

Texas school finance system survives latest Supreme Court review

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The state's current public school finance system meets the minimum requirements set out by the Texas Constitution, the Texas Supreme Court [ruled](#) in May. The case was the latest in a series of legal challenges brought against the state by school districts in recent decades over Texas' method of funding its public schools. In the most recent case, *Morath, et al. v. The Texas Taxpayer and Student Fairness Coalition, et al.*, the Supreme Court unanimously found that the existing system, while flawed, does provide an efficient, free public school system and does not function as an unconstitutional state property tax.

Noting that the framers of the Texas Constitution gave the Legislature responsibility for education policymaking, the court said the "judicial role is not to second-guess whether our system is optimal." The justices also said Texas students "deserve transformational, top-to-bottom reforms" in education funding but that the authority to act rests with the Texas Legislature.

The Supreme Court ruling overturned a 2014 district court decision that had found that the finance system inadequately funds schools, inequitably distributes funding, and effectively imposes a prohibited state property tax. Because the system has now been ruled constitutional, the 85th Legislature will not be under a court order in response to the latest school finance challenge. However, ongoing House and Senate committee interim reviews of education funding and tax laws could result in recommendations for lawmakers to consider next year.

This report briefly outlines the recent history of school finance litigation, summarizes the Supreme Court's ruling in the latest case, and reviews current interim committee charges related to public school finance.

This report reviews some recent history of the school finance system in Texas and the Supreme Court's latest ruling upholding its constitutionality.

Previous school finance litigation

Public education in Texas is funded by a combination of state revenue and locally imposed property taxes. These funds are distributed to local districts according to formulas based on the number of students enrolled and the level of local tax effort, among other factors (see *School finance terms*, page 3).

Over the past 25 years, the school finance system has evolved as the Legislature responded to a series of [legal challenges](#) from school districts and taxpayers. The legal challenges have focused on two provisions in the Texas Constitution: the ban on a state property tax in Article 8, [sec. 1-e](#) and the “education clause” requirement in Article 7, [sec. 1](#), which states:

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.

Edgewood cases. Beginning in 1989, the Texas Supreme Court issued a series of decisions on lawsuits initiated by Edgewood ISD in San Antonio. In the initial case, Edgewood ISD, 67 other districts, and numerous students and parents challenged what they said were funding inequities in the school finance system that violated the efficiency requirement in the constitution’s education clause. They claimed that wealthier districts could raise more revenue at lower tax rates than property-poor districts, such as Edgewood, which were forced to tax at higher rates but raised substantially less revenue.

The Supreme Court agreed, ruling that the system provided a “limited and unbalanced” diffusion of knowledge instead of the constitutionally required general diffusion of knowledge. In order to meet the constitutional requirement for an efficient system, the court said, districts must have substantially equal access to similar revenue per student at similar levels of tax effort.

Over the next three years, the Supreme Court twice ruled unconstitutional the legislation that was enacted in response to the first *Edgewood* ruling and later challenged by a variety of school districts. One appeal, *Edgewood III* in 1992, reviewed a legislatively created system designed to reduce geographic disparities in local tax revenue by

creating 188 county education districts to levy property taxes at a rate mandated by the state. The Supreme Court said this system violated the constitutional ban on a state property tax and levied a property tax without an election in violation of another section of the Texas Constitution. In response to the Supreme Court’s ruling, the 73rd Legislature in 1993 proposed a constitutional amendment to create county education districts. Texas voters rejected that measure in an election held during the regular legislative session.

The 73rd Legislature then enacted [SB 7](#) by Ratliff, which imposed a per-student cap on a district’s taxable property value and required districts whose property tax revenue exceeded this “equalized wealth level” to share some of their local tax revenue with property-poor districts. This system has come to be known as recapture and sometimes is referred to as “Robin Hood” or “Chapter 41,” for the section of the Education Code in which it appears.

In 1995, in response to challenges from both property-poor and property-wealthy districts, the Supreme Court upheld the constitutionality of the recapture system in *Edgewood IV*. The court found that SB 7 allowed districts of varying levels of wealth substantially equal access to a level of funds necessary to meet state accreditation standards while reducing the disparity in levels of tax effort required to raise these funds for 85 percent of students. The court said that despite the bill’s imposition of minimum and maximum tax rates that districts could levy, districts retained enough meaningful discretion as to not violate the state property tax ban. The court rejected the claims of property-wealthy districts that had challenged the recapture mechanisms of the bill on various grounds.

West Orange-Cove cases. In 2001, four property-wealthy school districts initiated a lawsuit against the commissioner of education, asserting that they had lost local discretion in setting maintenance and operations (M&O) tax rates because they were or soon would be levying local property taxes at the maximum allowable rate. A district court judge in Travis County dismissed the case without a trial for “lack of ripeness” because fewer than half of all districts had reached the cap of \$1.50 per \$100 of taxable property value. The Texas Supreme Court reversed the rulings of the district court and the Third Court of Appeals in Austin and remanded the case for trial. In doing so, it held that a district must have “meaningful discretion” in setting the rate for its local property tax or the tax would be considered a state property tax.

The case grew to include more than 300 other school districts of varying wealth levels and was tried before state District Judge John Dietz of Travis County. The district court ruled in 2004 that the school finance system was unconstitutional and amounted to a state property tax because school districts lacked meaningful discretion to set local tax rates — the combined result of the \$1.50 statutory cap and other legislative and constitutionally imposed education requirements. The court also ruled that the system violated the constitutional adequacy mandate because the cost of providing a general diffusion of knowledge exceeded the funds available to districts through existing funding formulas.

In 2005, the Texas Supreme Court, in *West Orange-Cove II*, upheld the district court’s finding that the school

finance system effectively created a state property tax because so many districts were taxing at the top legal rate for school M&O tax rates. The Supreme Court said the cap had become “a floor as well as a ceiling,” referring to a warning in *Edgewood IV* that such a result would indicate that school districts had lost meaningful discretion to tax below maximum rates and still provide an accredited education.

The Supreme Court, however, reversed portions of the district court ruling that had found the state in violation of the education clause because of inadequate funding for public education and lack of equal access to facilities funding. The Supreme Court said the potential for the system to become constitutionally inadequate at some point in the future could “be avoided by legislative reaction to

School finance terms

ASATR. This acronym refers to Additional State Aid for Tax Reduction, a requirement contained in Education Code, [sec. 42.2516](#). ASATR was enacted in 2006 as a “hold harmless” provision for certain districts that otherwise would have lost revenue when the Legislature reduced property taxes by one-third. Eligible districts may receive additional state aid or, if property wealthy, be required to give up less revenue through recapture. The provision, sometimes called “target revenue,” is set to expire September 1, 2017.

Foundation School Program. The Foundation School Program (FSP) distributes the majority of state funding to public schools for basic operations and enrichment through two tiers. The Tier 1 formula for maintenance and operations (M&O) is determined by multiplying a basic allotment amount set in the general appropriations act by the number of students per district and adjusted for varying student and district characteristics. Tier 2 local enrichment funding is provided through a guaranteed yield per penny of local school property tax levied in excess of the rate dedicated to meet the local share of M&O funding. The FSP also includes limited programs to repay locally authorized debt for school facilities construction.

M&O tax rate. Districts levy a maintenance and operations (M&O) tax on local property to pay for school operations. This tax is capped at \$1.17 per \$100 taxable property value. A district’s tax revenue is used to calculate the level of state funding in school finance formulas.

Recapture. This unofficial term refers to provisions in Education Code, [ch. 41](#), prohibiting local districts from exceeding a certain level of wealth per student, defined as the taxable value of property divided by the number of students in weighted average daily attendance. Districts that exceed the equalized wealth level for Tier 1, currently \$514,000 per weighted student, have five options for sharing wealth with property-poor districts. To date, all districts have chosen one of two options: purchase attendance credits using a mechanism for sending a portion of local property tax revenue to the state, which distributes it to poorer districts; or enter contracts to educate nonresident students from another district.

Weighted average daily attendance. The amount of state funding districts receive is based on adjusted student counts known as weighted average daily attendance (WADA). These counts weigh certain student characteristics, such as whether a student is economically disadvantaged, entitled to a bilingual education, or eligible for special education services. WADA adjusts for varying economic conditions across the state, based mainly on the Cost of Education Index, which includes district size, teacher salaries of neighboring districts, and percentage of low-income students in 1989-90.

widespread calls for changes” (see [Supreme Court Finds Current School Tax System Unconstitutional](#), HRO Interim News Number 79-1, December 19, 2005).

In the wake of the *West Orange-Cove II* ruling, the Legislature met in several special sessions to address the court’s requirements for bringing the school finance system into compliance with the constitution, and at the same time, to provide property tax relief. In 2006, the 79th Legislature, 3rd Called Session, enacted [HB 1](#) by Chisum, which required districts to lower their M&O tax rates by one-third over a two-year period. With this reduction, for districts taxing at \$1.50 per \$100 valuation, the new compressed tax rate became \$1.00 in tax year 2007. HB 1 also created a “hold harmless” mechanism to guarantee that districts would not lose revenue as a result of the compressed tax rate. This mechanism, known as Additional State Aid for Tax Reduction (ASATR), is statutorily scheduled to expire Sept. 1, 2017.

The bill also revised the way districts may raise additional revenue for local enrichment programs beyond the state-mandated curriculum. Districts generally may raise their M&O tax rate above the compressed rate by 4 cents per \$100 valuation. Voter approval is required for tax rates above that level, up to the maximum allowable tax rate of \$1.17 for most districts.

The Legislature enacted restrictions on local enrichment taxes to address concerns about funding inequities between property-poor and property-wealthy districts. For certain less wealthy districts, revenue generated by each of the first six pennies of local enrichment taxes is supplemented with state funds to ensure that every district has access to the same level of property wealth as Austin ISD (\$77.53 per weighted student per penny of tax effort for fiscal 2017). These first six pennies are not subject to recapture, so every district, regardless of wealth, may keep all of the revenue generated from them, leading the first six pennies to be called “golden pennies.” Each penny of tax levied above the golden pennies is guaranteed by statute to yield \$31.95 per weighted student for all districts. To achieve this, certain wealthier districts whose revenue exceeds the guaranteed yield are required to share a portion of this revenue with lower-wealth districts via recapture, leading these additional pennies of tax effort to be called “copper pennies.”

In an effort to replace the school finance revenue lost through the compression of local property tax rates, the

Legislature during the same special session enacted several tax bills, including [HB 3](#) by J. Keffer. HB 3 created a new mechanism for calculating the business franchise tax, also called the “margins tax,” which increased the amount of revenue collected by the state. The Legislature also enacted [HB 2](#) by Pitts, which created the Property Tax Relief Fund for the collection of revenue generated by the franchise tax and other new or increased taxes dedicated to paying for the property tax cuts. (see [Schools and Taxes: A Summary of Legislation of the 2006 Special Session](#), HRO Focus Report Number 79-13, May 25, 2006).

Most recent lawsuit

The most recent school finance litigation was a case consolidated from lawsuits filed in late 2011 by four groups of school districts of varying property wealth. Together, the more than 600 plaintiff districts educate about 70 percent of Texas schoolchildren. Several taxpayers and parents of public school students also were among the plaintiffs.

The districts filed a lawsuit after the 82nd legislative session in 2011. Facing a state revenue shortfall, lawmakers had cut \$4 billion from the Foundation School Program (FSP) and about \$1.3 billion in education grant programs, including funding to help with full-day pre-kindergarten and instruction for students who failed state assessments.

The plaintiff districts sought a declaration from a Travis County district court that the school finance system was unconstitutional because:

- the system was inadequately and unsuitably funded in violation of the constitution’s education clause mandate to provide a general diffusion of knowledge;
- districts had lost meaningful discretion to set their M&O tax rates in violation of the constitution’s prohibition on a state property tax; and
- the system lacked a direct and close correlation between a district’s tax effort and the educational resources available to it in violation of the constitution’s education clause requirements for financial efficiency, or equity. (Six property-wealthy districts did not join the “equity” part of the lawsuit.)

In 2012, the Texas Charter Schools Association and several parents joined the lawsuit as a plaintiff group,

raising claims about constitutionally inadequate funding similar to those raised by the school districts. The charter school plaintiffs also complained about differences in funding between traditional public schools and public charter schools, including the lack of facilities funding for charter schools. They said these funding differences render the system unconstitutionally inadequate, unsuitable, and inefficient.

Texans for Real Efficiency and Equity in Education — a group of parents and students joined by the Texas Association of Business — were allowed to intervene in the case. This group focused its constitutional claims on “qualitative efficiency,” arguing that the flaw in the public school system is not inadequate funding but wasteful spending resulting from inefficient rules and policies. They argued that the system would produce better results with policy changes such as eliminating the statutory cap on the number of charter schools and reforming statutory governance of teacher compensation, hiring, firing, and certification.

The state defendants were the education commissioner, the Texas comptroller, and the State Board of Education.

District court trials. Travis County District Judge John Dietz, who previously had heard the *West Orange-Cove* case, heard evidence in the new case in fall 2012 from district superintendents and school finance experts. In an initial ruling in February 2013, the trial court found the system failed to provide adequate funding overall, distributed money inequitably, and functioned as an unconstitutional state property tax. The judge delayed his final order detailing findings of fact and legal conclusions until after the 2013 legislative session.

The 83rd Legislature in 2013 restored to public education some funding that had been cut in 2011. The general appropriations act for fiscal 2014-15 added \$3.4 billion in Foundation School Program funding above what was required for increased enrollment and restored \$290 million in grant and special programs. It also enacted [HB 5](#) by Aycock, which instituted a new standard course of study for high school students and reduced the number of high school end-of-course (EOC) exams from 15 to five. The school districts had complained in the most recent case that the Legislature had cut funding at the same time it was implementing a new, more rigorous state testing system.

After the end of the regular legislative session, an attorney for one of the plaintiff school district groups asked

the district court to reopen evidence to ensure an up-to-date record for the Texas Supreme Court to review.

In January 2014, Judge Dietz presided over a second, shorter trial to consider the impact of the 2013 legislation. The district plaintiffs and state defendants differed in their views on the impact of the partially restored funding and reduced high school testing. The judge issued his detailed [findings](#) in August 2014, declaring the funding system still was in violation of the two constitutional provisions — the education clause requirements and state property tax ban. Charter school plaintiffs’ claims of unequal treatment in facilities funding and the intervenors’ qualitative inefficiency claim were again rejected by the district court.

Supreme Court ruling

The state appealed the district court ruling directly to the Texas Supreme Court, which heard arguments in *Morath, et al. v. The Texas Taxpayer and Student Fairness Coalition, et al.* in September 2015 and issued its opinion in May 2016. The court overturned the district court’s ruling that the system violated the constitutional provisions related to a state property tax and the education clause requirements for adequacy, suitability, and efficiency. The Supreme Court upheld the district court’s decision that had rejected the charter school plaintiff’s claims and intervenors’ qualitative inefficiency claims.

Adequacy and suitability. The Legislature’s constitutional duty to achieve a “general diffusion of knowledge” required by Tex. Const., Art. 7, sec. 1 has come to be known as the “adequacy” requirement. The Supreme Court said it has presumed in previous school finance rulings that the Legislature achieves a general diffusion of knowledge by devising a curriculum and accountability regime to meet accreditation standards. The education clause requirement to “make suitable provision” has been interpreted by the Supreme Court as requiring the school finance system to be structured, operated, and funded to accomplish this general diffusion of knowledge.

Adequacy. The district court had said the education funding system was inadequate because the cost of providing a general diffusion of knowledge exceeded the maximum funding that districts could raise, even at the highest tax rates allowed by law with taxpayer approval.

The Supreme Court, however, found that the district court had erred in its analysis by relying on “inputs,”

such as spending per student, and “best practices,” such as pre-kindergarten and class size limits, recognized by some experts. Ordering the Legislature to spend a specific amount of money to achieve a general diffusion of knowledge would deprive lawmakers of the broad discretion the Texas Constitution gives them to make such political decisions, the Supreme Court said.

In reaching its conclusions on funding adequacy, the Supreme Court reviewed recent data from the state’s accountability system, which rates campuses and districts based on graduation rates, dropout rates, and student performance on state assessments.

The district court had looked at scores on Texas and national exams in ruling that schools were not accomplishing a general diffusion of knowledge due to inadequate funding. The Supreme Court considered the fact that public schools in 2012 began transitioning from the previous testing system to the more rigorous STAAR exams and concluded that the system “is not unconstitutional because the State has decided to demand more of its schools and teachers, and they predictably faced a transitional period of adjusting to the more difficult tests.”

The Supreme Court discussed data presented at trial on the academic performance of students who are economically disadvantaged and English language learners. The plaintiff districts did not prove that achievement gaps could be eliminated or significantly reduced by allocating a greater share of funding to those student subgroups, the court said, noting that equality of educational achievement is a worthy goal, but not a constitutional requirement.

The court also noted that recent graduation rates for African-American and Hispanic students were ranked in 2013 by the U.S. Department of Education as the nation’s highest for those groups. The court said the recent graduation rates contrast with a “severe dropout problem” the court had observed in the 2005 *West Orange-Cove II* opinion.

Suitability. The district court had said the finance system failed the suitability requirement because it was underfunded and denied educational opportunities to all Texas school children, particularly those who are economically disadvantaged and English language learners.

The Supreme Court held that the current system is suitable. The court said it has never found a suitability

violation, noting that such a defect appears to be reserved for a fundamental and insurmountable structural flaw. For instance, allowing districts to ignore legislative goals would make the system unsuitable, the court said.

Equity. The Supreme Court previously has interpreted the “efficient system” mandated in the Texas Constitution’s education clause to require that school districts have substantially equal access to revenues necessary to provide an adequate education at similar tax effort. Financial efficiency, or equity, claims were raised by three of the four school district plaintiff groups. The group of property-wealthy districts did not raise equity claims.

Recapturing revenue from property-wealthy districts is one way to equalize funding among school districts, the Supreme Court said, noting that it has not found a violation of the financial efficiency requirement since *Edgewood II* in 1991. In its analysis, the court compared current and past funding disparities between property-wealthy and property-poor districts as measured by property wealth per student and spending per student. The court concluded that recent disparities are within the range in which it had found the system constitutionally efficient in previous cases, and that those disparities “are declining, indicating a trend toward more equal funding.”

State property tax. The Supreme Court disagreed with the district court’s holding that the current system violates the constitutional prohibition on a state property tax. According to the Supreme Court opinion, 24 percent of districts with about 13 percent of students tax at the \$1.17 cap and 69 percent of districts with about 76 percent of students tax at or below \$1.04, figures the court said do not suggest districts have lost meaningful discretion. The Supreme Court said plaintiffs offered no evidence that districts taxing at or near the \$1.17 cap had been forced to spend nearly all of their resources meeting state requirements instead of using some of the revenue for optional enrichment expenditures.

In its discussion of M&O tax rates, the district court had focused on the \$1.04 per \$100 taxable property value. The school district plaintiffs had argued that the courts’ focus should be on the \$1.04 rate because it could be politically difficult to seek the required voter approval to increase taxes beyond that rate for various reasons, including that such revenue is sometimes subject to recapture. The Supreme Court, however, agreed with the state’s position that letting “local voters decide whether

to raise taxes is the *exact opposite* of a state-imposed property-tax rate” [emphasis added by the court].

Other claims. The Supreme Court upheld the district court’s rejection of claims raised by charter school plaintiffs and the intervenors.

Charter schools. Charter school plaintiffs joined school district claims on funding adequacy and equity but also objected that funding for charter schools and school districts was unequal. Unlike public school districts, charter schools cannot issue tax-revenue bonds and must pay for facilities out of their state funding allotments. Charter schools also said that unlike districts, they do not receive certain funding adjustments for factors that increase costs such as the size and sparsity of the local student population and variations in economic conditions across the state.

The Supreme Court said that charter schools, in one sense, receive a better bargain than districts because they receive all their funding from the state and do not have to levy taxes. The court also noted that charter schools have more flexibility than districts in personnel decisions and do not have to follow state mandates on class sizes.

Agreeing with the district court, the justices said the charter school plaintiffs had not shown a difference in treatment so arbitrary as to violate the Texas Constitution.

Qualitative efficiency intervenors. The Supreme Court agreed with the district court’s response to a coalition of business interests and school choice advocates that intervened in the lawsuit. The intervenors had complained of policies they said create inefficiency and limit competition, including class-size limits, a cap on available charter schools, and state teacher certification requirements. Justices said the trial court was correct in rejecting the intervenors’ claims because the Texas Constitution “grants the Legislature broad discretion in determining the acceptable level of qualitative efficiency, and we cannot interfere unless it acts arbitrarily and unreasonably in making that choice.”

Concurring opinions. Justices issued two concurring opinions on the school finance case.

Justice Jeffrey Boyd, in an [opinion](#) joined by Justices Debra Lehrmann and John Devine, wrote that the court’s sole authority in challenges to education funding is to determine whether the Legislature’s decisions have been arbitrary and unreasonable. The personal opinions of

members of the Texas Supreme Court about the levels of funding, as well as other education policy decisions, are irrelevant, Justice Boyd said.

Justice Eva Guzman, in an [opinion](#) joined by Justice Lehrmann, focused on the need to support the nearly 60 percent of students who are economically disadvantaged. She urged the Legislature to “continue to be strategic and flexible in its approach to supporting economically disadvantaged students” who she said often enter school without the advantages and life experiences enjoyed by many of their more affluent classmates. Noting national rankings of Texas students on reading and math scores, Guzman said the school finance system may be constitutional “for now, but we should aspire to more than being solidly in the middle.”

Committees studying changes

The 85th Texas Legislature will head into the regular session in 2017 with the constitutionality of the school finance system upheld and no court order with which to comply, but legislative committees still are reviewing issues related to school finance this interim. House and Senate committees are exploring both tax revenue for school funding and how it is distributed.

One approach being reviewed is allocating funding based on school district performance, rather than student attendance. The Senate Committee on Education held a public hearing in August on its [charge](#) to study performance-based funding mechanisms that allocate dollars based upon student achievement. The committee reviewed programs in Texas and other states that use academic, financial, and demographic data to identify successful, cost-efficient districts and campuses.

Budget-writing committees in both chambers are studying the use of property taxes to fund public education. On the House side, the committees on appropriations and public education are jointly [charged](#) with finding ways to reverse the increasing reliance on recapture payments. A subcommittee of the Senate Committee on Finance is studying the property tax process and developing options to further reduce the burden on property owners.

The business franchise tax is a focus of the Senate Committee on Finance, which was [charged](#) by the lieutenant governor with studying the benefits to the economy and to taxpayers of continuing to phase out

the franchise tax. The review will consider alternate approaches for funding the Property Tax Relief Fund, which currently is funded largely through the franchise tax.

In addition to the directive on recapture, the speaker directed the appropriations and public education panels to jointly study the statutorily required elimination on September 1, 2017, of the “hold harmless” provision known as ASATR, and how the loss of an estimated \$350 million in ASATR funding would impact school districts.

The speaker also [charged](#) the House Committee on Public Education with studying the effectiveness and efficiency of the Cost of Education Index and making recommendations to improve or eliminate it. The index, which has not been updated since it was adopted, was designed to help districts adjust for varying economic conditions across the state, based mainly on the size of the district, teacher salaries of neighboring districts, and the percentage of low-income students in 1989-90.

The House Committee on Appropriations has begun a review of current public education programs administered by the Texas Education Agency and funded outside of the school finance formulas. It is charged with making recommendations to increase, decrease, or eliminate programs based on measurable performance and effectiveness. Examples of programs being studied include

instructional materials funding, grants for high-quality prekindergarten, funding for state exams, and money allocated to help students struggling to pass the exams.

Committees also are reviewing facilities funding for both school districts and charter schools. The House Committee on Public Education was directed to study school districts’ facility needs and debt and determine what constraints exist across the state, particularly in districts experiencing rapid growth in student enrollment. This charge includes reviewing how existing state facility funding programs address needs and providing property tax relief. The Senate Committee on Education was directed to examine how other states fund charter school facilities and to make recommendations on facility funding assistance for charter schools.

Both chambers also are studying school choice programs that could direct state funding to options outside the public school system. The Senate Committee on Education held a public hearing in September to explore such programs in other states. The House Committee on Public Education is charged with reviewing programs in other states and recommending whether an expansion of school choice is needed, including academic and financial accountability for any school receiving public funds.

— by *Janet Elliott*

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