place Nursing*, 2013-Ohio-3163, 996 N.E.2d 1001 (10th Dist.).

b. The White Hat Management Agreements are "Procedurally Unconscionable".

"Procedural unconscionability" involves the circumstances surrounding formation of the contract, including the relative bargaining power of the parties when the contract was signed, and whether there was a genuine and voluntary "meeting of the minds." *Konica Minolta Business Solutions, USA, Inc. v. Allied Office Products, Inc.*, 724 F.Supp.2d 861 (S.D. Ohio 2010). The one-sided and unfair terms of the White Hat form management agreements were the direct result of a sham "negotiation" between community school boards dominated and controlled at their creation by White Hat. The incestuous relationship between community school governing boards and their "managers" was a flaw noted by then Auditor of State James Petro in his 2002 "Operational Review" of the community school program:

The duties of the community school governing authority are not defined and some governing authorities are not independent of school vendors and management company representatives.²⁰

Public records filed in this Court in the *Ohio PTA* litigation, demonstrate that White Hat dominated and controlled the schools it has managed from the very inception of Ohio's experiment with community schools. Here is some of that evidence:

²⁰ Exhibit G, filed in support of Memorandum of Plaintiffs/ Relators Ohio PTA, et al. filed in Opposition to Summary Judgment, Case No. 01-CVH 05 04457, Franklin County Court of Common Pleas, included in record in *Ohio PTA, Case No. 2004-1668, 111 Ohio St. 3d 568, 2006-Ohio-5512, 857 N.E.2d 1148*, (referred to herein as "*Ohio PTA Exhibits*").

- The U.S. Internal Revenue Service (“IRS”) rejected a tax exempt application by HOPE Academy Chapelside Campus in June 1999, referencing an unreasonable management fee in the 97% range. The IRS noted that “an arbitrary incentive fee that bears no relationship to any service being delivered is not in the best interests of the school.” (*Ohio PTA Exhibit*, Ex. S.)
- The IRS rejected the application of HOPE Chapelside stating that the school had not “established that your board of directors does exercise authority and control over your operations,” due to the broad authority assumed by White Hat. (*Id.* Ex. S.)
- Ohio’s Legislative Office of Education Oversight was critical of many community schools’ failure to receive tax-exempt status, as originally required by Chapter 3314, attributing it to the failure of the schools’ governing boards to be in “sole control of school operations.” (*Id.*, Ex. NN, p. ix).
- In his 2002 “Operational Review,” State Auditor Petro also questioned the sweetheart deals crafted by the management companies with the schools they dominate:

Management company fees should not exceed the cost of services provided plus a reasonable profit. Management company representatives should be excluded from governing boards* * *.

(*Id.* at Ex. G. pp. 1-10, 11).

- The Auditor also agreed that certain management agreements call into question the “non-profit” status of community schools:

Certain kinds of fee arrangements may call into question a charter school’s eligibility for status as a charitable organization * * *. Charter boards that appear to be a funding pass-through for for-

profit companies may find it difficult to obtain or maintain 501(c)(3) status * * *.

(*Id.* at Ex. G., pp. 3-47).

- White Hat's control over the chain of "non-profit" community schools, then using the "Hope Academy" and "Life Skills" brands, was best exemplified by 14 community school contracts approved on a single motion by the Ohio State Board of Education, all of which were executed on May 16, 2000. (*Id.*, Ex. T-1 through T-14). The contracts did not list an address for any "school" or identify a single governing authority board member. Eight of the school contracts list the schools' "contact" address as White Hat's Akron headquarters, not the school's address or the address of any board member.
- ODE employees attempting to negotiate community school contracts were unable even to discuss plans for the HOPE schools with the schools or board members. An internal ODE memorandum of March 30, 1998, indicated that "[r]ather than attend the interview in person, the developers [for HOPE Academies] elected to send representatives from the HOPE Academies LLC," a White Hat entity:

Staff was also concerned about bringing an application forward for board decision without first having met with the development team named on the application. This concern is punctuated by the developers' relationship with HOPE Academies LLC, a for-profit corporation.

(*Id.* Ex. Z, emphasis added).

- A similar problem arose with interviews conducted by ODE prior to granting the HOPE Academy Brown Street Campus contract:

The development team as identified in the application did not attend the interview, instead, representatives from HOPE Academies LLC attended the interview.

(*Id.* Ex. AA, p. 2).

This left the interviewers “unclear as to the role of the developers.” (*Id.* Ex. AA, p. 5).

This history suggests that when the management agreements were signed with White Hat, the community school boards amounted to “sham corporations,” with no independent will of their own to negotiate at “arm’s length” with White Hat. “Sham corporations are legal fictions, and the fiction may be disregarded when asserted for a purpose within the reasons and policy (of corporate law).” *Kays v. Schregardus*, 138 Ohio App.3d 225, 230, 740 N.E.2d 1123 (11th Dist. 2000).

In this case, the question is whether a “sham” community school governing board could exercise the independent judgment required to surrender Ohio education capital funds and property to their for-profit operator when these management agreements were signed in 2005. White Hat’s management agreements assure that it receives virtually all funds allocated by the state to the schools it manages. White Hat does all of the purchasing, hiring, and policy making, keeping any money left over. Spending by management companies includes paying related companies rents and fees under various real estate and equipment leases, and keeping any money left over. (*See Auditor’s Operational Review, Id.* Ex. G, pp. 3-46, 47). The one-sided nature of these sweetheart arrangements shows that the community school governing boards that “negotiated” them had no separate mind or will of their own. Instead, they simply provided White Hat with a “laundry” to facilitate the transfer of state education funds, and the assets purchased with them, to for-profit corporations. The Auditor’s 2002 Operational Review agreed, concluding that “some governing authorities are not independent of school vendors and management company representatives.” (*Id.* at Ex. G, pp. 1-20).

White Hat's dominance when the Plaintiff boards entered into the management agreements shows the lack of arm's length negotiation that is an earmark of "procedural unconscionability." Coupled with the "substantive unconscionability" manifest in their patently unfair terms, the Court should find that the management agreements are unenforceable.

2. The Management Agreements Are Unenforceable As Contrary to Public Policy

While the right to make and enforce contracts is protected by Ohio law, the liberty to contract is not absolute. Reasonable restrictions on the right to contract may be imposed under the police power to protect the public welfare. *See Lake Ridge Academy v. Carney*, 66 Ohio St.3d 376, 613 N.E.2d 183 (1993). "A refusal to enforce a contract on the grounds of public policy may be distinguished from a finding of unconscionability. Rather than focus on the relationship between the parties and the effect of the agreement upon them, public policy analysis requires the Court to consider the impact of such arrangements upon society as a whole." *Eagle v. Fred Martin Motor Co.*, 157 Ohio App.3d 150, 2004-Ohio-829, ¶63, 809 N.E.2d 1161 (9th Dist.). "A contract injurious to the interest of the state will not be enforced." *Id.* at ¶64, *citing King v. King*, 63 Ohio St. 363, 372, 59 N.E.111 (1900).

In *Cincinnati City School Dist. Bd. of Edn. v. Conners*, 132 Ohio St.3d 468, 2012-Ohio-2447, 974 N.E.2d 78, this court acknowledged that while "the freedom to contract is a broad right," public policy can prohibit the enforcement of a contract which does not preserve for educational purposes assets purchased with scarce Ohio education funds. In *Conners*, the court dealt with a deed restriction placed on property sold by the Cincinnati Board of Education which provided that an unneeded school building could not be reused as a school building. The court found that the deed restriction contravened the public policy set forth in a statute which required

school districts to offer unused public school buildings for sale to community schools. R.C. 3313.41(G).

Comparable public policy concerns require this Court to void White Hat's management agreement provisions that purportedly allow White Hat to retain any assets purchased with Ohio education funds if a community school closes or if a management agreement is cancelled. R.C. 3314.074 requires the return of any remaining school assets following the closing of a community school to the "Department of Education for redistribution to the school districts in which the students who are enrolled in the school at the time it ceased operation are entitled to attend * * *." R.C. 3314.074 reflects a legislative intent that the assets of community schools purchased with scarce Ohio education funds should be preserved for education purposes, rather than 90 to a for-profit operator like White Hat.

In *Connors*, this Court accepted the Plaintiff's argument that "the public's interest in striking the deed restriction is heightened when the contract is not between private parties." *Id.* at ¶19. The Cincinnati Board's status as a political subdivision triggered "heightened scrutiny" of the deed restriction. Likewise, the Plaintiff governing authorities that signed the White Hat management agreements were public agencies exercising powers delegated to them by the Ohio General Assembly. This Court should apply comparable "heightened scrutiny" to the White Hat management agreements, and rule that any contracts that allow for-profit community school operators to retain the property purchased with Ohio education funds are unenforceable as contrary to public policy.

3. Community School Boards Do Not Have Authority to Give For-Profit Operators Title to Assets Purchased With State Education Funds.

Like the Cincinnati Board of Education in *Connors*, community school governing authorities "are creations of statute, and their authority is derived from and strictly limited to

powers that are expressly granted by statute or clearly implied therefrom.” *Connors*, 132 Ohio St.3d., 2012-Ohio-2447, 974 N.E.2d 78, at ¶9. While R.C. 3314.01(B) allows a school governing authority to “contract for any services necessary for the operation of the school,” there is no statutory authorization for a school governing authority to simply transfer all of its funds, including funds used to purchase hard assets, to a for-profit “operator.” Instead, R.C. 3314.01(B) only allows the community school board *itself* to “acquire facilities as needed.” While R.C. 3314.01(B) allows a community school board to contract for and pay reasonable compensation to an “operator” for services, it only allows the school board itself to acquire – and be accountable for – facilities, such as school buildings and equipment.

Like a traditional Board of Education, community school boards have a duty “to manage the schools in the public interest.” *Connors* at ¶10, *citing Xenia City Bd. of Edn. v. Xenia Edn. Assn.*, 52 Ohio App.2d 373, 377, 370 N.E.2d 756 (2d Dist. 1977). Likewise, “while a Board of Education has the authority to contract, it must do so with the public in mind.” *Id.* R.C. 3313.41 and related statutes relied on in *Connors* “show that the General Assembly did not intend that a Board of Education have an unfettered right to dispose of its property.” *Connors* at ¶10. Likewise, as R.C. 3314.074 and R.C. 3314.14, 3314.01(B) demonstrate, the General Assembly did not grant to community school boards the right to make a wholesale transfer of capital funds and school assets to for-profit operators like White Hat.

This Court has held that public funds may only be transferred pursuant to “clear legal authority.” *State ex rel. Smith v. Mahany*, 97 Ohio St. 272, 119 N.E. 822 (1918), paragraph one of the syllabus; *Crane Twp. Ex rel. Stalter v. Secory*, 103 Ohio St. 258, 261, 132 N.E. 851 (1921); *State ex rel. Hall v. Police Relief and Pension Fund*, 149 Ohio St. 367, 78 N.E.2d 719 (1948), paragraph one of the syllabus. Absent clear legal authority in R.C. Chapter 3314, the

transfer of capital funds and the resulting assets from community schools to private operations is unlawful. Any provisions in the White Hat management agreement that allow such unlawful transfers should be held unenforceable.

B. WHITE HAT OWES FIDUCIARY DUTIES TO OHIO'S TAXPAYERS AND TO THE SCHOOLS IT OPERATES

Amicus OSBA's Argument in Support of Appellants' Proposition of Law No. 3:

A private entity that agrees to operate all functions of a community school has a fiduciary relationship with the community school. Although the private entity may earn a profit for the services it provides, it must act primarily for the benefit of the community school.

Whether or not White Hat is a fiduciary for the community schools it operates is of material importance in this case. If White Hat was a fiduciary of the schools, then the furniture, books, computers and other assets which White Hat acquired with the state funds allocated to those schools belongs to the schools, not to White Hat. The special nature of a fiduciary relationship disqualifies a fiduciary from taking title to property from its principal, regardless of "fullness of price, absence of fraud, and fairness of purchase." *Magee v. Trautwine*, 160 Ohio St. 466, 468-69, 117 N.E.2d 351 (1957). This blanket prohibition of taking (or even purchasing for fair value) property from a principal prevents White Hat from retaining any hard assets acquired with the state education dollars received from its principals – the community school governing boards. White Hat also owes a fiduciary duty to the State of Ohio and its taxpayers because of its unique role as an operator of "public schools" with taxpayer dollars.

The Court of Appeals incorrectly found that there was no fiduciary duty because "the parties dealt with each other at arm's length in a commercial context," and formalized their agreement "by execution of 16-page contracts that specifically provided that the contracts were not to be construed as creating a partnership [or] joint venture between the parties * * *." (Court

of Appeals Decision, ¶37). The Court of Appeals was wrong. By taking control of virtually all of the schools' cash flow, and assuming virtually all powers to operate the schools, subject to hypothetical oversight by their boards, White Hat assumed and owes fiduciary duties to the schools and to Ohio's taxpayers.

1. White Hat Owes Fiduciary Duties to Ohio's Taxpayers

This Court has accepted the Ohio General Assembly's designation of community schools as part of Ohio's public school system. *Ohio PTA*, 111 Ohio St.3d 568, 2006-Ohio-5512, 857 N.E.2d 1148, ¶72. This Court has also ruled that those acting on behalf of community schools are "public officials." *See Cordray v. The International Preparatory School*, 128 Ohio St.3d 50, 2010-Ohio-6136, 941 N.E.2d 1170 (finding a community school treasurer could be held accountable for missing community school funds as a "public official" under R.C. 9.39 and 9.38 (I)). As held in *Cordray*, a "duly authorized representative of a community school is a public official." *Id.* at ¶25. As a result, White Hat is a "public official." The management agreement makes it the "authorized representative" of the community schools that it operates, for purposes of hiring and firing staff, applying for and managing grants, selecting curriculum, leasing or buying buildings and other capital equipment, and representing the schools in dealings with state and federal officials. (Management Agreement, p. 3-5).

As a "public official," White Hat "has a fiduciary duty to the citizens of this state." *State v. McKelvey*, 12 Ohio St.2d 92, 232 N.E.2d 391 (1967), paragraph one of the syllabus and 95. The Court of Appeals attempted to distinguish *McKelvey* by suggesting it was limited to circumstances where "public officials* * * engaged in some sort of financial misconduct, such as using their public office for private gain or misappropriating funds in contravention of expressed statutory duties." *Citing Cristino v. Bur. of Workers Comp.*, 2012-Ohio-4420, 977 N.E.2d 742, ¶19. But the history of this case certainly suggests that White Hat used its one-sided

management agreements to obtain millions of state dollars earmarked for public education facilities and equipment, and converted those assets for private gain. As recipients of about \$1 Billion in Ohio public education dollars since 1998, White Hat and its affiliates have the same fiduciary duties to the public as other “public officials,” including the duty to return to the state’s education system any property acquired with the state education funds entrusted to White Hat.

2. White Hat Owes A Fiduciary Duty to the Schools It Operates and Their Boards

The Court of Appeals found that White Hat was just another “independent contractor,” owing no fiduciary duties to the public, to the schools it operated, or to their governing boards. Ignoring the one-sided management agreement, the Court of Appeals found that “the parties dealt with each other at arm’s length in a commercial context* * *.” Court of Appeals Decision ¶37. But community schools are not a commercial enterprise: White Hat used its broad management authority and millions of state education dollars to operate and purchase assets on behalf of “public” schools, not franchise restaurants.

A fiduciary relationship is one “in which special confidence and trust is reposed in the integrity and fidelity of another and there is a resulting position of superiority or influence, acquired by virtue of this special trust.” *Groob v. KeyBank*, 108 Ohio St.3d 348, 2006-Ohio-1189, 843 N.E.2d 1170, ¶16 quoting *In re: Termination of Empl. of Pratt*, 40 Ohio St.2d, 107, 115, 321 N.E.2d 603 (1974). “One who acts as an agent for another becomes a fiduciary with respect to matters within the scope of the agency relation.” *Miles v. Perpetual S.&L. Company*, 58 Ohio St.2d 93, 388 N.E.2d 1364 (1979). Finally, the nature of the parties’ undertaking – in this case operation of a public school – is critical in determining whether a fiduciary duty exists. *See Strock v. Pressnell*, 38 Ohio St.3d 207, 216, 527 N.E.2d 1235 (1988).

White Hat's role as an agent of the community school boards is evidenced by the broad authority it assumed under the management agreement it wrote. White Hat can hire and fire employees, lease property and equipment, apply for and manage grants, obtain insurance on behalf of the schools and represent the schools before state and federal regulators. (Management Agreement, pp. 1-3 and 6-7). Under these agreements, the boards grant "broad discretion" and place "special confidence and trust" in White Hat, which assumes "a position of superiority and influence," all of which are hallmarks of a fiduciary relationship. *Groob, infra*, 108 Ohio St.3d 348, 2006-Ohio-1189, 843 N.E.2d 1170, ¶16.

While the management agreement gives White Hat broad authority, it also allows school boards to review and provide input with respect to such things as the size of the school's facility or whether it should be moved (Management Agreement p. 2) and requires the company to "report to the Board of Directors" with respect to financial disclosures, compliance with Ohio law, student performance, teacher and student retention, etc. (Management Agreement pp. 4-5). Though White Hat's discretion to operate the schools is extraordinarily broad, that does not alter its role as agent of the school boards. A principal's agreement "to leave details of the work to the [agent's] discretion, does not alter the relation of the parties, or make the agent an independent contractor." *AmeriFirst Savings Bank v. Krug*, 136 Ohio App.3d 468, 484, 737 N.E.2d 68 (2nd Dist. 1999).

The Court of Appeals relied on *Applegate v. Fund for Constitutional Govt.*, 70 Ohio App.3d 813, 817, 592 N.E.2d 878(10th Dist. 1990), for the proposition that "a fiduciary relationship cannot be unilateral," and requires "evidence that both parties understood that a fiduciary relationship existed." However, in *Applegate*, there was no formal agreement between the parties. Instead, *Applegate* involved a claim by a *pro se* litigant that a public interest group

purportedly had duties to him under an implied *de facto* fiduciary relationship, wherein “one person comes to rely and trust another in his important affairs and the relations there involved are not necessarily legal, but may be moral, social, domestic or merely personal* * *.” *Appelgate* at 816, quoting *Indermill v. United States*, 5 Ohio App.3d 243, 245, 451 N.E.2d 538 (1982). Significantly, Plaintiff *Applegate* paid nothing to the Defendant Fund as part of the alleged fiduciary relationship.

But the relationship between White Hat and the schools it manages does not involve such hazy “informal,” and *de facto* “duties” of a “moral, social, domestic or merely personal nature.” *Id.* Instead, the duties that White Hat assumed arose from an explicit written agreement detailing the schools transfer of virtually all of its cash flow to White Hat, along with the day-to-day management of the schools. From that broad agent/principal relationship fiduciary duties arose, as a matter of law, comparable to those described in *Health Alliance of Greater Cincinnati v. Christ Hosp.*, 1st Dist. Hamilton No. C-070426, 2008-Ohio-4981. In *Health Alliance*, the court found that a fiduciary duty arose from a formal written joint operating agreement between several Greater Cincinnati hospitals and the Health Alliance, a health care management organization. Under the Joint Operating Agreement:

The participating hospitals allowed the Alliance to manage their affairs, enter contracts on their behalf, collect and allocate the revenues, maintain their business records [and] employ their operational staff* * *.”

Id. at ¶21.

The Health Alliance was found to owe a fiduciary duty to the hospitals it managed, because “the hospitals repose special confidence and trust in the Alliance, which resulted in a position of superiority on the part of the Alliance, the very essence of a fiduciary relationship.”

Id. at ¶21. Likewise, the Management Agreement written by White Hat required the schools and

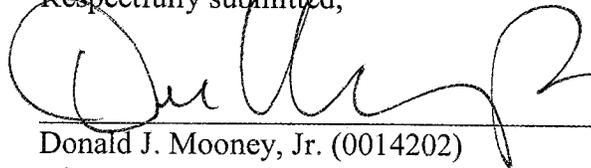
their Boards to “repose special confidence and trust” in White Hat which resulted in a “position of superiority” on the part of White Hat.

The Court should reverse the Court of Appeals, and find that a fiduciary duty was owed to the schools by White Hat that requires the return to the schools of any property purchased with state or federal education dollars transferred by the schools to White Hat.

V. CONCLUSION

White Hat operated community schools have collected and spent about \$1Billion in Ohio education funds since 1998. The school buildings, equipment and other physical assets bought with Ohio funds belong to the public, or the community schools that received those funds. Any form management agreement to the contrary should be found unenforceable as unconscionable, contrary to public policy, or beyond the authority of community school boards. In addition, White Hat’s fiduciary duty to the community schools it operated requires the return of any assets purchased with state funds to those schools. Accordingly, the Court of Appeals decision should be reversed.

Respectfully submitted,



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CERTIFICATE OF SERVICE

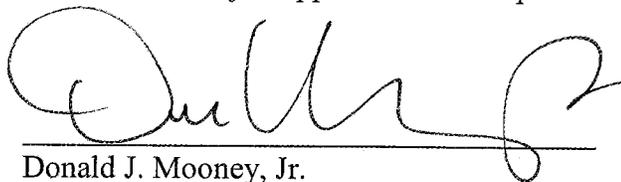
The undersigned hereby certifies that on June 10, 2014, a copy of the foregoing was served via regular U.S. Mail, postage prepaid upon the following:

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