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BEFORE SCHOOL DISTRICTS GO BROKE: A PROPOSAL FOR FEDERAL REFORM

*Kristi L. Bowman**

As school districts across the country continue to face falling revenues, they are scrambling to cut their budgets and adjust to leaner times. But districts have never had to make such drastic adjustments—and some of them are nearing a point of fiscal crisis. In fact, in summer and fall 2011, we will see school districts reach what education law and policy experts call the "funding cliff": revenue from state and local sources will not have rebounded, and the federal stimulus funding approved in August 2010 will nearly have run out. A nationwide solution is needed, and this Article proposes just that. First, the Article defines the problem, looking beyond the recession to examine the systemic and situational challenges in school finance that the recession has illuminated. Second, the Article searches federal and state statutes and regulations for legal mechanisms that are sufficient to deal with school districts' current and future fiscal crises and finds a substantial gap: in nineteen states, not one legal mechanism is available to school districts in fiscal crisis (including federal municipal bankruptcy), and in the remaining thirty-one states, there is considerable variation in the utility of the authorized legal mechanisms. Third, the Article proposes that when Congress reauthorizes No Child Left Behind, which it may do in 2011, it should include fiscal accountability provisions that require states to: (1) help districts create immediate, additional cost savings; (2) publicly monitor districts' fiscal health and create a plan for escalating involvement when a district nears and reaches fiscal crisis; and (3) assist in stabilizing districts' revenues long-term.

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INTRODUCTION

During 2010, 56,282 businesses filed for bankruptcy in the United States and more than 1.5 million individuals did so.[1] Media reports on these topics abound. But, we have heard little about municipalities reaching a similar breaking point—and until recently, news reports about school districts' fiscal crises in particular have been rare as well. In part, this is because municipal bankruptcy proceedings are very rare, and in fact only permitted in about half the states;[2] even from 2006

1. U.S. COURTS, TABLE F-2: U.S. BANKRUPTCY COURTS—BUSINESS AND NONBUSINESS CASES COMMENCED, BY CHAPTER OF THE BANKRUPTCY CODE, DURING THE 12-MONTH PERIOD ENDING DECEMBER 31, 2010, *available at* http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2010/1210_f2.pdf.

2. Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 425 (1993); James E. Spiotto, *Introduction to Municipal Bankruptcy*, *in* THE PROBLEMS OF INDENTURE TRUSTEES AND BONDHOLDERS 1992: DEFAULTED BONDS AND BANKRUPTCY, at 611, 613 (PLI Real Estate Law & Practice, Course Handbook Series No. 378, 1992); Frederick Tung, *After Orange County: Reforming California Municipal Bankruptcy Law*, 53 HASTINGS L.J. 885, 886 (2002). Less than an estimated 600 municipal bankruptcy petitions have been filed since 1937. Stephen Henderson, editorial page editor for the *Detroit Free Press*, estimates that 10,000 corporate bankruptcy filings in a year are not unusual. Stephen Henderson, *Is Bankruptcy the Road to Schools' Comeback?*, DETROIT FREE PRESS, July 12,

through mid-2010, during the recent recession, only twenty-seven municipalities filed for bankruptcy,[3] and no school districts did so. Yet, fiscal crises for local governments, including school districts, are far from over.[4] The executive director of the American Bankruptcy Institute recently speculated that a wave of municipal insolvency may be just around the corner.[5]

The past few years have been difficult for school districts across the country. In December 2008, a *Wall Street Journal* article noted that "many school districts [were] facing the biggest cutbacks they've seen in decades."[6] A few months later, the 2009 American Recovery and Reinvestment Act infused nearly $49 billion into elementary and secondary education.[7] Even with that influx of stimulus money school districts laid-off teachers, administrators, and staff; closed schools; and tried to cut costs wherever they could—sometimes even draining

2009, at A25; Nicholas B. Malito, *Municipal Bankruptcy: An Overview of Chapter 9 and a Critique of the "Specifically Authorized" and "Insolvent" Eligibility Requirements of 11 U.S.C. § 109(c)*, 17 J. BANKR. L. & PRACT. 4 Art. 2, n.2 (2008); Omer Kimhi, *Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem*, 27 YALE J. ON REG. 351, 360 (2010).

3. David Porter, *Facing $20M Judgment, Pa. Town Seeks Bankruptcy*, SEATTLE TIMES, June 15, 2009, *available at* http://seattletimes.nwsource.com/html/nationworld/2009345134_apustownonthebrink.html; James Spiotto, *Municipal Bankruptcy Remains "Last Resort" Despite Troubled Economy*, MUNINETGUIDE, June 8, 2010, http://www.muninetguide.com/articles/municipal-bankruptcy-remains-last-resort-despite-370.php.

4. State revenues may not recover from recession for "several more years." Lesli A. Maxwell, *School Funding on Block Again As States' Fiscal Woes Continue*, EDUC. WEEK, Mar. 3, 2010, at 3; Nicholas McGrath & Ji Hun Kim, *The Next Chapter for Municipal Bankruptcy*, ABI J., June 2010, at 14.

5. Alex P. Kellogg, *Detroit Schools on the Brink*, WALL ST. J., July 21, 2009, at A3. In November 2010, then-Michigan Governor Jennifer Granholm repeated this warning after a smaller city adjacent to Detroit asked the state for permission to file for bankruptcy—the first such request ever made in Michigan. Nick Bunkley, *Debt Rising, A City Seeks Donations in Michigan*, N.Y. TIMES, Nov. 20, 2010, at A10. *See also* Nicole Bullock, *US Cities Forced to Consider Bankruptcy*, FINANCIAL TIMES, Apr. 29, 2010; Associated Press, *Alabama School System Faces State Takeover in Crunch*, MONTGOMERY ADVISER, June 23, 2010 [hereinafter *Alabama School System*], *available at* http://www.montgomeryadvertiser.com/article/20100623/NEWS/100623009/Alabama+school+system+faces+state+takeover+in+crunch?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+StatelineorgRss-Alabama+%28Stateline.org+RSS+-+Alabama%29. For a cautionary note on this point, see Spiotto, *supra* note 3; Kimhi, supra note 2, at 352; Press Release, Miss. Dep't of Educ., State Superintendent of Education Releases Education Budget Cut Spreadsheet (Jan. 22, 2009), *available at* http://www.mde.k12.ms.us/extrel/news/2009/09EdBudgetCut.html; Matthew Tolbert Smith, *How Today's Solutions Become Tomorrow's Problems*, *in* BANKRUPTCY AND FINANCIAL RESTRUCTURING LAW 2010, at 93 (2010).

6. Anne Marie Chaker, *K–12 Schools Slashing Costs*, WALL ST. J., Dec. 11, 2008, at D1.

7. U.S. Dep't of Educ., *State Fiscal Stabilization Fund*, ED.GOV, Mar. 7, 2009, *available at* http://www2.ed.gov/policy/gen/leg/recovery/factsheet/stabilization-fund.html; Erik W. Robelen, *'Funding Cliff' Looms Large for States*, EDUC. WEEK , Nov. 4, 2009, at 19; Nick Anderson, *Sen. Harkin Proposes $23 Billion Bailout for Schools*, WASH. POST, Apr. 14, 2010; Tamar Lewin & Sam Dillon, *With Revenue Cut, Schools Are Warning of Huge Layoffs*, N.Y. TIMES, Apr. 21, 2010, at A12; Eric A. Hanushek, *Cry Wolf! This Budget Crunch is for Real*, EDUC. WEEK, May 19, 2010, at 40.

swimming pools to eliminate the expense of chlorine or asking parents to purchase boxes of tissue, copy paper, and garbage bags.[8] Congress intended the stimulus money to stretch over two years, but most states used the vast majority of those funds during Fiscal Year (FY) 2010.[9] As FY 2011 neared, the National Association of School Boards anticipated that states' budget shortfalls for education "could be as much as $38 billion,"[10] and others estimated the shortfalls could exceed $55 billion.[11] To address these gaps, Congress allocated an additional $10 billion of stimulus funds for public schools in August 2010.[12]

Although the additional stimulus funding certainly tempered the educational funding cliff experts had predicted for FY 2011, in reality, it only delayed the inevitable.[13] As the clock ticks down to FY 2012, a

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8. Press Release, Anne L. Bryant, Exec. Dir., Nat'l Sch. Bds. Ass'n, NSBA Statement: Swift Action is Needed to Save Education Jobs (Feb. 25, 2010), *available at* http://www.educationnews.org/pr_releases/62455.html; Lewin & Dillon, *supra* note 7; Michael Cooper, *Governments Go to Extremes as the Downturn Wears On*, N.Y. TIMES, Aug. 7, 2010, at A1; Kurt Eisele-Dyrli, *School Supplies on a Budget*, DIST. ADMIN., July 2008, at 25, *available at* http://www.districtadministration.com/viewarticlepf.aspx?articleid=1640.

9. Robelen, *supra* note 7; Anderson, *supra* note 7; Lewin & Dillon, *supra* note 7; Hanushek, *supra* note 7.

10. Press Release, Bryant, *supra* note 8.

11. Robelen, *supra* note 7; Anderson, *supra* note 7; Lewin & Dillon, *supra* note 7; Hanushek, *supra* note 7.

12. Motoko Rich, *Given Money, Schools Wait on Rehiring Teachers*, N.Y. TIMES, Aug. 18, 2010, at A1; Sean Cavanaugh, *Federal Aid Adds Twist to Election*, EDUC. WEEK, 1, Sept. 22, 1010, at 1 ("A number of state candidates explain that while they might normally oppose the federal spending that has gone to states this year and last, these are not normal times.").

13. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-999, RECOVERY ACT: OPPORTUNITIES TO IMPROVE MANAGEMENT AND STRENGTHEN ACCOUNTABILITY OVER STATES' AND LOCALITIES' USES OF FUNDS 20–22 (2010) [hereinafter GAO, RECOVERY ACT]; Press Release, Bryant, *supra* note 8; Robelen, *supra* note 7; Anderson, *supra* note 7; Albert Bozzo, *States, Cities Likely to Slash Jobs as Stimulus Dwindles*, CNBC.COM, Mar. 9, 2010, http://www.cnbc.com/id/35777695/States_Cities_Likely_to_Slash_Jobs_As_Stimulus_Dwindles; Lewis & Dillon, *supra* note 7; Terence Chea, *Public Schools Face Big Budget Holes as Stimulus Runs Out*, The PJSTAR.COM, Feb. 14, 2010, http://www.pjstar.com/news/x626056791/Schools-face-big-budget-holes-as-stimulus-runs-out; Andrea Eger, *Union Public Schools to Cut More Than 90 Jobs*, TULSA WORLD, June 30, 2010, http://www.tulsaworld.com/business/article.aspx?subjectid=48&articleid=20100630_19_0_UnionP939479; Jennifer Bonnett, *Galt Elementary Board Approves Budget with Eye on Next Year*, LODI NEWS-SENTINEL, June 25, 2010; Kerry Benefield, *Spring Sports Saved at Santa Rosa Schools*, PRESS DEMOCRAT (Santa Rosa, Calif.), May 27, 2010; Donald J. Boyd & Lucy Dadayan, *Revenue Declines Less Severe, But States' Fiscal Crisis is Far From Over*, STATE REVENUE REPORT, Apr. 2010, at 1; Victor Rivero, *Tightening the Purchasing Process: Superintendents Get More Involved in Buying Policies*, DIST. ADMIN., Nov. 2009, http://www.districtadministration.com/viewarticle.aspx?articleid=2204 ("[P]ublic schools are often tied to revenues that take two to three years to react to any economic conditions [thus] they are the last ones . . . to see an upturn after the economy recovers . . . ."); Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., Remarks at the Annual Meeting of the Southern Legislative Conference of the Council of State Governments: Challenges for the Economy and State Governments (Aug. 2, 2010), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20100802a.htm ("State budgets will probably remain under substantial pressure for a

small yet increasing number of school districts—sometimes major urban districts, often poorer districts, and perhaps especially rural districts that simply cannot raise local property taxes to survive the next few especially lean years[14]—are nearing the point where they may not be able to pay their bills and at the same time fulfill what state law requires of them regarding class size, length of school day or year, curricular coverage, and other such regulations.[15] In fact, in mid-2010, the California Department of Education estimated that 12% of its 1,042 school districts could become insolvent by 2012.[16] As school districts approach FY 2012, once again they will be bracing for more cuts and hoping for yet another deus ex machina intervention. Especially in states hit hardest by the recession, such as Michigan, economists predict that "it could take 15 years or more for tax revenue to rebound to pre-recession levels."[17] The funding cliff problem will not go away anytime soon.

It is a bad habit, to say the least, for school districts to expect an annual bailout when fiscal times are tough. Thus, in this Article, I offer a proposal to change the game. In Part I, I discuss the basics of school finance and budgeting and also explore the many roots of school districts' current and emerging fiscal crises. In Part II, I analyze the three statutory and regulatory remedies available to school districts in fiscal crisis: (1) federal municipal bankruptcy, which is available to school districts in twenty-four states; (2) state receivership, which is available to school districts in two states; and (3) state fiscal takeover of a school district, which is possible in seventeen states. Neither bankruptcy nor receivership serve school districts' needs well, and although state fiscal takeover is better able to address school districts' fiscal problems, there certainly are better and worse ways for a state to intervene at various stages of a takeover. However, in nineteen states not even one of these three imperfect legal mechanisms is available to assist school districts in fiscal crisis.

Therefore, because the federal government has a substantial interest in the financial stability of school districts across the country, in Part III I

while."); Stephen Sawchuk, *Slew of Layoffs May Be Linked to Overhiring*, EDUC. WEEK, May 19, 2010, at 18; Rich, *supra* note 12.

14. Associated Press, *Wealthier Districts Winning School Tax Hikes, Widening Divide, Experts Find*, EDUC. WEEK, June 28, 2010; *Alabama School System*, *supra* note 5; Melissa McKinney, *State Votes to Take Over Two School Systems*, WSFA, July 15, 2010, *available at* http://www.wsfa.com/global/story.asp?s=12809636 (discussing the state financial takeover of two rural Alabama school districts).

15. *See, e.g.*, *infra* notes 39–52 and accompanying text; Rich, *supra* note 12.

16. Andrew Ward, *More California Schools on Fiscal Brink*, BOND BUYER, Mar. 24, 2010, at 1.

17. Bunkley, *supra* note 5.

call for Congress to amend the Elementary and Secondary Education Act of 1965 (the ESEA, known best by the name of its most recent iteration, "No Child Left Behind"[18]) by adopting fiscal accountability provisions. This proposal is especially timely because the Obama Administration is in the process of proposing that the ESEA be substantially restructured when it is reauthorized, which may happen in 2011, and again roughly every five years after that.[19] Specifically, I argue that, as a condition of receiving federal ESEA funding, each state should create a plan that (1) helps school districts create immediate cost savings, (2) monitors school districts' fiscal health going forward and creates mechanisms for assisting them as they approach and enter fiscal crisis, and (3) makes efforts to stabilize education funding long-term.

Before turning to this argument, though, it is necessary to clarify why this Article does not discuss school finance litigation in any great detail. After all, a great many law review articles about school districts and money focus on that topic,[20] and some school finance lawsuits have been prompted by state-level cuts made as a result of the recent recession.[21] Indeed, as one commentator has stated and countless others must have noted, state courts' deference to legislatures "leaves many schools underfunded and under-resourced in spite of successful adequacy litigation—a problem that is aggravated during times of recession."[22] I do not argue that the current way in which public schools

18. The ESEA was initially passed in 1965 and has been reauthorized roughly every five years ever since; in 2001 its name was changed to "No Child Left Behind," however, the current Secretary of Education, Arne Duncan, intentionally has begun to call the legislation by its original name, ESEA. Remarks by Charlie Rose, General Counsel, U.S. Dep't of Educ., at Education Law Association annual meeting in Louisville, KY (2009); No Child Left Behind Act of 2001, Pub. L. No. 107-110, 115 Stat. 1425 (2002) (codified in scattered sections of 20 U.S.C.) (amending the Elementary and Secondary Education Act of 1965, 20 U.S.C. §§ 6301–6578 (2006)).

19. ED.gov, U.S. Dep't of Educ., ESEA Reauthorization: A Blueprint for Reform, http://www2.ed.gov/policy/elsec/leg/blueprint/index.html (last visited June 29, 2011); Alyson Klein, *K–12 Policy Shift Looms in GOP Surge*, EDUC. WEEK, Sept. 22, 2010, at 18, 21; Donald M. Payne, *Reauthorization of the Elementary and Secondary Education Act: Challenges Throughout the Legislative Process*, 26 SETON HALL LEGIS. J. 315, 316 (2002).

20. *See, e.g.*, Scott R. Bauries, *Is There an Elephant in the Room? Judicial Review of Educational Adequacy and the Separation of Powers in State Constitutions*, 61 ALA. L. REV. 701 (2010); John Dayton & Anne Dupre, *Blood and Turnips in School Finance Litigation: A Response to Building on Judicial Intervention*, 36 J.L. & EDUC. 481 (2007); Preston C. Green, III et al., *Race-Conscious Funding Strategies and School Finance Litigation*, 16 B.U. PUB. INT. L.J. 39 (2006); Susan Pace Hamill, *The Vast Injustice Perpetuated by State and Local Tax Policy*, 37 HOFSTRA L. REV. 117 (2008); Michael Heise, *Litigated Learning, Law's Limits, and Urban School Reform Challenges*, 85 N.C. L. REV. 1419 (2007); James E. Ryan, *Schools, Race, and Money*, 109 YALE L.J. 249 (1999); Vinay Harpalani, Note, *Maintaining Educational Adequacy in Times of Recession: Judicial Review of State Education Budget Cuts*, 85 N.Y.U. L. REV. 258 (2010).

21. *See infra* Part I.B.2.b.

22. Harpalani, *supra* note 20, at 258; Sonja Ralston Elder, Note, *Standing up to Legislative Bullies: Separation of Powers, State Courts, and Educational Rights*, 57 DUKE L.J. 755 (2007).

are funded is just; although the disparities among districts are notably less than they were twenty, thirty, or forty years ago, shocking inequalities remain.[23] But, whether a school district is fiscally stable and whether the education provided to students in that district or state is constitutionally adequate are separate issues. They are connected because fiscal stability is one necessary component among many in determining whether educational adequacy exists, but fiscal stability is certainly not a proxy for educational adequacy. This Article focuses on the complex problem of fiscal stability alone.

I. SCHOOL FINANCE BASICS

The reforms proposed in this Article are tailored to address school districts' existing and future fiscal crises. These crises are more complicated than perhaps assumed, and they are not limited to or fully explained by the recent recession. This Part is devoted to explaining those causes. First, it briefly explains how school districts operate financially. Then, it discusses the many variables that can contribute to school districts' fiscal crises.

A. Money Comes in, Money Goes out

1. School Districts' Major Sources of Revenue

Of the $584 billion in all U.S. public school districts' revenue columns during FY 2008, 8.2% was provided by the federal government, 43.5% by local governments, and 48.3% by state governments.[24] Of course the relative shares of federal, local, and state contributions vary from state to state and district to district[25]—and the variation among districts in per capita levels of property wealth can be shocking[26]—but these are the national averages.[27]

23. *See, e.g.*, JAMES E. RYAN, FIVE MILES AWAY, A WORLD APART (2010); Kristi L. Bowman, *A New Strategy for Pursuing Racial and Ethnic Equality in Public Schools*, 1 DUKE F. FOR L. & SOC. CHANGE 47 (2009).

24. LEI ZHOU & FRANK JOHNSON, NAT'L CTR. FOR EDUC. STATISTICS, NCES 2010-326, REVENUES AND EXPENDITURES FOR PUBLIC ELEMENTARY AND SECONDARY EDUCATION: SCHOOL YEAR 2007–2008, at 2 (2010), *available at* http://nces.ed.gov/pubs2010/2010326.pdf.

25. BRUCE D. BAKER, PRESTON GREEN & CRAIG E. RICHARDS, FINANCING EDUCATION SYSTEMS 48, 53 (2008) (presenting a graph comparing relative portions of state, federal, and local contributions to education across all fifty states, and listing the relative share of property tax, sales tax, and income tax to state and local education revenues across all fifty states).

26. Cynthia A. Baker, *What Do We Expect?: An Introduction to the Law, Money, and Results of State Educational Systems*, 42 IND. L. REV. 317, 319 (2009) (describing one difference in Texas, from $14 million of property wealth per student in the most affluent district to $20,000 per student in the

Over the past few years, school districts' revenues have fallen sharply. The decreases have varied by source, however: federal funding for education has remained constant during the recession, and if one considers the stimulus money targeted for education during this time, federal funding has actually increased.[28] But, since 2008, state funding for elementary and secondary education has fallen in thirty-three states and the District of Columbia.[29] Even after FY 2011 began, thirty-four states expected further cuts during that fiscal year.[30] Numerous states are considering further cuts to K–12 education funding for FY 2012, including New York, Texas, and Wisconsin.[31] These reductions have many causes, but the most immediate causes are that states' income tax revenue has been hit hard by job losses; local and state property tax revenue has fallen sharply because home values have been dropping as the real estate bubble burst and tax delinquencies and home foreclosures rose; and state sales tax revenues have decreased because of substantial drops in consumer spending.[32] Plus, states' and municipalities' safety net—the bond market—has been so unprecedentedly unstable that the federal government intervened during both 2009 and 2010 to make billions of dollars in bonding authority available to states and major school districts—money which would not have been available

poorest); Benjamin Michael Superfine, *New Directions in School Funding and Governance: Moving from Politics to Evidence*, 98 KY. L.J. 653, 654 (2010).

27. A notable exception to this formula is in Michigan, where education is financed by a combination of sales taxes, property taxes, lottery revenue, general funds, and stimulus funds. Kathy Barks Hoffman, *Cutbacks Stir Debate Over Michigan Funding System*, EDUC. WEEK, Nov. 11, 2009, at 16.

28. Sawchuk, *supra* note 13, at 1.

29. NAT'L GOVERNORS ASS'N & NAT'L ASS'N OF STATE BUDGET OFFICERS THE FISCAL SURVEY OF STATES 4 (2010); Nicholas Johnson et al., Ctr. on Budget Pol'y & Priorities, An Update on State Budget Cuts, http://www.cbpp.org/files/3-13-08sfp.pdf (last visited Mar. 30, 2011) (funding has fallen in Alabama, Arizona, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Mississippi, Missouri, Nebraska, Nevada, New Jersey, North Carolina, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, Utah, Virginia, Washington, and the District of Columbia).

30. Jacob E. Adams, Jr., *Where's the Smart Money in a Great Recession?*, EDUC. WEEK, Sept. 15, 2010, at 36.

31. *See, e.g.*, James C. McKinley, *Aid Dropping, Texas Schools Must Scramble to Save Money*, N.Y. TIMES, Feb. 15, 2011, at A16; Monica Davey & Richard A. Oppel Jr., *Wisconsin Budget Would Slash Municipal Aid*, N.Y. TIMES, Mar. 2, 2011, at A16; Thomas Kaplan, *Cuomo, Pushing School Cuts, Offers a Target: Superintendent Salaries*, N.Y. TIMES, Feb. 7, 2011, at A16.

32. Chaker, *supra* note 6; Michael Prombo et al., *Identifying and Mitigating Sources of School Revenue Erosion*, SCH. BUS. AFFAIRS, Sept. 2009, at 14, 16; Diane Rado, *State Tax Cap Puts Lid on School Budgets*, CHI. TRIB., Mar. 5, 2009; Orrick, Herrington & Sutcliffe LLP, Municipal Restructuring and Insolvency, http://www.orrick.com/practices/public_finance/municipalRestructuring.asp (last visited Mar. 30, 2011) [hereinafter Orrick]; Sara Behunek, *Three American Cities on the Brink of Broke*, CNNMONEY.COM, May 28, 2010, http://money.cnn.com/2010/05/28/news/economy/american_cities_broke.fortune/index.htm; Kimhi, *supra* note 2, at 376.

otherwise.[33]

2. School Districts' Major Expenditures

In FY 2008, public elementary and secondary schools across the country spent nearly $597 billion to educate roughly 49 million students.[34] School districts' largest expenditures are salaries for teachers, staff, and administrators, totaling approximately $360 billion in 2006 and constituting 69% of all expenditures that same year.[35] During FY 2008, this was followed by roughly $58 billion (11% of all expenditures) spent on the maintenance and acquisition of equipment and facilities, and almost $16 billion spent on interest (2.6% of all expenditures) for $322 billion of outstanding debt.[36] Nationally, this averages out to spending an average of about $10,000 on each public school student every year.[37] The inequalities among states and districts are great, however: per student spending ranged from the highest state average of $14,824 in New Jersey to the lowest state average of $6,060

33. Press Release, U.S. Dep't of Educ., Treasury and Education Announce 2010 School Bond Allocation (Mar. 17, 2010), *available at* http://www2.ed.gov/news/pressrelease/2010/03/03172010a.html; Orrick, *supra* note 32; *'Build America' Bonds Could Boost School Construction*, SCHOOL GRANTS 2009, Apr. 29, 2010, http://www.schoolgrants2009.com/content/%E2%80%98build-america%E2%80%99-bonds-could-boost-school-construction; *Build America & School Construction Bonds*, RECOVERY.GOV, Mar. 17, 2010, http://www.recovery.gov/News/featured/Pages/BuildAmericaBondsUpdate.aspx; Press Release, U.S. Dep't of the Treasury, Treasury Releases Guidance on Build America Bonds and School Bonds (Apr. 3, 2009), *available at* http://www.ustreas.gov/press/releases/tg80.htm; William Selway, *Build America Bonds Extended Under Jobs Bill Passed by House*, BUSINESSWEEK, May 28, 2010; Lisa Anne Hamilton, *Canary in the Coal Mine: Can the Campaign for Mandatory Climate Risk Disclosure Withstand the Municipal Bond Market's Resistance to Regulatory Reform?*, 36 WM. MITCHELL L. REV. 1014, 1018 (2010). Similarly, the Michigan Finance Authority supported the sale of bonds on behalf of the Detroit public schools in early 2010; this support helped the bonds earn a high rating from Standard & Poor's. However, the one-year bonds still paid unusually high rates (6.45% and 6.65%) to garner sufficient interest. Kelly Nolan, *Detroit's Schools Pay High Price to Borrow*, WALL ST. J., Mar. 3, 2011, *available at* http://online.wsj.com/article/SB10001424052748704507404576178912382687574.html.

34. ZHOU & JOHNSON, *supra* note 24, at 16.

35. U.S. CENSUS BUREAU, THE 2010 STATISTICAL ABSTRACT: EDUCATION, TABLE 252: PUBLIC ELEMENTARY AND SECONDARY SCHOOL FINANCES BY ENROLLMENT-SIZE GROUP: 2005 TO 2006 (2010) [hereinafter U.S. CENSUS BUREAU, TABLE 252]. During 2007, public elementary and secondary schools employed nearly 2.5 million full-time teachers plus 2.1 million administrators, nurses, social workers, clerical staff, custodial staff, bus drivers, and other staff. U.S. CENSUS BUREAU, THE 2010 STATISTICAL ABSTRACT: EDUCATION, TABLE 251: PUBLIC SCHOOL EMPLOYMENT: 1990 AND 2006 (2010). In small communities especially, the role of the public school system as a major employer is especially obvious. Kristi L. Bowman, *Rebuilding Schools, Rebuilding Communities: The Civic Role of Public Schools After Hurricane Katrina*, *in* 235 CHILDREN, LAW, AND DISASTERS: WHAT WE HAVE LEARNED FROM KATRINA AND THE HURRICANES OF 2005 (2009).

36. ZHOU & JOHNSON, *supra* note 24, at 2.

37. U.S. CENSUS BUREAU, THE 2010 STATISTICAL ABSTRACT: EDUCATION, TABLE 253: PUBLIC ELEMENTARY AND SECONDARY ESTIMATED FINANCES, 1980 TO 2007, AND BY STATE, 2007 (2010).

in Utah, and the average per-pupil spending difference between a district at the fifth percentile and the ninety-fifth percentile in any given state is nearly $4,000.[38]

State and local governments usually lag behind the private sector by a year or two in feeling the effects of a recession and having to cut their budgets,[39] but even by now it is old news that most school districts have been cutting back—postponing orders for new equipment and textbooks, cutting programs such as arts and athletics.[40] However, the cuts stretch beyond regular belt-tightening: at least two-thirds of school districts laid-off teachers and staff for the 2009–2010 school year and between seventy-five and ninety percent of school districts expected to do so before or during the 2010–2011 school year.[41] Because of the second round of stimulus funding, the number of teachers laid-off in fall 2010 did not reach the 100,000–300,000 previously predicted, but 60,000 teachers still lost their jobs.[42] As a result, almost two-thirds of school

38. Professors Goodwin Liu and Derek Black both have written persuasively about the incredible level of education inequalities across states because of these funding disparities. Both Liu and Black also argue that Title I of ESEA perversely exacerbates these inequalities. Goodwin Liu, *Education, Equality, and National Citizenship*, 116 YALE L.J. 330, 397–98 (2006); Goodwin Liu, *Interstate Inequality in Educational Opportunity*, 81 N.Y.U. L. REV. 2044 (2006); Goodwin Liu, *Improving Title I Funding Equity Across States, Districts, and Schools*, 93 IOWA L. REV. 973, 973 (2008); Derek W. Black, *The Congressional Failure to Enforce Equal Protection Through the Elementary and Secondary Education Act*, 90 B.U. L. REV. 313, 317–18 (2010). *See also* Amy Hightower, *School Finance*, EDUC. WEEK, Jan. 14, 2010, at 48, *available at* http://www.edweek.org/media/ew/qc/2010/17sos.h29.finance.pdf (documenting the per-pupil spending difference).

39. Bozzo, *supra* note 13.

40. Rado, *supra* note 32; Amanda Paulson, *On National Teacher Day, Unions Rail Against Cuts*, CHRISTIAN SCI. MONITOR, May 4, 2010; Anthony Rios, *Cash-Strapped Districts Shift to Pay-to-Play Sports*, EDUC. WEEK, July 6, 2010, *available at* http://www.edweek.org/ew/articles/2010/07/06/36ohiosports_ap.h29.html?r=1636543421; Ethan Stewart, *To the Bone*, SANTA BARBARA INDEP., Feb. 25, 2010, at 11 (A board member noted, "[w]e trimmed the fat a long time ago.").

41. Anderson, *supra* note 7; Erin Richards, *Bill in Congress Could Supply $400 Million to Save State Educators' Jobs*, MILWAUKEE J. SENTINEL, May 12, 2010 ("Cleveland Public Schools, with about 50,000 students, is expecting to lay off 545 teachers and 100 principals. In Atlanta, the 90,000-student Fulton County School System might have to cut about 1,000 jobs, including close to 500 teaching positions. Milwaukee Public Schools, with about 85,300 students, has proposed comparatively more layoffs than any other district in the state: 850 employees, including around 150 to 200 teachers."). Dakarai I. Aarons, *Report Says Stimulus Spending Staved Off Layoffs*, EDUC. WEEK., July 15, 2010, *available at* http://www.edweek.org/ew/articles/2010/07/14/37cep.h29.html?qs=Staved+Off. Reading and math specialists sometimes are cut disproportionately, thus removing crucial academic support for students who need it acutely. Danny Hakim, *School Districts Scramble After Albany Delays Aid*, N.Y. TIMES, Dec. 15, 2009, at A34; Press Release, Bryant, *supra* note 8.

42. *NBC Nightly News: School Districts Predict Drastic Teacher Cuts* (NBC television broadcast Apr. 21, 2010), *available at* http://www.msnbc.msn.com/id/21134540/vp/36699211#36699211; Charles Lane, *A Teacher-Layoff Crisis? Let's Do the Numbers*, WASH. POST., June 20, 2010; Pat Wingert & Evan Thomas, *Chicago's Lesson in Layoffs: Should the Newest Teachers Go?*, NEWSWEEK, July 17, 2010; Arthur Delaney, *States Lay Off 58,000 Teachers in September Despite $26 Billion Aid Package*, HUFFINGTON POST, Oct. 8, 2010, *available at* http://www.huffingtonpost.com/2010/10/08/states-lay-off-58000-teac_n_755965.html.

districts expected that they would be consolidating most students into larger classes by fall 2010.[43] More than a third of school districts also evaluated whether to eliminate summer school programs;[44] others have been closing sometimes massive numbers of schools: sixteen in Cleveland, thirty-three in Detroit, twenty-eight in Kansas City;[45] reducing the length of the school day, week, or year;[46] eliminating early-childhood education;[47] cutting gifted education;[48] closing alternative schools;[49] cutting back employees' health care benefits;[50] reopening collective bargaining agreement negotiations before the end of the term;[51] moving to a 401(k) retirement savings plan rather than a pension system;[52] charging students to ride the bus to school, selling ads on school buses and school district websites, and selling naming rights to athletic stadiums and other areas of school campuses;[53] and outsourcing

43. Hakim, *supra* note 41; Press Release, Bryant, *supra* note 8; Anderson, *supra* note 7; Maxwell, *supra* note 4, at 1, 18.

44. Anderson, *supra* note 7; Erik Robelen, *Financial Problems Force Districts to Cut Summer School*, EDUC. WEEK, July 13, 2010, at 9.

45. The Cleveland Public School district planned to close sixteen schools by fall 2010. Dakarai I. Aarons, *School Transformation Efforts Accelerate*, EDUC. WEEK, Mar. 17, 2010, at 1. To avoid insolvency, the long-troubled Kansas City, Missouri public school district plans to permanently close about half its schools over the summer of 2010. Susan Saulny, *Board's Decision to Close 28 Kansas City Schools Follows Years of Inaction*, N.Y. TIMES, Mar. 12, 2010, at A11; Aarons, *supra* note 45, at 1, 12; DETROIT PUB. SCHS., FINAL DECISION REGARDING BUILDING CLOSURES, REPURPOSING OF BUILDINGS, AND PROGRAM CHANGES 2010 THROUGH 2012, http://www.michiganradio.org/media/docs/DPS_final_closure_list.pdf.

46. Chris Herring, *Schools' New Math: the Four-Day Week*, WALL ST. J., Mar. 8, 2010, at A1; Lewin & Dillon, *supra* note 7. The Mississippi Senate approved a bill which reduced the number of required school days by five and also permitted school districts to require their employees to take five days of unpaid leave per year. *Mississippi Senate OKs Shorter School Year*, EDUC. WEEK, Mar. 10, 2010, at 4; Louis Freedberg, *School Year Shrinking as Budget Crisis Grows*, CAL. WATCH, July 19, 2010. For a discussion of the ramifications of a four-day week, see generally Katharine Baird Silbaugh, *Sprawl, Family Rhythms, and the Four-Day Work Week*, 42 CONN. L. REV. 1267 (2010).

47. Paulson, *supra* note 40.

48. Jennifer Gollan, *Gifted Programs Go on Block as Schools Must Do With Less*, N.Y. TIMES, Feb. 20, 2011, at A27.

49. Carla Rivera, *Students Face Closure of Alternative Schools Because of L.A. County Budget Cuts*, L.A. TIMES. June 27, 2010.

50. Hoffman, *supra* note 27.

51. *Id.*; W. Richard Fossey & John M. Sedor, *In Re* Copper River School District*: Collective Bargaining and Chapter 9 Municipal Bankruptcy*, 6 ALASKA L. REV. 133, 136 (1989). Not surprisingly, teachers react very negatively to this. In Illinois's Lake Bluff School District 65, for example, teachers are responding to the district's efforts to reopen negotiations by wearing black and refusing to talk with the district's central administration. Posting of Adrienne to Gazebo News, http://gazebonews.com/2010/08/20/teachers-have-contract-issues-in-lake-bluff/ (Aug. 20, 2010).

52. Hoffman, *supra* note 27.

53. Winnie Hu, *Big, Yellow, and Ripe for Budget Cuts*, N.Y. TIMES, Aug. 9, 2009, at MB1; Donna Gordon Blankinship, *Could School Bus Ads Save School Budgets?*, USA TODAY, Mar. 20, 2010; Sue McMillin, *Budget Cuts Mean School Bus Fees in Woodland Park*, GAZETTE (Colo. Springs), June 17, 2010; McKinley, *supra* note 31; Jennifer Medina, *Los Angeles Schools, Facing Budget Cuts, Decide*

transportation and cleaning.[54] Some school districts have been able to draw on their reserves to minimize cuts—although even wealthier suburban districts have been feeling financial pressure—but others, especially smaller, rural districts, went into the recession without any safety net.[55]

Some states have also been trying to help school districts create cost-savings. Hawaii closed schools across the entire state for seventeen Fridays during the 2009–2010 school year.[56] District consolidation is being seriously considered in Illinois, Michigan, and Mississippi.[57] Mississippi also enacted a measure reducing the required school year by five days and allowing districts to furlough their employees for another five days.[58] Idaho enacted a measure which would allow a school district to declare itself in fiscal emergency and cut salaries as needed, regardless of existing contractual or other obligations.[59] Class size caps have been raised in California, Georgia, Nevada, Ohio, Utah, and Wisconsin, and such proposals are under consideration in Idaho and Texas.[60] It seems that all that is left is to reduce curricular requirements.

to Seek Corporate Sponsors, N.Y. TIMES, Dec. 16, 2010, at A22; Walt Gardner, *US Public Schools Are Going Broke, Yet Some Spend Like a Kid in a Candy Store*, CHRISTIAN SCI. MONITOR, Dec. 27, 2010, *available at* http://www.csmonitor.com/Commentary/Opinion/2010/1227/US-public-schools-are-going-broke-yet-some-spend-like-a-kid-in-a-candy-store.

54. Hoffman, *supra* note 27.

55. Hakim, *supra* note 41; Louis Uchitelle, *Wealthy Suburb Cuts Corners To Keep a Lid on School Taxes*, N.Y. TIMES, Mar. 9, 2011, at A1.

56. Cooper, *supra* note 8.

57. Hoffman, *supra* note 27, at 16 (noting that this is similar to school districts' older municipal sibling, cities); Omer Kimhi, *Reviving Cities: Legal Remedies to Municipal Financial Crises*, 88 B.U. L. REV. 633, 637 (2008); Diane Rado & Duaa Eldeib, *Single-School Districts Have Higher Administrative Expenses Per Child, Tribune Finds*, CHI. TRIB., Mar. 5, 2011, *available at* www.chicagotribune.com/news/ct-met-1school-20110305,0,526334.story; Sharif M. Shakrani, *School District Consolidation Study in 10 Michigan Counties* (Educ. Pol'y Ctr. at Mich. St. Univ., Working Paper No. 15, 2010), *available at* http://education.msu.edu/epc/forms/Shakrani-2010-School-District-Consolidation-Study.pdf; Alyson Klein, *Proposes K–12, College Cuts Draw Fire in Mississippi*, EDUC. WEEK, Dec. 7, 2009, at 16. This is an especially dramatic suggestion in a state in which the school districts reflect a high degree of racial isolation, which is not coincidental. *See id.*; Kristi L. Bowman, *The Civil Rights Roots of* Tinker*'s Disruption Tests*, 58 AM. U. L. REV. 1129 (2009).

58. H.R. 1170 (Miss. 2010), *available at* http://billstatus.ls.state.ms.us/2010/pdf/history/HB/HB1170.xml.

59. Brad Iverson-Long, *'Financial Emergency' Provision Added to Schools Budget at the 11th Hour*, IDAHOREPORTER, Mar. 3, 2010, *available at* http://www.idahoreporter.com/2010/financial-emergency-provision-added-to-schools-budget-at-the-11th-hour/.

60. Sam Dillon, *Tight Budgets Mean a Squeeze in Classrooms*, N.Y. TIMES, Mar. 7, 2011, at A1.

B. The Causes of School Districts' Present Fiscal Crises

It might seem as though school districts should be fairly stable, in a financial sense—their income mainly is derived from state and local taxes, and their major expenditures are predictable employee salaries and benefits, capital expenditures, and debt service.[61] Yet, as we have seen recently, fiscal instability sometimes becomes inevitable. The general economic crisis clearly is the dominant, immediate trigger of most school districts' current fiscal crises; undisputedly, districts' revenues have dropped substantially in the past few years and districts have been unable to adjust their expenditures without substantial pain.[62] Other factors also have contributed to school districts being ill-prepared to deal with fiscal challenges, however.[63] This subsection first reviews the perennial, common systemic factors that contribute to many school districts' fiscal crises and then discusses the current and future situational factors, varying substantially over the course of time and from one district to another, which will cause substantial fiscal stress for many districts.

1. Systemic Factors

The systemic factors contributing to districts' fiscal crises generally fall into two categories: management and politics.[64] First, management problems could come in the form of outdated accounting methods,[65] a lack of "specialized knowledge in analytical tools developed to help local governments assess their fiscal health,"[66] a general lack of sophisticated fiscal expertise among school districts' financial officers,[67]

61. Kimhi, *supra* note 57, at 637; U.S. CENSUS BUREAU, TABLE 252, *supra* note 35.

62. Kimhi, *supra* note 57, at 638; Charles K. Coe, *Preventing Local Government Financial Crises: Emerging Best Practices*, 68 PUB. ADMIN. REV. 759, 763 (2008) (citing SCOTT R. MACKEY, STATE PROGRAMS TO ASSIST DISTRESSED LOCAL GOVERNMENTS (1993)); Beth Walter Honadle, *The States' Role in U.S. Local Government Fiscal Crises: A Theoretical Model and Results of a National Survey*, 26 INT'L J. OF PUB. ADMIN. 1431, 1458–59 (2003).

63. Behunek, *supra* note 32 ("Rampant unemployment, tepid consumer spending, and deeply underfunded public pensions are the leading causes of the balance sheet issues cities are having today. But years of political chicanery and poor financial decision-making by city officials are what led to this problem.").

64. Kimhi, *supra* note 57, at 638.

65. Coe, *supra* note 62, at 763 (citing Mackey); Honadle, *supra* note 62, at 1458–59.

66. Honadle, *supra* note 62, at 1434.

67. Gretchen Morgenson, *Exotic Deals Put Denver Schools Deeper in Debt*, N.Y. TIMES, Aug. 6, 2010, at A1.

dated and inflexible budgetary procedures,[68] and a sense of planning year-to-year rather than having a long-term fiscal plan that includes having sufficient money in reserves.[69] One example of mismanagement and short-sightedness is as follows: school districts hired aggressively between 2000 and 2008 in response to No Child Left Behind (NCLB) and the general push for accountability, decreasing class sizes and adding teaching coaches, instructional mentors, ELL instructors, special education teachers, and others who specialized in focused instruction. In fact, between 1999 and 2008, the public school student population grew five percent and the number of classroom teachers grew eleven percent.[70] Yet, when school districts were hiring these additional employees, they probably did not anticipate that their funding might decrease a little, let alone a lot.

Second, the problems of politics are obvious, if stubborn and complicated. As John Chubb and Terry Moe argued in 1990, when education policy is made at the local level by elected officials and those who report to them, it becomes influenced by interest groups who bring to the table concerns extending beyond the education of children, which can lead to policies that do not match the educational needs of children in the district.[71] Consider the inertia for the present system of budgeting: According to Marguerite Roza, a school finance expert, "[school] districts tend to think of everything in terms of fixed costs . . . stabilizing a budget would mean that a smaller share of the budget would be tied to committed or escalating costs, including salaries."[72] However, school districts have not adjusted to Roza's proposed model.[73] Many school district budgets are besieged by interest

68. Coe, *supra* note 62, at 763 (citing MACKEY, *supra* note 62); Honadle, *supra* note 62, at 1458–59; Hanushek, *supra* note 7 (noting that this is not unique to school districts, though as the Pew Center on the States notes, "as many as 17 states project only one or zero years beyond the current budget cycle"); The Pew Ctr. on the States, Long-Term Fiscal Planning, *available at* http://www.pewcenteronthestates.org/initiatives_detail.aspx?initaitive (last visited Mar. 31, 2011).

69. *See* sources cited *supra* note 68.

70. Sawchuk, *supra* note 13, at 18.

71. JOHN E. CHUBB & TERRY M. MOE, POLITICS, MARKETS & AMERICA'S SCHOOLS (1990) (discussing that, for example, a decision about laying off teachers is not a debate about the research on the effect of larger class sizes; especially in poorer communities, it becomes a powerful local political issue if the school district is a major employer); Aaron Saiger, Note, *Disestablishing Local School Districts as a Remedy for Educational Inadequacy*, 99 COLUM. L. REV. 1830, 1858–59 (1999).

72. Sawchuk, *supra* note 13, at 18.

73. Many school districts covered much of their FY2010 shortfalls with stimulus funding, thus avoiding substantial amounts of layoffs or other programmatic changes. *See, e.g.*, Gary Glancy & Lee G. Healy, *Spartanburg School Districts 4 and 5 to Furlough Teachers*, SPARTANBURG HERALD-JOURNAL, June 29, 2010 ("The district made up a large portion of its shortfall by using . . . federal stimulus dollars to fund personnel."). This is not the first time in recent history when school districts' revenues have decreased, and according to Stanford economist Erik Hanushek, districts "have found the

groups wielding political power,[74] complicated by power dynamics between and among government officials,[75] and obscured by many stakeholders' interests in making the financial situation seem better than it is because of the general unpopularity of options for dealing with fiscal crisis.[76] On top of all of this, some school districts also are weakened by corrupt government officials who embezzle, or coordinate the embezzlement of, millions of dollars annually (as in the Detroit and New Orleans public school districts).[77]

2. Situational Factors

The systemic factors identified above operate across decades and districts. The following three situational factors are more time-, region-, or district-specific factors that also will exert increasingly substantial financial pressure on various states and school districts, if they have not done so already. The proposal presented later in this Article is aimed mainly at addressing systemic factors. But, awareness of future substantial situational factors still can help states and districts engage in useful long-term fiscal planning and thus have a better chance of maintaining long-term fiscal stability, which is a central goal of this Article.

a. Pensions: The Third Rail

Some districts already can tell tales of pension-related woe. For example, in 2008, the Denver Public Schools entered into a creative financing deal to cover a $400 million shortfall in their pension obligations; because of the long arm of the recession, the deal has already cost the cash-strapped district at least $25 million more than it anticipated.[78] (The district may, however, come out ahead in this deal over the course of the thirty-year term to which it agreed.)[79]

'crying wolf' strategy always effective and thus have never really thought much about how to adjust to a leaner budget." Hanushek, *supra* note 7, at 40.

74. Coe, *supra* note 62, at 763 (citing MACKEY, *supra* note 62).

75. Honadle, *supra* note 62, at 1434.

76. *Id.*

77. Kellogg, *supra* note 5 (noting that in 2009, forensic accountants discovered 257 "ghost" employees receiving paychecks from DPS, and a former payroll manager and another individual were indicted in May, 2009 on charges of embezzling roughly $400,000 since 2005); Bowman, *supra* note 35.

78. Morgenson, *supra* note 67; David Milstead, *Analysis: Both Sides Right in DPS Pension Debate*, EDUC. NEWS COLO., Apr. 12, 2010, www.ednewscolorado.org/2010/04/12/4295-analysis-both-sides.

79. *Id.*

Denver is not alone. A January 2010 article in the professional journal *District Administration* stated, "[t]he financial state of the nation's public pension funds—which provide the retirement incomes for all state employees but in most states are dominated by teachers, administrators and other school employees—has gone from bad to worse, and for most it is only projected to worsen in coming decades."[80] The pension crisis has been exacerbated by the recent recession, but even before then, pension funds had become more dependent on investment returns than they had ever been in the past.[81] Thus, the stock market drops over the past decade, and in 2008 especially, affected pension funds substantially.[82] During 2008, Iowa's state pension fund declined by more than $3 billion and California's public employee and teachers' pension funds lost more than $100 billion.[83] States now are carrying hundreds of billions of dollars of unfunded pension obligations: estimates of the total unfunded liability for teachers' pensions across the country range from $330 billion to $900 billion.[84] The shortfall is scary, as is one major reason why the amount of the shortfall is so uncertain: few states or districts have done an actuarial study so that they can plan for the real future costs of retirees' health care and pensions, which remain largely unknown.[85]

Much like social security reform, pension reform appears to be a third rail, the sort of political issue so charged that engaging it directly is likely to inflict severe, if not fatal, damage to individual politicians' careers.[86] It is controversial for many reasons. Meaningful reform must engage fundamental issues about how public employees are paid; as one commentator has recently written, public employees' compensation is "skewed [] heavily toward pensions and health insurance" because

80. Kurt Eisele-Dyrli, *Will Pensions Bankrupt Your District?*, DIST. ADMIN., Jan. 2010, at 39.

81. *See id.* at 39–40.

82. *Id.*

83. *Id.*

84. Matt Miller, *Buyouts, not Bailouts, for Teachers*, WASH. POST, May 13, 2010; Eisele-Dyrli, *supra* note 80. *See also* Natalie Cohen, *San Diego City's Financial Crisis: The Past, Present, and Future*, BONDSQUAWK, June 10, 2010, *available at* http://www.bondsquawk.com/tag/municipal-bankruptcy/; Editorial, *States of Progress*, WALL ST. J., Mar. 20, 2010, at A14 (noting that New Jersey has $90 billion in unfunded pension and health care obligations).

85. CAL. GOVERNOR'S COMM. ON EDUC. EXCELLENCE, PRIORITY 2: ENSURE FAIR FUNDING THAT REWARDS RESULTS, 5-29, 5-30 (2007), *available at* http://www.everychildprepared.org/docs/5finance.pdf; Mary Williams Walsh, *The Burden of Pensions on States*, N.Y. TIMES, Mar. 11, 2011, at B1 ("[S]everal studies have shown that promises to workers are far more costly than routinely calculated by Wisconsin and most states.").

86. The city of Vallejo, California recently neared bankruptcy and chose to layoff employees, cut back on services, and reduce retirees' health care benefits—but it would increased pensions. Steven Greenhut, *Vallejo's Painful Lessons in Municipal Bankruptcy*, WALL ST. J., Mar. 26, 2010, *available at* http://www.pacificresearch.org/press/vallejos-painful-lessons-in-municipal-bankruptcy.

"politicians and union leaders have decided that generous future benefits offer the easiest way to hold down spending and still satisfy workers."[87] Additionally, reform is, of course, constrained by most states' very limited ability to alter previously accrued benefits, and by some states' only slightly greater ability to change future pension accruals—although lawsuits in at least two states are testing the strength of these agreements.[88]

A few states have begun to grapple with the problem of a growing pension fund shortfall, and some but certainly not all of these reforms address teachers' pension funds.[89]

b. Recession-Related Litigation

Since 2009, a number of lawsuits involving various legal claims have grown out of school districts' recession-driven budget cuts. For example, in 2009, multiple lawsuits brought on behalf of students challenged Hawaii's decision to furlough teachers and close schools for seventeen Fridays during the school year.[90] In February 2010, the American Civil Liberties Union (ACLU) and the Public Counsel Law Center sued the Los Angeles Unified School District, contesting the district's layoff of a disproportionate number of teachers at three inner-

87. David Leonhardt, *Union Pay Isn't Busting State Budgets*, N.Y. TIMES, Mar. 2, 2011, at B1.

88. Amy B. Monahan, *Public Pension Plan Reform: The Legal Framework* 1–2 (Univ. of Minn. Law Sch., Paper No. 10-13, 2010), *available at* http://ssrn.com/abstract=1573864; *Id.* at 3 ("State plans, however, are specifically exempted from the [federal] anti-cutback rule."); *id.* at 27–30 (providing a chart summarizing a number of states' legal restrictions on limiting pension benefits; seven of the states only limit the ability to alter already-accrued benefits; twelve of the states limit the ability to alter past or future accrued benefits; three of the states are unclear; one state is fact-specific; and one state has no restrictions). *See also* Jeannette Newman, *Pension Cuts Face Test in Colorado, Minnesota*, WALL ST. J., June 12, 2010, at A13.

89. Starting in fall 2010, Louisiana's two major teacher pension funds will raise the employer pension contribution, one by nearly five percent and the other by nearly seven percent of an employee's salary. Eisele-Dyrli, *supra* note 80. Reform debates in Kansas, Maryland, and Minnesota are also discussing teachers' pensions. John Hanna, *Kan. Pension Woes Incite Fight Over School Funding*, BLOOMBERG BUSINESSWEEK, Mar. 14, 2011, *available at* www.businessweek.com/ap/financialnews/D9LV1EV00.htm (Kansas); Aaron C. Davis, *Md. Teachers, State Employees Protest Budget Cuts, Pension Changes*, WASH. POST, Mar. 15, 2011, *available at* http://www.washingtonpost.com/local/politics/md-teachers-state-employees-protest-budget-cuts-pension-changes/2011/03/14/ABC0CJW_story.html (Maryland); Associated Press, *Minn. Bills to Curtail Public Workers' Pensions, Teachers' Bargaining Rights Get Look*, STAR TRIB., Mar. 15, 2011, *available at* http://www.startribune.com/templates/Print_This_Story?sid=117941349. For an overview of states' approaches to the pension shortfall problem, see KATHERINE BARRETT & RICHARD GREENE, THE PEW CTR. ON THE STATES, PROMISES WITH A PRICE: PUBLIC SECTOR RETIREMENT BENEFITS (2007).

90. Herbert A. Sample, *Hawaii Teacher Furlough Talks May Occur this Week*, THE STREET, Nov. 4, 2009, *available at* http://www.thestreet.com/story/10621846/hawaii-teacher-furlough-talks-may-occur-this-week.html.

city, high-minority middle schools as a violation of students' rights.[91] Also in February 2010, New Jersey Governor Chris Christie ordered school districts to cover a portion of the per capita funding promised by the state by dipping into their own reserves at a total of $475 million statewide; not surprisingly, school districts sued the state.[92] In mid-May 2010, the board of a major suburban school district, Montgomery County, Maryland, unanimously decided that it would sue its parent municipality, the county, if the county allocated less money for public schools than the minimum level required by the state, which seemed likely.[93] A school finance lawsuit filed during May 2010 in California appears to have been triggered by state cuts resulting from the recession, as does a similar lawsuit filed in Indiana a few months earlier.[94] In June 2010, Kansas City residents sued the Governor, contending state funding for education had been cut below the amount required by the state funding formula.[95] In early August 2010, the Chicago Teachers Union sued the Chicago Public Schools, contesting the layoff of 240 teachers and instructional coaches, and the Detroit Public Schools' (DPS) decision to outsource school security also was challenged in court.[96] Also in August 2010, the ACLU sued California school districts because they were imposing fees for materials for required courses, and also for elective courses.[97] It would not be shocking to see another round of school finance-litigation in New York or Texas in the near future, this time triggered by recession-related cuts.[98]

91. *Judge Blocks Teacher Layoffs at 3 Inner-City LA Schools*, EDUC. WEEK, May 19, 2010, at 4. The parties agreed to a settlement in which teachers at forty-five "'vulnerable' campuses [are protected] entirely from layoffs." A state appeals court refused to stay the settlement in March 2010. Posting of Howard Blume to L.A. NOW, http://latimesblogs.latimes.com/lanow/2011/03/appellate-court-los-angeles-teachers-layoffs.html (Mar. 7, 2011, 5:50 PM). As a *New York Times* article notes, "[i]f the ruling is upheld for the seemingly inevitable layoffs this summer, Los Angeles, the second-largest district in the country, will be among the first to dismiss teachers using criteria other than seniority." Jennifer Medina, *Teacher Layoff Plans in Los Angeles Pose Broad Implications*, N.Y. TIMES, Mar. 5, 2011, at A14.

92. Joan Gralla, *NJ Court Orders Schools to Use $475 Million of Reserves*, REUTERS, June 14, 2010, *available at* http://www.reuters.com/article/idUSTRE65D62920100614.

93. *Maryland School Board May Sue Over Budget*, EDUC. WEEK, May 19, 2010, at 4.

94. Terence Chea, *CA Lawsuit Seeks to Overhaul School Finance System*, BUSINESSWEEK, May 20, 2010; Associated Press, *Schools Decry Funding Disparity in Lawsuit*, INDIANAPOLIS BUS. J., Feb. 24, 2010.

95. Scott Lauck, *Kansas City Residents Challenge School Funding Cut*, MO. LAWYERS MEDIA, June 24, 2010.

96. Posting of Stephen Sawchuk to Teacher Beat, http://blogs.edweek.org/edweek/teacherbeat/2010/08/the_chicago_teachers_union_is.html (Aug. 4, 2010, 12:37 PM); Chastity Pratt Dawsey, *DPS is Ordered to Rehire Officers*, DETROIT FREE PRESS, Aug. 25, 2010, at A3.

97. Sam Dillon, *Public Schools Face Lawsuit Over Fees*, N.Y. TIMES, Sept. 10, 2010, at A14.

98. Ross Ramsey, *The Tricky Terrain of Education Finances*, N.Y. TIMES, Feb. 20, 2011, at A27; Kaplan, *supra* note 31.

It is unclear whether these lawsuits are isolated occurrences or anecdotal examples of a larger trend, but because they arise from such different school districts and include a wide range of legal claims, it seems likely that, unfortunately, it may be the latter. And at a time when school districts are trying to save money by asking parents to buy rolls of paper towels for their children's classrooms, large attorney bills hardly make districts' fiscal problems any easier.[99]

c. Changing Student Demographics

The population of school-aged children is growing across the U.S., and the vast majority of the increase comes from non-White students, many of whom are in poverty, and some of whom are not fluent in English.[100] The Brookings Institute describes this population change as "the most significant socio-demographic change since the huge wave of immigrants in the early 20th century."[101] It also forecasts that White children will comprise less than half of the school-age population by 2023, and by 2042, the entire country will be "majority minority."[102] Over the next forty years, Latinos/as[103] and African-Americans are projected to account for ninety percent of the growth in the working adult-age population, yet because their college graduation rates are less than half of Whites' and Asians', and because disadvantaged groups are most affected by the recession-driven cuts in education and other human services, they likely will continue to be concentrated in lower-paying jobs and have higher rates of unemployment, both of which mean their children are more likely to grow up in or near poverty.[104] All of this

99. Some districts have litigation insurance. This presents two additional complications, though: First, if the insurer does decide to cover the cost of litigation, the insurer gains a say in what litigation strategy and maneuvers are covered, and what type of settlement is acceptable. Second, of course, these policies are written so that not all litigation is covered. *See, e.g.*, Associated Press, *Philadelphia-Area School District's Insurance Company Says it Won't Cover Laptop Spying Litigation*, PENNLIVE.COM, Apr. 22, 1010; Ass. of Am. Educators, Professional Liability Insurance, http://www.aaeteachers.org/index.php/member-benefits/liability-insurance (last visited Mar. 31, 2011).

100. Erik W. Robelen, *Education Attainment Rises for Americans Across Race, Ethnicity*, EDUC. WEEK, May 19, 2010, at 6.

101. Bruce Katz & Judith Rodin, *An Impending National Transformation*, BROOKINGS, May 9, 2010, http://www.brookings.edu/opinions/2010/0509_demographics_katz.aspx.

102. William H. Frey, *Race & Ethnicity*, *in* METRO. POLICY PROGRAM AT BROOKINGS, THE STATE OF METROPOLITAN AMERICA 50, 51 (2010), *available at* http://www.brookings.edu/~/media/Files/Programs/Metro/state_of_metro_america/metro_america_report.pdf.

103. This term is used with the goal of gender inclusivity and neutrality. *See* Kristi L. Bowman, *Pursuing Educational Opportunities for Latino/a Students*, 88 N.C. L. REV. 911, 913 n.1 (2010).

104. Alan Berube, *Policy Implications*, *in* METRO. POLICY PROGRAM AT BROOKINGS, *supra* note 102, at 156, 160; Michael Greenstone, *Evidence From May's Employment Numbers on the Benefits of Education*, BROOKINGS, June 4, 2010, http://www.brookings.edu/opinions/2010/0604_jobs_

must be understood in light of changing residential migration patterns: although three-fourths of people of color live in the hundred largest metro areas in the United States today, more people of color and more people in poverty live in the suburbs than in urban centers; and, non-African-American minorities, such as Latinos/as and Asian-Americans, are moving away from major immigrant gateway cities with increasing speed.[105] Thus, the demographic changes described above will affect many different types of communities and districts all across the country: major urban districts, smaller urban districts, suburban districts, and rural districts.

These demographic changes increasingly will have a financial impact on school districts. In the words of a recent Brookings Institution report, students of color, students in poverty, and English Language Learner (ELL) students "require the most resources and the most focus . . . to achieve."[106] How much more they require is not clear, but according to the Education Trust, the National Center on Education Statistics, the U.S. Department of Education, the U.S. General Accounting Office, and Standard & Poor's, school districts should allocate 35–40% more resources to educate students in poverty than for non-poor students.[107] Educating ELLs appears to require a similar supplemental infusion of resources.[108]

Additionally, education research emphasizes not only the importance of investing in the education of at-risk children, but especially doing so when they are still quite young. For example, Latino/a children begin

greenstone.aspx; Bob Herbert, *A Ruinous Meltdown*, N.Y. TIMES, Mar. 20, 2010, at A17 ("In New Jersey, the newly elected governor, Chris Christie, has proposed a series of budget cuts that, among other things, would result in public schools receiving $820 million less in state aid than they had received in the prior school year. Some well-off districts would have their direct school aid cut off altogether. Poorer districts that rely almost entirely on state aid would absorb the biggest losses in terms of dollars. They're bracing for a terrible hit. For all the happy talk about 'no child left behind,' the truth is that in Arizona and New Jersey and dozens of other states trying to cope with the fiscal disaster brought on by the Great Recession, millions of children are being left far behind, and many millions of adults as well.").

105. Frey, *supra* note 102; Elizabeth Kneebone & Emily Garr, *The State of Metropolitan America: Chapters, Income and Poverty, in* METRO. POLICY PROGRAM AT BROOKINGS, *supra* note 102, at 132; Bowman, *supra* note 103, at 935–36.

106. Robelen, *supra* note 100.

107. CAL. GOVERNOR'S COMM. ON EDUC. EXCELLENCE, *supra* note 85, at 5-12. *See also* Black, *supra* note 38 ("[R]esearch on the issue uniformly indicates that as the concentration of poverty increases, the negative educational effects of poverty are compounded."). Illinois's Education Funding Advisory Board was expected in late 2010 to recommend that the state substantially increase the funding designated to educate students in poverty. Crystal Yednak, *A Federal Lifeline for Hard-Pressed School Districts*, N.Y. TIMES, Dec. 13, 2010, at A19.

108. CAL. GOVERNOR'S COMM. ON EDUC. EXCELLENCE, *supra* note 85, at 5-21 ("Oregon provides 50 percent more funding for its English learners, while Florida provides 27.5 percent higher funding for them.").

kindergarten with social and emotional skills comparable to middle-class White children.[109] Yet, Latinos/as have the highest high school dropout rates of any racial/ethnic group (at 22%, the rate is double that of African-Americans and almost four times that of Whites); they perform more poorly on standards-based tests than Whites but not quite as poorly as African-Americans; an estimated 18–45% of them are ELLs; and nearly half of Latino/a students attend schools that are both high-poverty and high-minority.[110] Thus, in sociologist Robert Crosnoe's words, "we need to make the investment at the start of school, when [Latino/a children] are eager and enthusiastic and motivated but before the many disadvantages they face (e.g. lower-quality schools, watered-down curricula) start to chip away at the socioemotional advantages they bring into school."[111]

The need for targeting additional resources for at-risk students will be higher than ever before, and this heightened need will occur at a time when there is a growing demographic disconnect between these children and the growing population of older adults without children who pay most of the local property taxes in many communities. In general, the members of the latter group are and will continue to be wealthier and White.[112] At best, this creates a puzzling "cultural generation gap,"[113] and at worst, it will lead to more of what has already happened even in some relatively racially/ethnically homogenous communities: older property owners without children in the schools will band together to limit funding for public education.[114]

109. Mary Ann Zehr, *Social Skills of Latino and White Kindergartners Found to be on Par*, EDUC. WEEK, May 12, 2010, at 16; Claudia Galdino & Bruce Fuller, *The Social Competence of Latino Kindergartners and Growth in Mathematical Understanding*, 46 DEV. PSYCHOL. 579 (2010).

110. Bowman, *supra* note 103, at 942.

111. Zehr, *supra* note 109, at 16.

112. Robelen, *supra* note 100, at 6.

113. William H. Frey, *Age*, *in* METRO. POLICY PROGRAM AT BROOKINGS, *supra* note 102, at 76.

114. For a review of the literature in this area, see David N. Figlio & Deborah Fletcher, *Suburbanization, Demographic Change and the Consequences for School Finance* 4–8 (Nat'l Bureau of Econ. Research, Working Paper No. 16137, 2010), *available at* http://www.nber.org/papers/w16137. Figlio and Fletcher conclude:

> We find strong evidence that the development dates of the suburbs and the resulting modern age distributions influence the level of school spending in these districts. School districts encompassing suburbs that developed earlier and with consequently older populations tended to cut back on school spending sooner, all else equal, once the Baby Boomer generation was out of school, than did those with later-developing suburbs. These estimated effects are particularly strong in the metropolitan areas where minorities comprise a relatively large share of the school-aged population. . . . [O]ur analyses go a long way toward cementing the conclusion that as a suburb ages, its support for schooling falls.

Id. at 34.

This dynamic is the focus of race/ethnicity-conscious school finance litigation, which addresses fundamental inter-group inequities that are outside the scope of this Article. As I have argued in another piece, since 1996, an increasing number of school finance cases have been "explicitly race/ethnicity-conscious. . . . in contrast with the long history of school finance litigation in which race/ethnicity was the proverbial elephant in the room, but the legal harms and remedies were technically colorblind."[115] The districts facing substantial demographic change, and with it substantial additional financial need, are not destined necessarily to shoulder these costs by themselves.

C. Summary

Undeniably, the recession has been a major cause of school districts' falling revenues over the past few years, and it has triggered fiscal crises for an increasing number of school districts. However, the crisis would not be so acute without the governance problems embedded in the existing system, which can be divided generally into two categories: mismanagement and politics. In addition to understanding the ways in which these systemic factors have contributed to school districts' current fiscal crisis, it is important to anticipate and understand the situational factors that pose increasingly significant fiscal challenges for school districts. Not all school districts are able, or will be able to, balance their books—hence the need for legal mechanisms.

II. AVAILABLE LEGAL MECHANISMS

For a variety of reasons, many school districts across the country are in fiscal crisis or will be facing a financial crisis very soon. Perhaps because school districts and other municipalities have been so financially stable historically, the law is not anywhere near as well-developed when the debtor is a municipality as it is when the debtor is a corporation or an individual. There are three legal mechanisms available to school districts in fiscal crisis; this Part analyzes them in turn, discussing each option along with its utility for school districts.

115. Bowman, *supra* note 23, at 58.

A. Federal Municipal Bankruptcy

1. A Brief History of Federal Municipal Bankruptcy and School Districts' Experiences

The availability of federal municipal bankruptcy was not at first intended to be permanent. Congress adopted the first such provision as a temporary measure in 1934, during the middle of the Great Depression.[116] The Supreme Court invalidated the provision in 1936 and Congress adopted a modified (though still temporary) municipal bankruptcy provision in 1937.[117] The provision eventually became a permanent part of the Bankruptcy Code in 1946, was made more accessible to municipalities when amended in 1976, and exists in substantially similar form today.[118] Importantly, the definition of "municipality" is broad: unlike state constitutions which generally define "municipality" to include only counties, cities, and towns,[119] the Bankruptcy Code defines municipalities to include any "political subdivision or public agency or instrumentality of the state," including school districts.[120]

Municipal bankruptcy is different from individual and corporate bankruptcy proceedings in several substantial ways. For example, to be eligible to file for bankruptcy, municipalities must meet a more strict definition of "insolvency" than applies to private entities—they must be almost literally unable to pay their bills.[121] Additionally, in bankruptcy proceedings, municipalities are not permitted to liquidate assets.[122] This is because the goal of the proceedings is not to eliminate a municipality's debt or wind–up business, but rather to restructure a

116. Spiotto, *supra* note 2, at 613–15; Malito, *supra* note 2, at text accompanying notes 12–66.

117. *See supra* note 116.

118. Kimhi, *supra* note 2, at 367; Spiotto, *supra* note 2, at 613–15; Malito, *supra* note 2, at text accompanying notes 12–66.

119. ALASKA CONST. art. X; ARK. CONST. art XII, § 3; ARIZ. CONST. art. XII, § 1; CAL. CONST. art. XIIIB, § 8d; COLO. CONST. art. XIV, § 13; COLO. CONST. art. XX, §§ 6, 9; COLO. CONST. art. IX, § 15; FLA. CONST. art. IX, § 4; GA. CONST. art. IX, §§ 1, 2, 3; IDAHO CONST. art. XII, § 1; KY. CONST. § 156a; LA. CONST. art. VI, §§ 1-3; MD. CONST. arts. 11A, 11E, 11f; MICH. CONST. of 1963, art. VII, § 21; MONT. CONST. art. XI, § 1; N.D. CONST. art. VII; NEV. CONST. art. VIII, § 8; N.C. CONST. art. VIII, § 1; N.M. CONST. art. IX, § 11–12; OHIO CONST. art 10, §§ 10.01, 10.03; OKLA. CONST. art. XVIII, § 1; OR. CONST. art. XI, § 2; PA. CONST. art. III, § 20; S.C. CONST. art. VIII, § 13d; S.D. CONST. art. IX, § 1; TEX. CONST. art. XI; UTAH CONST. art. XI, §§ 4, 5, 7; WASH. CONST. art. XI, § 3, 4; W.VA. CONST. art. XII, § 6; WIS. CONST. art. IX, § 3; WYO. CONST. art. XVI, § 5.

120. Malito, *supra* note 2, at text accompanying note 78.

121. *Id.* at passim; Tung, *supra* note 2, at 901–02; Kimhi, *supra* note 57, at 650–51; McConnell & Picker, *supra* note 2, at 456.

122. Spiotto, *supra* note 2, at 616; McConnell & Picker, *supra* note 2, at 427.

municipality's debt and major expenditures.[123] Perhaps most different from individual and corporate bankruptcy proceedings, because the federal Constitution's Tenth Amendment limits the reach of the federal government,[124] states must explicitly authorize municipalities to file for bankruptcy in federal court.[125] To one degree or another, twenty-four states do so.[126]

Municipal bankruptcy is very rarely used, though, despite its availability. Fewer than 600 municipalities have filed for bankruptcy since 1936 and this includes so few school districts that we probably can count them on one hand.[127] Even after filing for bankruptcy, not all municipalities complete the process: some school districts in particular have been able to renegotiate bargaining agreements out of court while their bankruptcy petitions were pending[128] or receive an emergency loan from the state[129] and thus negate the necessity of bankruptcy. Other times, public consideration of filing for bankruptcy (without actually filing) has been enough for some stakeholders to devise an alternative and change the contours of the district's fiscal crisis. This is true in three major urban school districts in recent memory. The Chicago

123. *See supra* note 122.

124. Bankruptcy courts are not permitted "to intervene directly in municipal management or operations, a sphere that falls squarely within the province of the respective states." Tung, *supra* note 2, at 890.

125. In 1994, an amendment to the Bankruptcy Code required specific authorization from states, prior to that time, only general authorization was required. *Id.*

126. Seventeen states specifically authorize municipal bankruptcy; seven states conditionally authorize municipal bankruptcy. James E. Spiotto, *The Last Resort for Financially Distressed Municipalities*, *in* 145 THE HANDBOOK OF MUNICIPAL BONDS 157 (Sylvan G. Feldstein & Frank J. Fabozzi eds., 2008).

127. McGrath & Kim, *supra* note 4; Spiotto, *supra* note 3 ("Traditional U.S. state and local government bonds enjoy a proud history of a low number of defaults and, when they rarely occur, higher recoveries compared to corporate debt, both investment grade and speculative. The default rate for municipal securities dramatically lags the default rate for corporate counterparts."). *See, e.g.*, *San Jose Schools Can Cut Pay, U.S. Bankruptcy Court Rules*, N.Y. TIMES, Aug. 30, 1983, at B8 (discussing that San Jose United School District in San Jose, California was involved in "the first school district bankruptcy in the nation since the district in the tiny oil-boom town of Cisco, Tex., bankruptcy in 1947"); Fossey & Sedor, *supra* note 51, at 134 (Copper River, Alaska's school district declared bankrupt).

128. The San Jose, California school district filed for bankruptcy in 1983 but then negotiated a new CBA with the teachers union out of court and was not declared insolvent. The school district had 30,000 students at the time. Fossey & Sedor, *supra* note 51, at 142.

129. Associated Press, *Ailing School District Files for Bankruptcy*, N.Y. TIMES, Apr. 20, 1991, *available at* http://www.nytimes.com/1991/04/20/us/ailing-school-district-files-for-bankruptcy.html (noting that the Richmond Unified School District, with 30,000 students in 1991, roughly 70% of whom were racial/ethnic minorities, was eventually bailed out by a loan from the state); William Celis, *California Has Agreed on Bailing Out Schools*, N.Y. TIMES, May 1, 1991, at A23 (in 2008, the since-renamed Richmond school district was again near bankruptcy); *Local School District Out of Money* (KGO-TV television broadcast Mar. 6, 2008), *available at* http://abclocal.go.com/kgo/story?section=news/local&id=6004296.

Public School system in 1980,[130] the Baltimore Public School District in 2004,[131] and the Detroit Public Schools in 2009[132] all were precipitously near insolvency. In Chicago, the Governor negotiated funding assistance from local banks.[133] In Baltimore, a $42 million emergency loan from the local city council provided the needed relief.[134] In Detroit, the situation was and is more complicated. The Detroit Public Schools' emergency financial manager, Robert Bobb, publicly stated after a few months on the job that given the district's $259 million deficit which resulted from seven years of deficit spending, bankruptcy might be the best way to turn around the financially failing system.[135] DPS has avoided bankruptcy for now, but the district's deficit rose to $327 million by spring 2011, even after the district implemented massive cuts and restructuring.[136] However, the plummeting population of Detroit (in 2010, three-quarters of what it was in 2000), and the even-more-rapidly dropping population of DPS (in 2010, less than half of what it was in 2000), are the sort of changes to a city not usually seen in the absence of a natural disaster.[137] A as a result of these factors, DPS's revenue from local taxes as well as its per-capita student allotment from the state continue to drop precipitously.[138] It remains unclear how DPS will escape from this downward spiral.[139]

130. *Illinois Governor Announces a Plan for Near-Bankrupt Chicago Schools*, WASH. POST, Jan. 6, 1980, at A4 [hereinafter *Illinois Governor Announces a Plan*].

131. Tim Craig & Nancy Trejos, *Baltimore Schools Solvency Plan Rejected; Erlich Will Announce Own Bankruptcy-Prevention Step Today, Officials Say*, WASH. POST, Feb. 24, 2004, at B5.

132. Dakarai I. Aarons, *Decline and Fall*, EDUC. WEEK, Aug. 12, 2009, at 24.

133. *Illinois Governor Announces a Plan*, *supra* note 130.

134. Lori Montgomery & Craig Whitlock, *Baltimore Rejects State Bailout of Schools*, WASH. POST, Mar. 9, 2004, at B08.

135. Aarons, *supra* note 132, at 24, 26.

136. Michael Winerip, *For Detroit Schools, Hope for the Hopeless*, N.Y. TIMES, Mar. 14, 2011, at A13; Nick Anderson, *Why D.C. Keeps an Eye on School Leader*, WASH. POST, Dec. 25, 2010, at A1.

137. Kate Linebaugh, *Detroit's Population Crashes*, WALL ST. J., Mar. 23, 2011, *available at* http://online.wsj.com/article/SB10001424052748704461304576216850733151470.html ("The flight of middle-class African-Americans to the suburbs fueled an exodus that cut Detroit's population 25% in the past decade to 713,777, according to Census Bureau data released Tuesday."); Anderson, *supra* note 136 ("Enrollment has fallen from 163,000 a decade ago to perhaps 76,000 this fall."); Posting of Arlette Saenz to The Note, http://blogs.abcnews.com/thenote/2011/03/motor-city-blues-detroit-loses-25-of-its-population.html (Mar. 22, 2011, 6:48 PM) ("While New Orleans lost 29 percent of its people due to natural disaster, Detroit experienced a 25 percent population decrease in part because of a disaster of another sort—economic strife.").

138. Anderson, *supra* note 136; Winerip, *supra* note 136 ("For each student who departs, $7,300 in state money gets subtracted from the Detroit budget—an annual loss of $58.4 million.").

139. Anderson, *supra* note 136 ("The school system is saddled with a $327 million budget deficit that is impossible to erase without cutting services or obtaining new sources of revenue. Annual operating expenses in Detroit are $1 billion.").

2. Benefits and Disadvantages of Municipal Bankruptcy

The basic benefits of bankruptcy for a municipality are that creditors' collection efforts are hampered by a stay when a bankruptcy petition is filed,[140] and the municipality's largest expenditures—usually collective bargaining agreements (CBAs)[141] and debt service[142]—are modified. In the short term, the stay enables the municipality to continue to provide public services—education, in the case of a school district—and to pay its employees while its fiscal situation is sorted out.[143] In the long term, adjustments to CBAs and debt obligations often, but not always, place the district on more advantageous fiscal footing.[144] Although bankruptcy courts have the authority to unilaterally modify CBAs and to oversee the renegotiation of municipal debt, they are especially reluctant to do the former. Thus, unions and creditors sometimes attempt to renegotiate their contracts without the involvement of the court in an attempt to secure more advantageous terms.[145] The basic benefits of bankruptcy to the creditors are a right to be heard, a formal, transparent process, and an adjudicated decision.[146]

Like the benefits, the disadvantages of bankruptcy for a municipality both the short- and long-term. First, the stigma of filing for bankruptcy fits into both of these categories, and indeed the hit to a municipality's reputation when it files for bankruptcy, especially if the municipality is a school district, can be significant.[147] Second, the costs of renegotiated CBAs fall squarely on teachers, clerical and custodial staff, bus drivers, and other generally modestly-paid individuals. Especially if a school district is a major employer in a community, the effects of modifying a CBA can be felt widely. Third, particularly in small school districts, bankruptcy proceedings may literally cost more than they save: these costs come both through attorneys' fees and district employees' diverted time and attention.[148] Fourth, as with individual bankruptcy, municipal

140. Tung, *supra* note 2, at 893; Kimhi, *supra* note 57, at 650–51.

141. McConnell & Picker, *supra* note 2, at 467; Tung, *supra* note 2, at 897.

142. This includes extending terms of debt, reducing principal/interest, and refinancing debt. Tung, *supra* note 2, at 897; Malito, *supra* note 2, at text accompanying note 67.

143. Tung, *supra* note 2, at 893; Kimhi, *supra* note 57, at 651.

144. Henderson, *supra* note 2; Kimhi, *supra* note 2, at 381–82.

145. Ronald D. Wenkart, *Unilateral Modification of Collective Bargaining Agreements in Times of Fiscal Crisis and Bankruptcy: An Unconstitutional Impairment of Contract?*, 225 Ed. L. Rep. (West) 1, 19–20 (Dec. 27, 2007); Henderson, *supra* note 2.

146. Kunibert Raffer, *Internationalizing US Municipal Insolvency: A Fair, Equitable, and Efficient Way to Overcome a Debt Overhang*, 6 CHI. J. INT'L L. 361, 364, 368 (2005).

147. Spiotto, *supra* note 2, at 641; Kimhi, *supra* note 2, at 382.

148. Tung, *supra* note 2, at 911 (discussing that in the Orange County bankruptcy proceeding, the cost to the county was $50 million in attorney fees and related expenses).

bankruptcy will affect a municipality's credit rating and decrease its ability to borrow at competitive rates in the future, thus decreasing its likelihood of long-term solvency.[149] It may also affect other municipalities in the state in the same way.[150] Given these substantial disadvantages, it is not surprising that both the California and Rhode Island legislatures are currently entertaining proposals to make it more difficult for municipalities to file for bankruptcy.[151]

Fifth and perhaps most importantly, bankruptcy is an ill fit to address school districts' fiscal crises because bankruptcy courts' powers are so limited due to federalism concerns.[152] As Michael McConnell and Randal Picker described in their seminal work on municipal bankruptcy, "In most cases, chronic financial difficulty is a sign that ordinary political processes are not functioning properly."[153] Bankruptcy courts cannot influence these "ordinary political processes" or the problems of mismanagement—they cannot affect a school district's choices about its operating budget, consolidate school districts with one another, require the reorganization of a school district's administrative or operational structure, or order that a school district raise taxes, issue bonds, or replace key decision makers.[154] Yet it is these sorts of changes that would address the systemic causes of a school district's fiscal difficulties, the causes which, when amplified by a recession, can lead to fiscal crisis.

Thus, while municipal bankruptcy does offer some advantages to cash-strapped school districts, those benefits almost always will be outweighed by the substantial costs—including the fundamentally poor fit between the aims of federal municipal bankruptcy and the problems of school districts' fiscal crisis. And because of the limitations imposed by the Tenth Amendment, there is no way to transform federal municipal bankruptcy so that it is a better fit for school districts' needs. Accordingly, this Article now turns to an examination of legal options

149. *Id.* at 903–04; Kimhi, *supra* note 2, at 382–83.

150. Tung, *supra* note 2, at 903–04, 911.

151. Posting of Torey Van Oot to Capitol Alert Blog, http://blogs.sacbee.com/capitolalertlatest/2010/05/cox-asks-to-sen.html (May 25, 2010, 2:49 PM) (California); R.I. Assembly Digest: Rules Change on Municipal Bankruptcy, (June 11, 2010, 1:00 AM EDT), http://www.projo.com/generalassembly/ASSEMBLY_DIGEST_11_06-11-10_FJIR3P2_v29. 191a9d6.html (Rhode Island).

152. Specifically, the administration of local government is typically left to the states. Kimhi, *supra* note 57, at 633; Kimhi, *supra* note 2, at 351. *See also* Malito, *supra* note 2, at text accompanying note 144 ("Chapter 9 does not give courts the power to address the policy matters of municipalities that may have led to bankruptcy in the first place."); Jonathan J. Spitz, Comment, *Federalism, States, and the Power to Regulate Municipal Bankruptcies: Who May Be a Debtor Under Section 109(c)?*, 9 BANKR. DEV. J. 621, passim (1993).

153. McConnell & Picker, *supra* note 2, at 472.

154. *Id.* at 435; Malito, *supra* note 2, at text accompanying notes 105–06.

available at the state level to assist school districts in fiscal crisis.

B. Receivership

1. A Brief History of Receivership and School Districts' Experiences

In receivership, a fiduciary agent is appointed by a state court to manage a financially troubled legal entity. In a corporate receivership, a receiver typically assumes control of a company with the goal of maximizing the short-term returns from the corporation's assets, thus stabilizing the company financially before recommending a long-term plan.[155] Traditionally, corporate receivership is more like Chapter 11 bankruptcy in that it usually is focused on reorganization, although sometimes the receiver decides that the best course of action is to liquidate assets and wind up the business.[156] Of course, for a municipality such as a school district, winding up business is not an option (unless a school district is consolidated with one or more contiguous districts, of course) and thus a receiver must pursue the same reorganization-type goals as in a municipal bankruptcy proceeding.

Municipal receivership has existed since the 1870s, when Missouri became the first state to enact a statute permitting municipal receivership.[157] A few other states adopted municipal receivership legislation during the last few decades of the nineteenth century, but most adopted such legislation, like federal municipal bankruptcy legislation, during the Great Depression.[158] Although forty-eight states now authorize some municipalities to be put into receivership, the eligible municipalities usually are public utilities—only two states specifically authorize public school districts to be put into receivership.[159]

155. Ken Philip & Kerin Kaminski, *Receivership: A Value-Adding Tool*, THE SECURED LENDER, Jan.–Feb. 2007, passim.

156. *Id.*

157. Tennessee was the first state to impose municipal receivership, disincorporating the city of Memphis in 1879. McConnell & Picker, *supra* note 2, at 436.

158. *Id.*

159. James E. Spiotto, *Municipal Insolvency: Bankruptcy, Receivership, Workouts, and Alternative Remedies*, *in* 2 STATE AND LOCAL GOVERNMENT DEBT FINANCING ch. 13, § 13:39 (M. David Gelfand ed., 2008) (Kentucky and Pennsylvania). *See also* Appendix.

Arizona calls its takeover mechanism "receivership," but this mechanism is overseen by the state education bureaucracy, not the courts. Thus, it is not "receivership" in the traditional sense as discussed in this subsection. ARIZ. REV. STAT. ANN. §§ 15-103, 15-107 (2010); Pat Kossan, *Colorado City School District Faces Bankruptcy*, ARIZ. REPUBLIC, Aug. 12, 2005, at 1B.

2. Benefits and Disadvantages of Municipal Receivership

The main difference between municipal bankruptcy and municipal receivership is that a receiver's authority to change a municipality's internal practices is more far-reaching than a bankruptcy court's.[160] Thus, a receiver can interrupt the "ordinary political processes" and incidents of mismanagement which often contribute substantially to municipal fiscal crisis.[161] Because receivership has its genesis in state law and thus is not constrained by the Tenth Amendment, it is more flexible than bankruptcy in numerous ways.[162] Also, it brings the benefit of expertise—in the corporate context, a receiver "should be a skilled turnaround consultant,"[163] and fortunately for school districts this concept of a turnaround consultant is familiar to education as well.[164] Thus, states could select receivers who have in-depth knowledge about public education, educational policy, and best fiscal practices in school districts.

However, while receivership is theoretically a better fit than bankruptcy for most school districts in fiscal crisis, it also has major drawbacks for districts. First, receivership may not be as expensive as bankruptcy, but it still is not without some financial cost (as in bankruptcy, this consists of the cost of outside counsel as well as the diverted attention of district administrators).[165] Second, receivership involves the more stringent and extensive procedures of court oversight when the looser procedures of administrative agency oversight may well be sufficient. Third, receivership is a procedure rarely used in the U.S., and thus while receivers may bring subject matter expertise, courts "often do not have extensive experience or precedent relating to receiverships"[166]—this seems especially likely in the rare and unusual context of municipal receivership.

Thus, similar to federal municipal bankruptcy, state receivership could be advantageous to school districts in fiscal crisis, but at best it is

160. Ted Hampton, *Receivership an Alternative to Filing Chapter 9 for Troubled Cities, But It's Not Without Costs*, BOND BUYER, June 24, 1991, *available at* http://www.highbeam.com/doc/1G1-11882092.html.

161. McConnell & Picker, *supra* note 2, at 472.

162. Philip & Kaminski, *supra* note 155, at 30.

163. *Id.*

164. *See, e.g.*, The EdVenture Group, Consulting, http://www.theedventuregroup.org/consulting.html?gclid=CN_Iy-DhrKACFQOfnAodx0z1Zg (last visited Mar. 31, 2011). Not all turnaround firms may be what they seem, though. As of August 2010, the U.S. House of Representatives planned to hold hearings to review turnaround firms. Dakarai I. Aarons, *House Panel to Examine Turnaround Firms*, EDUC. WEEK, Aug. 25, 2010, at 5.

165. Philip & Kaminski, *supra* note 155, at 30.

166. *Id.*

not a widely tested legal mechanism and at worst it may cause new problems even while it solves others. In part, it is not surprising that neither federal municipal bankruptcy nor state receivership present a good mechanism for addressing school districts' fiscal crises—they were not designed to address these problems or these contexts. Accordingly, the next subsection turns to a procedure that was specifically designed to address school districts' needs.

C. State Fiscal Takeover of School Districts

1. A Brief History of State Fiscal Takeover and School Districts' Experiences

State statutes and regulations authorizing the "takeover" of major school district administrative functions have emerged over the past thirty years. Today, thirty-three states authorize a state or mayoral takeover of a local school district for academic and/or fiscal reasons.[167] Seventeen of those thirty-three states authorize a takeover due to a school district's fiscal crisis, while sixteen limit a takeover to situations of academic crisis alone.[168] School district takeovers are more common than school district bankruptcy filings, but they are still quite rare: only seventy-three takeovers have occurred in the past thirty years.[169] Forty-three percent (thirty-one) of these takeovers were triggered primarily because of a district's fiscal distress; thirty percent (twenty-two) were comprehensive, focusing on academic, management, and fiscal problems; four percent (three) began as fiscal-only but became comprehensive; and twenty-three percent (seventeen) did not directly address the district's fiscal health but focused on academic or management problems.[170] Prior to the mid-1990s, most takeovers

167. *See infra* Appendix. In 1989, only six states authorized state takeover of school districts. Patricia Cahape Hammer, *Corrective Action: A Look at State Takeovers of Urban and Rural Districts*, AEL POL'Y BRIEFS, July 2005, at 2.

168. *See infra* Appendix.

169. Joseph O. Oluwole & Preston C. Green, III, *State Takeovers of School Districts: Race and the Equal Protection Clause*, 42 IND. L. REV. 343, 363–94 (2009).

Takeovers are more likely to occur in major cities and rural areas than in suburban areas. Thirteen of the nation's largest urban districts have been taken over by the mayor or the state in the past twenty years. Susan Black, *The Takeover Threat*, AM. SCH. BD. J., Jan. 2008, at 34.

170. The calculations presented above the line in this Article are summaries of the data discussed by Oluwole and Green. Oluwole & Green, III, *supra* note 169, at 363–94.

Takeovers are more likely to occur in major cities and rural areas than in suburban areas. Thirteen of the nation's largest urban districts have been taken over by the mayor or the state in the past twenty years. Black, *supra* note 169, at 34. The scope of a takeover influences its duration: takeovers focused on districts' fiscal problems are shorter than those with a more comprehensive focus. Hammer, *supra* note 167, at 3.

focused solely on reforming school districts' finances; since then, more takeovers have been comprehensive.[171] However, we likely are entering another period during which an increasing number of takeovers will be triggered in substantial part by fiscal crises.

There is great variation among statutes and regulations in the seventeen states which authorize state takeover for fiscal reasons, but the most comprehensive takeover statutes and regulations share six common elements. First, they list specific factors which can trigger state investigation or involvement, such as a school district running a deficit and not having a plan to remedy the situation, failing to pay employees' wages or retirement benefits, failing to pay bond debt service, or declaring a fiscal emergency.[172] Second, they try, at the start, to solve the district's fiscal problems at the district level with the state involved only in an advisory capacity. For example, a financially troubled district could be required to work with a state-approved expert to generate a fiscal plan and submit it to the state board of education; if the state board accepts the plan and the school district is able to implement it, the state does not become involved any further.[173] Third, the relevant statutes and regulations contain a framework in which the state's involvement will escalate if the district's fiscal condition continues to be poor, or worsens.[174] Fourth, they clearly designate who will have authority to intervene in a school district's affairs at a certain point as well as how that agent will be selected. For example, the agent may be an emergency financial manager, a fiscal oversight board, or a multi-member group; the agent may be selected by the legislature or the Governor, appointed by the state board of education, or selected in part by a local court[175] Fifth, the relevant statutes and regulations describe the extent of the agent's authority and set forth an illustrative list of actions the agent may take. The agent may have the authority of a superintendent, a chief financial officer, or even a school board; it may create a new budget, borrow money, negotiate or renegotiate contracts

171. KENNETH K. WONG & FRANCIS X. SHEN, ERIC CLEARINGHOUSE ON URBAN EDUC., NO. 174, CITY AND STATE TAKEOVER AS A SCHOOL REFORM STRATEGY (2002).

172. *See, e.g.*, MICH. COMP. LAWS ANN. §§ 141.1231 to 1244 (West 2010); FLA. STAT. ANN. § 218.503 (West 2010); ARK. CODE ANN. § 6-20-1900 to 1911 (West 2010). This Article cites to Michigan's general provisions; soon before the article went to press Michigan passed a new statutory framework for takeovers. *See infra* note 387.

173. *See, e.g.*, CAL. EDUC. CODE §§ 1630, 41320, 41326 (West 2010); 105 ILL. COMP. STAT. ANN. 5/1A-8, 1B1-22 (West 2010); MISS. CODE ANN. § 37-17-6 (2010).

174. *See, e.g.*, ALA. CODE § 16-6B-4 (2010); KY. REV. STAT. ANN. §§ 158.785, 158.780(1) (2010); OHIO REV. CODE ANN. §§ 3316.03 to .05 (LexisNexis 2010); TEX. EDUC. CODE ANN. § 39.102 (Vernon 2010); W. VA. CODE § 18-2E-5 (LexisNexis 2010).

175. *See, e.g.*, MICH. COMP. LAWS ANN. § 141.1231 to 1244 (West 2010); 105 ILL. COMP. STAT. ANN. 5/1A-8, 1B1-22 (West 2010); 24 PA. STAT. ANN. § 6-692 (West 2010).

including collective bargaining agreements; it could recommend that the state dissolve the school district and consolidate it with adjacent districts; or it could take many additional actions.[176] Sixth, and finally, although these plans may expect the state to subsidize the cost of additional human resources supplied to a district, they do *not* necessarily involve education "bailout" funds supplied by the state.

2. Benefits and Disadvantages of Takeovers

The main proven benefit of takeovers is that, they have been able to achieve the goal of increased fiscal stability at the district level fairly consistently, which is no small feat for a school district in fiscal crisis.[177] In fact, the consensus in the limited literature is that fiscal stability is much easier to achieve than academic improvement.[178] In a way, this is not surprising—accomplishing the former is much more straightforward than addressing the countless factors which influence the latter.[179]

At the same time, however, takeovers also have substantial drawbacks. But before reaching those, it is important to note that unlike bankruptcy, which a district voluntarily, if regretfully, selects, state intervention and takeover are involuntary for a district. As this Article will discuss, this is both the greatest strength and the most complicating drawback of the takeover mechanism. More specific drawbacks are as follows: First, depending on the statutory and/or regulatory structure authorizing a takeover, the decision about whether to initiate a takeover either can be ad hoc or phrased in the most general of terms so that state involvement is viewed as a politically-motivated decision.[180] More specifically, if the district is racially isolated, as so many districts are,

176. *See, e.g.*, FLA. STAT. ANN. § 218.503 (West 2010); W. VA. CODE § 18-2E-5 (LexisNexis 2010); Preston C. Green, III, Joseph O. Oluwole & Bruce D. Baker, *No School Left Behind: Providing Equal Educational Opportunities*, 12 J. GENDER RACE & JUST. 285, 297 (2009); TODD ZIEBARTH, EDUC. COMM'N OF THE STATES, STATE TAKEOVERS AND RECONSTITUTIONS: POLICY BRIEF 1 (2002, updated March 2004); Oluwole & Green, III, *supra* note 169, at 396.

177. Eugene Judson et al., *Rescuing Distressed Schools*, AM. SCH. BD. J., Apr. 2008, at 42; Del Stover, *Take It To The Limit*, AM. SCH. BD. J., Nov. 2007, at 33 (discussing the fiscal success of mayoral takeover in Chicago); David R. Berman, *Takeovers of Local Governments: An Overview and Evaluation of State Policies*, PUBLIUS, Summer 1995, at 55, 66 (discussing two districts in New Jersey); Mayraj Fahim, *No Magic Solution Available for Improved Education in U.S. Cities*, CITY MAYORS, Sept. 19, 2005, *available at* http://www.citymayors.com/education/cityschools_usa.html; ZIEBARTH, *supra* note 176, at 2.

178. Hammer, *supra* note 167, at 2; ZIEBARTH, *supra* note 176.

179. Stover, *supra* note 177, at 33 ("Limited financial resources, coupled with the effects of poverty and high populations of limited English-proficient students, make significant academic gains challenging to any school leadership, regardless of its composition or governance structure."); Fahim, *supra* note 177.

180. Kimhi, *supra* note 57, at 654.

members of the community may question whether the state intervention is racially-motivated.[181] Second, the impact of takeovers on student achievement is inconclusive at best; thus, comprehensive takeovers are much more likely to generate fiscal stability than academic success, and challenges in the latter could prolong state involvement.[182] Third, and probably most important, is the incredible level of local resistance that can face an agent in charge of overseeing the takeover.[183]

The Detroit Public Schools (DPS) demonstrate both the advantages and especially this last disadvantage of the takeover approach.[184] However, it is important to keep in mind that the dynamics at work in the DPS takeover are amplified by a long history of what some would describe as racially-tinged acrimony between the city of Detroit and the rest of the state.[185] In spring 2009, then-Michigan Governor Jennifer Granholm appointed veteran public administrator Robert Bobb as the DPS emergency financial manager. Bobb not only had a background as the city administrator and deputy mayor of Washington, D.C., but he also had been president of the Washington, D.C. school board and was a graduate of an urban superintendents academy.[186] In short, Bobb brought municipal financial management experience to the table as well as a nuanced understanding of challenges facing urban public schools—a unique combination and one which prepared him well to take on the fiscal leadership of DPS. During his appointment, Bobb instituted many changes, beginning with an intensive audit of the district in which

181. Oluwole & Green, III, *supra* note 169, at 405 (investigating this claim of racially-motivated state takeovers, and finding it overwhelmingly not to be the case).

182. Judson et al., *supra* note 177, at 42; Stover, *supra* note 177, at 33; Glenn Cook, *Taking Charge*, AM. SCH. BD. J., Dec. 2002, at 32; Berman, *supra* note 177, at 66; ZIEBARTH, supra note 176. There is little research on the impact of takeovers beyond an assessment of student performance on standardized or standards-based tests, and that research shows little or no improvement resulting from takeovers. Black, *supra* note 169, at 34.

183. Philip Kloha et al., *Someone to Watch Over Me: State Monitoring of Local Fiscal Conditions*, 35 AM. REV. PUB. ADMIN. 236, 237 (2005); Berman, *supra* note 177, at 67.

184. Although most state-authorized takeovers arise out of statutes or regulations designed specifically for states and enacted in the past few decades, some arise out of more general municipal fiscal distress procedures; this was the case in Michigan until the passage of the 2011 Local Government and School District Financial Accountability Act, *infra* note 387. Hampton, *supra* note 160, at 1; Daniel J. Freyberg, Comment, *Municipal Bankruptcy and Express State Authorization to be a Chapter 9 Debtor: Current State Approaches to Municipal Insolvency—And What Will States Do Now?*, 23 OHIO N.U. L. REV. 1001, 1013–14 (1997); Kimhi, *supra* note 57, at 654. In Michigan, even prior to the 2011 Act, the Governor could appoint a financial review board or manager to assume financial control of a municipality—including a school district—in fiscal crisis. The Governor's use of this procedure in 2009 commenced the second state takeover of the Detroit Public Schools in recent memory. *Detroit Schools Face $45M Deficit*, DETROIT NEWS, May 16, 2008, at B1; Aarons, *supra* note 132, at 24.

185. Dante Chinni, *Along Detroit's Eight Mile Road, A Stark Racial Split*, CHRISTIAN SCI. MONITOR, Nov. 15, 2002, at 1.

186. Aarons, *supra* note 132, at 24, 26, 27.

forensic accountants discovered 257 "ghost" employees receiving paychecks from DPS.[187] He also made many programmatic and capital changes in a district whose student enrollment was roughly 76,000 students in fall 2010—less than half of what it was in 2000.[188]

The district still faces epic fiscal challenges, though, including a deficit of $327 million dollars as of spring—about $100 million more than in mid-2009, when Bobb took the helm.[189] As mentioned earlier, this deficit keeps growing at a time when the population of the school district and the community are plummeting and district revenues are expected to keep falling.[190] These unusual circumstances call for drastic measures: not long before his term concluded, Bobb proposed moving to a district of mostly charter schools (ala post-Katrina New Orleans), injecting $400 million into DPS with the money to come from a national tobacco litigation settlement, or splitting the district into two smaller districts with the goal of helping retire the district's debt.[191] If the district's structure does not fundamentally change, the only real alternative may be skyrocketing class sizes.[192]

As the radical nature of these proposals suggests, DPS faces many unique challenges. At the same time at least one of its challenges is typical of districts subject to takeover: events taking place during Bobb's tenure at DPS demonstrated how resistant a local government can be to state involvement in education. Over the course of one year, the school board sued Bobb twice, first claiming in August 2009 that Bobb's academic reforms exceeded his authority as emergency financial manager, and more recently, in March 2010, alleging that Bobb violated state ethics rules by accepting part of his salary from a foundation.[193]

187. Kellogg, *supra* note 5 (discussing a former payroll manager and another individual who were indicted in May, 2009 on charges of embezzling roughly $400,000 since 2005). Similarly, an audit of ten New York districts discovered that the districts had "paid nearly $239,000 to provide health insurance benefits for dead or ineligible retirees over two years." Associated Press, *NY School Audits Find Health Benefits for the Dead*, LONG ISLAND PRESS, Jan. 19, 2011, *available at* http://www.longislandpress.com/2011/01/21/ny-school-audits-find-health-benefits-for-the-dead/.

188. Anderson, *supra* note 136.

189. Kellogg, *supra* note 5; Anderson, *supra* note 136.

190. Alex P. Kellogg, *Detroit Schools in Financial Rut Despite Cuts*, WALL ST. J., July 1, 2010, at A2; Diane Bukowski, *DPS Debt Balloons*, MICH. CITIZEN, July 18, 2010, at A1.

191. Matthew Dolan, *Crisis Mode Persists for Detroit Schools*, WALL ST. J., Feb. 15, 2011, *available at* http://online.wsj.com/article/SB10001424052748703507804576130350340294080.html.

192. *Id.*

193. Aarons, *supra* note 45, at 1, 12; Corey Williams, *Manager to Move Ahead With Detroit Closings*, BUSINESSWEEK, Apr. 21, 2010, *available at* http://www.businessweek.com/ap/financialnews/D9F7LPPO2.htm. In the most recent chapters in the showdown between Bobb and the Board, the Board contested (in court, of course) Bobb's authority to terminate the superintendent's contract. Hours after the local trial court determined that Bobb did have that authority, he sent a letter to the superintendent terminating her. Chastity Pratt Dawsey, *DPS's Bobb Terminates Superintendent Gueyser*, DETROIT

The strength of the local resistance may have been in part because Bobb actually had the authority to disrupt the processes of politics and mismanagement which helped drive DPS to the brink of disaster even before the recession hit.

Thus, while state takeovers hold much more promise for assisting school districts in fiscal crisis than bankruptcy or receivership, they, too, are not without drawbacks.

D. Summary

In sum, federal and state law contain three means of assisting school districts in fiscal crisis, none of which are an ideal solution to school districts' problems. First, although municipal bankruptcy has the advantages of restructuring a district's debt and unilaterally renegotiating its CBAs, ultimately bankruptcy proceedings cannot reach far enough to fundamentally restructure a school district in ways necessary to interrupt problems driven by politics or mismanagement. As a result, in the twenty-four states where bankruptcy is an option for school districts, it is a bad option. Second, state receivership has more flexibility and the potential to create greater systemic change than the bankruptcy process, but is only available to school districts in two states, is almost entirely untested in the case of school districts' fiscal crises, and even when available likely triggers more court involvement than necessary. Third, fiscal takeover mechanisms, like receivership, can address root causes of fiscal crisis better than bankruptcy. Available in varied forms in seventeen states , takeover mechanisms are much more common than receivership and have had respectable success in stabilizing districts financially. However, when employed, takeover mechanisms can face high levels of local resistance. Finally, in nineteen states school districts do not have access to even one of these three imperfect options. Taken together, states as a whole do not provide anywhere near sufficient support for the increasing number of school districts nearing or facing fiscal crisis across the country.

III. THE PROPOSAL: STATE FISCAL ACCOUNTABILITY IN EDUCATION

The recent recession's impact on school districts has illuminated a number of systemic defects and situational challenges in school finance. It also has cast light on many school districts' inability to adjust to and

FREE PRESS, June 30, 2010, *available at* http://m.freep.com/news.jsp?key=680708&rc=ne. However, the district recently won one round, as well, when a court held that Bobb's authority extended to fiscal matters only, not academic reform. Anderson, *supra* note 136.

weather difficult financial times, and the inadequacy of legal mechanisms in most states to assist school districts in fiscal crisis. Because school districts all across the country are experiencing many of the same types of problems, a long-term, nation-wide solution is needed.

Accordingly, in this Part I first analyze the federal government's strong interest in the fiscal stability of school districts in all fifty states. Second, I make the case for a federal requirement for individualized state plans which demonstrate states' fiscal accountability for federal education dollars. Third, I propose model federal legislation so that these plans are imposed as a condition of funding under the Elementary and Secondary Education Act (ESEA), which is expected to be amended and reauthorized in 2011, and again roughly every five years after that.[194] The state plans should have three aspects: (1) help school districts create cost savings immediately; (2) monitor school districts' fiscal health and intervene when districts approach and enter fiscal crises; and (3) attempt to stabilize state-level education funding long-term. Importantly, these options are not intended to facilitate a further education "bailout"—none of the options are intended to allow or require a state to buoy a district with an infusion of cash. This becomes clear in the final subsection of this Part, in which I briefly discuss a variety of policies that states could use to satisfy the obligations proposed.

A. Why a Federal Requirement for a State Plan?

Education may be the quintessential local issue, but the federal interest in fiscally stable school districts is strong as well. In short, much like a family must know that it can pay its rent or mortgage before considering whether a child should play soccer or learn the violin, school districts must be fiscally stable before they can implement meaningful educational reforms that improve educational quality and thus help create local, state, and nationwide economic and civic benefits.[195] In 2009, "relatively few" school districts reported to the Government Accountability Office that they were "making significant progress" in achieving federal education reform goals.[196] That same

194. No Child Left Behind Act of 2001, Pub. L. No. 107-110, 115 Stat. 1425 (2002) (codified in scattered sections of 20 U.S.C.) (amending the Elementary and Secondary Education Act of 1965, 20 U.S.C. §§ 6301–6578); Donald M. Payne, *Reauthorization of the Elementary and Secondary Education Act: Challenges Throughout the Legislative Process*, 26 SETON HALL LEGIS. J. 315, 316 (2002).

195. Adams, Jr., *supra* note 30.

196. GAO, RECOVERY ACT, *supra* note 13, at 39. As Jacob Adams notes, "states are unlikely to accomplish ambitious learning goals until they fix the finance systems that support the nation's schools." Adams, Jr., *supra* note 30.

year, three percent of districts reported that they had decreased Title I-related reform efforts compared to the previous year; before the 2010 stimulus funding passed, eleven percent of districts reported that they planned to decrease Title I-related education reform efforts during FY 2011.[197]

The economic and civic effects of stagnant and declining educational quality are a substantial federal concern, in part because sixty-three percent of all adult Americans have moved away from the community in which they were born, and forty-three percent of adult Americans have left the state in which they were born.[198] Thus, local communities are less and less often the direct, long-term beneficiaries of the education they give to the children in their community, especially because the more educated an individual, the more likely he or she is to move out of town or out of state.[199] Additionally, whether or not individuals move, their ability to contribute to the United States' global competitiveness and to meaningfully enjoy the rights of federal citizenship is the same. Accordingly, the federal interest in financially stable schools is an interest in maintaining and improving educational quality through reform, which is driven by two main concerns: one economic, the other civic. In pursuit of the federal interest, there are many reasons for imposing a general federal requirement which allows states some policy-making leeway.

1. The National Economic Benefits of Strong Public Schools

In 1983, the U.S. Department of Education report *A Nation at Risk* called for a major investment in public education, arguing that the United States was being overtaken by global competitors and that the eroding quality of our education system was a major factor in this shift.[200] Twenty-five years later, in 2008, the U.S. Department of Education issued a follow-up report, contending that "if we were 'at risk' in 1983, we are at even greater risk now,"[201] and acknowledging that U.S. students have been "at best[ ] running in place, while other

197. Adams, Jr., *supra* note 30.

198. D'VERA COHN ET AL., THE PEW RESEARCH CTR., AMERICAN MOBILITY: WHO MOVES? WHO STAYS? WHERE'S HOME? 1 (2008).

199. *Id.* at 2.

200. NAT'L COMM'N ON EXCELLENCE IN EDUC., U.S. DEP'T OF EDUC., A NATION AT RISK: THE IMPERATIVE FOR EDUCATIONAL REFORM (1983), *available at* http://www2.ed.gov/pubs/NatAtRisk/index.html.

201. U.S. DEP'T OF EDUC., A NATION ACCOUNTABLE: TWENTY-FIVE YEARS AFTER A NATION AT RISK 1 (2008), *available at* http://www2.ed.gov/rschstat/research/pubs/accountable/accountable.pdf.

nations are passing us by."[202] The report noted that only roughly seventy percent of U.S. students complete high school within four years.[203] Graduating from high school has a dramatic impact on an individual's earnings,[204] as well as an impact on society, which Goodwin Liu has summarized:

> Increases in schooling have long been associated with reduced crime, incarceration, and related costs, and with greater political participation and likelihood of voting. Educational attainment is also positively associated with lower utilization of public health insurance, cash assistance, food stamps, and public assistance. . . . [A]nnual losses in federal and state income taxes due to high-school noncompletion, aggregated over all working age adults "likely exceed $50 billion—enough to cover the annual discretionary expenditures of the U.S. Department of Education."[205]

Not surprisingly, improving public education has been, in the words of a 2010 Brookings Institute report, "no less than a public policy obsession for many public- and private-sector leaders, at all levels of the system."[206] The report continues: "[This focus is] with good reason—the rising human capital levels of our population explained much of America's economic success in the 20th century, and will probably be an even more important contributor to our standards of living into the future."[207]

Similarly, when the *Wall Street Journal* asked a group of corporate executive officers in late 2009 about their ideas for rebuilding global prosperity, the group ranked education second only to sustainable job creation.[208] U.S. Secretary of Education Arne Duncan wrote in 2010 that "to maintain our competitive advantage in knowledge-based industries and fields, the United States must implement an education policy that produces a 'more flexible labor force that can cope more readily with non-routine tasks and occupational change.'"[209] Federal

202. *Id. See also* Superfine, *supra* note 26, at 656.

203. This statistic varies widely by racial/ethnic group, with four-year completion rates for African-Americans and especially Latinos/as being much lower than for Whites still today. U.S. DEP'T OF EDUC., *supra* note 201, at 10–13.

204. *Id.*

205. Liu, *Interstate Inequality in Educational Opportunity*, *supra* note 38, at 2113, 2124–26; *see also* Arne Duncan, *Through the Schoolhouse Gate: The Changing Role of Education in the 21st Century*, 24 NOTRE DAME J.L. ETHICS & PUB. POL'Y 293 (2010).

206. Berube, *supra* note 104, at 160.

207. *Id.*

208. William Cibes, *Proposed Cuts Threaten State's Future Strenghts*, HARTFORD COURANT, Dec. 1, 2009, at A11.

209. Duncan, *supra* note 205.

Reserve Chairman Ben Bernake stated, when speaking to the U.S. Chamber of Commerce in 2007, that "Economists have long recognized that the skills of the workforce are an important source of economic growth. Education fundamentally supports advances in productivity, upon which our ability to generate continued improvement in our standard of living depends."[210]

For all of these reasons, the Brookings Institute advises: "Over the longer run, educational policies that prepare a larger segment of the workforce to serve in higher-paying industries and occupations are [a] wise investment."[211] Yet, the percentage of younger adults who have completed college has been falling, and this has led to a situation where national averages show that more middle-aged workers are better educated than younger ones.[212] This varies by region and in part is a result of where college-educated adults choose to live.[213] Not coincidentally, the regions with less-educated workers have many of the highest rates of unemployment—and the education and employment disparities between the "haves" and "have nots" of metro areas and regions are expected to grow, unless deliberate public policy initiatives counteract these trends.[214] These regional trends could dovetail in dangerous ways with the earlier-discussed demographic changes anticipated to occur in public schools—the increasing population of disadvantaged students, especially in disadvantaged communities—producing an even larger gap in educational equity and economic achievement than currently exists.[215] The federal government's goal of ensuring the United States' continued global competiveness and prosperity is also linked to an interest in deterring these regional disparities. For education to affect regional, national, or global prosperity, school districts must implement substantial reform. And before they can focus on reform, districts must have a foundation of fiscal stability.

210. Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., Speech to the U.S. Chamber of Commerce: Education and Economic Competitiveness (Sept. 24, 2007), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20070924a.htm; Duncan, *supra* note 205, at 303 ("The correlation between education and economic success is strong.").

211. Berube, *supra* note 104, at 161.

212. Alan Berube, *Educational Attainment*, *in* METRO. POLICY PROGRAM AT BROOKINGS, *supra* note 102, at 104, 107.

213. *Id.* at 109–10.

214. *Id.* at 115–16; Greenstone, *supra* note 104 ("Job opportunities are increasingly concentrated in relatively high-skill, high wage jobs and low-skill, low wage jobs.").

215. *See supra* Part I.B.2.c.

2. Federal Constitutional Citizenship

In 1979, the Supreme Court wrote: "The importance of public schools in the preparation of individuals for participation as citizens . . . has long been recognized by our decisions."[216] To be sure, there is no presently-recognized fundamental federal right to education,[217] but taken together, the Court's jurisprudence demonstrates a strong federal interest in the public good of an educated citizenry—people who can contribute constructively to public debate, meaningfully exercise their own federal constitutional rights, and participate in and ultimately sustain a democratic government.[218] Like economic benefits, civic benefits inure

216. Ambach v. Norwalk, 441 U.S. 68, 76–77 (1979).

217. Professor Goodwin Liu has written about the Fourteenth Amendment's Citizenship Clause giving rise to a congressional obligation to "ensure a meaningful floor of educational opportunity throughout the nation." Liu, *Education, Equality, and National Citizenship*, *supra* note 38, at 334.

218. The long line of cases discussing the relationship between education and citizenship has three primary parts. The first part addresses the creation or nurturing of nationalism. *See, e.g.*, Pierce v. Soc'y of Sisters, 268 U.S. 510, 534 (1925); Minersville v. Gobitis, 310 U.S. 586, 598 (1940), *overruled by* W. Va. State Bd. of Educ. v. Barnette, 319 U.S. 624 (1943); *Barnette*, 319 U.S. at 637.

The following excerpt from *Brown* is not the decision's most famous language, but it was a necessary premise for *Brown*'s ultimate conclusion because it explained why denying some children a quality education mattered:

> Compulsory school attendance laws and the great expenditures for education both demonstrate our recognition of the importance of education to our democratic society. It is required in the performance of our most basic public responsibilities, even service in the armed forces. It is the very foundation of good citizenship. Today it is a principal instrument in awakening the child to cultural values, in preparing him for later professional training, and in helping him to adjust normally to his environment. In these days, it is doubtful that any child may reasonably be expected to succeed in life if he is denied the opportunity of an education.

Brown v. Bd. of Educ., 347 U.S. 483, 493 (1954). See discussion of the same in *Wisconsin v. Yoder*, 406 U.S. 205, 221 (1972) and *Ambach*, 441 U.S. at 76–77. This language was quoted in *Board of Education v. Pico*, 457 U.S. 853, 864 (1982), *quoted in Board of Education v. Mergens*, 496 U.S. 226, 265 (1990) (Marshall, J., concurring), *Pico*, 457 U.S. at 876 (Blackmun, J., concurring), and *Plyler v. Doe*, 457 U.S. 202, 221 (1982), *limited by Kadrmas v. Dickinson Pub. Sch.*, 487 U.S. 450, 459–60 (1988).

Additionally, some of the Court's First Amendment cases specifically focus on the idea that students are citizens-in-training, practicing the exercise of their rights in public schools. The above-cited language from *Barnette* has appeared in the majority opinion in the seminal 1969 student free speech case, *Tinker v. Des Moines*, 393 U.S. 503, 507 (1969), the plurality opinion in a 1982 case prohibiting a school district from removing books from the school library for political reasons, *Pico*, 457 U.S. at 864, Justice Stevens's 1990 dissent in *Board of Education v. Mergens*, 496 U.S. at 290 (Stevens, J., dissenting), and Justice Ginsburg's 2002 dissenting opinion in a student search and seizure case, *Board of Education v. Earls*, 536 U.S. 822, 855 (2002) (Ginsburg, J., dissenting).

The civic lessons learned while participating in school were also at issue in *Hazelwood School District v. Kuhlmeier*, 484 U.S. 260 (1988), but in a less overt way. The Court held that a school principal's decision to censor portions of the school newspaper before publishing did not violate students' free speech rights. *Id.* Justice Brennan, disputing this holding, wrote in dissent: "Public education serves vital national interests in preparing the Nation's youth for life in our increasingly to the federal government as well as state and local governments, which are the entities primarily responsible for funding and providing education.[219] They also apply to all citizens, whether or not they move out of the state in which they were born.

Admittedly, school districts' fiscal crises will not result in the federal government failing to receive any economic or civic benefits—students enrolled in school districts that are in fiscal crisis will still receive some sort of education. But, districts' fiscal crises will inevitably weaken their ability to maintain their preexisting level of educational quality, let alone fulfill education reform priorities identified by the federal government. In a district in fiscal crisis, the extent to which schools are able to prepare students for a global workforce and federal citizenship by providing a high-quality education will decrease, and although the drop will be difficult to measure, that does not mean the effects are insignificant.

3. Individualized State Plans

Even though the federal government has a strong interest in the existence of fiscally strong schools that can implement reform, this does not mean that a uniform federal solution to the problem of school districts' fiscal crises should follow from that interest. This subsection discusses four reasons why the legislation proposed below would be enacted at the federal level, and yet require each state to develop its own plan to assist school districts in current and future fiscal crises.

First, some sort of a federal requirement is necessary because the federal interests discussed above should not be satisfied in some states but not others. Right now, thirty-three states do not authorize state involvement in school districts' fiscal crises at all.[220] That number includes the nineteen states in which school districts are not able to take advantage of *any* legal mechanisms to help them cope with fiscal crisis.[221] The solution need not be the same in every state, but the problem must be addressed in all states. To achieve this goal, I propose

complex society and for the duties of citizenship in our democratic Republic." *Id.* at 278 (Brennan, J., dissenting). *See also* Bethel Sch. Dist. v. Fraser, 478 U.S. 675, 681, 683 (1986) (Schools "prepare pupils for citizenship in the Republic [and] inculcate the habits and manners of civility as values in themselves conductive to happiness and as indispensable to the practice of self-government in the community and the nation." (internal quotations and citations omitted)), *quoted in* Bd. of Educ. v. Earls, 536 U.S. 822, 840 (2002) (Breyer, J., concurring).

219. *See Brown*, 347 U.S. 483 (describing education as a traditional state function); United States v. Lopez, 514 U.S. 549 (1995) (same).

220. *See infra* Appendix.

221. *See id.*

legislation that is written to be part of Title I of NCLB/ESEA, which provides $15 billion to public schools annually.[222] Although the conditions in NCLB are onerous, no state has yet opted out of NCLB/ESEA and refused these funds.[223] Especially in the current economic climate, it seems highly unlikely that a state would opt out of NCLB/ESEA at this point.

Second, this approach of a federal requirement for a state policy is consistent with federal education policy more generally. Ultimately, my proposed legislation is about accountability, which on the academic front has been a growing focus of federal education policy since the 1980s.[224] Additionally, the accountability is accomplished through spending conditions, which are common in federal legislation in general and have become increasingly common in federal education legislation over the past few decades.[225]

Third, like many of the NCLB conditions, my proposed legislation also involves significant deference to states and thus allows states to satisfy the purpose of the conditions in a way that makes sense given their unique demographics and dynamics.[226] As Michael McConnell, Randall Picker, and Omer Kimhi have convincingly argued, compared to federal law, state law is much better suited to the task of addressing municipal fiscal crisis.[227] Therefore, in the proposed legislation I set out statutory language which, for two of the three requirements, includes not only several options for compliance but also a provision which permits the U.S. Department of Education to approve alternatives proposed by the states, as it does with some aspects of NCLB.[228] And even for the third requirement, states are expected to develop their own way of complying with the terms.[229]

222. U.S. DEPT. OF EDUC., FY 2011 BUDGET SUMMARY app. 1 (2010), *available at* http://www2.ed.gov/about/overview/budget/budget11/summary/appendix1.pdf.

223. Jane Gordon, *Towns are Rejecting No Child Left Behind*, N.Y. TIMES, Dec. 21, 2003, *available at* http://www.nytimes.com/2003/12/21/nyregion/towns-are-rejecting-no-child-left-behind.html?pagewanted=6&src=pm; ZHOU & JOHNSON, *supra* note 24.

224. *See, e.g.*, Superfine, *supra* note 26, at 673–74; Black, *supra* note 38, at 371–72.

225. David Engdahl, *The Contract Thesis of the Federal Spending Power*, 52 S.D. L. REV. 486, 535 (2007).

226. Berube, *supra* note 104, at 162 ("National policy responses must recognize the diverse starting points of metropolitan areas and, where necessary, ensure that interventions are tailored to those differing on-the-ground realities. . . . Because [the 100 largest metro areas] pulled even farther apart from one another on several dimensions of the new realities in the 2000s, federal policy alone cannot provide a solution tailored to each metropolitan area's individual situation. Therefore, leaders at the state, regional, and local levels must now more than ever understand and respond purposefully to the demographic, social, and economic changes most affecting their places.").

227. Kimhi, *supra* note 57; Kimhi, *supra* note 2.

228. *See infra* Part III.B.1.

229. *Id.*

Fourth, a general federal requirement also gives states political cover to enact controversial policies during difficult economic times. States, too, have a strong interest in the fiscal health of school districts—not only can a bankrupt school district affect the credit rating of the rest of the state, but all states' constitutions contain provisions establishing some right to an education, however limited.[230] States also have an interest in helping communities maintain schools that are good enough to retain their population, if not even attract new residents.[231] And states are in a much better position than local districts to grapple with the systemic problems of mismanagement and politics.[232]

B. Proposed Legislation

States should have substantial flexibility in fashioning the plans that will structure their involvement with school districts' fiscal difficulties. As the legislation proposed below will make clear, the plans must contain three crucial parts: (1) measures to assist districts in generating additional immediate cost savings; (2) plans to monitor when school districts are nearing fiscal crisis and to intervene when school districts approach or enter fiscal crisis; and (3) practices intended to stabilize education funding. This subsection sets forth proposed legislation and analyzes the validity of the legislation pursuant to the Spending Clause. The following subsection will briefly discuss the policies presented immediately below.

1. Proposed Legislative Text

The proposed legislation contained below would add a subsection to the text of Title I, Part A, Subpart 1 of the No Child Left Behind Act, which was signed into law in January 2002 as the most recent iteration of the 1965 Elementary and Secondary Education Act.[233] Subpart 1

230. Baker, *supra* note 26, at 318 n.5 (listing all such provisions).

231. Otherwise, if poor-quality schools are one factor that helps drive away existing or potential residents, as in Detroit, the affected city or town will become hampered by a dwindling tax base, further limiting its ability to improve the government services which were already so bad they helped drive away residents. Kimhi, *supra* note 57, at 640. And, the city or town in effect will be shifting the burden of its residents to surrounding communities and thus potentially creating financial difficulties for those receiving municipalities as they struggle under the weight of an increased population. Kloha et al., *supra* note 183, at 237; Bowman, *supra* note 35.

232. This may be especially true for urban districts, which are already financially burdened by having greater concentrations of disadvantaged students, and where problems of corruption often accompany the more common systemic deficiencies. Kimhi, *supra* note 57, at 636 (States have "both the legal authority and the political power to deal with the causes of urban crisis.").

233. No Child Left Behind Act of 2001, Pub. L. No. 107-110, 115 Stat. 1425 (2002) (codified in

contains the basic requirements for the compliance plans each state must submit to the U.S. Department of Education as a condition of receiving its share of the $15 billion in annual Title I funding.[234] The proposed legislation is included below in bold text:

TITLE I—IMPROVING THE ACADEMIC ACHIEVEMENT OF THE DISADVANTAGED

PART A—IMPROVING BASIC PROGRAMS OPERATED BY LOCAL EDUCATIONAL AGENCIES

Subpart 1—Basic Program Requirements

SEC. 1111. STATE PLANS.

(a) PLANS REQUIRED
(b) ACADEMIC STANDARDS, ACADEMIC ASSESSMENTS, AND ACCOUNTABILITY
(c) OTHER PROVISIONS TO SUPPORT TEACHING AND LEARNING.
(d) PARENTAL INVOLVEMENT
(e) FISCAL ACCOUNTABILITY.—Each State plan shall demonstrate that the State is a responsible steward of the funding allocated pursuant to this Act. Such a demonstration shall—
   (1) Through legislation or regulation, enable school districts to create additional cost savings during FY 2012. Such cost savings shall be created by—
      (A) Expanding the fiscal expertise available to school districts by—
         i. Entering into a long-term contract with an outside consulting agency with expertise in education policy and municipal finance, and partially subsidizing such consultants' interactions with school districts; or
         ii. Approving partnerships between school districts and universities with education and municipal finance expertise for the purpose of studying the

scattered sections of 20 U.S.C.) (amending the Elementary and Secondary Education Act of 1965, 20 U.S.C. §§ 6301–6578).

234. Liu, *Improving Title I Funding Equity Across States, Districts, and Schools*, *supra* note 38, at 976.

effect of cost-saving measures on student learning;

(B) Requiring the administrative or comprehensive consolidation of school districts with 1,000 students or fewer;

(C) Permitting school districts to more easily outsource contracts for non-instructional services;

(D) Providing incentives for the reduction of school districts' salary expenses. Such reductions shall occur through the layoff of low-performing teachers regardless of seniority; or

(E) Satisfying the purposes of this part, (e)(1), as determined by the Secretary of Education and in accordance with such criteria as the Secretary establishes.[235]

(2) Through legislation or regulation, provide technical assistance to anticipate and assist school districts in fiscal crisis. Such assistance shall—

(A) Assess school districts' fiscal health on an annual basis. This assessment shall—

i. Be based on pre-determined criteria; and,

ii. Make public the names of the districts approaching and in fiscal crisis; and

(B) Determine a plan of escalating state intervention to assist a school district approaching and in fiscal crisis.

(3) Through legislation or regulation, seek to stabilize education funding over the long term. Such stabilization shall—

(A) Set in place guaranteed state funding allocations, tied to the previous fiscal year;

(B) Create an adequately-funded state reserve fund for education which may not be used for other purposes;

(C) Create a system which allows school districts to insure against idiosyncratic risk of fiscal crisis;

(D) Authorize school districts to engage in private contracts to stabilize funding and regulate such financing arrangements; or

(E) Satisfy the purposes of this part, (e)(3), as determined by the Secretary of Education and in accordance with such criteria as the Secretary establishes.

235. The language for parts (e)(1)(E) and (e)(3)(D) is modified from No Child Left Behind Act of 2001, Pub. L. No. 107-110, § 1470, 115 Stat. 1425.

(f) PEER REVIEW AND SECRETARIAL APPROVAL
(g) DURATION OF THE PLAN
(h) PENALTIES

2. A Legitimate Exercise of Congressional Spending Power

Conditions on federal funding, like the ones proposed above, are incredibly common.[236] However, to be a valid exercise of Congress's power under the Tax and Spend Clause, legislation containing conditions must satisfy the four-part test laid out by the Supreme Court in 1987 in *South Dakota v. Dole*.[237] For the following reasons, this proposed legislation does so.

First, *Dole* requires that spending power legislation must "be in pursuit of 'the general welfare.'"[238] The term "general welfare" is expansive and easily includes public education. Second, the legislation must be "unambiguous" about the conditions it contains and the consequences of not complying with the conditions.[239] The second prong of *Dole* has been given the most teeth, precedentially speaking, by the Supreme Court.[240] Like some aspects of NCLB, the proposed legislation is specific about what is required of states, yet two of the three parts also permit the Department of Education to approve other types of compliance plans if they satisfy the same main goals of the proposal.[241] Furthermore, the consequences of non-compliance are present in the already-enacted legislation: the Department of Education has the authority to withhold funding from a state until it is satisfied that the state has provided a plan that complies with the requirements.[242] Third, the legislation must contain conditions that are related "to the federal interest in particular national projects or programs."[243] The nexus between the condition and the federal interest in this situation is easily sufficient: the conditions require that states enact policies to ensure the current and future fiscal health of school districts. As discussed above, the federal government has a demonstrated interest in the fiscal stability of local districts across the country so that districts

236. Engdahl, *supra* note 225, at 535.

237. Craig Eichstadt, *Twenty-Year Legacy of* South Dakota v. Dole, 52 S.D. L. REV. 458, 458–59, 463–64 (2007). Eichstadt was counsel to the state of South Dakota in this legendary case.

238. South Dakota v. Dole, 483 U.S. 203, 207–08 (1987).

239. *Id.*

240. Eichstadt, *supra* note 237, at 458–59; Black, *supra* note 38, at 332–33.

241. The language for parts (e)(1)(E) and (e)(3)(D) is modified from No Child Left Behind Act of 2001, Pub. L. No. 107-110, § 1470, 115 Stat. 1425 (2002).

242. *Id.* § 1457.

243. *Dole*, 483 U.S. at 207–08.

can implement reform in pursuit of federal economic and civic benefits.[244] Fourth, the legislation must not conflict with an "independent constitutional provision"[245] such as the First Amendment's Free Speech Clause or the Fourteenth Amendment's Equal Protection Clause. The proposed legislation has no such conflict. For these reasons, the proposed legislation is fully compliant with the requirements of *Dole*.

C. Policy Proposals

This subsection briefly discusses each of the policies included in the proposed legislation set forth above.[246] Importantly, because the proposed legislation permits states to satisfy the first and third conditions (creating additional immediate cost savings for districts, and seeking to stabilize educational funding) in ways not stated in the legislation, states should not be limited to the policy options discussed here. Similarly, although the proposed legislation requires states to have mechanisms for monitoring school districts' fiscal health and for intervening in school districts' fiscal crises, states retain substantial flexibility about the substance of those measures. To be sure, each of these policies is complex and this subsection is designed merely to introduce each topic and summarize its possible benefits and shortcomings. Many of the policy proposals contained here are likely to be highly controversial, but as one commentator has noted, "it takes a crisis [like a recession] to shake up the equilibrium of policy decisions, budgetary commitments, and interest-group politics that supports education's business as usual" and to create substantial, lasting education finance reform.[247]

1. Ameliorate the Immediate Crisis

As is obvious, the recession has not spared school districts.[248] Because the effects of the recession are layered on top of the systemic problems of politics and mismanagement as well as the situational factors of pension fund shortfalls, litigation growing out of recession-driven cuts, and also changing demographics, an increasing number of

244. *See supra* Part III.A.

245. *Dole*, 483 U.S. at 207–08. *Dole* also contained a discussion focusing on coercion, but did not elaborate on this or include it as part of the four-part test. *Id.* at 211.

246. *See supra* Part III.B.1.

247. Adams, Jr., *supra* note 30.

248. *See supra* Part I.A.1–2.

school districts are or will be nearing a point of fiscal crisis—and even those not in crisis are not doing all that well.[249] Accordingly, to address the problem of falling revenues, this first part of the proposed legislation calls for states to amend or adopt legislation or regulations which will enable school districts to create additional cost savings in FY 2012, which in most states will begin in July 2011.

The four short-term policy solutions discussed below are examples of policy approaches that may do this, depending on the unique environment of the state. As mentioned above and noted throughout this subsection, different approaches will be better suited to different states, and the suitability may depend on factors such as the traditional relationship between the state and local governments; the demographics of the state—for example, whether it has a large urban and/or rural population; and the traditional strength of unions in a given state.

Additionally, given recent events in Wisconsin, Indiana, Idaho, and Ohio in which governors and legislators have proposed broad limitations on the collective bargaining rights of teachers and other public employees, it is important to note that this section does not advance that idea as a proposed solution.[250] Although states and school districts have more flexibility if not bound by obligations to bargain with unions,[251] the financial effects of weaker or nonexistent unions are complex and not always intuitive. For example, an economist studying public employee pensions across the country recently concluded—admittedly much to his surprise—that there was "no correlation" between the presence of unions and a more generous state pension program.[252] This section aims to advance policies with more straightforward financial implications for districts.

a. Expand Available Human Resources

As the past few years have shown, many school districts lack fiscal sophistication.[253] This is not a problem most of the time, but the need for fiscal expertise has been especially acute during the past couple of

249. *Id.*

250. Timothy Williams, *The Battle Over Union Rights, State by State*, N.Y. TIMES, Mar. 11, 2011, at A16 (discussing pending legislation in Wisconsin, Indiana, Idaho, and Ohio).

251. *See, e.g.*, Steven Greenhouse, *In Indiana, Clues to Future of Wisconsin Labor*, N.Y. TIMES, Feb. 27, 2011, at A1 (discussing Indiana); Emily Wagster Pettus & Erik Schelzig, *Union Bargaining Just a Dream for Many Gov Workers*, WASH. POST, Feb. 27, 2011, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2011/02/27/AR2011022700910.html (discussing many states in which public employees lack collective bargaining rights).

252. Mary Williams Walsh, *The Burden of Pensions on States*, N.Y. TIMES, Mar. 11, 2011, at B1.

253. Morgenson, *supra* note 67.

years. Thus, states should endeavor to connect school districts in fiscal crisis with individuals who have this unique sort of expertise.

As proposed above, a state could take at least two approaches in pursuit of this goal.[254] First, the state could enter into a long-term contract with an entity which would be able to provide well-trained consultants who could effectively assess a school district's fiscal state and make specific recommendations for meaningful fiscal and programmatic changes. Several existing entities are already well-positioned to fill this need, including a regional educational laboratory which already serves multiple states,[255] a regional office of education which serves many counties within a given state,[256] or a national non-profit such as the RAND Corporation.[257] Although it may seem that states should be able to provide this assistance directly, many simply do not have the capacity or knowledge to do so on a large scale. To finance this long-term contract, Title I could allocate funding specifically to cover the state's additional cost of seeking and maintaining a contract and help the state to partially subsidize districts' use of these services. Districts still would bear a good portion of the costs, however. Because of this, states, the federal government, or both should make efforts to attract the attention of major foundations which support educational reform and seek to engage those foundations in funding this effort.[258]

Second, another approach a state could take is to encourage formal partnerships between school districts and colleges or universities with the goal of studying the educational impact of certain cost-saving measures that are not believed or known to reduce academic quality.[259] One such notable partnership has grown out of a district takeover: Boston University managed the Chelsea Public School District for

254. *See supra* Part III.B.1.

255. Learning Point Assoc., REL Midwest at Learning Point Associates, http://www.learningpt.org/rel/ (last visited Apr. 3, 2011).

256. Washington State School Districts: Maps and Web Sites, http://www.k12.wa.us/maps/ESDmap.aspx (last visited Apr. 3, 2011); Illinois Regional Offices, http://www.isbe.state.il.us/regionaloffices/Default.htm (last visited Apr. 3, 2011).

257. Rand Corp., http://rand.org (last visited Apr. 3, 2011).

258. Before talking with Dr. Raegen Miller, I planned to propose that states merely create ad hoc lists of people who were potentially able to perform these functions, such as former superintendents and university faculty, and make that information available to school districts. Our conversation convinced me not only that something more formal was needed, but also that it was important to consider the various ways in which such programs could be funded. Telephone interview with Raegen Miller, Assoc. Dir. for Educ. Research Ctr. for Am. Progress (Sept. 27, 2010).

259. Superfine, *supra* note 26, at 657–58, 690–92, 695–96 (noting the limited literature on the topic of the relationship between specific reforms and easily quantifiable results, discussing the limitations the educational context imposes on various types of research design, and calling for more research in this area).

nearly a decade.[260] The partnership was not without problems, but at the same time it was advantageous enough to both parties that they agreed to extend it for several years beyond the initial period.[261]

To facilitate these partnerships, a state could serve a clearinghouse function, gathering names of interested researchers and proposed research questions and making that information available to school districts. Or, it could let the partnerships happen organically. Regardless, if researchers are able to secure grant funding to study the effect of cost-saving education reforms, particular school districts would benefit in the short term by having strong connections to education researchers and possibly receiving additional funding related to the research. In the long term, school districts across the state and also the country would benefit from having more current, high-quality education research that is designed specifically to study the relationship between certain cost-saving measures and student achievement.[262]

b. Consolidate Districts with Fewer than 1,000 Students

District consolidation is such an unpopular policy in small districts that it seems highly unlikely any district would voluntarily enter into it. But, when exceptionally small districts are consolidated, the consolidation has been shown to produce substantial cost savings, expand curricular offerings, and increase specialized services such as education for students with disabilities.[263] Specifically, economists William Duncombe and John Yinger concluded in a study conducted in New York from the mid-1980s through the late-1990s that "consolidation is likely to lower the costs of two 300-pupil districts by over 20 percent, to lower the costs of two 900-pupil districts by 7 to 9 percent, and to have little, if any, impact on the costs of two 1,500-pupil districts."[264]

260. Oluwole & Green, III, *supra* note 169, at 377.

261. The calculations presented above the line in this Article are summaries of the data discussed by Oluwole and Green. *Id.* at 405–06.

262. Especially in emergency situations, it seems necessary to incentivize research. Six years after Hurricane Katrina hit the Gulf Coast, researchers bemoaned the lack of research analyzing the innovative educational responses to the crisis. Sarah D. Sparks, *Missed Opportunities: Research Scarce on Post-Katrina Reforms*, EDUC. WEEK, Aug. 25, 2010, at 13.

263. Joe Bard et al., *Rural School District Consolidation*, ACADEMIC LEADERSHIP J., Spring 2006; Melissa Maynard, *Still Too Many Schools?*, STATELINE.ORG, Mar. 22, 2010, http://www.stateline.org/live/details/story?contentId=470554.

264. William Duncombe & John Yinger, *Does School District Consolidation Cut Costs?* 3–4 (Ctr. for Pol'y Research, Working Paper No. 33, 2005). Interestingly, consolidation is similar to an idea Omer Kimhi advocates: creating special districts which have access to both the city and suburban tax base. However, Kimhi discusses this as a way of assisting a particular distressed municipality; for

Thus, district consolidation may be especially beneficial in states such as Illinois, which has 869 districts,[265] of which more than half (446) enroll 1,000 students or fewer and almost a quarter (214) are one-school districts.[266] Illinois is not the only state with numerous small districts, though—out of the 13,234 school districts across the country, 6,067 enroll 1,000 or fewer students.[267] As one would expect, the cost savings from district consolidation result mainly from economies of scale—a mid-sized, consolidated district will have fewer administrative and infrastructure-type costs than two smaller, separate districts.[268] Yet, these savings may be offset to a degree by increased costs of transportation, additional capital expenditures, and salary increases (salaries often rise to the highest level paid by any of the affected districts prior to consolidation).[269] Still, Maine reported $36 million in savings as a result of moving from 290 school districts to 215.[270] Recent reports suggest that Illinois and Michigan could stand to save hundreds of millions of dollars by aggressively consolidating districts.[271] Arkansas and Iowa also have consolidated dozens of smaller districts in recent years, anticipating substantial cost savings.[272] During the past ten years, district consolidation has been on the table in Arizona, Indiana, Kansas, Maine, Mississippi, Montana, Nevada, New York, Pennsylvania, South Carolina, Vermont, Washington, Wyoming, and

political reasons at the very least (which relatively financially sound school district wants to be consolidated with an economically failing school district?), this issue is not discussed in the context of school district consolidation. Still, it is one a state should be aware of, and for which it should provide adequate support, if mandating or strongly incentivizing district consolidation. *See* Kimhi, *supra* note 57, at 667–68.

265. Nat'l Ctr. for Educ. Statistics, Search for Public School Districts, http://nces.ed.gov/ccd/districtsearch/ (last visited Apr. 3, 2011).

266. *Id.* Illinois's total number of districts (868) is not too far behind Texas (1,031) even though Texas's public schools enroll more than twice as many students as Illinois's. *Id. See also* Rado & Eldeib, *supra* note 57.

267. Nat'l Ctr. for Educ. Statistics, *supra* note 265.

268. Berube, *supra* note 104, at 165; VT. LEGISLATIVE RESEARCH SHOP, SCHOOL DISTRICT CONSOLIDATION (2007), *available at* http://www.uvm.edu/~vlrs/Education/schooldistrictconsolidation.pdf.

269. Educ. Nw., What the Research Says (or Doesn't Say): Consolidation of School Districts, http://educationnorthwest.org/news/1119 (last visited Apr. 3, 2011); VT. LEGISLATIVE RESEARCH SHOP, *supra* note 268.

270. *See* Berube, *supra* note 104, at 165. *But see* Marvin E. Dodson, III & Thomas A. Garrett, *Inefficient Education Spending in Public School Districts: A Case for Consolidation?*, CONTEMP. ECON. POL'Y, Apr. 2004, at 270 (finding that transportation costs decrease after consolidation).

271. Mary Schulken, *Consolidation Could Save Mich. Millions, Study Says*, EDUC. WEEK, Aug. 25, 2010, at 4; Shakrani, *supra* note 57; Rado & Eldeib, *supra* note 57.

272. Bard et. al., *supra* note 263; Maynard, *supra* note 263; Dodson, III & Garrett, *supra* note 270.

West Virginia.[273]

The disadvantages of consolidation are that students' academic achievement sometimes suffers and often the smaller districts subjected to consolidation are major employers and social anchors for the rural communities in which they are located.[274] For these reasons, the National Rural Education Association is categorically opposed to mandatory consolidation.[275] However, the local social and economic impact of school closings which result from district consolidation has been somewhat mitigated when the consolidated district maintains, for example, an elementary school in one community and a high school in the other.[276] Furthermore, even if geographic constraints make traditional district consolidation impractical (in which schools are consolidated as well as administrative functions), states should still consider consolidating districts administratively, even if all or most students continue to attend the same school they attended prior to consolidation.[277] Recent studies in Michigan show that this alternative of administrative consolidation without school closures is substantially more palatable to voters.[278] Because local resistance can be so strong, it is especially important that the state provide major incentives for district consolidation or require consolidation outright in particular cases. It is also important for the state to provide incentives for financially more-healthy districts to consolidate with less-healthy districts, which is unattractive to the better-off districts even during the best of times.[279]

Finally, there may be limited circumstances in which smaller districts should not be consolidated, either because financial savings will not result or because public policy dictates otherwise. For example, especially isolated rural districts and districts on Native American Reservations should be exempt from consolidation.

273. Berube, *supra* note 104, at 165; Bard et. al., *supra* note 263; Maynard, *supra* note 263; Educ. Nw., *supra* note 269; Dodson & Garrett, *supra* note 270.

274. VT. LEGISLATIVE RESEARCH SHOP, *supra* note 268.

275. Bard et. al., *supra* note 263.

276. *Id.*

277. Dodson & Garrett, *supra* note 270.

278. Shakrani, *supra* note 57, at 8.

279. *School-Merger Plan Faces Big Hurdles*, CHI. TRIB., Mar. 5, 2011, *available at* http://articles.chicagotribune.com/2011-03-05/news/ct-met-1schoolsidebar-20110305_1_district-consolidation-school-merger-plan-district-boundaries.

c. Permit More Outsourcing of Non-Instructional Services

All states regulate the procedures by which local governments award contracts to private vendors.[280] Judging by the frequency of outsourcing in school districts, in some states the regulation is fairly permissive.[281] In others, such as California, state law restricts local governments from contracting out services unless the local government can prove "a guaranteed cost savings."[282] Not surprisingly, because "it is often difficult to verify efficiencies and prove them in court," California municipalities—including school districts—are much more hesitant to outsource contracts for services than they were prior to the enactment of the restrictive statute.[283] Furthermore, in Illinois, changes to state law in 2008 included, in the words of one Illinois attorney, "requirements [ ] so prohibitive that subcontracting no longer remains a viable or cost-effective alternative for school boards."[284]

280. Jennifer Maciejewski, *Ins and Outs of Outsourcing*, DIST. ADMIN., Aug. 1, 2007, at 50.

281. MARY MCCAIN, RUTGERS CTR. FOR WOMEN & WORK, SERVING STUDENTS: A SURVEY OF CONTRACTED FOOD SERVICE WORK IN NEW JERSEY'S K–12 PUBLIC SCHOOLS 1 (2009), *available at* http://www.cww.rutgers.edu/Docs/NJschoolcafeteriaworkers.pdf.

282. CAL. GOVERNOR'S COMM. ON EDUC. EXCELLENCE, *supra* note 85, at 5-31.

283. *Id.* The California Governor's Committee on Education Excellence advocates repealing the statute because "[c]ontracting for non-teacher services generally results in lower costs, which can free up funds for other education purposes." *Id.* So does Lisa Snell of the Reason Foundation. Lisa Snell, *Lift Restrictions on School Outsourcing in California*, REASON FOUND., June 30, 2009, *available at* http://reason.org/news/show/lift-restrictions-on-school-ou.

284. Matt Roeschley, *New Legislation Deters Outsourcing by School Districts*, OTTOSEN BRITZ KELLY COOPER & GILBERT, LTD., Spring 2008, *available at* http://www.obkcg.com/article.asp?a=309. A vendor must submit a bid, plus:

> A. Evidence of liability insurance that is greater than or equal in scope and amount to the liability insurance provided by the school board;
>
> B. Employee benefits comparable to those provided to employees of the school board;
>
> C. A complete list of the number of employees who will provide the non-instructional services, their job classifications, and the wages they are paid by the third party;
>
> D. A minimum three (3)-year cost projection for each and every expenditure category and account for the performance of non-instructional services; such projection may not be increased if the third party's bid is accepted;
>
> E. Upon the request of the school board, composite information including: criminal and disciplinary records, DCFS complaints and investigations, traffic violations, license revocations and other license problems; and
>
> F. A notarized affidavit from the president or CEO of the third party attesting that, within the three (3) months immediately preceding the submission of its bid, each of its employees has completed a criminal background check that complies with the requirements of the School Code. (105 ILCS 5/10-22.34c(a)(3)).

Id. Additionally, "third party contracts must now require that a contractor offer any available positions to qualified school personnel who have lost their jobs because of the contract and must contain provisions that require the employer to ensure non-discrimination and equal employment opportunity for all persons. (105 ILCS 5/10-22.34c(a)(7) and (8))." *Id.*

Bowman: BEFORE SCHOOL DISTRICTS GO BROKE: A PROPOSAL FOR FEDERAL REFORM

Outsourcing non-instructional services is not a panacea for districts' fiscal woes, and it can have disadvantages that affect many stakeholders. Vendors generate some cost savings because of economies of scale, but often this is dwarfed by the savings generated because the vendors pay their employees less and give them fewer benefits than the school district did.[285] Sometimes vendors are attuned to working in a business environment but not a school environment.[286] At other times, the savings are not what the school district thought they would be, especially if a district is trying to bid out a contract for which there is not much competition, which often occurs when districts try to outsource transportation.[287] Finally, because any school district that seeks to outsource non-instructional services should consult an attorney to ensure that the district complies with relevant statutory and regulatory requirements, attorney fees, plus administrative time spent conducting the process, are disadvantages of this option, as well.[288] The importance of complying with relevant regulations and thus avoiding litigation cannot be overstated: in August 2010, the Detroit Public School District was in court, defending the outsourcing of security services.[289]

If done well and carefully, however, outsourcing some non-instructional services may generate enough cost savings for a district that, despite the disadvantages, outsourcing is worthwhile.[290] In school districts across the country, three non-instructional services are outsourced more frequently than any others: transportation, custodial services, and food service.[291] In fact, thirteen percent of school districts across the country outsource food service, and this number continues to grow.[292] Other school districts also have outsourced maintenance,[293] school security,[294] IT services,[295] school nurses,[296] substitute

285. MCCAIN, *supra* note 281.

286. Mike Dano, Sourcingmag, When Outsourcing Didn't Work, This School Cancelled its Contract, *available at* http://www.sourcingmag.com/content/c051110a.asp (last visited Apr. 3, 2011).

287. Sheryl S. Lazarus & Gerard J. McCullough, *The Impact of Outsourcing on Efficiency in Rural and Nonrural Districts: The Case of Pupil Transportation in Minnesota*, 35 J. REGIONAL ANALYSIS & POL'Y 55 (2005); Maciejewski, *supra* note 280.

288. William J. Mathis & Lorna Jimerson, *Weighing Outsourcing*, SCH. ADMIN., Oct. 2009, 10–15.

289. Dawsey, *supra* note 96.

290. OFFICE OF PROGRAM POL'Y ANALYSIS & GOV'T ACCOUNTABILITY, WITH EFFECTIVE PLANNING, ACCOUNTABILITY, AND OVERSIGHT, SCHOOL DISTRICTS CAN SUCCESSFULLY OUTSOURCE SERVICES (2004), *available at* http://www.oppaga.state.fl.us/MonitorDocs/Reports/pdf/0426rpt.pdf.

291. Michael D. LaFaive & Daniel J. Smith, *Survey: School Outsourcing Grows*, MACKINAC CTR. FOR PUB. POL'Y, Aug. 1, 2005, *available at* http://www.mackinac.org/7212.

292. MCCAIN, *supra* note 281.

293. LaFaive & Smith, *supra* note 291.

294. Associated Press, *School Chief: Outsourcing Security Saves Millions*, CBS DETROIT, Aug. 3, 2010, *available at* http://detroit.cbslocal.com/2010/08/03/school-chief-outsourcing-security-saves-

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teachers,[297] special education aides,[298] and drivers' education.[299] And depending on the service, some school districts have been able to solicit bids from vendors across the country, thus increasing competition for the contract even more.[300]

d. Incentivize Layoff of Low-Performing Teachers

In fifteen states, state law requires that seniority is the controlling factor when school districts lay off employees; in countless individual school districts across the country, this same approach also is memorialized in countless collective bargaining agreements.[301] Thus, this is the proposal likely to face the most political opposition, especially in states with a strong union tradition.[302] Yet, like pension reform, it must be part of the current discussion, and increasingly over the past couple of years it has been.[303] During late 2009, Arizona amended state law to require that layoffs be conducted without regard to teachers' seniority or tenure.[304] In 2010, California, Colorado, and New York all considered legislative proposals to let districts make layoff decisions based on performance and need rather than seniority alone—but all of

millions/.

295. Dano, *supra* note 286.

296. Keith Paradise, *Franklin County's School Districts Outsource Jobs to Save More Money*, PUB. OPINION, Aug. 1, 2010, *available at* http://stephanieconlon.com/2010/08/04/franklin-countys-school-districts-outsource-jobs-to-save-money/.

297. Maciejewski, *supra* note 280.

298. Mary Mann, *School District to Outsource Special Education Paraprofessionals*, S. ORANGE PATCH, Mar. 23, 2010, *available at* http://southorange.patch.com/articles/school-district-to-outsource-special-ed-paraprofessionals-2.

299. Paradise, *supra* note 296.

300. Rivero, *supra* note 13 (noting that this is the practice in Troy, Michigan's school district).

301. Larry Abramson, *In Teacher Layoffs, Seniority Rules. But Should It?*, NPR, June 2, 2010.

302. Ruben Navarrette, *Why Let Senior Teachers Get a Free Pass During Layoffs?*, CNN.COM, Apr. 29, 2010, http://cnn.staging.perfectmarket.com/2010-04-29/opinion/navarrette.teachers.unions_1_teachers-unions-senior-teachers-younger-teachers; Stephen Sawchuk, *L.A. Times Stirs Controversy With Teacher-Effectiveness Scoring*, EDUC. WEEK, Aug. 25, 2010, at 4; Stephen Sawchuk, *NEA, AFT Chose Divergent Paths on Obama Goals*, EDUC. WEEK, Aug. 25, 2010, at 1, 18–19.

303. *See, e.g.*, Hanushek, *supra* note 7; Abramson, *supra* note 301; Wingert & Thomas, *supra* note 42 (noting that increasingly and in response to Race to the Top, states "have changed their laws to make teacher performance matter in tenure and firing decisions, but very few can use it to make layoff decisions"); Fernanda Santos, *City Details Worst-Case Teacher Layoffs*, N.Y. TIMES, Feb. 28, 2011, at A17 ("Natalie Ravitz, the Education Department's chief spokeswoman, described so-called 'last in, first out' layoffs as 'an arbitrary standard' that punishes schools that have chosen to hire teachers who are new to the profession.").

304. Alex Bloom, *Arizona Law Changes Way Teachers Contract with Districts*, ARIZ. REPUBLIC, Nov. 23, 2009, at B1. Likely because Arizona is a "right to work" state, legislators faced comparatively little opposition to this change. ARIZ. REV. STAT. ANN. §§ 23-1301 to 23-1307 (2010).

those proposals failed.[305]

Despite deep-seated political opposition, especially in union states such as California, Colorado, and New York,[306] this policy approach merits consideration because of the incredible cost-savings a district can generate without sacrificing educational quality—recall that school districts spend more money on salaries than any other category of expenditures.[307] In 2009, Marguerite Roza published a paper modeling the number of layoffs needed to reduce a hypothetical district budget by one to ten percent under both a seniority-neutral and seniority-based system, documenting what is intuitive: under a seniority-based system, more layoffs were needed because the teachers being laid off were the most junior, who were paid the least.[308] In 2010, economist Erik Hanushek wrote:

> [O]ne of the most consistent education research findings [over the past several decades] has been that there is no systematic impact of teacher experience past the first two or three years. [Thus, schools should] lay off ineffective teachers selectively while letting class sizes drift up a little. . . . An increase of two students per class typically amounts to a savings of some 10 percent in per-pupil spending, more than most estimates of the current fiscal shortfalls.[309]

Additionally, as numerous media articles document, laying off the most junior teachers often hurts the lowest-performing schools, which are more likely to be schools with high concentrations of students in poverty, students of color, or both.[310] In fact, this effect on students was the subject of one of the many lawsuits that have been filed as a result of recession-driven cuts.[311] In the coming months, the settlement agreement in that lawsuit likely will require the Los Angeles school

305. Jennifer Medina, *Bill Would Allow Layoffs of Teachers with Seniority*, N.Y. TIMES, Apr. 12, 2010, at A22; Navarrette, *supra* note 302. For the status of the New York bill, see http://assembly.state.ny.us/leg/?default_fld=%0D%0A&bn=S7346&Summary=Y&Actions=Y&Votes=Y&Memo=Y&Text=Y, and for the status of the California bill, see http://www.legislature.ca.gov/cgi-bin/port-postquery?bill_number=sb_955&sess=CUR&house=B&author=huff.

306. *See, e.g.*, Jennifer Medina, *Last Teacher In, First Out? City has Another Idea*, N.Y. TIMES, Apr. 25, 2010, at A1; Medina, *supra* note 305.

307. *See supra* Part I.A.2.

308. MARGUERITE ROZA, CTR. ON REINVENTING PUB. EDUC., SENIORITY-BASED LAYOFFS WILL EXACERBATE JOB LOSS IN PUBLIC EDUCATION (2009), *available at* http://www.crpe.org/cs/crpe/download/csr_files/rr_crpe_layoff_feb09_.pdf.

309. Hanushek, *supra* note 7. *See also* Steven G. Rivkin et al., *Teachers, Schools, and Academic Achievement*, 73 ECONOMETRICA 417 (2005).

310. Abramson, *supra* note 301; Medina, *supra* note 305; Wingert & Thomas, *supra* note 42 (Layoffs of junior teachers "disproportionately hurt students attending the lowest-performing schools, because they tend to have the highest proportion of new teachers. In some Los Angeles schools last year, such cuts wiped out 50 to 70 percent of the faculty.").

311. *Judge Blocks Teacher Layoffs at 3 Inner-City LA Schools*, EDUC. WEEK, May 19, 2010, at 4.

district to lay off teachers by focusing on the impact of such layoffs on schools with high poor and non-White student populations, rather than considering only the affected teachers' seniority.[312]

Nonetheless, it is important that school districts and education advocates continue to work on ways to measure a teacher's performance and thus use fair evaluations of teachers' performance when making employment decisions (in other words, not merely relying on one factor such as students' performance on standards-based tests or principal evaluation of the classroom).[313] Understandably, unions' central objection to seniority-blind evaluation systems is that, in one advocate's words, "Without an objective criterion for judging teachers . . . the game would be rigged in favor of younger, less expensive teachers."[314]

Performance evaluation systems are becoming more commonplace; major public school districts in Denver, Detroit, and Washington, D.C. have recently implemented evaluation systems.[315] One interesting initiative has demonstrated that teachers may not be as resistant to increasing performance evaluations as might be assumed: in a spring 2009 survey of 9,000 teachers, seventy-four percent of teachers in one district, seventy-seven percent in another district, and more than half of the most senior teachers in both districts thought factors in addition to seniority should be considered when a district is making layoffs.[316] The teachers also were asked about the most important factors to be considered when evaluating teaching effectiveness; they selected "classroom management," "teacher attendance," "specific licensure," and "instructional performance based on evaluation rating" as the most important.[317] From a practical perspective, it would seem that involving teachers in the development of seniority-neutral determinations of performance is essential.

312. Medina, *supra* note 91.

313. The Washington, D.C. Public School District employed a new evaluation process for the first time in 2009. *See* Stephen Sawchuk, *New D.C. Evaluation Process Targets Hundreds for Firing*, EDUC. WEEK, Aug. 11, 2010, at 4.

314. Abramson, supra note 301.

315. Peggy Walsh-Sarnecki, *DPS' Bobb: 'Good Things are Happening in Detroit'*, DETROIT FREE PRESS, Sept. 26, 2010, *available at* http://detroitpsfoundation.org/article.php?id=65.

316. NEW TEACHER PROJECT, A SMARTER TEACHER LAYOFF SYSTEM 3 (2010), *available at* http://tntp.org/files/TNTP_Smarter_Teacher_Layoffs_Mar10.pdf.

317. *Id.* at 4.

2. Remedying the Lack of an Adequate Legal Mechanism

As Part II of this Article demonstrated, most states do not have adequate legal mechanisms on which districts in fiscal crisis can rely.[318] First, federal municipal bankruptcy is only available in twenty-four states and even then has many disadvantages, including that it is a very poor fit for school districts in fiscal crisis.[319] Second, state receivership is only available in two states, and while more flexible and far-reaching than bankruptcy, it is untested in the realm of school districts' fiscal crises and requires more extensive court oversight when administrative agency oversight is likely sufficient.[320] Third, state fiscal takeover, like receivership, has the ability to affect the systemic factors which contributed to fiscal crisis, but it is plagued by local resistance and available in various forms in only seventeen states.[321] Furthermore, in nineteen states, not one of these imperfect legal mechanisms is available.[322] The proposal in this subsection aims to fill that substantial gap.

In particular, this subsection champions the state monitoring and fiscal takeover mechanism, attempting to reduce the pitfalls of that approach which have become clear in some states, and also to ensure some consistency in mechanisms across states. Of course, this requirement, too, is phrased generally in the proposed legislation, leaving states much discretion in determining its particulars. In my view, the ideal role of the state in any of these plans is limited, temporary, and narrow;[323] however, states should be able to decide this for themselves. Several states—including Alabama, California, Florida,

318. *See supra* Part II.

319. *See supra* Part II.A.

320. *See supra* Part II.B.

321. *See supra* Part II.C.

322. *See infra* Appendix.

323. Berman, *supra* note 177, at 68. Recent changes to Michigan's law could be beneficial by allowing for earlier intervention by the state. Tim Martin, *Mich. Senate Passes Bill to Give Broad Powers to Emergency Managers*, MSNBC, Mar. 9, 2011, *available at* http://news.mobile.msn.com/en-us/articles.aspx?aid=41998710&afid=1. But, they also are aggressive and arguably extend an emergency financial manager's authority too far. The changes would allow managers to "toss out union contracts, dissolve school boards and set wage and benefit levels without collective bargaining," Matthew Dolan, *Detroit Schools' Cuts Plan Approved*, WALL ST. J., Feb. 22, 2011, *available at* http://online.wsj.com/article/SB10001424052748703610604576158783513445212.html, and also to make the decision that a municipality should ask the state for permission to file for bankruptcy, Jason Linkins, *Michigan Set to Enact Sweeping 'Financial Martial Law' Bill*, HUFFINGTON POST, Mar. 15, 2011, *available at* www.huffingtonpost.com/2011/03/14/michigan-set-to-enact-sweeping-financial-martial-law_n_835526.html. *See also* Ed Brayton, *The Emergency Manager Law from A to Z*, MICH. MESSENGER, June 22, 2011, *available at* http://michiganmessenger.com/50132/the-emergency-manager-law-from-a-to-z.

Illinois, Kentucky, Michigan, Ohio, Texas, and West Virginia—already satisfy some, if not all, of the requirements imposed by the relevant portion of the proposed legislation, and accordingly, provide a variety of models for the many other states which lack such legislation or regulation.[324]

a. Monitoring School Districts' Fiscal Health, and Making the Diagnosis Public

Although most states do not monitor municipalities' fiscal health in any systematic way,[325] it has become relatively common for states to engage in a very basic level of such monitoring: requiring school districts to submit an annual budget or audit to the state.[326] However, only four states' statutes and regulations indicate how a state evaluates a district's submission of its budget or audit, specify the action the state takes if the submission raises red flags, and establish procedures for creating and publicly releasing of a list of school districts approaching or in fiscal crisis.[327] Furthermore, there are many factors outside a district's budget which can serve as an indication of a district's fiscal health, and few states gather that information. Thus, most states' ability to assess whether school districts are nearing fiscal crisis is severely limited.

Both this type of monitoring and the public distribution of a financial early warning or watch list are critically important for several reasons, though. As discussed earlier, school districts often do not have long-term fiscal plans or fiscal expertise.[328] But, even if a district has one or both of these things, district officials in many different roles have incentives for making the district's fiscal situation seem better than it

324. *See supra* Part II.C; *infra* Part III.C.2.a, b; Kimhi, *supra* note 2, at 392–95.

325. Kimhi, *supra* note 57, at 675 n.236 (citing Kloha et al., *supra* note 183, at 252–53); EUGENE MCQUILLIN, THE LAW OF MUNICIPAL CORPORATIONS 154 (3d rev. ed. 2005) ("The largest group of states have no enabling statutes or other provision within their law for dealing with municipal financial distress.").

326. *See, e.g.*, DEL. CODE ANN. tit. 14, § 155 (2010); IND. CODE ANN. § 20-25-9-4 (2010); LA. REV. STAT. ANN. § 17:88–17:99 (2010); MD. ADMIN. CODE §§ 13A.02.07.01–.10 (2010) (implementing regulations); MINN. STAT. §§ 127A.19, 123B.77 (2010); MISS. CODE. ANN. § 31-67-9 (2010); MO. REV. STAT. § 160.720 (2010); MONT. CODE ANN. § 20-9-211 (2010); NEB. REV. STAT. ANN. § 79-528(3)(a)–(b) (2010); N.H. REV. STAT. ANN. § 198:4-d (2010); N.M. STAT. ANN. §§ 22-8-6, 22-9-41 (2010); N.Y. EDUC. LAW § 2590-h (McKinney 2010); 70 OKLA. STAT. § 5-134.1 (2010); S.C. CODE ANN. §§ 59-69-240, 59-69-250 (2010); TEX. EDUC. CODE ANN. § 44.008 (Vernon 2010); UTAH CODE ANN. §§ 53A-19-101, 53A-19-108 (2010); VA. CODE ANN. §§ 21.1-90, 22.1-97 (2010); WASH. REV. CODE ANN. §§ 28A.330.090, 28A.505.070 (2010).

327. ARK. CODE ANN. § 6-20-1900 (2010); CAL. EDUC. CODE § 1630 (West 2010); 105 ILL. COMP. STAT. ANN. 5 / 1A‑ 8 (2010); OHIO REV. CODE ANN. § 3316.03(A) (West 2010).

328. *See supra* Part I.B.1.

actually is.[329] This is unfortunate because the earlier a district's fiscal crisis is discovered by a person or agency with the authority to intervene, the easier it is to assist the district and bring it back to a point of fiscal health.[330] Relatedly, this lack of state monitoring and public disclosure inevitably has exacerbated some school districts' fiscal crises. And, it also may have increased local resistance to state intervention and takeover because parents, community members, and possibly even school board members and senior district administrators in a taken-over district have had very little time to process an unfortunate fact: if a school district is approaching or in fiscal crisis, local control has failed.

Fortunately, establishing a monitoring and public reporting structure is fairly straightforward, and the four states in which these procedures exist—Arkansas, California, Illinois, and Ohio—provide solid examples of a variety of approaches.[331] The relevant statutes or regulations usually set forth a procedure first for evaluating a school district's fiscal health based on pre-determined criteria, and then for assigning school districts to one of two or three categories delineating various degrees of fiscal crisis.[332] Additionally, public policy literature contains multiple

329. *Id.*

330. R.I. Assembly Digest, *supra* note 151; Kimhi, *supra* note 2, at 385.

331. ARK. CODE ANN. §§ 6-20-1904, 6-20-1900 (2010); CAL. EDUC. CODE § 1630 (West 2010); 105 ILL. COMP. STAT. ANN. 5 / 1A‑8 (2010); OHIO REV. CODE ANN. § 3316.03(A) (West 2010).

332. The factors include:

> [T]he previous [pre-2002] Fund Balance to Revenue Ratio plus four additional measures, including Expenditures to Revenue Ratio, Days Cash on Hand, Percent of Short-Term Borrowing Ability Remaining, and Percent of Long-Term Debt Margin Remaining. These five indicators are individually scored on a scale from one to four (four being the highest or best), weighted, and added together to produce a financial profile score for each district.

Ill. State Comptroller, School Performance Under Scrutiny, http://www.ioc.state.il.us/FiscalFocus/article.cfm?ID=101 (last visited Apr. 3, 2011).

On July 1, 2010, the Arkansas Department of Education announced that eight school districts were on the state's financial distress list, down from twelve the year before. ARK. DEP'T OF EDUC., FISCAL DISTRESS DISTRICTS OS OF JULY 1, 2010 (2010), *available at* http://arkansased.org/about/reports.html; ARK. DEP'T OF EDUC., 2009–2010 FISCAL DISTRESS DISTRICTS (2010), *available at* http://www.arkansased.org/about/pdf/fiscal_distress_09-10_050809.pdf. In spring 2011, the California Superintendent of Public Instruction announced that 110 school districts were on the state's fiscal watch list. Editorial, *Galt Join Union High School District May Land on Financial Watch List*, LODI NEWS SENTINEL, Mar. 24, 2011, *available at* http://www.lodinews.com/news/article_3406b0c2-561a-11e0-99a1-001cc4c03286.html. Also in spring 2011, the Illinois State Board announced that sixty-two school districts were on the state's Financial Early Warning List and thirty-two were on the state's Financial Watch List. Ill. St. Bd. of Educ., School Business Services: 2011 School District Financial Profile, http://www.isbe.state.il.us/sfms/P/profile.htm (last visited June 30, 2011). As of spring 2011, twenty-seven Ohio school districts were on the state's fiscal caution list, five on the fiscal watch list, and nine on the fiscal emergency list. Ohio Dep't of Educ., Fiscal Caution School Districts, Search Conducted on Apr. 20, 2011, http://www.ode.state.oh.us/GD/Templates/Pages/ODE/ODEDetail.aspx?page=3&TopicRelationID=1012&ContentID=7646&Content=76157; OHIO AUDITOR OF STATE, SCHOOL approaches for evaluating municipalities' fiscal health; approaches applicable to towns or small cities are likely also largely applicable to many school districts.[333]

b. Authorizing and Structuring State Fiscal Takeover of School Districts

Only seventeen states have any statutory or regulatory authority to intervene if a school district is approaching or in fiscal crisis,[334] and in those states, state takeovers of financially troubled school districts have produced remarkable financial stability.[335] But in the remaining thirty-three states, school districts in fiscal crisis are either dealt with by the state in an ill-advised ad hoc manner or receive no guidance from the state. This is not acceptable. All states should have a plan for escalating involvement in a school district approaching or in fiscal crisis, and school districts should have notice of the contours of that plan.

The type and degree of state intervention could vary from one state to another, but ideally each state's plan would have all six of the characteristics of comprehensive plans discussed earlier in this Article.[336] First, in the interest of fairness, consistency, and transparency, a plan should contain specific triggers for various levels of state involvement, rather than responding to individual districts' fiscal crises on a case-by-case basis.[337] Second, to reduce local resistance, minimize the necessity of state involvement, and encourage early action by the state, the plan should require an initial attempt to solve the problem at the district level with minimal state involvement. For example, the state could provide a consultant to assist the district in budgeting or reviewing its fiscal practices; require the district to produce a budget that the state board of education would need to approve; or set an expenditure cap within which the school district must operate.[338] Third (and this is the only element explicitly required in the proposed legislation because it is the most essential), also for reasons of consistency and deference to districts when possible, the plan should

DISTRICTS IN FISCAL WATCH AND SCHOOL DISTRICTS IN FISCAL EMERGENCY (2011), *available at* http://www.auditor.state.oh.us/services/lgs/fiscalwatch/Schools.pdf.

333. Ken W. Brown, *The 10-Point Test of Financial Condition: Toward an Easy-to-Use Assessment Tool for Smaller Cities*, GOV'T FIN. REV., Dec. 1993, at 21; R.I. Assembly Digest, *supra* note 151; Kimhi, *supra* note 57, at 677 n.241, 680.

334. *See infra* Appendix.

335. *See supra* Part II.C.

336. *See supra* Part II.C.1.

337. Kimhi, *supra* note 57, at 655–56, 678; Kimhi, *supra* note 2, at 390–91.

338. Ill. State Comptroller, School Performance Under Scrutiny, http://www.ioc.state.il.us/FiscalFocus/article.cfm?ID=101 (last visited Apr. 3, 2011); Kimhi, *supra* note 57, at 670.

establish a framework for escalating state involvement in a district's fiscal matters. For example, the state involvement could move from the consultation described above, to information gathering (conducting financial inquiries, including internal audits), to debt management (renegotiating the district's debt and major expenditures), to fiscal management (implementing a recovery plan).[339] Fourth, the plan should contain a clear statement about who will have the authority to take these actions and how that agent will be selected: will the state create a fiscal oversight board, appoint a fiscal manager/advisor, or follow another approach?[340] Fifth, the plan should include a clear statement about the extent of the agent's authority, establishing whether the state agent may, for example, terminate senior administrators' contracts or dissolve the elected school board.[341] Sixth and finally, the plan should not function as a financial bailout for fiscally troubled school districts.

As discussed in Section II.C.2, the state takeover approach can have incredible benefits: it can bring additional fiscal expertise to a financially floundering district, correct poor management practices that have contributed to a fiscal crisis, and interrupt municipalities' entrenched political dysfunction which prevents a district from dealing with an approaching or existing fiscal crisis.[342] Unlike filing for bankruptcy, submitting to a state takeover is not voluntary. For these reasons and others, state takeovers have demonstrated success in financially stabilizing districts in fiscal crisis.[343] Because the legal mechanism of state fiscal takeover can be such a good fit for the problem of school districts' fiscal crises, it is important to try to minimize the pitfalls of this mechanism—first among them, local resistance. The policy advocated here seeks to minimize that resistance in two main ways: First, the relevant state statute and regulations must be transparent about the entire process and use clear, predetermined criteria as much as possible, to minimize resistance from within the district. Second, the state must communicate with the public about school districts that are approaching or entering fiscal crises and the reason for state intervention so that the local community understands the unfortunate degree to which local control has failed.

339. Kimhi, *supra* note 2.

340. *Id.*

341. Ill. St. Comptroller, *supra* note 332.

342. *See supra* Part II.C.2.

343. Recall the specific example of DPS emergency financial manager Robert Bobb who has enabled DPS to face the next chapter of its existence, which is no small feat. *See supra* text accompanying notes 184–193.

3. Stabilizing Education Funding

In August 2010, Federal Reserve Chairman Ben Bernake gave a speech in which he noted that "many government programs . . . such as education . . . are likely to be most effective when funding sources are stable and predictable, allowing for long-term planning."[344] The funding cuts to education during FY 2010, FY 2011, and those forecast for FY 2012 have illuminated the instability of education funding at both the state and local levels.[345] Districts' desperate responses to these revenue drops have demonstrated precisely why this instability must be reduced in the future.[346] The good news is that the extent of instability with which many school districts across the country are grappling can be reduced, but the bad news is that doing so will be politically and pragmatically difficult. Accordingly, this subsection discusses four options included in the proposed legislation with the goal of moving toward greater long-term fiscal stability for school districts.

a. Guarantee a Floor of State Funding

In an average school district, forty-eight percent of revenues come from state coffers.[347] Thus, even if a school district can estimate its local and federal revenues for the next fiscal year, if its state funding is unstable, that instability can affect short- and long-term budgeting and financial planning substantially. In fact, because some states' budgets are not finalized until mid-year, school districts in those states often are not able to finalize their own annual budgets until after the fiscal year has begun, and sometimes after the school year has started.[348] School districts' budgeting processes are further complicated when the education funding proposed in an early version of the state budget is dramatically different from that eventually finalized by the state.[349]

This problem could be reduced to a degree if the federal government required that states provide a certain level of funding based on the

344. Bernanke, *supra* note 13.

345. *See supra* Part I.A.1.

346. *See supra* Part I.A.2.

347. ZHOU & JOHNSON, *supra* note 24; *see also supra* Part I.A.1.

348. CAL. GOVERNOR'S COMM. ON EDUC. EXCELLENCE, *supra* note 85, at 5-5.

349. *Id.* ("The timing of the annual adoption of the state budget leaves schools little time to develop their budgets, making it difficult for districts to make long-term plans. [Education] budgets often change significantly from the January 10 version to that proposed in the May Revision. These changes may produce billions of additional revenues to schools...or billions less. Then, state budgets are often so late that districts, especially those with year-round schools, have already started their school year before the state adopts its budget for that school year.").

previous year's per capita educational expenditures (for example, at least ninety-eight percent); or, if states statutorily or constitutionally required themselves to do this. While this would not eliminate other causes of uncertainty such as reductions in special program funds or falling local tax revenues, school districts could create various budget options if they knew that a floor of state funding was guaranteed. This proposal is similar in function to the "maintenance of effort" requirement in the 2010 Education Stimulus Bill, which requires: "[F]or State fiscal year 2011, the State will maintain State support for elementary and secondary education (in the aggregate or on the basis of expenditures per pupil) . . . at not less than the level of such support . . . for State fiscal year 2009."[350] Importantly, the "maintenance of effort" approach in the 2010 stimulus bill is different from ESEA's long-standing "maintenance of effort" approach in a few ways: it focuses on state expenditures for education rather than district-level expenditures for education, and although it permits a reduction to 2009 (or potentially 2006) levels, it does not easily allow a ten percent drop in education expenditures from the previous year, as the ESEA approach did.[351] However, both of those "maintenance of effort" provisions were implemented for a substantially different reason than stabilizing districts' budgets: they were intended to help ensure that federal funds supplement, and do not supplant, state or local funds for education.[352]

Of course, a state's ability to commit to providing a certain level of per capita education funding may in part depend on the availability of reserve funds, which is what the next subsection suggests.

b. Create an Untouchable, Adequately-Funded State Reserve Fund for Education

Between 2008 and 2010, thirty-three states and the District of Columbia cut funding for K–12 public education.[353] At least one state also was severely delinquent in disbursing hundreds of millions of

350. Pub. L. No. 111-226, § 101(10)(A)(i), 124 Stat. 2389, 2391 (2010). The 2010 Education Stimulus Bill also included the following exception: if state tax collections were less in 2009 than in 2006, the state may fund K–12 and higher education for FY 2011 at levels as low as provided in 2006. § 101(10)(A)(iii).

351. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-03-377, DISADVANTAGED STUDENTS: FISCAL OVERSIGHT OF TITLE I COULD BE IMPROVED 1 (2003).

352. Black, *supra* note 38, at 319–20.

353. Johnson et al., *supra* note 29 (funding has fallen in Alabama, Arizona, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Mississippi, Missouri, Nebraska, Nevada, New Jersey, North Carolina, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, Utah, Virginia, Washington, and the District of Columbia).

promised state funds to school districts.[354] As state revenues have shrunk, there has been somewhat of a buffer at the state level—in forty-seven states and the District of Columbia, state budget stabilization funds (otherwise known as "rainy day funds") exist.[355] However, only two states—Alabama and Oregon—have state reserve funds that are limited to funding public education.[356] As Federal Reserve Chairman Ben Bernake and others have noted, there are few political incentives for governors and state legislators to set aside funds in reserves.[357] In fact, because the rainy day funds represent, in one scholar's words, "a political gift from one legislature to another across time [which] cannot be repaid," reserves have fallen far short of what has been needed to stabilize state finances over the long-term.[358]

However, because forty-nine states must balance their budgets each year, maintaining reserves is essential to future stability of state budgets—including stable state allocations for education. Adequately funded state rainy day funds help extend the amount of time over which a state's revenue and expenditure flow exists; instead of focusing on an annual budget, a rainy day fund can allow a state to stabilize its finances over a longer-term business cycle.[359] Federal education legislation has not yet given states an incentive to create or adequately fund education reserves; in fact, the 2010 Education Stimulus Bill, focused on job recovery, explicitly prohibited states from using stimulus funds to directly or indirectly rebuild their reserves, although it did allow some of the stimulus funds to be used during FY 2012.[360] But, a federal requirement could compensate for the political will that state legislators lack. Finally, to be clear: this proposal is not intended to create

354. Crystal Yednak, *A Federal Lifeline for Hard-Pressed School Districts*, N.Y. TIMES, Dec. 13, 2010, at A19.

355. Daniel G. Thatcher, *State Budget Stabilization Funds*, NAT'L CONFERENCE OF STATE LEGIS., Sept. 26, 2008, at 1. *See also* Kimhi, *supra* note 2, at 387 (discussing the wisdom of budget stabilization funds); CAL. GOVERNOR'S COMM. ON EDUC. EXCELLENCE, *supra* note 85, at 5-26 (recommending the establishment of such a fund in California).

356. Thatcher, *supra* note 355.

357. Bernanke, *supra* note 13.

358. David A. Super, *Rethinking Fiscal Federalism*, 118 HARV. L. REV. 2544, 2611 (2005). *See also* Andrew Reschovsky, *Taxpayer Bill of Right ("TABOR"): The Taxpayer Bill of Rights: A Solution to Wisconsin's Fiscal Problems or a Prescription for Future Fiscal Crises?*, 88 MARQ. L. REV. 135 (2004); Robert Ward Shaw, *The States, Balanced Budgets, and Fundamental Shifts in Federalism*, 82 N.C. L. REV. 1195, 1231 (2004); William F. Fox, *The Ongoing Evolution of State Revenue Systems*, 88 MARQ. L. REV. 19 (2004).

359. Super, *supra* note 358, at 2643.

360. Because the 2010 Education Stimulus Bill was intended to help with job retention and creation, it explicitly prohibited stimulus funds for being used to directly or indirectly pay down a state's or district's debt, or to create or supplement any existing rainy day funds. Pub. L. No. 111-226, 124 Stat. 2389, 2390–91 (2010).

education bailout funds at the state level, but rather to create reserves which allow the state to maintain a more stable amount of funding for education from one year to the next.

c. Allow Districts to Insure Against Idiosyncratic Risk[361]

A different approach to the goal of stabilizing districts' budgets is inspired by workers compensation systems, which require businesses ("firms") to pay into an insurance pool and allow those firms to make claims when the unexpected happens and a workplace injury or death results.[362] While these systems provide a safety net for workers, they also give firms an incentive to prioritize workplace safety because making a claim means that, as with most insurance systems, a firm's workers compensation contributions must increase in the future.[363] The larger the claim, the greater the increase in the firm's contribution.[364] While the systems are not perfect, many economists seem to agree that these systems balance the various parties' incentives in a fair and efficient manner.[365]

This same general type of pooled-risk system could be adapted to education funding. In short, a few years down the road when most state and local education funding increases, states could implement a system in which eligible districts would be required to pay into an insurance program at a particular rate. (To be eligible, a district might have to meet criteria demonstrating that it is a moderately good risk—for example, three percent of its annual expenditures are in unrestricted reserves.) In return, districts would receive specific benefits—notably, the ability to make a claim for additional revenue in a future year when they face a shortfall. The system might also provide a dividend or reduced rate to districts with especially good records.[366]

361. Many thanks to Steven Haider, a colleague in the Michigan State University Economics Department, for suggesting I consider the model of workers compensation systems.

362. Richard A. Epstein, *The Historical Origins and Economic Structure of Workers' Compensation Law*, 16 GA. L. REV. 775 (1982); P. Blake Keating, *Historical Origins of Workmen's Compensation Laws in the United States: Implementing the European Social Insurance Idea*, 11 KAN. J.L. & PUB. POL'Y 279 (2002). See, for example, the California system which allows firms to self-insure, privately-insure, or state-insure. Div. of Workers' Comp., Cal. Dep't of Indus. Relations, http://www.dir.ca.gov/DWC/ (last visited Apr. 4, 2011).

363. Keating, *supra* note 362.

364. *Id.*

365. Christopher F. McLaren et al., *How Effective are Employer Return to Work Programs?*, S-1 (Rand Inst. for Civil Justice, Working Paper No. WR-745-CHSWC, 2010); Darius N. Laksawalla et al., *How Does Health Insurance Affect Workers' Compensation Filing?*, 2–7 (Rand Inst. for Civil Justice, Working Paper No. WR-205-1-ICJ, 2005).

366. For example, an Arizona insurance carrier does this. *See* Ariz. Small Bus. Ass'n, ASBA

School districts will not all face fiscal challenges in the same way—for example, demographic changes, pension shortfalls, and litigation each will have a substantial effect on some districts' budgets but not on others[367]—thus creating a system in which the insured entities are a blend of more and less fiscally healthy districts. And if this system supplants local school districts' larger rainy day funds, then presumably many districts will be able to save less and yet have at least the same amount of emergency cushion because instead of bearing all the risk themselves, the risk will be pooled and also will be borne at the highest practical level: the state.

d. Authorize and Regulate Private Contracts to Stabilize Funding[368]

As discussed in Section I.A.1., both state and local funding for education have been incredibly unstable over the past few years.[369] Also over the past twenty years, an increasing number of municipalities, including school districts, have begun to manage their revenue streams in creative ways, most often through derivative instruments.[370] These schemes have in many cases lowered districts' borrowing costs, provided needed cash infusions, and stabilized the revenue stream.[371] However, they are systems much more complex than school districts or other municipalities are used to working with, and as a result of several factors, a derivative-financing scheme has become an albatross for more than one school district. Consider what recently happened in the Denver Public Schools:[372] In 2008, Denver needed $400 million to cover underfunded pension obligations, so it entered into a financing scheme which had the potential to save the district $129 million in pension costs over the next three decades.[373] However, because the scheme was dependent on a variable interest rate, and a credit crisis hit unexpectedly later that year, the district has paid at least $25 million more than it expected to during the past two years and can only get out of the thirty year contract by paying $81 million in termination fees.[374] The school

Offers a Special Cost-Saving Workers' Compensation Insurance Program Through SCF Arizona, http://www.asba.com/?page=workerscomp (last visited Apr. 3, 2011).

367. *See supra* Part I.B.2.

368. Many thanks to my colleague Ben Walther for helpful conversations about these issues.

369. *See supra* Part I.A.1.

370. Walter A. Robbins, *GASB 53: New Standards for Derivative and Hedging Activities in the Public Sector*, CPA J, Apr. 2009, at 15; Morgenson, *supra* note 67.

371. Robbins, *supra* note 370.

372. Morgenson, *supra* note 67.

373. *Id.*

374. *Id.* (noting that public sector entities regularly have been entering into contracts with a term

district may come out ahead in the long run, but for right now, it is bearing substantial costs it did not expect to shoulder.[375]

Denver and other school districts have been stung by this sort of financing scheme for several reasons. Most significantly, the complexity of the deal means that a district is likely out of its league and, among other things, is not told or does not understand its level of risk, the fees the bank stands to gain, and the cost of terminating the contract before the end of the term.[376] Even the most common form of outside expertise is not helpful: the "independent" advisors districts usually employ have a vested interest in the deal happening because that is the only circumstance under which they will get paid.[377] Additionally, the deals are usually made outside of the traditional public bidding system, thus competition does not lower the price or even give the district a sense of the market, and districts have little or no comparative data about what they should be paying in these situations.[378] Finally, as with any transaction, a bank may engage in tortious activity, as some allegedly have.[379]

However, because local government entities must be authorized by their state to enter into contracts involving derivatives,[380] there is the potential for a state to regulate school districts' involvement with derivative contracts or at least publish a list of approved investment

such as thirty years—this term would be "highly unusual among private sector issuers like corporations" which generally only commit to such contracts for five years, especially because the termination rates are often so high).

375. Milstead, *supra* note 78.

376. Martin Z. Braun & William Selway, *Hidden Swap Fees by JPMorgan, Morgan Stanley Hit School Boards*, BLOOMBERG, Feb. 1, 2008, *available at* www.bloomberg.com/apps/news?pid=21070001; Hamilton, *supra* note 33, at 1018–19. A Money Magazine survey in 1995 documented the lack of sophisticated municipal finance knowledge among municipal finance officers. Ruth Simon, *Why Your Town Could Get Stung Like Orange County*, MONEY, Feb. 1995, at 20. Among school districts at least, the situation seems to have changed little since then. *See, e.g.*, Braun & Selway, *supra*.

377. Braun & Selway, *supra* note 376.

378. *Id.*

379. After Orange County, California emerged from the largest municipal bankruptcy in history, it sued Merrill Lynch, alleging that the firm had sold derivatives to the county that were not well suited to municipal investment. Thirteen other municipalities joined Orange County as plaintiffs and the lawsuit settled out of court, with Merrill Lynch agreeing to pay the municipalities $67 million. Leslie Wayne & Andrew Pollack, *The Master of Orange County; A Merrill Lynch Broker Survives Municipal Bankruptcy*, N.Y. TIMES, July 22, 1988, *available at* http://www.nytimes.com/1998/07/22/business/the-master-of-orange-county-a-merrill-lynch-broker-survives-municipal-bankruptcy.html.?pagewanted=1. For a discussion of current litigation alleging that financial services firms rigged bids for municipal bond derivatives. Daniel W. Hawthorne, *Recent Trends in Federal Antitrust Class Action Cases*, ANTITRUST, Summer 2010, at 58, 60.

380. Jeanette Redmond, Note, *State and Local Government Entities: In Search of . . . Statutory Authority to Enter Into Interest Rate Swap Agreements*, 63 FORDHAM L. REV. 2177, 2180 (1995).

advisors, and thus preserve the benefits of this financing structure while managing districts' risk. A number of commentators have called for increasing state oversight of these sorts of transactions, arguing that the increasingly complicated municipal finance market has "outgrown" state regulation,[381] that the existing regulation "fails to account for new instruments and risk,"[382] and that state regulation should grant more independence to the more financially sophisticated municipal investors but much less deference to others.[383] Some states have responded to these concerns, but most have not.[384] Thus, because sufficient regulation can minimize many of the greatest risks of the use of derivatives, states should consider whether they want to implement or amend state law to permit creative financing with the goal of stabilizing districts' long-term revenue.

E. Summary

This Part has made the case for a federal interest in fiscally stable school districts, set forth proposed federal fiscal accountability legislation in pursuit of that interest, and presented brief descriptions of ten specific policy proposals included as alternative ways of satisfying the three main requirements in the proposed legislation. Changing fiscal education policy is not easy, and the goal of this legislation is to federally require many of the most difficult decisions to be made at the state level.

CONCLUSION

School districts' shrunken budgets are one aspect of the recession expected to lag behind the country's economic recovery; when FY 2012 begins in mid-to-late 2011, many school districts across the country will be looking over the edge of a funding cliff. That is a complex problem, and accordingly in this Article I have argued for a complex solution. Specifically, I have argued for a three-part fiscal accountability amendment to the ESEA for multiple reasons. First, prudent state policy can help districts generate some immediate cost savings. Second, both

381. Hamilton, *supra* note 33, at 1019.

382. Charles D. Thompson, III, Note, *Money for Nothing—Or Dire Straits? Public Funds and the Derivatives Market*, 1997 U. ILL. L. REV. 611, 637.

383. *Id.* at 632–37.

384. *See, e.g.*, BUREAU OF BOND FIN., MICH. DEP'T OF TREASURY, BOND STRUCTURES WITH VARIABLE RATE AND DERIVATIVE TRANSACTIONS (2009), *available at* http://www.michigan.gov/documents/treasury/SBQLP_261702_7.pdf.

now and in the future, state plans to publicly monitor districts' fiscal health and intervene when a district approaches or enters fiscal crisis can help districts head off such a crisis, or reduce its duration and long-term effect. Third, looking down the road even further, states can help stabilize districts' revenues for years to come, which will enable districts to engage in better long-term fiscal planning and reduce the need for future state intervention.

In *Brown v. Board of Education*, Chief Justice Earl Warren famously wrote for a unanimous Court that education is "perhaps the most important function of state and local governments."[385] The unprecedented drop in school districts' revenues, the uneven impact of systemic and situational factors across districts, and the desperate, sometimes haphazard ways in which districts have tried to reduce their expenditures over the past few years do not reflect the importance of education to the Court, to the country's future economic prosperity and civic health, or to the 49 million children who are enrolled in public schools in the United States today.[386] It is not too late to change this, and another education "bailout" is not the answer.

385. Brown v. Bd. of Educ., 347 U.S. 483 (1954).

386. AMBER M. NOEL ET AL., U.S. DEP'T OF EDUC., NCES 2010–309, PUBLIC ELEMENTARY AND SECONDARY SCHOOL STUDENT ENROLLMENT AND STAFF COUNTS FROM THE COMMON CORE OF DATA: SCHOOL YEAR 2007–2008, at 4–5 (2009), *available at* http://nces.ed.gov/pubs2010/2010309.pdf.

APPENDIX

Legal Mechanisms Available for School Districts in Fiscal Crisis

State	Federal bankruptcy available to municipal-ities, including school districts	State receiver-ship available to school districts	State takeover of a school district for fiscal reasons (for academic reasons)	No mechanism available
Alabama	AL ST § 11-81-3; (amendment 2001)		Ala. Code § 16-6B-4 Ala. Code § 16-6B-3	
Alaska			4 AAC 06.840	X
Arizona	A.R.S. § 35-603		A.R.S. § 15-103 & § 15-107	
Arkansas	A.C.A. § 14-74-103		A.C.A. § 6-20-1900-11 A.C.A. § 6-15-403, § 6-15-430 & ADE 162 – see http://www.arkansased.org/pdf/sarg_resource_guide_060909.pdf (refer to section on state directed schools)	
California	West's Ann. Cal. Gov. Code § 53760		Cal. Ed. Code § 1630, 41320, 41326 Cal. Ed. Code § 52055.5 (f) http://www.leginfo.ca.gov/cgi-bin/displaycode	

			?section=edc&group=52001-53000&file=52053-52055.55	
Colorado	C.R.S.A. § 32-1-1402			
Connecticut	C.G.S.A. § 7-566			
Delaware			14 Del.C. § 155 & DE ADC 103 6.0	
Florida	West's F.S.A. § 218.01		West's F.S.A. § 218.503	
Georgia				X
Hawaii				X
Idaho	I.C. § 67-3903		IDAPA 08.02.03.112 & 08.02.03.114 http://adm.idaho.gov/adminrules/rules/idapa08/08index.htm.	
Illinois			105 ILCS 5/1A-8, 1B-1a–1B-22 105 ILCS 5/2-3.25f & 105 ILCS 5/34-1 – 34-1.1 (Chicago Public Schools)	
Indiana			Ind. Code Ann. 20-25-9-4, 20-25-15-1, 20-25-15-2, 20-25-15-3 (applies to Indianapolis Public Schools)	
Iowa			I.C.A. § 256.11 Amendment: 2010 Ia. Legis.	X

			Serv. S.F. 2289 (West)	
Kansas				X
Kentucky	KRS § 66.400	KRS § 162.220	KRS § 158.785, 158.780(1) KRS § 158.6455, 158.780, 158.785 & 703 KAR 3:205, 5:130	
Louisiana	LSA-R.S. 39:619			
Maine			Maine Department of Education Regulation 125, Section 14	X
Maryland			13A.02.07.01–13A.02.07.10 SB 795 (1997) http://mlis.state.md.us/1997rs/billfile/sb0795.htm HB 949 (2002) http://mlis.state.md.us/2002rs/billfile/hb0949.htm & COMAR 13A.01.04.08	
Massachu-setts			M.G.L.A. 69 § 1J, 1K & 603 CMR § 2.01–2.06, 2.03	
Michigan	M.C.L.A. 141.1222		M.C.L.A. § 141.1231–1244[387]	

387. Soon before this Article went to press, Michigan enacted the Local Government and School District Fiscal Accountability Act, MICH. COMP. LAWS § 141.1501–31 (2011). The law is already subject to legal challenge and possibly also a ballot recall initiative. Brayton, *supra* note 323.

			M.C.L.A. 380.372 & 380.371	
Minnesota	M.S.A. § 471.831			
Mississippi			Miss. Code Ann. § 37-17-6, 37-18-7 Amendment: 2010 Miss. Laws Ch. 420 (H.B. 625) & CMSR § 36-000-069	
Missouri	V.A.M.S. 427.100		Mo. Rev. Stat. § 160.720 162.081, 163.023	
Montana	MCA 7-7-132			
Nebraska	Neb.Rev.St. § 13-402			
Nevada			N.R.S. 385.3772, 385.3773	X
New Hampshire				X
New Jersey	N.J.S.A. 52:27-40		N.J.S.A. § 18A: 7A-10, 11; N.J.S.A. § 18A:7A-14, 15, 15.1	
New Mexico			N.M.S.A. § 22-2-2, 22-2-14, 22-2C-7	X
New York	McKinney's Local Finance Law § 85.80 (amended, 2009 Sess. Law News		N.Y. Educ. Law § 2590-h & 8 NYCRR § 100.2	

	of N.Y. Ch 494 (S. 66002)).			
North Carolina	N.C.G.S.A. § 23-48		N.C.G.S.A. § 115C-447, 4514; N.C.G.S.A. § 115C-105.39, § 115C-325, § 115C-105.37	
North Dakota				X
Ohio	R.C. § 133.36		R.C. § 3316.03–.05 R.C. § 3302.04, § 3302.03, § 3302.041, § 3302.10	
Oklahoma	62 Okl.St.Ann § 281		70 Okl.St.Ann. § 1210.541	
Oregon				X
Pennsylva-nia	53 P.S. § 11701.261	24 P.S. § 791.7	24 P.S. § 6-691–697 24 P.S. § 17-1701-B–§ 17-1716-B	
Rhode Island			R.I. Gen. Laws § 16-7.1-5	X
South Carolina	Code 1976 § 6-1-10		Code 1976 § 59-1A8-1570	
South Dakota				X
Tennessee			T.C.A. § 49-1-601–§ 49-1-602	X
Texas	V.T.C.A., Local Government Code § 140.001		Tex. Educ. Code § 39.102	
Utah				X
Vermont			16 V.S.A.	X

			§ 165	
Virginia				X
Washington	West's RWCA 39.64.040			
West Virginia			W. Va. Code, § 18-2E-5 & W. Va. Code State R. 126-13-1 thru 126-13-12	
Wisconsin			Wis. Stat. Ann. 118.42	X
Wyoming				X
TOTAL	24	2	17[388]/29 (only academic, not fiscal: 16) (total: 33)	19

388. This number does not include Connecticut, which passed special legislation declaring the Hartford School District to be in a state of emergency and authorizing a comprehensive takeover by the state. Special Act 97-4 (1997 Regular Session).