

**UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION**

LITTLE ROCK SCHOOL DISTRICT

PLAINTIFF

v.

No. 4:82-cv-866 DPM

**PULASKI COUNTY SPECIAL SCHOOL
DISTRICT NO. 1, et al.**

DEFENDANTS

MRS. LORENE JOSHUA, et al.

INTERVENORS

KATHERINE KNIGHT, et al.

INTERVENORS

**REPLY TO RESPONSES TO
MOTION FOR ORDER**

The State of Arkansas and the Arkansas Department of Education (ADE), by and through its attorneys, Attorney General Dustin McDaniel and Assistant Attorney General Scott P. Richardson, state for their Reply to Responses to Motion for Order:

On Monday, June 20, 2011, the ADE exercised its authority under State law to relieve the superintendent and the board of directors of the PCSSD of their administrative authority over the district. Given the responses filed and the comments at the hearing held on this matter, some background on what gave rise to the ADE's decision is appropriate.

Every school district is required to undergo an annual audit of the district's finances. Ark. Code Ann. § 6-20-1802. For the years ending June 2008 and 2009, PCSSD's audits found significant deficiencies and material weaknesses in PCSSD's internal controls over its financial reporting. Ex. B, C, Excerpts from Report of Independent CPA for year ending June 30, 2008 and 2009 (full text of school district yearly audits are available at www.legaudit.state.ar.us). In both yearly audits PCSSD was determined to be a "high-risk auditee," meaning that there was a high-risk the district was in violation of federal or state laws as a result of failures in its accounting procedures. Id., see OMB Circular No. A-133. These audits were released on 21

March 2009, and 28 May 2010. In layman's terms, the audits revealed that PCSSD was having serious problems managing its money in a responsible manner.

Around the time of the release of the second independent audit, the Arkansas Division of Legislative Audit was conducting an investigation for the Legislative Joint Auditing Committee of the PCSSD's fiscal practices at the request of the Commissioner of the ADE and the PCSSD Board of Directors. Ex. D, 14 May 2010 Investigative Report. This "Review of Selected Transactions" was released on 14 May 2010. The summary of this report on the first page revealed that district employees, a prior superintendent, and Board members had taken over half a million dollars of District money through illegal and questionable payments or theft allowed by internal control deficiencies and a lack of oversight by district management. Ex. D, 14 May 2010 Investigative Report. The report detailed the many fiscal failures found in the district that allowed these things to happen and put the PCSSD at risk of further serious fraud, waste, and abuse.

A month later, on 10 June 2010, the ADE sent a letter to the PCSSD administration reminding them (and informing the then-incoming superintendent Dr. Charles Hopson) of the audit findings including the finding of that the PCSSD administrative staff and Board "did not demonstrate a 'tone at the top' promoting commitment to financial prudence and consistency with policies and procedures." Ex. E, 10 June 2010 letter. The ADE's letter specifically warned PCSSD's administration that the audits contained "extremely serious violations of the administration and Board's fiduciary responsibilities pertaining to public funds." Id. Although the ADE stated that it did not have evidence at that time that the violations had negatively impacted the continuation of educational services by PCSSD; ADE specifically warned PCSSD that if the deficiencies found in the audits were not corrected then "the ADE may identify

PCSSD as a district in fiscal distress” and explained the potential consequences of that action. Removal of the superintendent and Board were specifically noted in the letter as a potential consequence if PCSSD did not correct its failure to properly manage its revenues and expenditures. *Id.* The ADE’s Department of Fiscal and Administrative Services send a second letter containing similar warnings to Dr. Hopson on 8 September 2010. Ex. F, 8 Sept. 2010 letter.

Unfortunately, PCSSD did not heed the warnings in the letters; the deficiencies in the audits and investigative reports were not corrected. On 15 December 2010, the Division of Legislative Audit updated its 14 May investigative report. Ex. G, 15 Dec. 2010 Investigative Report Update. The December report identified over \$60,000 in overpayments to district employees and board members, a still outstanding payment to the prior superintendent, and legally questionable payments to people hired by Dr. Hopson (including his brother). The report also reported over \$20,000 that a program operated by a PCSSD Associate Superintendent’s daughter owed the district and was not required to pay back until Legislative Audit brought this situation to light. This money had still not been paid to the PCSSD as of 1 April 2011. On 7 February 2011, the PCSSD’s independent audit for the year ending 30 June 2010, was released. Ex. H, Excerpts from 30 June 2010 Audit. This audit, like the two prior, identified material weaknesses in the financial controls at the district and identified PCSSD, again, as a “high-risk auditee.” *Id.*

The deadline in State law for ADE to notify a district that it is being identified as fiscally distressed is 30 March each year. Ark. Code Ann. § 6-20-1905. On 30 March 2011, the ADE notified PCSSD that it was being identified as a school district in fiscal distress. The following day, on 1 April 2011, the Division of Legislative Audit issued a second update to its May 2010

Investigative Report. The 1 April update found that over \$37,000 was still owed or potentially owed to the PCSSD by a Board member, employees, and vendors; that Dr. Hopson had been improperly paid and still retained about \$4,000 in unallowed expenses and insurance premium reimbursements; and that the other financial deficiencies identified in the 15 December report had not been addressed. As all of these fiscal problems at PCSSD were being revealed, other problems were coming to ADE's attention including serious infighting among district board members.

In short, the audits and investigative reports revealed massive internal financial control problems that remained unaddressed in the face of stern warnings from the ADE and Legislative Audit. Despite having nine months to correct the deficiencies found in the May 2010 investigative report and two years worth of adverse audits from the PCSSD's independent accountants, nothing had been done to correct the problems and it appeared that the problems in the district were actually becoming worse. It should be noted as well that the audits and investigative reports were based on a limited number of tests of the fiscal controls in the PCSSD and the questionable expenditures resulting from the failures found in the PCSSD's fiscal controls. A broader audit or investigation could have (and probably would have) revealed even more questionable expenditures and reimbursements due to the failure of the PCSSD to properly control its revenue and spending. Essentially, the auditors opened up the window at PCSSD, looked in, and discovered uncontrolled spending that resulted in hundreds of thousands of dollars walking out of the doors of the PCSSD. The PCSSD's administration failed to implement proper controls to rein in its questionable expenditures and reimbursements; problems that the superintendent and Board of Directors help create and did little to repair. Knowing of the failures of the administration at the PCSSD, the State could not "continue to leave adequacy . . .

considerations regarding school expenditures solely to local decision-making.” *Lake View School Dist. No. 25 v. Huckabee*, 351 Ark. 31, 98, 91 S.W.3d 472 (2002). Something had to be done, so on 20 June 2011, Commissioner Tom Kimbrell exercised his authority to relieve the PCSSD Board and Superintendent of the authority they possessed over PCSSD. Ex. I, Letters to Board and Superintendent. Dr. Jerry Guess, formerly of the Camden-Fairview School District, has agreed to step in and clean up the mess that the district’s former administration created. He began that work just this week on 5 July 2011.

While the State was considering what needed to be done to address the fiscal deficiencies of the PCSSD, it understood that the action it was contemplating could raise issues related to the PCSSD’s involvement in the current desegregation litigation. These issues could not, however, prevent the ADE from taking action to restore the fiscal health of the State’s third largest school district and to repair that district’s standing in the community. Difficult as they may be, the issues that State take-over, necessitated by PCSSD’s leadership’s failure to properly administer the district, raises in this case are not as serious as the fiscal impact of the failures of the PCSSD’s prior administration.

Some guiding principals of federal law are important to note here: Federal remedial powers can only be exercised on the basis of a violation of federal law and, even then, can “extend no farther than required by the nature and the extent of that violation.” *Gen. Bldg. Contractors Ass’n v. Pennsylvania*, 458 U.S. 375 (1982); *see also Board of Education of Oklahoma City v. Dowell*, 498 U.S. 237, 111 S.Ct. 630 (1991); *Milliken v. Bradley*, 433 U.S. 267, 97 S.Ct. 2749 (1977)(*Milliken II*). Federal “remedies that override state law must be narrowly tailored so as to infringe state sovereignty as minimally as possible.” *Perkins v. City of Chicago Heights*, 47 F.3d 212 (7th Cir. 1995); *St. Charles Tower, Inc. v. Kurtz*, ___ F.3d ___,

2011 WL 2535530 (8th Cir. June 28, 2011). The State has a duty that arises under the State's Constitution to see that an adequate education is provided in the school districts of the State. *Lake View School Dist. No. 25 v. Huckabee*, (2002). The State's exercise of administrative control over the PCSSD is a core function of the State's sovereignty. *Jenkins v. Missouri*, 216 F.3d 720, 726 (8th Cir. 2000)(stating that court exercising equitable powers must resist the "temptation to blur the separation of powers, to shift the balance between the federal courts and state and local government too far toward the courts). The 1989 Settlement Agreement and this case can only interfere with the State's exercise of its sovereignty over the PCSSD to the extent that the State's action would undermine compliance with the PCSSD's desegregation plan.¹

As things stand today, the district is now under the control and being operated by a superintendent, Dr. Jerry Guess, appointed by Dr. Kimbrell. The district has not become an arm of the State: its bank accounts are still held in PCSSD's name, the employees are PCSSD employees not State employees, the schools are run by PCSSD principals not State principals, and the teachers' contracts remain with the PCSSD (not the State) as do all of the other contracts that district vendors (including its lawyers) hold with the district. The district continues as a political subdivision of the State with its own legislatively granted corporate form. Ark. Code Ann. § 6-13-101, 102; *Herts v. Smith*, 345 F.3d 581 (8th Cir. 2003)(holding that PCSSD is a political subdivision of the State of Arkansas). PCSSD still embraces a certain territory and its inhabitants; it remains organized for the public advantage; its chief design remains the exercise

¹ LRSD and the Joshua Intervenors have filed Responses to the State's Motion for Order suggesting that the State was not authorized to take action to correct the problems in the PCSSD. First, it is not clear what standing LRSD has to complain about the State's action viz. PCSSD. Second, if any party is seeking relief from the Court, it should file a formal motion requesting that relief. See Docket Entry # 4155 (Letter/Order directing Joshua Intervenors to file a formal motion if they are seeking relief from the Court).

of governmental functions, namely providing public elementary and secondary education in parts of Pulaski and Lonoke Counties. *Dermott Special School Dist. v. Johnson*, 343 Ark. 90, 32 S.W.3d 477 (2000). The principal change is that the board has been suspended for a period of time that cannot exceed two years. Ark. Code Ann. § 6-20-1908(d). This change in central office administration is necessary in order for the State to correct the fiscal distress caused by the prior administration of the PCSSD. Dr. Guess is well experienced in addressing court-ordered desegregation obligations. It is hoped that his leadership will move the district forward with compliance with Plan 2000 (the PCSSD's desegregation plan).

In thinking through the issues that State take-over of the PCSSD presents in this on-going litigation, the Attorney General's office sought the advice of former Arkansas Supreme Court Associate Justice David Newbern. His opinion is attached as exhibit A. The Court will see that this opinion forms the basis for the State's Motion for Order. The current potential for conflict of interest arises principally with the issue of Judge Miller's order terminating the State's obligation to provide desegregation payments except for M to M funding and Judge Miller's order to the districts to show cause why the M to M funding should not be discontinued as well. The impact of the conflict is lessened because all four other parties to this case (LRSD, NLRSD, Joshua, and Knight) fully oppose Judge Miller's order on the funding issues. Any change to Judge Miller's order by this Court or the Eighth Circuit will likely apply equally to each district, so the other parties' opposition should inure to the benefit of PCSSD.

As stated by counsel for PCSSD, Mr. Sam Jones, the State has not directed him to change his legal strategy in the case nor has the State attempted to override the instructions given to him by the prior board and superintendent. Consistent with Justice Newbern's opinion, the State through the Attorney General's office has informed counsel for PCSSD that he is to proceed as

he sees fit consistent with the prior orders and direction he was provided by the former superintendent and board of the district. Many of these decisions have now been executed by Mr. Jones: the stay has been granted at the 8th Circuit after full briefing and PCSSD's brief on M to M funding has been provided to the Court (along with briefs from every other party). The main issue remaining in the legal representation is the PCSSD's brief on the merits of Judge Miller's order to release the State from its obligation to provide desegregation funds other than M to M funding. The State has left Mr. Jones in the same position as with the other issues: he is free to draft the brief as he sees fit and consistent with the directions of the prior superintendent and board of the PCSSD. There are currently no other significant conflicts of which the undersigned is aware. If others are to arise, an order consistent with Justice Newbern's opinion should resolve the conflict.²

At the hearing on Friday, 1 July 2011, the Court raised the possibility of the Attorney General's office proceeding under Arkansas Code Annotated section 25-16-711. That statute provides that if the Attorney General and a constitutional officer of the State (Governor, Lt. Governor, Secretary of State, Auditor, Treasurer, Land Commissioner) disagree on the interpretation of a constitutional provision, act, rule, or regulation which affects the duties of that constitutional officer, then the officer can employ special counsel to resolve the disagreement. Generally, the Attorney General represents all state agencies and the State in litigation in federal and state courts. Ark. Code Ann. § 25-16-702. The PCSSD is not a department, institution, or agency of the State. Ark. Code Ann. § 25-16-702. It is a political subdivision of the State.

² "Unlike lawyers representing clients, the Attorney General is not necessarily prohibited from representing governmental clients whose interest may be adverse to each other. The majority rule is that the Attorney General, through its assistants, may represent adverse state agencies in intra-governmental disputes." *Holloway v. Ark. State Bd. Of Architects*, 79 Ark. App. 200, 215 (2002).

Herts v. Smith, 345 F.3d 581 (8th Cir. 2003) *see also Smith v. Decatur School Dist.*, 2011 Ark. App. 126 (2011)(holding that former superintendent was not entitled to payment because performance under employment contract was rendered impossible by ADE's reconstitution of district, permanent removal of superintendent, and appointment of new superintendent). So, this statute is not directly applicable. However, to the extent that the statute provides analogous authority, the State has, essentially, put into place a solution like that in the statute. PCSSD still retains Mr. Jones and he has been given the freedom to litigate the case as he sees fit. Mr. Jones confirmed at the hearing on Friday that his legal positions have remained the same and no one from the State has sought to alter those positions. He is essentially functioning as an independent counsel with the ability to litigate the case consistent with the directions of the prior superintendent and board.

The Attorney General's office believes that the best solution is the one suggested by Justice Newbern: allowing Mr. Jones to continue to participate in the appellate process to its conclusion and be reasonably compensated by the PCSSD in accordance with whatever contract or other arrangement that counsel had with PCSSD prior to State take-over of the District. In light of Mr. Jones's response to the State's Motion for Order, the Court could decide to not enter an order at this time but to notify the parties that if a dispute arises then Mr. Jones or the State can seek the Court's guidance in resolving the conflict. However, an order entered consistent with Justice Newbern's recommendation would provide the State, PCSSD, and Mr. Jones a clear protocol on how to proceed.

WHEREFORE, the State of Arkansas requests that the Court enter an order consistent with the recommendation in paragraph six of its Motion for Order, or, alternatively, an order providing terms on which counsel for PCSSD can continue in their representation of the district in this case while PCSSD remains, temporarily under direct State control, and for all other relief to which it is entitled.

Respectfully submitted,

DUSTIN McDANIEL
Attorney General

BY: /s/ Scott P. Richardson
SCOTT P. RICHARDSON, Bar No. 01208
Assistant Attorneys General
323 Center Street, Suite 1100
Little Rock, AR 72201-2610
(501) 682-1019 direct
(501) 682-2591 facsimile
Email: scott.richardson@arkansasag.gov

ATTORNEYS FOR STATE OF ARKANSAS AND
ARKANSAS DEPARTMENT OF EDUCATION

CERTIFICATE OF SERVICE

I hereby certify that on July 8, 2011, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system, which shall send notification of such filing to the following:

Mr. Clayton R. Blackstock
cblackstock@mbbwi.com

Mr. John W. Walker
johnwalkeratty@aol.com

Mr. Mark Terry Burnette
mburnette@mbbwi.com

Mr. Stephen W. Jones
sjones@jlj.com

Mr. John Clayburn Fendley , Jr
clayfendley@comcast.net

Ms. Deborah Linton
dlinton@jacknelsonjones.com

Mr. Christopher J. Heller
heller@fec.net

Ms. Mika Shadid Tucker
mika.tucker@jacknelsonjones.com

Mr. M. Samuel Jones , III
sjones@mwsqw.com

Office of Desegregation Monitor
mqpowell@odmemail.com, lfbryant@odmemail.com, paramer@odmemail.com

I, Scott P. Richardson, Assistant Attorney General, do hereby certify that I have served the foregoing and a copy of the Notice of Electronic Filing by depositing a copy in the United States Mail, postage prepaid, on July 8, 2011, to the following non-CM/ECF participants:

Mr. Robert Pressman
22 Locust Avenue
Lexington, Mass. 02173

/s/ Scott P. Richardson
SCOTT P. RICHARDSON