Public versus Private Characteristics of State Charter Laws

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Agenda

(Open discussion/workshop format intended to optimize the project)

I.  Project Description and Purpose
II.  Progress Report
III.  Federal Law Framework
IV.  State Law Analysis
V.  Applicability of Research Results
Project Description

Since inception of charter school movement, novel legal issues have challenged school operators, their advisors, courts and policy makers. For the past couple years, the public versus private character of charter schools in the context of various federal laws has been a focus of the national charter school bar, under the leadership of NAPCS.

Federal agencies and federal courts have recently been evaluating whether charter schools are, or should be, treated as “political subdivisions” of the state or local government in which they are created – administrative decisions, court decisions and regulatory activities.

Notably, the IRS and the NLRB have addressed, or are currently evaluating, high profile/high impact issues forecasting different treatment of charter schools in different jurisdictions.

1) Are employees of a charter school eligible to participate in a state teachers retirement system?
2) Are charter schools exempt as employers under the National Labor Relations Act?
3) Are charters allowed to finance new facilities on the same terms as cities and school districts?
4) Are charters culpable as state actors in the context of federal constitutional violations?
Project Description

• Determine whether each jurisdiction’s legal scheme treats its charter schools as political subdivisions for purposes of various federal legal regimes.

• Research and written analysis of 43 state charter school laws, including the District of Columbia’s charter school law, under the following federal legal regimes:
  1. federal tax law (facility finance, retirement systems and income tax return filing)
  2. federal labor law (coverage under the NLRA and SSA)
  3. federal civil rights law and Eleventh Amendment immunity

• Create a formal legal analysis, and create summary presentation that can be used for policy/advocacy purposes.

• Research process: interdisciplinary legal team of federal tax, labor and employment, litigation and public finance attorneys
Project Description

• Why pursue this legal research?
  – charter school law continues to evolve
  – policy making/advocacy work contextualized
  – policy observations; areas for legislative improvement – trade offs

• Research assumes that charter schools will use all the independence allowed under a charter statute, however there is a level of optionality within certain state statutes that could serve as a mechanism to address unwanted outcomes under the federal law analysis.
Progress Report

• To date, Orrick has completed review and analysis of the following federal laws:
  – National Labor Relations Act
  – Social Security Act
  – Internal Revenue Code as applied to tax-exempt bond finance
  – Internal Revenue Code as applied to public pension system eligibility
  – Internal Revenue Code as applied to income tax return filing
  – Federal Civil Rights Law under 42 USC 1983 (deprivation of constitutional rights)
  – Eleventh Amendment Immunity (immune from suit as “arm of the state”)

• Orrick has completed preliminary analysis of Michigan charter school law under each federal regime

• Remaining state charter laws will be analyzed according to NAPCS priorities, with project completion scheduled for March 2014 (milestones in November and January).
Federal Law Framework

Overview

• Research across the various federal laws identified distinct legal tests for determining eligibility or character as a public entity/instrumentality, however certain factors are present in each test, and while weighted differently in each context, can be summarized as follows:

1) Organizational Purpose
2) State Function
3) Public Control
4) State Funding
Federal Law Framework

Organizational Purpose

• Does the organization in question perform traditional government functions?
• Has a public function or functions been delegated to the organization?
• Is the organization entwined in government policies?
• No matter how the test is articulated, though, the more obviously an organization’s purpose is a typical governmental purpose, the more likely it is to satisfy this area of focus.
Federal Law Framework

State Function

• The second area of focus is whether the organization is acting on behalf of the state.
• whether employees of the organization are considered employees of the state,
• whether the organization can be sued, and
• whether the organization can take property.
• The implication seems to be that if the organization enjoys benefits or exercises powers typically reserved for the state, like immunity or eminent domain, it is likely acting on behalf of the State.
Public Control

• The degree of control that public authorities or laws have over the organization.

• whether the creation of the organization requires express statutory authority,

• whether the organization is created by a governmental entity,

• whether public authorities have power to select the organization’s board, and

• whether the state can coerce the organization to act.

• The more control the state exerts over the organization, the more likely the organization is deemed to be an instrumentality.
The fourth area of focus is the degree of financial autonomy the organization has from the State.

- where the organization derives its funding,
- whether an organization would have to satisfy a judgment against it from state funds, and
- whether its principal source of revenue is typically governmental (taxes, tolls, fines, etc.).

The less financial autonomy, the better the case that the organization is an instrumentality.
Federal Law Framework

Observations

• National Labor Relations Act applicability seems to be the simplest test – a two-prong test articulated by a 1971 Supreme Court case (Hawkins).

• Federal Civil Rights Law seems to be the least settled, and most complicated test to apply. Federal courts around the country have reached different conclusions and applied the factors of the “state actor” test differently, giving more weight or less weight to each and relying heavily on the specific facts of each case.

• IRS guidance is not controlling, so outcomes remain uncertain. However, there is a body of IRS analysis that gives rise to a fairly coherent approach to the instrumentality analysis.

• For eligibility of public pension systems as exempt organizations, the IRS is currently involved in a rulemaking process that would change the way the various factors are weighted in the analysis – potentially giving rise to a regulatory scheme that concludes most charter school teachers are not eligible for state pension systems.
State Law Analysis

Michigan

• Feedback loop is critical with stakeholders at the local level.
  – Identification of unpublished legal authorities or other local rules.
  – Identification of local practices (not governed by statute) that influence the analysis.

• Research results owned by NAPCS and disseminated in cooperation with local stakeholders – legal/policy implications of the analysis; sensitivity to giving opponents benefit of analysis.
Applicability of the Research

Policy questions that can be informed by the research:

• Natural consequences of growth: sacrifice innovation and control; acquire regulation and homogeneity. How should these factors balance?

• How should accountability look going forward?

• Should charters be accountable as governmental entities to students (discipline, assessment, special needs, attendance)?

• But accountable as private employers to employees (labor organizing, compensation, benefits)?

• How should management companies be treated as compared to the charter schools themselves?

• Is the sector (still) designed to foster true innovation in pedagogy, curriculum, delivery, results?

• Should we replicate optionality across all states – permit operators to elect their desired public/private treatment?
Eugene Clark-Herrera, a partner in Orrick's Public Finance Group, focuses his practice on financing for school and college facilities, as well as city and county facilities and infrastructure. His practice includes serving as bond and disclosure counsel on revenue and tax-supported bond financing involving charter schools, counties, cities, school and college districts, airports, and student and multi-family housing projects. Mr. Clark-Herrera has experience with a variety of financing structures and characteristics, including pension obligation bonds, synthetic fixed rate bonds, and various reinvestment vehicles.

Mr. Clark-Herrera is Chair of Orrick’s Charter School Finance Group, and has served as bond counsel for public charter schools across the country in debt financing transactions for over ten years. He pioneered capital markets access for California public charter schools, structured the largest multi-campus single-issuer public charter school financing to date, and has advised governmental issuers, foundations, advocacy groups and policy makers in the development and expansion of public charter school access to tax-advantaged financing.

Mr. Clark-Herrera also serves on the Board of Directors of the nonprofit Mural Music & Arts Project, an arts-based youth development organization he founded in the San Francisco Bay Area to educate, inspire and empower teens through the arts.

Mr. Clark-Herrera earned a J.D. at Stanford Law School, and a B.S. in Business Administration at University of Colorado, Boulder. Prior to joining Orrick, Mr. Clark-Herrera was a public school teacher and science curriculum developer in the South Bronx and Washington Heights neighborhoods of New York City from 1993 to 1998. He is an alumni of the Teach for America Corps.
John Palmer, a managing associate in Orrick’s San Francisco office, focuses his practice on financing for school facilities, general obligation bond issues, and city and county facilities and infrastructure. His practice includes serving as bond and disclosure counsel on revenue and tax-supported bond financings involving school districts, charter schools, cities, and transportation. Mr. Palmer has experience with a variety of financing structures and characteristics, including synthetic fixed rate bonds and conduit issues.

Representative charter school transactions include the following.

- California School Finance Authority Revenue Anticipation Notes (Aspire Public Schools), Series 2011B
- California School Finance Authority Lease Revenue Bond (New Jerusalem School Project) Series 2011 (Direct Subsidy Qualified School Construction Bonds)
- California School Finance Authority Revenue Anticipation Notes (Aspire Public Schools) Series 2012A and Series 2012B
- California School Finance Authority Lease Revenue Bonds (Oak Grove Elementary / Willowside Middle School Project) Series 2011 (Direct Subsidy Qualified School Construction Bonds)
- California School Finance Authority Revenue Anticipation Notes (Birmingham Community Charter High School) Series 2010
- Charter School Capital Muskegon Heights Public Schools Academy (Direct Loan).
Chas Cardall, a partner in the San Francisco office, is a member of the Tax Department and the Public Finance Department. Mr. Cardall primarily focuses his practice on municipal finance tax and nonprofit corporation tax matters. Mr. Cardall also has legal expertise relating to both charter schools and the federal income tax classification of governmental and quasi-governmental entities. He has consulted on thousands of tax-exempt, build America and tax credit bond issues and has developed deep expertise in almost every tax aspect of municipal finance. Private activity bonds for multifamily housing, solid waste, charter schools and independent schools are areas of particular focus in Mr. Cardall’s practice, as are higher education, short-term and long-term working capital and the various forms of pooled financings. Mr. Cardall also has advised numerous clients experiencing financial distress or bankruptcy in tax matters relating to their municipal bonds. Representative active clients include the State of California, the University of California, the Bay Area Toll Authority, and Charter School Capital.

As an advocate, Mr. Cardall represents both government and non-government clients in IRS proceedings, including the various types of tax-exempt bond audits, voluntary compliance (VCAP) requests and requests for private letter rulings. Mr. Cardall has successfully closed IRS examinations relating to solid waste, working capital, healthcare, pooled, multifamily housing, and industrial development bond financings. He has obtained multiple private letter rulings and technical advice memoranda and has been integrally involved in numerous regulation and legislative projects. He has found that a close working relationship with IRS and Treasury Department personnel often is critical to obtaining good results for clients.

Mr. Cardall is a regular panelist at industry and bar association seminars on public finance tax topics (most recently on the topics of working capital financing and IRS enforcement) and has lectured to the IRS at their field agent training program. Representative List of Active Clients: Charter School Capital, State of California, University of California, Bay Area Toll Authority, Counties of Contra Costa, Orange, Sacramento, and Santa Clara, and Cities of Oakland, Richmond, and Sacramento.