



Funding Issues and Lawsuits

Updated June 20, 2016

The following lawsuits and funding issues highlight possible topics the legislature may focus on during the upcoming session. Recent court cases include:

- [A Supreme Court of Texas finding that the state’s school finance system is constitutional,](#)
- [A costly overhaul of the foster care system that was mandated by the U.S. District Court Southern District of Texas.](#)
- [A case in the Texas Third Court of Appeals brought by AMC movie theaters regarding the definition of “cost of goods sold,”](#) and
- [A pending decision in the Texas Supreme Court on whether certain oil and gas production equipment is exempt from sales taxes.](#)

One ongoing funding issue that may arise during session is that of rising premiums for teachers under state-run health insurance plans.

Issue	Expected Action (date)	Estimated Impact (Cost)
Foster care system overhaul	Began April 2016	\$100 million per year
Exempt oil and gas equipment	Texas Supreme Court decision pending, but expected in 2016 Update: On June 17, 2016, the Texas Supreme Court rejected the argument for the exemption of certain oil/gas equipment.	\$4.4 billion in refund filings for 2017; \$500 million per year after 2017
AMC “cost of goods sold” definition	Texas Third Court of Appeals decision pending, but expected after 2017	\$6 billion in initial refunds and \$1.5 billion per year after in lost collections

House Speaker Joe Straus recently charged the Committee on Appropriations and Public Education with [considering additional school finance system reforms](#). Though meetings have not yet taken place, future measures are not expected to impact Transportation funding.

Below is more information, gathered from news sources, with detail about each case and issue.

Lawsuits

[Texas' High Court Upholds School Funding Formula](#)

May 13, 2016

- Texas' complicated school finance system is constitutional, the state Supreme Court ruled Friday — a surprise decision that handed a major defeat to the 600-plus school districts that sued the state more than four years ago.
- The all-Republican court reversed a lower-court ruling that had sided with schools and called the funding set by the GOP-controlled Legislature in 2011 inadequate and unfairly distributed among the wealthy and poor parts of the state.
- The decision ends a sweeping school finance case that was the largest of its kind in Texas history. Major legal battles over classroom funding have raged six times since 1984, but the latest decision by the high court's justices marks just the second time they've failed to find the system unconstitutional. *It also means the Texas Legislature won't have to devise a new funding system.* [Emphasis added]
- "Our Byzantine school funding 'system' is undeniably imperfect, with immense room for improvement. But it satisfies minimum constitutional requirements," the court found in its ruling. "Accordingly, we decline to usurp legislative authority by issuing reform diktats from on high, supplanting lawmakers' policy wisdom with our own."
- At issue in the case was the \$5.4 billion in cuts to public education and related classroom grant programs that the Legislature approved in 2011, when the state's economy was still reeling from the Great Recession. That prompted more than 600 rich and poor school districts — which educate three-quarters of the state's public school students — to sue, arguing they could no longer properly function amid Texas' public school enrollment growth of nearly 80,000 students annually.

(Source: AP)

[Bills Coming Due for Troubled Foster Care System](#)

May 8, 2016

- Two special masters appointed by a federal judge to oversee reforms to the state's embattled foster care system have begun visiting with state officials, and their recent two-and-a-half-day orientation is projected to cost the state roughly \$43,000, according to state officials.
- The cost of the meetings held April 25-27 are just the beginning of an open-ended tab for court-ordered oversight after U.S. District Judge Janis Jack ruled last year that Texas' long-term foster care system treated children inhumanely and violated their civil rights.
- In that December ruling, Jack ordered the state to pay special masters to study ways to improve foster care over a six-month period. In March, Jack [picked two special masters](#) favored by children's rights advocates: Francis McGovern, a Duke University law professor, and Kevin Ryan, a partner at the New Jersey nonprofit Public Catalyst, which advocates for child welfare.

- Emails obtained by The Texas Tribune show the special masters and their staff arranged meetings with state officials for late April. Jack approved pay for McGovern and Ryan at \$345 per hour, according to the court record.
- Ryan also hired four staff members to assist him: Deborah Fowler, Eileen Crummy, Lisa Taylor and Margaret McHale. McHale received court approval to charge \$305 per hour; the other three staff could charge \$325 per hour, according to an email from staff at the Texas Department of Family and Protective Services.
- State officials confirmed the meetings took place, over a total of 22 billable hours. A spokesman for the Department of Family and Protective Services said the agency has not yet been billed for the work.
- This isn't the first time the state has been on the hook for the costs of an external review of the state's child welfare system. In 2014, the state paid The Stephen Group to review the operations of the state's Child Protective Services agency. The initial \$750,000 contract has been renewed twice, for a total cost of \$2.7 million.

(Source: *Texas Tribune*)

[Texas Court Ruling Could Undermine Major State Taxes](#)

May 6, 2015

- Texas' 3rd Court of Appeals punched a potentially huge hole in the state's franchise tax, allowing the parent company of AMC movie theaters to use a liberal definition of its cost of goods sold.
- If that holds up on appeal, it means just over \$1.1 million to AMC, but it could cost the state of Texas \$1.5 billion annually, according to estimates from the state comptroller. The state's sales tax — its biggest single source of revenue — could also take a hit, because the court's ruling on franchise taxes turned on a legal definition that is also used in the sales tax code.
- The ruling applies to taxes collected over the past four years; if it stands, that could mean up to \$6 billion in tax refunds, according to the comptroller.
- The case hinges on a definition of "tangible personal property" that includes "personal property that can be seen, weighed, measured, felt or touched, or that is perceptible to the senses in any other manner."
- AMC takes "perceptible to the senses" to include movies, and if that's the case, contends all of its costs for space should be included in its cost of goods sold. The comptroller argued that AMC is selling intangible property or a service and that it shouldn't be included.

(Source: *Texas Tribune*)

[Oil Driller's Lawsuit Could Cost Texas Billions in Tax Refunds](#)

Jan. 30, 2016

- The state's highest civil court agreed to hear a case hinging on whether metal pipes, tubing and other equipment used in oil and gas production should be exempt from sales taxes. While the issue is arcane, the impact to the state could be significant.
- Texas Comptroller Glenn Hegar says a ruling favoring the industry could force the state to issue tax refunds of as much as \$4.4 billion – enough to wipe out the state's projected budget surplus.
- Midland-based Southwest Royalties, a subsidiary of Clayton Williams Energy, sued the state in 2009 – just before a drilling boom transformed the U.S. energy landscape – after Susan Combs, Hegar's predecessor, rejected a claim for refunds on purchases dating back to 1997. Over the years, the case has wound its way through the court system.
- Now, the state's Supreme Court justices are set to weigh the company's appeal of a lower court's ruling amid concerns that a prolonged drilling slowdown might hurt Texas' bottom line.

(Source: *Texas Tribune*)

Update:

On June 17, 2016, the [Texas Supreme Court](#) sided with the Texas Comptroller of Public Accounts and ruled against the sales tax exemption for oil and gas production equipment. The court said "Southwest did not prove that the equipment for which it sought a tax exemption was used in 'actual manufacturing, processing, or fabricating' of hydrocarbons within the meaning of" the tax code. The opinion noted that other materials used in drilling, such as explosives used in fracking, do qualify for the exemption¹.

Funding Issues

[Lawmakers Promise Fix for Teacher Health Care Plan](#)

April 13, 2016

- The Joint Legislative Committee on TRS Health Benefit Plans met in April to discuss how to address skyrocketing premiums for teachers under state-run health insurance plans.
- Members repeatedly promised a mutually agreeable fix – one that may require the state, and possibly school districts, to pay more into the plan and teachers to receive fewer or more limited benefits.
- Teacher groups and school officials agreed that finding a solution would be difficult but reminded members that they have been asking state lawmakers to put more money into

¹ <http://www.dallasnews.com/business/energy/20160617-texas-supreme-court-rules-against-multi-billion-tax-refund-to-oil-drillers.ece>

the plan for years and are willing to absorb some of the pain to ensure its long-term sustainability.

- About half of all school employees in the state are covered under the plan, which was created to help smaller districts offer health insurance coverage. While it is used by almost all of the state's more than 1,000 school districts, many larger ones with more employees are self-insured.
- The employee share of premiums has more than doubled since 2003, the year after state lawmakers created the plan, while the state's contribution has remained fixed at \$75 per employee per month. School districts are also required to contribute a minimum of \$150 per employee per month and have the option to contribute more. But teacher groups said Wednesday that many districts have not upped their contributions, or have done so by very little, leaving school employees to absorb most or all of the premium increases over the years.

(Source: *Texas Tribune*)

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