

SENATE BILL REPORT

SHB 1431

As Reported by Senate Committee On:
Early Learning & K-12 Education, March 23, 2011
Ways & Means, April 1, 2011

Title: An act relating to addressing financial insolvency of school districts.

Brief Description: Addressing financial insolvency of school districts.

Sponsors: House Committee on Education (originally sponsored by Representatives Anderson and Haigh).

Brief History: Passed House: 3/04/11, 97-0.

Committee Activity: Early Learning & K-12 Education: 3/16/11, 3/23/11 [DP-WM].
Ways & Means: 3/29/11, 4/01/11 [DPA].

SENATE COMMITTEE ON EARLY LEARNING & K-12 EDUCATION

Majority Report: Do pass and be referred to Committee on Ways & Means.

Signed by Senators McAuliffe, Chair; Harper, Vice Chair; Litzow, Ranking Minority Member; Eide, Fain, Hill, Hobbs, King, Nelson, Rockefeller and Tom.

Staff: Juliana Roe (786-7438)

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: Do pass as amended.

Signed by Senators Murray, Chair; Kilmer, Vice Chair, Capital Budget Chair; Zarelli, Ranking Minority Member; Parlette, Ranking Minority Member Capital; Baumgartner, Baxter, Brown, Conway, Fraser, Hewitt, Holmquist Newbry, Honeyford, Kastama, Keiser, Pflug, Pridemore, Regala, Rockefeller and Schoesler.

Staff: Elise Greef (786-7708)

Background: After experiencing severe financial problems, Vader School District No. 18 (Vader) was dissolved and annexed to Castle Rock School District No. 401 in 2007. Prior to that event, it had been almost 25 years since the last school consolidation in Washington took place. In November of 2009, Jon Molohon, Educational Service District (ESD) 113 Assistant Superintendent for Fiscal Services, ESD Fiscal Officer, and the Administrator of Vader

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Binding Conditions, published a report about the process, *The Vader School District Closing In Retrospect*. Primarily, the report identifies and makes recommendations to address the lack of a clear legal framework and process for dissolving a school district for financial reasons, including the lack of clear legal authority for the Office of the Superintendent of Public Instruction (OSPI) or an ESD Regional Committee to determine and manage the myriad financial and practical issues that such an event presents.

Current laws emphasize voluntary and negotiated reorganization of school districts:

- Boundary changes and consolidations can be initiated by agreement between the school boards of the affected districts, or by a petition from one board or a group of citizens.
- If a petitioned district does not agree with the proposed change, a Regional Committee appointed by ESD has decision-making authority.
- Consolidations and transfers of territory that affect 10 percent or more of the student population require voter approval.
- Regional Committee decisions can be appealed.

After a reorganization, the Regional Committee is charged with the reallocation of assets and liabilities, including levies and bonded indebtedness. A new district can result from a consolidation or reorganization of all, or parts of two or more, current districts, but not a division of a single current district into separate ones.

There are only two references to dissolution of a district

1. School district boundaries may be altered by the dissolution and annexation to an existing district of a part or all of another district.
2. A Regional Committee is required to dissolve any school district that, in the prior year:
 - a. has an annual enrollment of fewer than five K-8 students; or
 - b. has not made a reasonable effort to provide the minimum 180-day school year.

No statutes provide for dissolution of a school district in any other fashion or for any other reason. The dissolution of Vader occurred under the second of the two laws referenced above, but only because the district agreed not to make up some days missed in the prior year due to an emergency closure in order to fall under the provisions of this statute.

School districts must annually submit a budget to OSPI when expected expenditures for the upcoming school year do not exceed expected revenues from all sources. If a school district cannot submit a balanced budget, it can petition OSPI to be allowed to include revenues from a future school year, in effect to borrow against future state apportionment payments, only if the district agrees to certain binding conditions that are intended to improve the district's financial condition.

There are nine ESDs in the state. The ESD Financial Officer for ESD in which the school district is located is assigned to be the administrator of the binding conditions. This role has limited authority and primarily serves as a consultant to the school district for how to improve their financial situation. The presence of a third party, even if somewhat symbolic, acts as a motivating factor for districts and their boards. According to a Joint Legislative Audit and Review Committee analysis, there have been 12 districts in binding conditions at

some point over the last ten years. Most resolve their finances in one to two years. All but two of these districts have had fewer than 2000 students.

The recommendations made in the Vader report can be summarized as follows:

1. authorize OSPI or a school district to initiate the dissolution of a district due to financial insolvency and authorize the Regional Committee to make the determination and oversee the dissolution;
2. address various financial and legal issues associated with dissolution, including determining what is the appropriate length of time to permit a district to solve its own problems without outside intervention; and
3. make technical amendments to other laws dealing with district reorganization, including, but not limited, to dissolution of a district.

Summary of Bill (Recommended Amendments): The Superintendent of Public Instruction (SPI) must convene ESDs to analyze options and make recommendations for a clear legal framework and process for the dissolution of a school district on the basis of financial insolvency. The analysis must include:

- a definition of financial insolvency;
- a timeframe, criteria, and process for initiating dissolution of a district;
- roles and responsibilities of various entities, including OSPI, ESDs, and regional committees on school district organization; and
- recommendations with respect to various issues such as terminating staff contracts, liquidation of liabilities, and dealing with bonded indebtedness.

In conducting the analysis, ESDs must consult with individuals with legal and financial expertise. ESDs may recommend a financial early warning system for consistent, early identification of school districts with potential fiscal difficulties. The recommendations must address amendments to current law as well as propose new laws as necessary.

The SPI must submit a final report and recommendations to the Governor and the fiscal committees of the Legislature, which are due January 5, 2012.

The bill is null and void unless funded in the budget.

EFFECT OF CHANGES MADE BY WAYS & MEANS COMMITTEE (Recommended Amendments): The SPI must convene the ESDs to come up with a legal framework and process for dissolution.

The SPI must submit a final report rather than the ESDs.

Appropriation: None.

Fiscal Note: Available.

Committee/Commission/Task Force Created: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony on Substitute House Bill (Early Learning & K-12 Education): PRO: This bill came about because a district went bankrupt. In the process that followed, it was clear that the state's laws were at best a legal spaghetti ball. This bill takes the recommendations from Vader's report and implements them. This bill is important because people need a clear outline as to what will happen if another school district faces bankruptcy.

There is a great deal of uncertainty of what will be left after this legislative session. The ESDs are the appropriate persons to study this issue because their role in the school districts is deeper than that of OSPI. There are some challenges with school funding. It is likely that there may be more districts than we're comfortable with that may be pushed to financial insolvency. If it does occur, this bill will provide a clear recourse.

Persons Testifying (Early Learning & K-12 Education): PRO: Representative Anderson, prime sponsor; Dan Steele, Washington Association of School Administrators.

Staff Summary of Public Testimony on Substitute House Bill (Ways & Means): PRO: The experience of the Vader School District dissolution taught us that a clear legal framework and guidance for the process is needed. Though we all hope to avoid this situation, if it occurs the people involved and the communities deserve a process that is prompt and efficient. These are traumatic circumstances and shouldn't be prolonged for lack of clear procedures. There's currently no real process to facilitate the dissolution of a school district for reasons of insolvency. The Vader situation was certainly unique but, given current fiscal circumstances, we're concerned there will be more school districts in this circumstance in the next few years. The ESDs do good work but they are taking cuts, as is everyone else, and if the bill goes forward we urge you to include funding support for the task. Superintendent Dorn supports the legislation. Currently, the laws around dissolution of school districts are muddled, and we believe this effort will rectify that. We have two friendly amendments to which the prime sponsor and the ESDs are agreeable. The first would have the OSPI convene the group, and the second would have OSPI issue the final report.

Persons Testifying (Ways & Means): PRO: Representative Anderson, prime sponsor; Dan Steele, Washington Association of School Administrators; Bob Butts, OSPI.