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## KANSAS SUPREME COURT'S FOURTH OPINION IN *GANNON V. STATE* SECOND OPINION ON ADEQUACY

The Kansas Supreme Court issued its fourth opinion in *Gannon v. State* on Thursday, March 2, 2017. The primary legal issues in the *Gannon* litigation are the constitutional equity and adequacy of K-12 public education funding. In the fourth opinion, the Court held the financing system is constitutionally inadequate, retained jurisdiction, and continued the stay of the three-judge panel's order and its own mandate to give the Legislature an opportunity to bring the State's education financing system into compliance with Article 6, Section 6 of the *Kansas Constitution* by June 30, 2017. This memorandum summarizes the procedural history of *Gannon*, the Supreme Court's March 2017 opinion, and legislative action following *Gannon I, II, III*, and the December 2014 opinion of the three-judge panel.

*Note: This memorandum is not intended to be a full legal analysis of the March 2, 2017, Supreme Court decision, but rather a summary discussion of important points of the decision in the context of broader school finance policy in Kansas. A full legal analysis of the panel's decision will be provided at a later date by the Revisor of Statutes.*

### Procedural History

In November 2010, plaintiff school districts filed suit alleging the Legislature had failed to adequately fund K-12 education. Since FY 2009, each district lost funding due to reductions in base state aid per pupil (BSAPP), the withholding of Capital Outlay State Aid, and the proration of Supplemental General State Aid (Local Option Budget [LOB] State Aid). A three-judge panel conducted a trial in Shawnee County District Court in June 2012 and, on January 10, 2013, ruled the amount of funding appropriated was constitutionally inadequate under Article 6, Section 6 of the *Kansas Constitution*. In relevant part, Article 6 requires the Legislature to "make suitable provision for finance of the educational interests of the state." Further, the panel held the nonappropriation of Capital Outlay State Aid resulted in an unconstitutional, wealth-based distribution of capital outlay funds, and the proration of LOB State Aid created unconstitutional, wealth-based disparities among districts.

The Kansas Supreme Court issued its first opinion in the case (*Gannon I*) in March 2014 and provided the following test for equity: "School districts must have reasonably equal access to substantially similar educational opportunity through similar tax effort." Further, the Court stated adequacy would be achieved when the school finance system is reasonably calculated to have all Kansas public education students meet or exceed the capacities set out in *Rose v. Council for Better Educ., Inc.*, 790 S.W.2d 186 (Ky. 1989), including sufficient oral and written communication skills; knowledge of economic, social, and political systems; understanding of governmental processes; self knowledge and knowledge of one's mental and physical wellness;

grounding in the arts; training or preparation for advanced training in either academic or vocational fields; and academic or vocational skills that enable favorable competition in academics or the job market.

Soon after *Gannon I*, the Legislature enacted 2014 Senate Sub. for HB 2506, which provided additional LOB and Capital Outlay funds and required the State Board of Education (the Board) to design subjects and areas of instruction to achieve the goal of providing every child with at least the seven *Rose* capacities. The three-judge panel found this legislation brought the State into compliance with the Supreme Court's order concerning equity but did not dismiss the issue. Additionally, it found the existing school finance formula, the School District Finance and Quality Performance Act (SDFQPA) was basically sound but actual funding of the formula was not. The 2015 Legislature subsequently enacted 2015 House Sub. for SB 7 (SB 7), which repealed the SDFQPA and replaced it with a 2-year block grant of funding.

On remand, the three-judge panel found SB 7 to be unconstitutional and held it “does nothing to alleviate the unconstitutional inadequacy of funding . . . but, rather, exacerbates it.” *Gannon II*, issued in February 2016, affirmed that SB 7 failed to cure inequities in the school finance system, continued the stay of the panel's order, and ordered the State to satisfactorily demonstrate the Legislature has complied with the equity standard by June 30, 2016. The opinion provided that if the State was unable to demonstrate compliance with that standard, the Court would lift its stay, invalidating the current school finance system. Without a constitutionally equitable school finance system, the schools in Kansas would not be able to operate beyond June 30. The Supreme Court also stayed the adequacy portion of the appeal. The 2016 Legislature enacted 2016 Senate Sub. for HB 2655 (HB 2655) in response.

*Gannon III*, issued in May 2016, found that, although HB 2655 did remedy constitutional infirmities related to Capital Outlay State Aid, the LOB State Aid funding mechanism was unconstitutional, and use of “hold harmless” funds and the Extraordinary Need Fund was insufficient to mitigate LOB inequities. The Court found the unconstitutional provisions of HB 2655 could not be severed from SB 7, and Kansas schools could not operate without a valid school finance system. The Court continued its earlier stay until June 30, 2016, to minimize the threat of disruptions in education funding. On June 28, the Court found 2016 Special Session HB 2001 brought the Legislature into compliance and retained jurisdiction over the issue. The Kansas Supreme Court heard oral arguments on adequacy on September 21, 2016.

#### ***Gannon IV (March 2, 2017) – Adequacy Part 2***

The Kansas Supreme Court affirmed the three-judge panel's holding that the financing system is constitutionally inadequate as it is not reasonably calculated to have all Kansas public education students meet or exceed the capacities set out in *Rose*. Specifically, the Court found the block grant system created by SB 7 freezes school districts' funding for two school years at a prior year's level and only minimally responds to financially important changing conditions such as increased enrollment. Further, the Court held SB 7 does not meet the implementation requirement for adequacy as evidence provided by the plaintiffs shows the State is failing to provide approximately one-fourth of students with the basic skills of both reading and math and leaving behind significant groups of harder-to-educate students. Additionally, the Court stated plaintiffs have proven student performance reflected in the data is related to funding.

The Court retained jurisdiction and continued the stay of the three-judge panel's order and its own mandate to give the Legislature an opportunity to bring the state's education

financing system into compliance with Article 6, Section 6 of the *Kansas Constitution*. The Court called for the State to satisfactorily demonstrate by June 30, 2017, that its proposed remedy is reasonably calculated to address constitutional violations identified in this opinion and comports with previously identified constitutional mandates, such as equity. The State will bear the burden of establishing compliance and explaining its rationales for the choices made to achieve it.

### ***Adequacy***

The standard for adequacy provided in *Gannon I* states Article 6, Section 6 contains minimum standards of adequacy that are met when the K-12 financing system provided by the Legislature, through structure and implementation, is reasonably calculated to have all Kansas public education students meet or exceed the *Rose* standards. While the Court rejected the State's argument that it should give "virtually conclusive deference" to the Legislature in reviewing legislative compliance with Article 6, it acknowledged the Legislature's considerable discretion in satisfying the requirements. Nevertheless, the Court found the panel's findings of fact were supported by substantial competent evidence, the panel applied the correct standard, and the State has not met the constitutional requirement of adequacy.

### ***Structure***

The Court found SB 7 fails to meet constitutional requirements in terms of structure. The Court found the block grant is not a financing system, but rather a stopgap measure, which freezes school districts' funding for two school years at a prior year's level and only minimally responds to financially important changing conditions such as increased enrollment.

### ***Implementation***

In its analysis of implementation of the block grant, the Court looked to both inputs and outputs and reviewed the evidence considered by the three-judge panel. The Court discussed the panel's consideration and rejection of some sources of funding, including LOB, federal funds, and contributions to the Kansas Public Employees Retirement System (KPERs), and stated these sources, and their relevant limitations, should have been considered as part of the panel's adequacy analysis, even if ultimately they were determined to have insufficient impact on the *Rose* standards to offset other problems created by SB 7. The Court also recognized the panel's consideration of reductions in the BSAPP and cost studies should be considered in context as "total spending is not the touchstone for adequacy." However, the Court acknowledged the panel considered the effects limitations on funding had on actual resources and found demands on schools increased, while available resources declined. Among other factors, the Supreme Court highlighted impacts on services and opportunities directly beneficial to the achievement of the *Rose* standards such as all-day kindergarten; before and after school programs; extracurricular activities such as speech, debate, band, and orchestra; smaller class sizes; technology and vocational studies; professional development; employment of non-teaching staff, including librarians, paraprofessionals, and counselors; and the employment of qualified teachers.

Considering outputs, the Court determined substantial competent evidence supported the panel's finding of a correlation between funding and student achievement, including facts demonstrating student achievement rose when funding increased and a 2006 cost study by the Legislative Division of Post Audit that found a 1 percent increase in student performance was

associated with a 0.83 percent increase in spending. While the State argued outputs are most important when looking at adequacy, the Court noted that outputs such as student achievement scores on standardized tests have declined as cuts to BSAPP occurred, which suggests consideration of funding in relation to these outputs is appropriate. While the Court noted some “frailties” in the panel’s analysis, its authority to review the evidence and law without deference to the trial court “severely dilutes, if not eliminates, the importance of the panel’s consideration, or refusal to accept, some of these factors about which the State objects.” It then reviewed output data at length, including test scores, college-entrance exam scores, and graduation rates, and ultimately found, at a minimum, the results on various standardized tests reveal that an achievement or proficiency gap exists between all students and certain subgroups, and the number of all students failing to reach proficiency in core subjects each year continues to be significant.

Based upon demonstrated inputs and outputs, the Court independently concluded as a matter of law that, through its structure and implementation, SB 7 is not reasonably calculated to have all Kansas K-12 public students meet or exceed the *Rose* standards, even considering all sources of funding that the panel either disallowed or heavily discounted. Further, it agreed with the panel’s conclusion that more funding was needed to meet the *Rose* standards.

### ***Other Issues***

As preliminary issues, the Supreme Court held it did have jurisdiction to consider the case, the plaintiffs’ claims were justiciable, the three-judge panel did not abuse its discretion in not reopening the record on remand and did not err in taking judicial notice of assessment results, and the panel’s December 2014 order sufficiently reflected the factual determining and reasoning processes through which the decision had actually been reached. Additionally, the Court addressed issues related to attorney fees.

### ***Remedies***

The Supreme Court stated there is no one way to constitutionally fund K-12 public education and rejected the idea of a litmus test that relies on a specific funding level to reach constitutional compliance. Further, while acknowledging the cost studies are estimates, the Court stated they represent evaluations it cannot simply disregard, and the State should not ignore them in creating a remedy. The Court directed the Legislature to focus on creating a K-12 financing system that through structure and implementation is reasonably calculated to have all Kansas public education students meet or exceed the *Rose* standards and to be mindful of the connection between equity and adequacy. Further, the Court reiterated the *Rose* standards are minimal standards and the Legislature may exceed those standards.

The Court retained jurisdiction and continued the stay of the three-judge panel’s order and its own mandate to give the Legislature an opportunity to bring the state’s education financing system into compliance with the *Kansas Constitution*. The Court called for the State to satisfactorily demonstrate compliance by June 30, 2017, after which time a lifting of the stay would mean the State’s education financing system is unconstitutionally invalid and therefore void. The Court expressed its confidence in the State’s ability to reach compliance by that date based on the Legislature’s history of acting to cure infirmities and the long-scheduled expiration of the block grant on June 30, 2017.

## Legislative Action

Four bills since 2014 have addressed amounts of funding for public K-12 education.

### **2014 Senate Sub. for HB 2506**

HB 2506 appropriated an additional \$109.3 million for LOB State Aid and made a revenue transfer of \$25.2 million to the Capital Outlay Fund from the State General Fund (SGF). Additionally, the bill stated the purpose and intention of the Legislature is to provide a K-12 funding system that provides students with the seven *Rose* capacities and required the funding system to be sufficiently flexible for the Legislature to consider and use financing methods from all available resources, including:

- Federal funding to school districts or schools;
- State moneys appropriated for the improvement of public education (the bill included a list of examples of such state funding sources);
- Any provision authorizing local tax levies for school funding purposes; or
- Any transfer of funds or appropriations from one object or fund to another approved for the purpose of funding public schools.

Further, the bill revised KSA 2013 Supp. 72-1127, concerning subjects and areas of instruction, to eliminate a set of goals similar, but not identical, to the *Rose* capacities, and replace these goals with the exact language of the *Rose* capacities. The revised language states the Board must design subjects and areas of instruction to achieve the goal established by the Legislature of providing every child with at least the seven *Rose* capacities.

### **2015 House Sub. for SB 7**

SB 7 made appropriations for K-12 education for fiscal years (FYs) 2015, 2016, and 2017. The bill also repealed the SDFQPA and created the Classroom Learning Assurance Student Success (CLASS) Act. Subsequent legislation amended SB 7.

### ***Components of the Block Grant for FYs 2016 and 2017***

The block grant includes:

- General State Aid school districts are entitled to receive for school year 2014-15, as adjusted by virtual school state aid calculations (described below) and a 0.4 percent reduction for an Extraordinary Need Fund (ENF);
- LOB State Aid and Capital Outlay State Aid as adjusted in 2014-15 (adjustment described below);

- Virtual School State Aid as recalculated for FYs 2016 and 2017 (described below);
- Amounts attributable to the tax proceeds collected by school districts for the ancillary school facilities tax levy, the cost of living tax levy, and the declining enrollment tax levy; and
- KPERS employer obligations, as certified by KPERS.

General State Aid for school year 2014-15 was adjusted to account for consolidated school districts. Adjustments also were made in all school years to ensure districts eligible for the new facilities weighting receive that weighting.

- General State Aid will be disbursed to districts in the same manner as under prior law.
- ENF. For FYs 2016 and 2017, 0.4 percent of General State Aid will be transferred to the ENF. Any unencumbered funds remaining in this Fund at the end of the fiscal year will be transferred back to the State General Fund (SGF). Districts could apply to the State Finance Council for payments from this Fund. (2016 HB 2655 moved authority to review and decide upon applications to the State Board of Education.) In reviewing a district's application for payment from the Fund, the bill provided the Finance Council would consider:
  - Any extraordinary increase in enrollment;
  - Any extraordinary decrease in the district's assessed valuation; and
  - Any other unforeseen acts or circumstances substantially impacting a district's general fund.

#### *Recalculation of LOB State Aid*

LOB State Aid is recalculated based on quintiles below the 81.2 percentile of school districts' assessed valuation per pupil (AVPP) in school year 2014-15 and capped at that amount for subsequent school years with gradations as follows based on AVPP, beginning with the districts with the lowest AVPP. (Each quintile equals about 46 school districts.)

- Lowest quintile – 97 percent of LOB State Aid;
- Second lowest quintile – 95 percent of LOB State Aid;
- Middle quintile – 92 percent of LOB State Aid;
- Second highest quintile – 82 percent of LOB State Aid; and
- Highest quintile – 72 percent of LOB State Aid.

Districts continue to be authorized to adopt a LOB and levy a property tax in an amount not to exceed the LOB of the district in school year 2014-15, unless the district approved a higher amount for school year 2015-16 prior to July 1, 2015.

### *Recalculation of Capital Outlay State Aid*

The state aid percentage begins at 75 percent for the district with the lowest AVPP and decreases by 1 percent for each \$1,000 incremental increase in AVPP.

### *Bond and Interest State Aid*

The bill amended the calculation of state aid for general obligation bonds approved for issuance at an election held on or after July 1, 2015, using the same formula as the amended Capital Outlay State Aid formula.

### *Virtual School State Aid*

In school year 2014-15, there was no change in the calculation of Virtual School State Aid.

In school year 2015-16, funding for full-time equivalent students was calculated at \$5,000 per student; part-time students, \$4,045 per student; and students 19 and older, \$933 per 1-hour credit course successfully completed in the school year.

In school year 2016-17, funding for full-time equivalent students will be calculated at \$5,600 per student; part-time students, \$1,700 per student; and students 19 and older, \$933 per 1-hour credit course successfully completed in the school year.

A virtual student must reside in-state for the district to receive state aid for the student.

### *Special Levies*

Districts are authorized to impose special local tax levies (for ancillary facilities, cost of living, and declining enrollment), if the district levied such tax in school year 2014-15 or if the district is qualified to levy such tax under law unchanged by the bill.

### *Fund Flexibility*

Districts have fund flexibility at the district level; that is, funds can be transferred to the general fund of the district with no cap on the amount of the transfer. Excluded from this flexibility are three funds: bond and interest, special education, and the special retirement contributions fund.

### *Other Provisions*

The bill used the AVPP for school year 2015-2016 (instead of the 2014-2015 school year) for the purpose of determining LOB State Aid for any district if the district had a total assessed valuation for school year 2015-2016 less than the assessed valuation in the 2014-2015 school year; the difference in assessed valuation between the 2014-2015 school year and 2015-2016 is greater than 25 percent; and having such reduction be the direct result of the classification of tangible personal property by 2014 legislation changing the tax classification of

commercial and industrial machinery used directly in the manufacture of cement, lime, or similar products.

### **2016 Senate Sub. for HB 2655**

HB 2655 altered statutory formulas for providing LOB State Aid and Capital Outlay State Aid for FY 2017; amended law related to the ENF; provided for School District Equalization State Aid; changed a non-severability provision to a severability provision; and amended law related to ancillary school facilities state aid. The bill made necessary appropriations for the statutory changes in the bill.

#### *Appropriations*

The bill appropriated \$367,582,721 for LOB State Aid, \$50,780,296 for Capital Outlay State Aid, and \$61,792,947 for School District Equalization State Aid. The bill also changed the appropriation for the ENF from \$17,521,425 to \$15,167,962, and lapsed \$477,802,500 from the block grants to unified school districts for fiscal year 2017. The bill also provided that, if the appropriated amounts for LOB State Aid or Capital Outlay State Aid are not sufficient to fund the statutory requirements for those two categories of aid, the amount of money necessary to satisfy such statutory requirements shall be transferred out of the ENF.

#### *LOB State Aid*

The bill revised the amount of LOB State Aid provided by SB 7 by adopting a new formula for determining the amount of LOB State Aid. Under the new formula, a school district's LOB State Aid is determined by multiplying the school district's local option budget by an equalization factor. The equalization factor is determined by arranging the AVPP of all school districts from largest to smallest, rounding the AVPPs to the nearest \$1,000 and identifying the median. The equalization factor of the median is 25 percent. For every \$1,000 a school district's AVPP is above the median, the school district's equalization factor is reduced from 25 percent by 1 percent and for every \$1,000 a school district's AVPP is below the median, the school district's equalization factor is increased from 25 percent by 1 percent.

#### *Capital Outlay State Aid*

The bill reinstated the Capital Outlay State Aid formula in effect prior to passage of SB 7.

#### *ENF*

The bill also moved the authority to review and decide upon applications for ENF funding from the State Finance Council to the Board, while adding school finance equity as a factor for the Board to consider in evaluating such applications.



### *School District Equalization State Aid*

The bill provided funds to school districts if the changes to LOB State Aid or Capital Outlay State Aid in the bill resulted in the school districts being entitled to less state aid than under prior law.

### *Severability*

The bill changed the non-severability provision in SB 7 to a provision specifically allowing the provisions of the CLASS Act to be severed and for the provisions of the bill to be severed.

### *Ancillary School Facilities*

The bill also amended statutes related to the authority of a school district to levy a tax for the purpose of financing costs incurred that are directly attributable to ancillary school facilities. The bill allowed the levying of the tax for the operation of a school facility whose construction was financed by the issuance of bonds approved for issuance at an election held on or before June 30, 2016.

### ***2016 Special Session Sub. for HB 2001***

Sub. for HB 2001 altered the statutory formula for providing LOB State Aid for FY 2017 and amended laws related to virtual school state aid, the ENF, hold-harmless funding under HB 2655, and federal funding for certain pre-kindergarten programs. The bill also amended law related to the sale of the Kansas Bioscience Authority (KBA).

### *Appropriations*

The bill appropriated \$99,408,027 for LOB State Aid. The bill also changed the appropriation from the SGF to the ENF to \$8.0 million and transferred \$5.0 million from the State Highway Fund to the ENF. The bill lapsed \$61,792,947 of School District Equalization State Aid and \$2.8 million from the block grant to school districts.

The bill lapsed \$4.1 million of the appropriation for the Children's Initiatives Fund (CIF) and transferred \$4.1 million from the CIF to the SGF. It also directed the Department for Children and Families to expend \$4.1 million from the Temporary Assistance for Needy Families Fund for the purpose of providing additional funding for programs provided by the Kansas State Department of Education (KSDE).

### *LOB State Aid*

The bill reinstated the LOB State Aid formula in effect prior to enactment of SB 7.

### *Virtual School State Aid*

The bill changed the amount school districts receive for each full-time virtual school student for FY 2017 from \$5,600 to \$5,000.

### *Extraordinary Need Fund*

The bill allowed the KSDE to accept applications to the ENF and approve them, if the proceeds of the KBA sale or merger are at least \$38.0 million. However, no moneys may be expended from that fund in FY 2017 until the sale or merger of the KBA is complete. If the proceeds of the sale or merger of the KBA are less than \$38.0 million, then the amount of money appropriated to the ENF will be reduced by the amount of the shortfall. [The sale of the KBA did not yield sufficient funds for any ENF appropriations.]

### *Sale of the KBA*

The bill provided that any proceeds of the sale of the KBA in excess of \$25.0 million but less than \$38.0 million will be deposited in the SGF.

### *Other Provisions*

The bill eliminated the School District Equalization State Aid provisions created in HB 2655 and included a severability clause.