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focus
REPORT

February 21, 2005

Court Rules School Finance System Unconstitutional

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State District Judge John Dietz has ruled that the state's school finance system is unconstitutional because school districts lack meaningful discretion to set local tax rates and because the cost of providing an adequate education exceeds the funds available to districts through current funding formulas. Judge Dietz also found that the system for funding school facilities violates constitutional standards for equity between property-wealthy and property-poor school districts.

Judge Dietz has given the Legislature until October 1, 2005, to address the problems detailed in his findings of fact and conclusions of law, which were issued November 30, 2004. The Texas Supreme Court has accepted a direct appeal of the case in order to expedite a final decision, which is not expected before the end of the 2005 regular legislative session. Even if the Supreme Court takes the case directly, a decision is not expected before the end of the 2005 regular legislative session. This report outlines the principal findings and conclusions in Judge Dietz's decision.

Background

The current school finance lawsuit (*West Orange-Cove Consolidated ISD, et. al. v. Neeley, et. al.*) originally was filed in 2001 by four property-wealthy school districts. Those districts asserted that because they were or soon would be levying local property taxes at $1.50 per $100 of taxable value, the maximum allowable rate for maintenance and operation (M&O) of schools, they had lost local discretion in setting M&O rates. They sought a declaration from the 250th District Court in Travis County that the system effectively creates a state property tax, prohibited under the Texas Constitution, Art. 8, sec. 1-e.

This report outlines the principal findings and conclusions in the State District Court decision that found the state's school finance system unconstitutional.

State District Judge Scott McCown dismissed the case without a trial for "lack of ripeness," agreeing with the state that fewer than half of all districts had reached the $1.50 cap, an insufficient

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number for the court to consider whether the state had established a prohibited statewide property tax. The Third Court of Appeals in Austin upheld Judge McCown's decision, but the Texas Supreme Court, in *West Orange-Cove Consolidated I.S.D. et. al. v. Alanis et. al.,* 107 S.W. 3d 558 (Tex. 2003), reversed the two lower court decisions and remanded the case to Travis County District Court for a trial. (For additional background on this phase of the lawsuit, click here to see "Taking Stock of School Finance Litigation," HRO *Interim News*, Number 77-8, May 29, 2002.)

More than 300 other school districts, including both property-poor and property-wealthy districts, subsequently joined the lawsuit as part of three separate groups.

The four original *West Orange-Cove* plaintiffs were joined by 43 other districts – including Dallas, Houston, and Austin – as well as smaller property-poor and property-wealthy districts from throughout the state. These districts claimed that because they were forced to tax at or near the $1.50 cap in order to meet the minimum requirements for educating their students, they lacked local discretion in setting tax rates. They claimed that this lack of discretion created a state ad valorem property tax prohibited by Art. 8, sec.1-e of the Texas Constitution. This expanded plaintiff group also asserted that the revenue they were able to raise under the tax cap was not sufficient to provide a constitutionally adequate education to their students. This marked the first time that "adequacy" has been at the forefront of a Texas school finance lawsuit, reflecting a national trend to have courts examine whether states are providing adequate funding to meet constitutional and legislative mandates for public education.

Twenty-two of the state's poorest districts formed a second group, the *Edgewood* intervenors. They intervened to resist any changes to the tax structure or school finance formulas that would erode the gains in equity between property-poor and property-wealthy districts made as a result of the 1990s school finance lawsuits, in which the Edgewood school district was lead plaintiff. They asserted that the current funding gap between the richest and poorest districts, including for school facilities, does not meet constitutional standards for equity.

A third group made up of more than 200 property-poor districts entered the case as the *Alvarado* plaintiff/intervenors. They supported efforts to preserve equity in the system but emphasized the "adequacy" claim, contending that state and local funds available to public schools are inadequate to meet the constitutional requirements to provide "a general diffusion of knowledge." (For a detailed description of the original claims made by each plaintiff group, click here to see "School Finance Litigation Update," HRO *Interim News* Number 78-4, April 7, 2004.)

Adequacy

All three plaintiff groups asserted that the state's school finance system fails to meet the standard in Art. 7, sec. 1 of the Texas Constitution, which requires the Legislature to create an efficient system for providing a "general diffusion of knowledge." In the original appeal, the Texas Supreme Court said it would not second-guess the Legislature's policy choices on what constitutes a minimally adequate education but would decide whether those choices as a whole meet the constitutional standard in Art. 7, sec. 1.

At the six-week trial, which began in August 2004, superintendents of Austin, Dallas, and other "focus" districts representing the plaintiffs presented testimony. The *West Orange-Cove* plaintiffs and the state each introduced a study that used an econometric "cost function" approach to determine the cost of meeting certain performance standards, such as a 55 percent pass rate on the TAKS test. While indicating that the two studies likely underestimated the cost of meeting minimal standards, Judge Dietz determined that both studies supported the claim that school districts lack sufficient funds to provide an adequate education even while taxing at or near the $1.50 cap.

Judge Dietz concluded that the *West Orange-Cove* plaintiffs had shown that the cost of meeting the constitutional mandate of adequacy (the "general diffusion of knowledge") exceeds the maximum amount provided by the state's funding formulas. He found that the plaintiffs had established that the problem was systemic and statewide and that the system fails to provide these districts with an adequate, suitable, and efficient system as required by Art. 7, sec. 1 of the Constitution.

In response to adequacy claims by the *Alvarado* and *Edgewood* intervenors, Judge Dietz determined that the current Texas school finance system fails to provide these districts with sufficient access to revenue to provide for a general diffusion of knowledge to their students, in violation of Art. 7, sec. 1 of the Constitution.

Judge Dietz did not indicate what level of funding would satisfy the constitutional requirements for providing an adequate education but identified where current funding falls short. He pointed to inadequate weight adjustments in school finance formulas for bilingual, disadvantaged, and other special-needs students. The greater burden for these inadequate weights, he noted, is borne by property-poor districts, given that their student populations disproportionately are economically disadvantaged and of limited English proficiency.

> *A general diffusion of knowledge being essential to the preservation of the liberties and rights of the people, it shall be the duty of the Legislature of the State to establish and make suitable provision for the support and maintenance of an efficient system of public free schools.*
>
> – Texas Constitution, Art. 7. sec. 1

Judge Dietz documented the negative effects on test performance, student retention, and graduation rates that result from underfunded weights, particularly for students who are economically disadvantaged or have limited English proficiency. He noted that the Legislature had determined that the weight for bilingual education would be determined by the funds available for appropriation, rather than by the actual costs associated with the needs of this population. He pointed out that inadequate funding diminished the ability of property-poor districts to provide for adequate libraries and library staff and to recruit and retain highly qualified teachers. (For more information about how program weights operate in the school finance system, click here to see *Formula Adjustments and the School Finance System,* HRO Focus Report Number 78-15, March 31, 2004.)

State property tax

In May 2003, the Texas Supreme Court in the original appeal of the case held that a school district must have "meaningful discretion" in setting its property tax rates for a local ad valorem tax or it would be considered a state property tax prohibited by Article 8, section 1-e of the Texas Constitution. In remanding the case to district court, the Texas Supreme Court said that an "accredited education" and a "general diffusion of knowledge" both are minimum standards binding on the districts. As a result, a district may allege that if it is forced to tax at the $1.50 cap to satisfy either standard, then the state is imposing an unconstitutional state property tax. While the Supreme Court presumed that the two minimum standards are the same, it said the trial court could determine if they were different in deciding whether the plaintiff districts had lost meaningful discretion in setting their taxes at or near the cap to meet either of the standards.

Judge Dietz determined that the plaintiffs had rebutted any presumption that an "academically acceptable" ranking under the state's accountability system is the proper measure of a "general diffusion of knowledge." Rejecting the position that the "general diffusion of knowledge" requires expenditures only in the instructional program, he noted that many legislative requirements describe a level of educational "adequacy" beyond the achievement of an "academically acceptable" accreditation ranking. He pointed out that a district cannot provide an adequate education without a sufficient support network, which may include but is not limited to well maintained facilities, remedial and literacy programs, qualified teachers, preschool programs, and extracurricular activities.

He found, therefore, that the current system is in violation of Art. 8, sec. 1-e of the Constitution because districts lack meaningful discretion in setting their local tax rates – the combined result of the $1.50 statutory cap and legislative and constitutionally imposed requirements. Further, he said, the plaintiffs had established a systemic/statewide constitutional violation. Judge Dietz said that a district has meaningful discretion only if it can devote 10 percent of its taxing capacity, or about 15 cents of tax effort, to raise additional revenues to enrich its programs beyond what is required to provide a general diffusion of knowledge and to comply with state and federal mandates.

Equity

Judge Dietz upheld the constitutionality of the current system of recapture, also known as Robin Hood, to fund the maintenance and operation of public schools, saying, "The disparate property values among Texas public school districts, coupled with the state's continued reliance on local property taxes for the majority of funding for the Texas school finance system, requires the state to maintain equalization provisions similar to those at present, in order to ensure an efficient system among public free schools."

While upholding the recapture system, Judge Dietz recognized "a structural disparity in access to revenues, that, while not reaching the level of a constitutional violation at this time, still puts property-poor districts at a financial disadvantage when compared with Chapter 41 [property-wealthy] districts." He denied a claim by the *Edgewood* intervenors that the gap in M&O funding between property-poor and property-wealthy districts, in conjunction with the greater burden borne by property-poor districts of inadequate funding formulas, violated the efficiency and suitability (equity) provisions of the Constitution.

However, Judge Dietz found the state's system of financing school facilities did not meet the constitutional standard for equity. He attributed this to the lack of recapture for facilities funding combined with the Legislature's failure to adequately fund the Instructional Facilities Allotment (IFA) or to roll forward the Existing Debt Allotment (EDA), as well as the state's prohibition against the use of M&O funds for school facilities. This system violates the efficiency and suitability provisions of Art. 7, sec. 1 of the Constitution, he said, because it means property-wealthy and property-poor districts do not have substantially equal access to funds for facilities.

Judge Dietz noted the negative impact of inadequate school facilities on student achievement and teacher effectiveness and pointed out that the *Edgewood* districts have school facilities that do not even meet the state's own standards of adequacy.

After Judge Dietz released the findings of fact and conclusions of law, the *Edgewood* intervenors filed motions in district court to reconsider whether the gap in access to M&O funds violates constitutional standards for equity. Judge Dietz did not rule on the motion before his jurisdiction over the case ended February 14.

Appellate status

On February 18, 2005, the Supreme Court accepted the state's direct appeal and set a briefing schedule. The state has until March 30 to file its appellants' brief. The plaintiffs have until May 9 to respond, and the state has until May 31 to reply. The court has not set a date for oral arguments.

– by Betsy Blair

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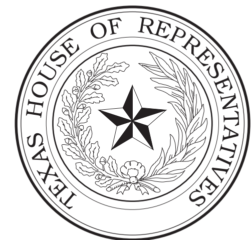

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