M E M O R A N D U M

Date: November 28, 2005

To: West Orange-Cove Plaintiffs
Texas School Coalition membership
Other interested parties

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Subject: Analysis of Texas Supreme Court's opinion in *Neeley et al. v. West Orange-Cove et al.*, No. 04-144 (Tex. Nov. 22, 2005)

On November 22, 2005, the Texas Supreme Court, in a 7–1 opinion, struck down the state's school finance system, finding that it had evolved into an unconstitutional state property tax. The Court gave the Legislature until June 1, 2006 to correct the constitutional deficiencies in the system.

The Court's opinion is a groundbreaking decision that will require the Legislature to come up with new revenue – and new revenue sources – to fund our public school system. The Court observed that "structural changes, and not *merely* increased funding, are needed in the public education system to meet the constitutional challenges that have been raised." (Opinion at 117 (emphasis added)). Further, the Court took note of the "substantial evidence . . . that the public education system has reached the point where continued improvement will not be possible absent significant change." (Opinion at 91-92). This memorandum is intended to summarize and analyze the Court's historic opinion.

EXECUTIVE SUMMARY

1. The Court struck down the state's school finance system because it had evolved into an unconstitutional state property tax in violation of Article VIII, Section 1-e of the Texas Constitution.

   - The Court concluded that it was not even a "close question" as to whether districts have meaningful discretion to set their local property tax rates under the current system.

   - The Court concluded that districts must be able to provide local supplementation to fund programming beyond state educational requirements.

2. The Court reversed the trial court's finding that the system was inadequate in violation of Article VII, Section 1 of the Texas Constitution. However, the Court made several important legal rulings in favor of the plaintiffs and fired a shot across the bow to the

Legislature, warning that it must reverse the "predicted drift towards constitutional inadequacy."

- The Court concluded that the issue of adequacy is "justiciable," i.e., subject to review by the courts.

- The Court adopted the trial court's broad definition of adequacy, which recognized that *all* students must reasonably be given a meaningful opportunity to meet the state's academic standards.

- The Court rejected the State's argument that a minimalist "rational basis" standard of review applied – i.e., that any challenge to the school finance system must be rejected if the Legislature can merely state a "rational basis" for the structure of the system.

- Finally, even though it was unwilling to declare the system inadequate at this time, the Court very strongly indicated that the state is on the cusp of a constitutional violation.

3. The Court rejected the Intervenors' equity claims, but did not retreat from its prior (*Edgewood IV*) formulation as to the scope and meaning of the equity mandate in the Constitution.

4. The Court recognized that money – spent wisely – has an effect on student achievement, but that money is only part of the solution. The Court suggested that structural changes also were necessary to ensure that the system does not remain exposed to constitutional challenge, including an end to the state's overrreliance on the local property tax.

5. The Legislature cannot cure the constitutional deficiency identified by the Court without providing districts significantly more financial capacity than exists in the system at the present time. The Court specifically warned the Legislature that the legislation it had considered during the failed regular and special sessions was, at best, a stopgap solution, which we believe would not survive judicial scrutiny.

ANALYSIS OF SUPREME COURT'S OPINION

I. The West Orange-Cove Plaintiffs' Claims

Our group, the West Orange-Cove Plaintiffs, brought two claims in this case. First, we argued that the school finance system has evolved into an unconstitutional state property tax (in violation of Article VIII, section 1-e of the Texas Constitution) because districts lacked "meaningful discretion" in setting their local property tax rates. Specifically, the statutory $1.50 cap on maintenance and operations ("M&O) tax rates has become both a "floor" (because districts cannot meaningfully lower their tax rates without compromising their ability to provide a constitutionally adequate education) and a "ceiling" (because the cap bars districts from raising their tax rates further), such that they lack meaningful discretion in setting their M&O tax rates. This claim is referred to as the "state property tax" claim.

Second, we argued that the current school finance system fails to provide the plaintiff districts access to funds sufficient to provide a constitutionally adequate education (or, in Texas

constitutional parlance, a "general diffusion of knowledge"), even though they were taxing at or near the $1.50 tax rate cap. We argued that this funding inadequacy was systemic and pervasive and violated Article VII, section 1 of the Texas Constitution. This claim is referred to as the "adequacy" claim.

The trial court had ruled in our favor on both of these claims. The Supreme Court affirmed the trial court on the state property tax claim, but reversed on the adequacy claim. These rulings are discussed below.

A. The Court held that the system had evolved into an unconstitutional state property tax and struck down the system on that basis.

In affirming Judge Dietz's finding that the system had evolved into an unconstitutional state property tax, the Court reaffirmed that the Legislature must provide a funding system that allows local school districts to meet the state's high educational standards, while leaving local school boards with meaningful discretion over their local property tax rates.

While the Court acknowledged that "meaningful discretion" is an "imprecise standard," it concluded that **it was not even a "close question"** as to whether districts have such discretion in the current system. (Opinion at 107).[1] The Court cited evidence of "how districts are struggling to maintain accreditation with increasing standards, a demographically diverse and changing student population, and fewer qualified teachers, while cutting budgets even further." (Opinion at 108). It referenced falling teacher certification rates, growing teacher turnover and attrition, the increasing numbers of limited English proficient and economically disadvantaged students, the higher costs of educating these special needs students, and the more rigorous curriculum, testing and accreditation standards. (Opinion at 108). After pointing to statistics regarding the number of districts taxing at the cap and the exhaustion of fiscal capacity in the system, the Court noted that **"[t]he current situation has become virtually indistinguishable from one in which the State simply set an ad valorem tax rate of $1.50 and redistributed the revenue to the districts."** (Opinion at 109).

The Court also reaffirmed that districts must have funding for "local supplementation" under the system, noting that it was inherent in the statutory scheme:

> Although the statute does not promise any particular level of supplemental funding, local supplementation is made a core component of the system structure, necessitated by the basic philosophy of local control. *The State cannot provide for local supplementation, pressure most of the districts by increasing accreditation standards in an environment of increasing costs to tax at maximum rates in order to afford any supplementation at all, and then argue that it is not controlling tax rates.*

(Opinion at 111 (emphasis added)).

We discuss the impact of the Court's state property tax holding on the anticipated legislative special session below in Section IV.A.

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[1] Page references to the opinion are based on the PDF version of the majority opinion available at http://www.supreme.courts.state.tx.us/Historical/2005/nov/041144.pdf.

B. While the Court reversed the adequacy claim, it warned the Legislature that the system was drifting towards constitutional inadequacy.

Even though the Court reversed Judge Dietz's conclusion that the system was inadequate, there are many positive aspects of its analysis from the school districts' perspective. First, the Court rejected the State's arguments that the adequacy issue is not "justiciable," i.e., not subject to a review by the courts. Second, it adopted the trial court's broad definition of adequacy, which recognized that *all* students must reasonably be given a meaningful opportunity to meet the state's academic standards. Third, it rejected the State's argument that a minimalist "rational basis" standard of review applied – i.e., that any challenge to the school finance system must be rejected if the Legislature can merely state a "rational basis" for the structure of the system. And finally, even though it was unwilling to declare the system inadequate at this time, the Court very strongly indicated that the we are on the cusp of a constitutional violation. The Supreme Court fired a "shot across the bow" to the Legislature, warning that it should not pursue a stopgap solution and instead should take the looming adequacy crisis into account in its redesign of the school finance system.

1. The Court rejected the State's challenges to the justiciability of adequacy.

The State raised three arguments for why the Court should not even reach the issue of adequacy: (1) adequacy is a "political question" that is exclusively within the province of the Legislature, (2) the constitutional provision at issue is not "self-executing," i.e., it does not provide a district the right to enforce the duties contained therein unless the Legislature first passes legislation authorizing such a suit, and (3) the districts lack "standing" to bring an adequacy claim, because the constitutional right is conferred only on students, not districts.

The Court unequivocally rejected each of these arguments. The significance of these holdings – particularly, the rejection of the political question argument – cannot be overstated. At least six state supreme courts previously had rejected adequacy challenges under the political question doctrine. Had the Texas Supreme Court followed their lead, as the State urged, the issue of adequacy would have been permanently off the table. The Legislature would know that its duty to provide an adequate education would be meaningless because the duty would not be enforceable in court. Instead, the Legislature now knows that the duty assigned to it in the Constitution is real and has teeth. Further, in any future round of litigation, the "sagebrush" will have been cleared. There is no longer any doubt that districts have the right to bring adequacy claims and that these claims are justiciable – permitting future litigants to proceed directly to the merits of their claims.

2. The Court, like the trial court, defined adequacy broadly.

Perhaps even more significantly, the Supreme Court essentially adopted the trial court's definition of adequacy. The Supreme Court concluded that:

> To fulfill the constitutional obligation to provide a general diffusion of knowledge, districts must provide "*all Texas children . . . access* to a quality education that enables them to achieve their potential and fully participate now and in the future in the social, economic, and educational opportunities of our state and nation." TEX. EDUC. CODE § 4.001(a). Districts satisfy this constitutional obligation when they

> [are reasonably able to] provide all of their students with a *meaningful opportunity* to acquire the essential knowledge and skills reflected in . . curriculum requirements . . . such that upon graduation, students are prepared to "continue to learn in postsecondary educational, training, or employment settings." TEX. EDUC. CODE § 28.001.

(Opinion at 86-87.) The Supreme Court's only modification to the trial court's definition was the inclusion of the phrase "are reasonably able to," underlined and bracketed above.

The Court rejected the State's argument that statutory language referenced in the definition (e.g., promising to provide *all* students *access* to a *quality education*, etc.) was merely aspirational. (Opinion at 89). It further rejected the State's invitation to "dumb down" the definition of adequacy by linking it to an "academically acceptable" rating that nearly every district achieves. Consequently, future litigants will be able to (1) point to the very broad language in the Court's definition of adequacy (2) utilize data regarding dropouts, completion rates, college preparedness, and TAKS scores, among other items, in demonstrating the inadequacy of the school finance system.

3. The Court rejected a "rational basis" standard of review.

The State had urged the Court to adopt a "rational basis" standard of review for reviewing the adequacy claim and future claims under the education clause of the Texas Constitution. Under the standard proposed by the State, the system would be deemed constitutional as long as there was "any rational basis for the Legislature to have fashioned the system the way it has." (Opinion at 78). The Court rejected this approach, stating that the Constitution "does not allow the Legislature to structure a public school finance system that is inadequate, inefficient, or unsuitable, regardless of whether it has a rational basis or even a compelling reason for doing so." (Opinion at 80).

Instead, the Court adopted an "arbitrariness" standard of review and emphasized that this standard has teeth: "These standards do not require perfection, but neither are they lax. They may be satisfied in many different ways, but they must be satisfied." (Opinion at 80). While the Legislature has "a large measure of discretion . . . that discretion is not without bounds." (Opinion at 81). Though the standard is deferential to the Legislature, "the standard can be violated." (Opinion at 91).

Most significantly, the Court held that "[i]t would be arbitrary . . . for the Legislature to **define the goals for accomplishing the constitutionally required general diffusion of knowledge, and then to provide an insufficient means for achieving those goals."** (Opinion at 81). This was exactly our theory of the case and likely will be the theory of any future adequacy challenge. Consequently, the Court's "arbitrary" standard of review should not pose an insurmountable roadblock in future adequacy challenges.

4. The Court fired a shot across the bow to the Legislature on adequacy.

Finally, even though the Court reversed the adequacy claim, it delivered a clear and unmistakable warning to the Legislature. Citing (1) dropout and noncompletion rates, (2) poor college preparedness statistics, (3) high teacher attrition and turnover, due in part to stagnating

compensation, (4) wide gaps in performance among student groups differentiated by race, proficiency in English and economic advantage, (5) increasingly rigorous academic standards, (6) growing numbers of disadvantaged students, and (7) the lack of additional funding to meet these challenges, the Court concluded that there was **"substantial evidence . . . that the public education system has reached the point where continued improvement will not be possible absent significant change**." (Opinion at 91-92).

We believe strongly that the evidence cited above, as well as additional evidence presented to the trial court, was sufficient to demonstrate that the system is inadequate. However, the Court appeared to conclude that as long as the State was making "forward progress" – in TAKS scores, NAEP scores, etc. – it would not find a constitutional violation. (Opinion at 91).

Nevertheless, the Court strongly suggested that the Legislature was on the cusp of violating its constitutional duty of adequacy. It characterized the situation as an "impending constitutional violation" (Opinion at 92), a characterization made even more significant by the fact that the Court's analysis was based on data through only the end of the 2003-04 school year. (Opinion at 12).

The Court also warned that the Legislature should take this "impending constitutional violation" into account in its redesign of the new school finance system, stating: "it remains to be seen whether the ***system's predicted drift toward constitutional inadequacy*** will be avoided by legislative reaction to widespread calls for changes." (Opinion at 92).

It is significant that the only testimony from the trial court directly quoted by the Supreme Court was the testimony of former Lieutenant Governor Bill Ratliff, who testified:

> I am convinced that, just by my knowledge of the overall situation in Texas, school districts are virtually at the end of their resources, and to continue to raise the standards . . . is reaching a situation where we're asking people to make bricks without straw."

(Opinion at 92).

II. The Intervenors' claims

The Alvarado and Edgewood Intervenors also brought adequacy claims. The Intervenors brought two distinct "equity" claims as well. First, they argued that property-poor districts do not have substantially equal access to funding for facilities, violating the efficiency and suitability provisions of article VII § 1 of the Texas Constitution (the "facilities equity claim"). Second, they argued that the gap in M&O funding between property-poor and property-rich districts (the so-called "equity gap") violated the equity mandate of the Constitution, as interpreted in the prior *Edgewood* cases (the "M&O equity claim").

The trial court ruled in favor of the Intervenors on their adequacy claims and their facilities equity claim. However, it rejected the M&O equity claim, concluding that structural gap in funding available to property-rich and property-poor districts was not so great that that it violated the Constitution "at this time." In other words, the trial court sustained the Intervenors' equity

challenge on the Tier 3 portion of the school finance system (facilities/debt service) but not on the Tier 1/Tier 2 portion (maintenance and operations).

The Supreme Court ruled against the Intervenors on both of their equity claims, affirming the trial court on the M&O equity claim and reversing the trial court on the facilities equity claim. We will leave it to the Intervenors to analyze these aspects of the Court's opinion, but it appears that the Court did not retreat from its prior (*Edgewood IV*) formulation as to the scope and meaning of the equity mandate in the Constitution.

III. Other noteworthy aspects of the Opinion

There are several other noteworthy aspects of the Court's opinion. First, the Court acknowledged that money, spent well, matters, i.e., that available resources is related to student achievement. It observed:

> While the end-product of public education is related to the resources available for its use, the relationship is neither simple nor direct; public education can and often does improve with greater resources just as it struggles when resources are withheld, but more money does not guarantee better schools or more educated students.

(Opinion at 88-89.) This statement is consistent with the position we have asserted throughout this litigation – that money spent wisely (reducing class size, preschool education, improving teacher quality, etc.) has an undeniable effect on student achievement, as even the State's witnesses at trial acknowledged.

Second, the Court identified two major structural problems inherent in the current education system – the large number of school districts in Texas and the overreliance on local property taxes:

- "The large number of districts, with their redundant staffing, facilities, and administration, make it impossible to reduce costs through economies of scale. Bigger is not always better, but a multitude of small districts is undeniably inefficient." (Opinion at 19).

- "The Legislature's decision to rely so heavily on local property taxes to fund public education does not in itself violate any provision of the Texas Constitution, but in the context of the proliferation of local districts enormously different in size and wealth, it is difficult to make the result efficient . . . as required by article VII, section 1 of the Constitution." (Opinion at 16).

- "'The need is apparent for reform in tax systems which may well have relied too long and too heavily on the local property tax.'" (Opinion at 116-17 (quoting *San Antonio I.S.D. v. Rodriguez*, 411 U.S. 1, 58 (1973)).

The Court warned that these structural defects – if not corrected – will continue to "expose the [school finance] system to constitutional challenge." (Opinion at 11). Of course, as the Court itself noted, it has been rendering the same warnings since the early rounds of the *Edgewood*

litigation. (*See* Opinion at 11 n.21 and 19, n.45.) These warnings consistently have been ignored by the Legislature.[2]

Finally, at the conclusion of the opinion, the Court included a quotation from *Brown v. Board of Education* regarding the importance of education in our society. (Opinion at 115-16). It added: "Since then [1954], especially in this Information Age, education as a fundamental basis for our future has grown by orders of magnitude." (Opinion at 116). The inclusion of this language – which was not necessary to any of its legal holdings – signals that the Court (1) considers this litigation to be of utmost importance, (2) will continue to hold the Legislature to its constitutional duties, and (3) will step in if the Legislature does not reverse the system's "drift towards constitutional inadequacy."

IV. The Road Ahead

A. The ball is in the Legislature's court.

The Court gave the Legislature until June 1, 2006 to cure the constitutional deficiencies in the finance system.

The critical question is what will the Legislature have to do to comply with the Court's opinion. A number of legislators and lobbyists have argued that the opinion requires only a "tax swap" and does not require any infusion of new money into the system. We believe that they have fundamentally misread the Court's opinion. The Court itself recognized that additional resources were part of any solution – just not the only part. (Opinion at 117) ("[S]tructural changes, and not *merely* increased funding, are needed in the public education system to meet the constitutional challenges that have been raised.").

The legislative leadership may be inclined to use the draft legislation considered during the failed 2005 regular and special sessions as a starting point (HB2 and HB3). This legislation envisioned:

(1) compressing the local property tax rate to $1.20 (or $1.00, in an earlier iteration of the legislation) through a "tax swap," i.e., replacing local property tax revenues with revenues from a higher sales tax or new business tax;

(2) capping tax rates for districts at $1.20 instead of $1.50;

(3) allowing districts to exceed this cap by five cents beginning in 2007 and additional five cents/biennium thereafter (up to a maximum of 15 cents), but only after approval by the districts' voters;

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[2] While the Court identified the large number of districts in the state as a potential structural problem with the current system, we are not aware of any studies finding that significant savings could be achieved through consolidation and we do not believe that such an approach is a substitute for expanding the overall financial capacity of the system. Further, consolidation is not a viable option to achieve cost savings in many of the larger districts in the State (e.g., Houston I.S.D., Dallas I.S.D., Austin I.S.D., Cy-Fair I.S.D., et al.), most of which are part of the West Orange-Cove Plaintiffs coalition.

(4) a guaranteed 3% increase in state and local funding (without the supplemental tax); and

(5) additional mandates, including, but not limited to (i) a $1500 increase in teacher salaries; (ii) a requirement that districts set aside 1% of their professional staff payroll to fund teacher incentive programs; (iii) a requirement that, by 2009-10, each district would have to allocate at least 65% of its total available revenues to fund direct instructional activities.

The Court itself cautioned that these proposals, which merely lower tax rates without addressing the fundamental lack of financial capacity in the school funding system, were a mere stopgap solution and would violate the Constitution "in short order":

> Various legislative proposals during the past year to remedy perceived problems with the public education system and its funding would reduce the maximum ad valorem tax rate and allow it to be exceeded for certain purposes. While we express no view on the appropriateness of any of these proposals, we are constrained to caution, as we have before, that a cap to which districts are inexorably forced by educational requirements and economic necessities, as they have been under Senate Bill 7, will in short order violate the prohibition of a state property tax.

(Opinion at 111-12).

In fact, we believe that HB2/HB3, if implemented, would not survive judicial scrutiny today. As Scott McCown correctly observed, "[I]f the school property tax is an unconstitutional state property tax at $1.50, it does not become constitutional merely because it has been compressed to $1.20. Adding 3% more money to the system over two years does not create 'meaningful discretion' at the local level. To begin with, it doesn't cover inflation, and in any event, would have to be spent on the new mandates in HB 2."[3]

This statement is all the more true in light of the Court's finding that it was not a "close question" as to whether districts have meaningful discretion in the current system. (Opinion at 107). The almost complete lack of meaningful discretion cannot be cured with an additional five cents of taxing authority in *2007*, especially when accompanied by costly mandates that the Legislature seems intent on including in any school finance reform package. This conclusion is further strengthened by the Court's statement that districts must be able to provide "local supplementation" under the system. (Opinion at 111).

To cure the constitutional violation, and assuming that a "buy down" of local property tax rates will be part of any solution, the Legislature must (1) allow districts access to significant additional taxing capacity after the buy-down (i.e., more than five cents); (2) modify the school finance formulas so that the percentage increase in total funding per penny of tax effort is significantly greater than the percentage of the "buy down" of tax rates; or (3) adopt some

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[3] An Open Letter to the 79th Legislature from F. Scott McCown, executive director of the Center for Public Policy Priorities (July 20, 2005), *available at* http://www.cppp.org/files/5/Open Letter.pdf.

combination of the two. Stated another way, the Legislature must build significant financial capacity back into the system, which necessarily will mean that districts will have access to additional funding. Further, any modifications to the finance system cannot be accompanied by mandates that would swallow the additional taxing capacity.

If the Legislature fails to comply with these principles in its redesign of the school finance system, further litigation inevitably will follow.

B. Additional proceedings in the trial court.

The trial court had awarded the West Orange-Cove Plaintiffs their attorneys' fees because of their successful prosecution of the state property tax and adequacy claims. Because we ultimately prevailed on only one of the two claims, the Supreme Court reversed the attorneys' fees award and remanded it to the trial court for reconsideration. Texas law permits us to recover our fees for both claims if they are so interrelated that their prosecution or defense entails proof or denial of essentially the same facts. We believe this principle applies in this case and we will seek reinstatement of the full attorneys' fee award on behalf of our clients.

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