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BILL ANALYSIS

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Senate Bill 1398 (as enrolled)
Sponsor: Senator Wayne Kuipers
Senate Committee: Education
House Committee: Education

Date Completed: 12-20-06

RATIONALE

Under the Federal Schools/Child Nutrition Commodity Programs, the United States Department of Agriculture (USDA) purchases surplus food and other food items, to be distributed to school districts participating in the National School Lunch Program. Each school is entitled to a specific allotment of USDA commodities based on the number of school lunches it serves, valued at 16.75 cents per lunch for the current school year. Because the USDA will deliver shipments only of a certain minimum size, most school districts are unable to receive their commodity deliveries directly from the Federal government.

In 2001, 15 school districts in Michigan created a pilot program known as the Great Lakes Consortium (GLC) to receive USDA commodity foods, and process and distribute them among the members. In 2002, the Department of Education (DOE) entered into a contract with two commercial distributors, Northern Warehousing and Total Logistics Control (TLC), for distribution of the USDA commodities to schools in Michigan. For this purpose, the State was split into three regions; Northern Warehousing was awarded the contract for two of the regions while TLC was awarded a contract for the remaining region. The two regions awarded to Northern cover most of the Upper and Lower Peninsulas except for eight counties in the southeastern part of the State.

Evidently, although the distributors were made aware of the GLC pilot program and the contract did not guarantee any specific sales volumes, the contract did indicate that the companies would be considered the primary distributors in their respective regions. In preparation for high delivery volumes, Northern Warehousing reportedly invested over $2.5 million to expand its storage and delivery capacity.

Between 2001 and 2005, the Great Lakes Consortium expanded beyond its initial 15 members as a growing number of districts chose to join the cooperative rather than receive deliveries through Northern Warehousing. Districts cited cost savings, consolidated administrative tasks, more frequent delivery schedules, and added convenience as reasons for preferring the GLC. Also, in November 2003, a second cooperative, known as the School Purchasing and Resources Consortium (SPARC), was formed. A third cooperative, Macomb Oakland Resa, was formed later. By 2006, at least 210 school districts were participating in these cooperatives, leaving Northern Warehousing with fewer customers and lower revenue. Concerned about the continued viability of its business, the company filed a lawsuit against the Department of Education for breach of contract, among other charges. (For more information on *Northern Warehousing, Inc.* v. *State of Michigan, Department of Education*, please see **BACKGROUND**.)

In bringing the case, the plaintiff alleged in part that the cooperatives had not been operating legally under the Urban Cooperation Act, which requires the filing of an interlocal agreement with the Secretary of State and the county clerk for the county where each party is located, as well as the approval of the Governor or a State officer or agency, before an interlocal cooperative agreement can go into effect. In its

defense, the DOE argued that the cooperatives were organized not under that Act, but instead under the Revised School Code, which permits a general powers school district to enter into cooperative arrangements in performing the functions of the school district. Although the lawsuit involved other areas of contention (and has since been dismissed), it has been suggested that the Revised School Code should specifically permit schools to enter into cooperative arrangements without complying with the Urban Cooperation Act, in order to avoid future confusion over the applicability of the two statutes.

CONTENT

The bill would amend the Revised School Code to specify that an agreement or cooperative arrangement that was entered into under the Code would not have to comply with the Urban Cooperation Act.

The Code permits a general powers school district to enter into agreements or cooperative arrangements with other public and private entities or to join organizations as part of performing the functions of the school district.

Under the bill, such an agreement or cooperative arrangement would not have to comply with the Urban Cooperation Act, as provided in Section 503 of that Act. (The Urban Cooperation Act allows a public agency of the State to exercise jointly with any other public agency of this or any other state, with a public agency of Canada, or with a public agency of the United States government, any power, privilege, or authority that the agencies share in common and that each might exercise separately. Section 503 specifies that if any provision of that Act conflicts with any other State statute providing for the authorization or performance of joint or cooperative agreements or undertakings between State public agencies or between State public agencies and public agencies of other states or of Canada, the provisions of the other statute control.)

MCL 380.11a

BACKGROUND

In January 2005, Northern Warehousing, Inc. filed suit in the Michigan Court of Claims against the Michigan Department of Education. The suit alleged a violation of the Urban Cooperation Act, promissory estoppel, breach of contract, silent fraud, fraudulent misrepresentation, and other complaints.

Those charges rested on evidence that the cooperatives had failed to file their interlocal agreement with the Secretary of State and with the local county clerks before the cooperatives went into effect as required under the Urban Cooperation Act; that the DOE had expressly promised increased volumes to Northern Warehousing in a 2002 letter, although those volumes were in fact eroded by the cooperatives; that the DOE had failed to disclose to Northern the expansion of the cooperatives and did not account for them in later estimates supplied to the company upon contract renewal; and that the DOE had indicated to Northern that the cooperatives would cause only a "minor change" in the distributor's volume, although in fact they resulted in a 42% decline in revenue.

To maintain the status quo while the trial was proceeding, the plaintiff requested that the Court grant a preliminary injunction requiring members of the cooperatives to resume receiving shipments from Northern Warehousing. The Court concluded that there were grounds for granting the preliminary injunction, finding, among other things, that the plaintiff was likely to succeed on the merits of the case, and that a failure to grant the injunction could mean that the plaintiff could go out of business and cease to exist, constituting irreparable injury. On January 21, 2005, the Court ordered all districts in the affected regions, other than the original 15 GLC members, to resume receiving USDA commodity deliveries from Northern Warehousing, rather than through the cooperatives.

The DOE appealed the injunction. In March 2006, the Michigan Court of Appeals upheld the decision, concluding that the trial court did not abuse its discretion in finding a likelihood of success on the merits on the promissory estoppel claim. (As the Court of Appeals explained, the elements of such a claim are: 1) a promise; 2) that the

promissor should reasonably have expected to induce action of a definite and substantial character on the part of the promissee; and 3) the promise in fact produced reliance or forbearance such that the promise must be enforced to avoid injustice.) The Court of Claims then ordered districts to comply with the injunction by April 27, 2006. After that date, the cooperatives were not allowed to distribute USDA commodity foods to any districts other than the original members, although the Court did say that the consortia could distribute commercial foods and perform other services. Because of the court order, all USDA food items that were in the possession of the cooperative were transferred to the commercial distributor.

On October 11, 2006, the Court of Claims dismissed the case, once again allowing school districts to join the GLC, SPARC, or other cooperatives. According to a spokesperson for the DOE, the consortia are in the process of reorganizing.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The GLC and SPARC cooperatives represent innovative ways to cut costs and improve the efficiency of schools in the State. At a time when school districts are struggling with rising costs and increasingly tight budgets, those efforts should be encouraged. The cooperatives benefit schools by combining administrative responsibilities and providing more frequent delivery schedules that better suit the storage needs of the districts. As another advantage, the cooperatives can divert shipments of bulk chicken or beef to be processed into more usable food items, saving on food preparation costs. Because of these benefits, the cooperatives have expanded rapidly over the few years that they have existed, and likely will continue to grow, if permitted to do so. The recent litigation has introduced an element of uncertainty regarding the future of these cooperatives, however.

As *Northern Warehousing* v *State of Michigan* proceeded, school districts were caught in the middle, being ordered to return to delivery service by Northern Warehousing. Districts have complained that the delivery service by Northern is less frequent than and not as convenient as the services provided by the consortia. In addition, the food that was in transition when the schools were ordered to switch distributors had to be returned, in some cases costing school districts significant amounts of money. A representative of the Saline Area Schools testified before the Senate Education Committee that the school district lost $28,000 when it was ordered to return to the services of Northern Warehousing. The Department of Education has spent considerable time and effort attempting to sort out the details and ensure that districts did not lose allotments of food that they previously were entitled to under the consortia. The lawsuit has caused a tremendous amount of confusion and inconvenience, despite the fact that many believed the cooperatives were clearly permissible under State law. The bill could help prevent such confusion and costly litigation in the future by clarifying that school districts have the authority to engage in cooperative arrangements to provide food service to schoolchildren, without complying with the Urban Cooperation Act.

Legislative Analyst: Curtis Walker

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

Fiscal Analyst: Kathryn Summers-Coty

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