

January 23, 2014

Hon. Kamala D. Harris  
Attorney General  
1300 I Street, 17<sup>th</sup> Floor  
Sacramento, California 95814

Attention: Ms. Ashley Johansson  
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed the proposed statutory initiative relating to charter schools (A.G. File No. 13-0056).

## BACKGROUND

### Charter Schools in California

*California Law Allows for Charter Schools.* Charter schools are publicly funded elementary and secondary schools. Charter schools are exempt from many state laws and operate under locally developed agreements (or “charters”) that describe their educational programs. In 2012-13, approximately 1,100 charter schools served 460,000 students (8 percent of the state’s public school students).

*All Charter Schools Receive Oversight From an Authorizer.* Every charter school has an authorizer that is responsible for approving the school’s charter. The authorizer monitors the charter school and may close a school that does not adhere to its charter, performs poorly on state measures of academic performance, or violates the law. (To defray the costs of this oversight, the charter school typically pays an annual oversight fee equal to 1 percent of its general purpose revenue.) In most cases, the authorizer is the school district with jurisdiction over the location where the charter school is located. About 110 charter schools, however, are authorized by the county office of education (COE) in the county where the charter school is located. In addition, about 25 charter schools are authorized by the State Board of Education (SBE). These 25 schools receive oversight from the California Department of Education (CDE).

*Charter Schools Can Be Operated in Several Different Ways.* Roughly 40 percent of charter schools operate as independent, stand-alone entities. About one-third of charter schools are operated entirely or in large part by a school district. Another one-quarter of charter schools are members of networks of charter schools that are operated by charter management organizations (CMOs). A CMO can have varying responsibilities, but it typically operates the instructional and administrative services for its member schools. Currently, about 50 CMOs operate in California.

*Some Charter Schools Establish Special Lease-Related Entities.* Some charter schools establish special entities for the purpose of obtaining a school facility lease. These entities own the facility that is subsequently leased to the charter school. Charter schools often establish these entities when they have financial reasons to lease rather than own their facilities directly.

### **Charter Schools Differ From School Districts**

*Charter Schools Differ From School Districts in Various Ways.* Charter schools differ from their school district peers in that they generally are exempt from state education laws, except when explicitly specified otherwise. Below, we describe a few of these differences.

- ***For-Profit and Nonprofit Status.*** Charter schools may operate as nonprofit or for-profit entities. Charter schools operate as nonprofit entities in nearly all cases, but a few charter schools do incorporate as for-profit entities. (Data suggest fewer than ten for-profit charter schools operate statewide.) School districts, by contrast, cannot be operated as for-profit entities.
- ***Collective Bargaining.*** State law allows charter school employees to collectively bargain over wages and other working conditions, but few charter schools have collective bargaining agreements in place. School districts, by contrast, commonly have collective bargaining agreements.
- ***Members of Governing Boards.*** The method of selecting members of a charter school's governing board is determined by the school's charter. In school districts, by contrast, members of the governing board are elected by local voters. An individual who is convicted of certain felony offenses, however, can be disqualified from holding public office and lose the ability to serve on the governing board of a school district. Such an individual is not automatically disqualified from serving on the governing board of a charter school.
- ***Investment of Public Funds.*** Charter schools may deposit or invest the public funds they receive, and state law does not contain specific rules relating to these investments. School districts, by contrast, are legally required to make safeguarding the principal of their funds their primary objective and are generally limited to low- and moderately-low risk investments. (As a practical matter, many districts hold their reserves with other local agencies in low-risk investment pools maintained by their county governments.)

### **Laws Affecting Local Public Agencies**

*Various Laws Govern the Conduct of School Districts and Local Governments.* The Legislature has passed a number of laws to regulate the way local agencies such as cities, counties, and school districts interact with the public. Below, we summarize five of these laws.

- ***Ralph M. Brown Act.*** The Ralph M. Brown Act (“Brown Act”) requires the governing body of a local agency to conduct its activities in open meetings except for situations specifically exempted by law. The agency also must take special steps to facilitate public participation in its meetings, such as: (1) releasing an agenda 72 hours in advance of any meeting; (2) holding meetings only within the boundaries of its jurisdiction; and (3) allowing any member of the public to attend, record, and speak at a meeting.
- ***California Public Records Act.*** The California Public Records Act requires a local agency to disclose any of its records to the public upon request unless the record is specifically exempted by law. The agency may charge a fee for making copies of records but not for researching or responding to a request.
- ***Financial Interest Law.*** California law prohibits the governing board of a local agency from entering into a contract if a member of the governing board has a “financial interest” in the entity receiving the contract. (A board member may not avoid the conflict simply by abstaining from an individual decision.) A financial interest can occur when a board member has a financial relationship with an entity receiving a contract or could personally benefit from that contract. The law has a few exceptions. For example, a contract with a nonprofit entity is permissible even if a board member of the agency also is a board member of the nonprofit entity. The state’s Fair Political Practices Commission (FPPC) investigates violations of this law and provides technical advice.
- ***Political Reform Act.*** The Political Reform Act requires board members and officers of local agencies to file annual statements of economic interest disclosing their sources of income, ownership of real property, investment interests, and other information. The level of disclosure varies according to the responsibilities associated with the position held. To implement these rules, agencies must identify the disclosure requirements for every position covered by the Political Reform Act. The FPPC investigates violations of this law and provides technical advice.
- ***Grand Jury Reviews.*** California law requires the courts in each county to convene panels of citizens known as grand juries. Among other responsibilities, a grand jury may investigate the performance of local agencies. Agencies must provide the records or information the grand jury wishes to review.

***Application of Laws to Charter Schools Is Disputed.*** Although these five laws have been interpreted to include virtually all local agencies, the laws do not explicitly state whether charter schools must follow them. California courts have never ruled directly on whether charter schools are bound by these laws. As a practical matter, some charter schools follow these laws voluntarily or as a condition imposed by their authorizer. Other charter schools do not follow all of these laws or follow only certain provisions of the laws.

## PROPOSAL

### ***Prohibits For-Profit Charter Schools and Certain Contracts With For-Profit Companies.***

The measure prohibits any charter school from operating as a for-profit entity. The measure further prohibits any charter school from contracting with a for-profit entity to “provide instructional services or exercise control over the school’s daily operations.”

***Explicitly Requires Charter Schools to Comply With Certain Laws Applicable to Local Agencies.*** The measure explicitly requires charter schools to comply with the Brown Act, Public Records Act, financial interest law, and Political Reform Act. In addition, the measure explicitly authorizes grand juries to review the records of a charter school. For purposes of the Brown Act, the measure generally requires the governing board of a charter school to hold its meetings in a county where it has a school facility or in a neighboring county that is home to at least 10 percent of the charter school’s students. For purposes of the financial interest law, the measure removes the exception permitting a member of the charter school’s governing board to serve simultaneously as a board member of a nonprofit entity contracting with the charter school. For purposes of the Political Reform Act, the measure requires every member of the charter’s governing board and any superintendent, chief executive, chief financial officer, or other person managing funds on behalf of the charter school to file statements of economic interest at the highest level of disclosure.

***Requires Board Approval and Disclosure for Transactions Larger Than \$10,000.*** The measure requires the governing board of a charter school to approve any contract, loan, lease, or other transaction whose value exceeds \$10,000. In addition, the governing board is required to disclose to the public specific information before approving any such transaction, including: (1) the name of all parties to the transaction, (2) the terms of the transaction, (3) whether the transaction was competitively bid, (4) the extent to which the board determined the transaction was the lowest cost option, (5) the extent to which the board investigated alternative options, and (6) a statement disclosing the name of any charter school official or employee with a financial interest in the transaction. The requirements for board approval and disclosure would extend to the hiring of an employee above the \$10,000 threshold, except that the hiring of an individual for a position covered by a collective bargaining agreement is specifically exempted.

***Sets Limits on Investment of Public Funds.*** The measure requires charter schools to deposit or invest public funds only in (1) federally insured accounts; (2) bonds and other obligations issued by the United States government or its agencies; (3) bonds and other obligations issued by the state of California; (4) bonds and other obligations issued by certain local agencies within California, including counties, cities, school districts, and water districts; and (5) investment certificates issued by federally insured savings and loan associations.

***Requires Online Posting of Information.*** The measure requires a charter school to post several documents on its website or the website of its authorizer. These documents include: (1) the charter under which the school operates, (2) the articles of incorporation and bylaws of the charter school, (3) the individual conflict of interest forms required by the Political Reform Act, and (4) a list of all individuals who within the past two years have served as board members or designated senior employees of the charter school and the compensation received by those board members and employees.

***Disqualifies Charter School Board Members Who Also Are Disqualified for Public Office.***

The measure provides that any individual who is disqualified from holding a public office also is disqualified from serving on the governing board of a charter school.

***Extends All Changes to CMOs and Leasing-Related Entities.*** The measure extends all of its provisions to CMOs and leasing-related entities. (Since CMOs and leasing-related entities are currently not defined by state law, the scope of this provision would depend upon how subsequent regulations or the courts defined these entities.)

## **FISCAL EFFECTS**

This measure would have several fiscal effects on state and local governments. The largest effect would be on charter schools, though the measure also would create additional costs for charter school authorizers and two state agencies.

***New Costs for Charter Schools.*** We estimate this measure would create additional costs for an average charter school of several thousand dollars annually. With about 1,100 charter schools in California, these costs would result in statewide costs of several million dollars annually. Below, we discuss new costs for charter schools generated by the measure.

- ***Legal Counsel and Training.*** Charter schools would need to obtain additional legal counsel and training to comply with the terms of this measure. These costs would include training board members and officers to review the school's operations for compliance with the laws explicitly applied to charter schools (to the extent the charter school is not already complying with these laws). Additional costs would be associated with legal review of contracts, transactions, and investments to ensure the prohibitions and requirements contained in this measure are satisfied. For example, a charter school with a leasing-related entity would need to ensure its lease agreement conformed with the financial interest law. On average, each charter school likely would require a few dozen additional hours of legal counsel and training per year.
- ***Transaction Disclosures.*** Additional staff hours would be needed to prepare the required disclosures for transactions greater than \$10,000. Since charter schools commonly make annual decisions about the staff they hire, facilities they rent, and services they purchase, on average each charter school likely would need to prepare a few dozen of these disclosures annually.
- ***Posting Documents Online.*** Additional staff hours would be required to post documents online. Since a school's charter, bylaws, list of officers, and other required documents can change throughout the year, on average each charter school likely would need to compile updated documents and post them on its website several times per year.

***Two Other Provisions Could Create Costs for Charter Schools.*** In addition to the three costs described previously, this measure could create additional costs for charter schools in two other ways. We describe these costs in greater detail below and explain why they cannot be easily estimated.

- ***Fewer Options for Contracting.*** By prohibiting charter schools from contracting with for-profit companies for instructional services, the measure would reduce the options for charter schools to purchase certain services. The exact fiscal effect would depend on whether the measure is interpreted broadly or narrowly and the number of contracts affected. For example, some charter schools currently purchase learning software from for-profit companies. If the measure were interpreted broadly, these contracts likely would be disallowed. If interpreted narrowly, these contracts might be unaffected by the measure.
- ***Lower Investment Returns in the Long Run.*** The investment options allowed by this measure tend to be very low-risk, since all the options are federally insured or backed by federal, state, or local authorities. Low-risk investments are safer than alternative investments yet tend to have lower rates of return over the long run. The exact effect on a charter school would depend on the rates of return the charter school receives from the allowable investments relative to other investments it might have made.

***Additional Costs for Charter School Authorizers.*** By requiring charter schools to comply with additional laws, this measure also would create additional costs for authorizers to carry out their oversight functions. Some of these costs would be due to additional monitoring of the charter school. For example, the authorizer might need to check a charter school's website to see if the required documents were posted. The authorizer also might receive additional complaints if a charter school failed to follow the provisions of this measure. The authorizer could incur costs to investigate these complaints and take the appropriate response, such as requiring the charter school to correct a violation or—for more serious violations—taking action to close the charter school. The additional actions taken in response to this measure likely would represent a minor increase statewide in existing oversight duties, perhaps in the range of tens of thousands of dollars to low hundreds of thousands of dollars per year.

***Additional Costs for Two State Agencies.*** The measure could result in minor cost increases for the FPPC and CDE. By specifically requiring all charter schools—including all CMOs and leasing-related entities—to comply with the financial interest law and Political Reform Act, FPPC likely would need to provide additional technical advice and investigate additional violations of the laws. The CDE could experience higher costs associated with monitoring the charter schools authorized by the SBE. The additional workload for both agencies likely could be managed with a few additional staff at a cost of a few hundred thousand dollars annually.

### **Summary of Fiscal Effects**

We estimate the measure would have the following fiscal effects:

- Costs to charter schools, of at least several million dollars annually statewide, to undertake additional legal, financial, and disclosure-related work.
- Minor annual costs to school districts, county offices of education, and two state agencies to provide additional oversight and assistance to charter schools.

Sincerely,

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Mac Taylor  
Legislative Analyst

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Michael Cohen  
Director of Finance