

MINUTES

MONTANA HOUSE OF REPRESENTATIVES 51st LEGISLATURE - REGULAR SESSION

SELECT COMMITTEE ON EDUCATION FUNDING

Call to Order: By Chairman Ray Peck, on January 17, 1989,
at 2:30 p.m.

ROLL CALL

Members Present: Chairman Peck, Rep. Eudaily, Rep. Gilbert,
Rep. Glaser, Rep. Grinde, Rep. Kadas, Rep. Schye

Members Excused: Rep. Harrington

Members Absent: None

Staff Present: Andrea Merrill, Madalyn Quinlan, Dave
Cogley, Jeanne Flynn

Announcements/Discussion: Rep. Peck, Chairman consults
with Rep. Eudaily, Vice Chairman as they work out the
agendas. The Select Committee invites interested
persons to respond at the time of public testimony.
The Committee will meet again on Tuesday, January 24,
1989.

Governor's Proposal to Equalize the Retirement Benefit Portion of School Funding.

Dr. Ken Nordtvedt, Director of Department of Revenue stated
that equalizing the present county mandatory levies
which fund retirement benefits is a substantial first
step in the equalization question facing Montana. It
amounts to \$50 plus million per year. Our final goal
is to move from 60% equalized funding of education to
the 80% to 85% people have proposed. Our plan would
create a state wide levy to substitute for the county
retirement levy. The number of mills that would be
proposed would be determined by taking the total FY 89
retirement levies and subtracting the projected the FY
89 lottery revenues which are already dedicated to
taking care of this burden. Divide by the 1988 state
property taxable value; that gives the mills that would
be generated from the statewide levy. The lottery
money goes into the foundation program, rather than
being allocated to these levies which we have just
abolished. Increase the foundation program schedules
to account for retirement costs. That number averages

out to about \$340 per student. Then adjust the oil, coal, and gas severance taxes so that they don't pick up an additional burden of supporting statewide levies. They are already absorbing a burden to support education.

- Rep. Peck asked Dr. Nordtvedt if his projected reduction in coal tax collections amount to \$1.5 million? Mr. Nordtvedt stated that the projected reduction would be \$1.23 million per year, and that does include oil, coal, and gas tax reduction.
- Rep. Kadas is this a formula you intend to run once to determine the number of mills? Mr. Nordtvedt said in order to make the conversion, this should not be thought of as a separate levy. It will be part of the 45 mill statewide levy to support the foundation program. The retirement benefits become a general fund obligation. This \$340 is a one-time increase in the base of the foundation schedules to deliver equalized money to pay for the additional burden that would be added to the general fund.
- Rep. Kadas asked if the retirement costs change over time, does the proposal tie that change to a change in millage? Mr. Nordtvedt stated that it will be raised each time the legislature changes the foundation program schedules.
- Rep. Kadas stated that you are offsetting the retirement by increasing the schedules. Do you know if there is a relationship between the schedules and the costs of retirement? Mr. Nordtvedt said that the costs of running a school system are overwhelmingly salaries for teachers and support personnel.
- Rep. Kadas asked Mr. Nordtvedt what is his rationale that those resources should be treated in a revenue neutral fashion while everyone else isn't? Mr. Nordtvedt stated that we are equalizing what is an unequal mill levy burden. It's revenue neutral from the point of view of all of the comparable tax payers in the state.
- Rep. Kadas said that one of the main problems noted in the Loble decision is disequalization in property tax based wealth. And a major component of that is resource property taxes, and now you are going to exclude them from being any part of the solution? Mr. Nordtvedt said not at all. What we are doing is saying we have a property tax resource in coal, oil, and gas. By converting it from a county levy to a state levy, we are basically saying it is a state resource of property

taxes to support the state school systems. We are sharing that highly localized property wealth with the state. We are not adding to their particular burden, but we are sharing their present value with the whole state on an equalized basis. What we want to do is in the spirit of equalization as we understood it.

Rep. Peck asked why we would single out those taxpayers and not the railroad, utilities, and so forth? Mr. Nordtvedt said that they were originally on the list but most of them have their property fairly well dispersed in the state, and if you average out the effective mills that their property is taxed at, it doesn't miss by much the state average mills you have to have to make up the revenues.

Madalyn Quinlan asked does the rate on coal severance tax go from 25% to the 19%? Mr. Nordtvedt said no, it goes from 25% to 24.4%. It would go down 6/10 of 1% from whatever it is now.

Rep. Kadas said retirement is a significant part of what is addressed in the Loble decision, but the largest part is the district general fund, and there is also transportation and capital costs. What is the Governor's plan in those areas? Mr. Nordtvedt said we think that the voted area of funding should be the last area addressed. The next items to be addressed after retirement is the insurance mandatory levies to pay for the premiums of the school districts.

Rep. Kadas asked Mr. Nordtvedt if he was saying the general fund voted part of the budget is something that we shouldn't be addressing this session? Mr. Nordtvedt stated that his view is probably not. I don't think we've had the last word on that subject or we have the consensus of how far we want to go.

Rep. Kadas asked whether Mr. Nordtvedt was speaking for himself or the Department of Revenue or the Governor. Mr. Nordtvedt stated that he is speaking for himself, he would recommend to not try to solve equalization of the voted levy part of school funding this session or before the Court has finally made a ruling.

Rep. Kadas stated that he thinks we can anticipate the Court making a ruling before October 1, 1989. Do you see a need to address it before then? Mr. Nordtvedt said we should certainly be discussing it to try to find out what different groups in the state feel would be the proper thing to do when that issue faces us, but I don't think we should rush into a decision on

equalizing the voted levy part component of education before all things fall into place, like the final word from the court and arriving at a consensus within the legislative process.

Rep. Kadas asked Mr. Nordtvedt if it is safe to say the administration will be making no proposal as far as the voted and general fund portion of the suit? Mr. Nordtvedt said that it is a fair assumption.

Rep. Peck asked Mr. Nordtvedt if he would try to tell the committee when we are getting an administration recommendation? Mr. Nordtvedt stated that this is in the bill drafting process and is almost completed.

Rep. Eudaily asked if he thought the committee shouldn't do a single thing with voted levies this legislature, not even talk about caps? Mr. Nordtvedt said no, I was talking about the issue of solving the equalization question with respect to the voted levy component that the school funding. If we put caps on, it probably will have to coincide with the time when we do respond to equalization of voted levies.

The Impact of the Proposal to Reduce Personal Property Taxes.

Mr. Nordtvedt said school taxes account for about 60% of property taxes. The reduction amounts to \$6 million the first year and \$12 million the second year. This \$6 and \$12 million of revenue is lost to the schools because we reduced the taxable value of districts. We have to find substitute revenue from the general fund or from other sources for the state losses. We propose to increase the schedules in the foundation program to equalize the losses. In the process of reimbursing schools for the lost revenues in the personal property tax, we have picked up \$10.5 million of school funding that we have moved from the unequalized category of funding into the equalized category of funding. It is important to equalize the property base which means equalizing the distribution of the taxes raised. The basic mechanism is to adjust the schedules to pick up those lost taxes from personal property.

Rep. Peck asked when you say adjust the schedules, and how do we pay for this? Mr. Nordtvedt said whatever we propose, we should be able to find the funds for, and we believe that there is no unexpected new loss in the state budget for things that haven't occurred to us yet, and we can find the revenues in this biennium to

pay for the first two years of this plan.

Rep. Peck: Are you saying that if we reduce current expenditures out of the general fund we can cover the increases to school funding? Mr. Nordtvedt said no, he is saying we will find the revenue sources that will meet the final budget, including whatever needs to be appropriated to cover the reduction of personal property taxes the first two years.

Rep. Peck asked where is that revenue to be found? Mr. Nordtvedt stated that it is in the budget base, plus the adjusted programs that we will recommend.

Rep. Peck asked Mr. Nordtvedt if he was cooperating with the budget office? Mr. Nordtvedt said we work closely together.

Rep. Kadas asked Mr. Nordtvedt if on his total costs for property tax reduction, you have \$10 and \$20 million reduction. Do you have a more specific number as to what it is going to cost? Mr. Nordtvedt said our basic plan is a \$10, \$20, \$30, and \$40, million reduction by the fourth year. I can't tell you that \$30 million will be the impact in this biennium because of the timing of our fiscal year and the due date of various property taxes and the cash flow. So this is a maximum.

Rep. Kadas asked if he replaced revenue coming from increases to taxes on other kinds of property? Mr. Nordtvedt said we do not believe that we should do this by increasing property taxes on some other category of property.

Rep. Kadas said and the way you will accomplish that for the school is by increasing the schedules in the foundation program? How do you see providing that lost revenue to local governments? Another block grant program? Mr. Nordtvedt said he would tell you there is still discussion as to what we think is the wisest way to do that.

Rep. Bardanoue asked if we take a \$20 million short fall in property taxes, where in the general fund are you going to find that \$20 million? Mr. Nordtvedt stated that the dollars coming into the general fund and the dollars going out lose their identity. We don't match the sources with the expenditures. I've looked at the various kinds of changes we could make, and I've got a package of revenue can then cover this program and the other things the Governor has stated he would like to

do to adjust. In the absence of some new major surprises on the outgoing side, I think we have the revenue to cover the budget.

- Rep. Bardanoue asked Mr. Nordtvedt will you support some new revenue sources? Mr. Nordtvedt said that he will find the revenue for programs the Governor has recommended.
- Rep. Bardanoue asked is that new revenue? Mr. Nordtvedt said he doesn't necessarily think it would have to be new revenue. I don't think we need any permanent tax increases.
- Rep. Eudaily asked Mr. Nordtvedt, in his proposal, is he recommending that the first year be 1990 or 1989? Mr. Nordtvedt stated that we are discussing both options. The earlier you start the more revenue you have to find.
- Rep. Eudaily asked do you think that if we put off year one until 1990, the Judge would accept that as a step in the right direction? Would that be one of the phase-in parts that you think would be satisfactory? Mr. Nordtvedt stated that he doesn't think there is any reason to delay at all the equalization of the county retirement benefits. It is important and there is a wide consensus that it should be equalized. The final outcome will be that I-105 is amended to be compatible with replacing county levies with a state levy which will raise no new dollars.
- Rep. Peck asked wasn't there a bill in 1983 to do that with the retirement fund on a statewide basis? Mr. Nordtvedt said he had a proposal in 1981 when we had an incredible surplus, but I lost in my caucus.

Foundation Program Revenue Estimates Under Current Law.

Madalyn Quinlan, Office of the Legislative Fiscal Analyst compared the foundation program estimates under current law as prepared by both the Fiscal Analyst Office and the Office of Budget and Program Planning, including net lottery revenues, property tax revenue estimates, and the income tax surcharge. (See Exhibit 1).

Judy Waldron, Office of the Legislative Fiscal Analyst stated that a 10% income tax surtax that goes through 1991 will be expected to increase revenue by \$6 million in fiscal 1989, \$23 million in fiscal 1990, and \$25 million in 1991. Realizing the revenue gain in the very first year depends upon enacting the surtax goal

early enough in the session that the withholding tables could be changed so you could actually get in revenue fiscal 1989. If it weren't enacted that early, then you would pick up the revenue in fiscal 1990. Higher surtaxes than 10% will be expected to generate proportionally more revenues. That is, if you had a 20% surtax, you would get twice the amount of revenue that is shown in this report with a 10% surtax.

Rep. Kadas stated that we have a pretty significant drop of taxable valuation on an ongoing basis, could you give us some background as to why that is happening. How long can we expect it to continue? Ms. Quinlan said that the reduction in tax years 1989 and 1990 under the forecast is further declines in net and gross proceeds.

In tax year 1988 we are still seeing some of the impact of the property tax reductions that were passed by the legislature last session. There were shifts in trucks last session from class 10 to class 8 there was a lower tax rate as a result of that. There has also been a significant decline in the taxable valuation of railroad property, and that had more to do with settlements between the Department of Revenue and the Railroad than with legislative action.

Rep. Kadas asked Ms. Quinlan do you expect us to continue to decline following 1990, 1991, and 1992? Ms. Quinlan said it seems like the largest category that would answer that question is net and gross proceeds and what is going to happen to the price of oil and the coal, and the production level in the state.

Rep. Eudaily asked would the lottery money come into the equalized portion of the revenue? Ms. Quinlan stated that it would be a source of revenue to equalization and it could be set up to come into this account.

Rep. Kadas asked do you have any numbers on what the additional revenue generated would be for eliminating the deductibility of federal taxes on the personal income tax? Ms. Quinlan said we haven't worked on those numbers yet.

Rep. Kadas asked if he could request for eliminating altogether the deductibility and where it would be if you could put a cap at \$3,000 and a cap \$6,000 just to give us a range. Ms. Quinlan said yes.

Terry Johnson, Office of Budget and Program Planning stated that OBPP estimates and the fiscal analysts' estimates are amazingly close for the level of revenue that we are looking at. At this point Madalyn and myself have

not sat down and actually looked at the individual assumptions that went into those forecasts, so I don't think we can really offer any concrete information in terms of why there is a significant difference.

Sales Tax Option.

Jeff Martin, Staff Researcher Legislative Council said he discussed the amount of money that could be generated by a 1% sales tax under a broad-based or, a narrow-based tax, and what could have been generated in House Bill 377 from last session. (See Exhibit 2).

Rep. Kadas asked Mr. Martin that in his studies, did he go into the time frame required to put a sales tax into place and actually generate revenue? Mr. Martin stated no, he doesn't discuss any of the administrative concerns or the advisability of taxing various kinds of things. All I've done in this report is present a data base of what could be raised if you taxed these items. It is comprehensive enough that you can make various assumptions and get a general idea of the revenue you can raise from taxing various things. I can give a fairly general estimate of what the food exemption would cost, but the only information I have is from food stores.

Dale Harris, Montana Ambassadors stated that the Ambassadors' proposal is a comprehensive tax reform because a major portion of the revenue that they recommend be raised from a sales tax would be allocated to fund education and to help in the implementation of the Loble decision. The Ambassadors strongly urge this legislature to go as far as possible in implementing the Loble decision, not simply because of the judicial decision, but because of the justice in equalizing both the level of school funding in Montana and the level of tax burden on the citizens of Montana for public education. (See Exhibit 3).

Rep. Eudaily asked in drawing up your plan, what do you estimate the time of implementation for a sales tax such as this? You mentioned you would encourage us to take immediate action, but there is really no immediate action if we throw sales tax in because don't we have a delay situation when we put that into effect? Mr. Harris said yes, there is a period of at least a year for implementation and some people suggest 18 months. We would recommend a interim revenue package. The most obvious would be continuation of a the surcharge on the income tax. It may not be effective until fiscal year 1990 or 1991 but this legislature could enact a program

for implementing the Loble decision, even though it may not actually be implemented until the end of the biennium.

Rep. Peck asked do you recommend a referendum vote on the sales tax or do you take a position? Mr. Harris stated that the position in the report is against a referendum. They are also very practical in that if a vote is inevitable, it might be better for the legislature to share in how the vote is presented to the people.

Rep. Peck asked Mr. Harris what he meant by setting a date? Mr. Harris said yes.

Rep. Peck asked Mr. Harris if he the Ambassadors in any way discuss the idea that a sales tax is not deductible on federal income tax where other taxes are? Mr. Harris said that they have not considered that issue.

Revenue Allocation in the Executive Budget.

Terry Johnson, OBPP stated that the handout covers the coal severance tax reallocations and also the use of education trust transfers. (See Exhibit 4).

Rep. Peck asked Mr. Johnson if we actually transfer more out of there than was needed? Mr. Johnson said yes, in terms of fiscal years 1988 and 1989 according to the revenue estimates that we have in the Governor's Office, we are projecting about a \$8.4 million surplus in the foundation program.

Rep. Peck asked if there is a position currently from Governor Stephens on that question? Mr. Johnson said at this point I don't know.

Rep. Peck asked is there legislation to put money back into the education trust? Mr. Johnson stated if you were to take a look at the statute, I think you can make an interpretation that those funds are to revert to the education trust account.

Rep. Peck stated that that is the LFA position.

Rep. Kadas asked under the Schwinden budget \$35 million in general fund is required to bring the foundation program to zero and zero. Does that include the \$8.4 million or is that in addition to the \$8.4 million? Mr. Johnson said no, that would not include the \$8.4 million.

- Rep. Kadas stated if the \$8.4 goes back into education trust, then we are looking at \$43 million to just get to zero and zero? Mr. Johnson said he is not sure about the \$35 million number but, yes, whatever that number is you would have to add in that \$8 million.
- Rep. Eudaily asked then in the future will that money not go into that account or is it going to start building up that account again? Mr. Johnson said based on the Schwinden proposal, the education trust distribution and the park acquisition trust distribution is only temporary. The diversion to the foundation program will sunset at the end of the 1990 -1991 biennium; therefore, starting in fiscal year 1992, there would be revenues flowing back to the education trust account.

Preparation of School District Budgets for the 1989 - 1990 School Year.

Nancy Keenan, Superintendent of Public Instruction: We have all agreed, both in the educational community and most legislators, that there is no way your actions during this session can actually kick in for the first year of the biennium. School districts can not implement the kinds of changes that we might make this session in that first year. Our recommendation is that the legislature notify school districts or administrators that in the first year of the biennium, we are going to be operating on the present foundation program, depending on the increase that you'll give to the foundation program schedule. In the second year of the biennium, the equalization formula that the legislature may agree upon this session could have five-year phase-in period.

Rep. Peck asked have you discussed this with your legal counsel? Does she see any difficulty or problem with the Loble decision and that kind of a time frame? Ms. Keenan stated that she has not discussed the implication of that with my legal counsel. The education community, many of whom are lawyers, feel that we could continue with the status quo the first year of the biennium and the second year. I don't think there is a legal issue there as long as school districts know where they are going and the time line we're operating on.

Bruce Moerer, Montana School Board Association said he thinks you've got to look at a reasonableness factor here. Practically I don't think you can go back and undue all of the budgeting and implement it as soon as it's approved. We would make the argument to the Court

that perhaps out of practical necessity this next year has to operate under the current system.

Rep. Peck asked have the defendants actually been ordered to make that report to him? Pat Melby, Attorney for the plaintiff school districts stated that the Court has asked the parties to report back on October 1, 1989 to give a status report essentially. If there is a good faith effort by the legislature in phasing in a new equalization program that might be acceptable to the Judge. We certainly would recommend to the Judge whether it was something that we support. We aren't so concerned about immediate implementation as we are in what the program is eventually going to look like when it is finally phased in.

Rep. Peck asked if he would anticipate any difficulty if there was an increase in the existing schedules as long as you have a program laid out for the second year that is agreeable to the plaintiff districts? Mr. Melby said that he thinks everybody in the education community expects a program to be phased-in.

Rep. Eudaily asked Mr. Melby if he thinks it would strengthen your situation if we equalize the retirement part the first year and had that to take to the Judge other than to just say we are working on it?

Mr. Melby said certainly he thinks it would, depending on what that equalization program is.

Rep. Gilbert asked specifically what are you referring to with a phase-in period? Increasing the schedules the principal part of this lawsuit. It looks like we are going to scramble to get zero and zero.

Rep. Peck said he thinks what Mr. Nordtvedt is saying is that you put retirement into the foundation program schedules and increase the schedules to provide for that and you add that to the basic 45-mill levy on the statewide levy.

Rep. Gilbert said we can do that and increase the schedule even though I don't know the required amount to increase the schedule. But that doesn't really put more money into education and that will be part of the problem, but I do think phasing-in will help in some communities.

Rep. Eudaily asked how and what authority our Committee would have to issue the statement to school districts about maintaining the status quo as far as the

foundation program is concerned. If the schedule changed a little bit, there will be no difference over what it has been over the past years when we fought for two and two until the very last day.

Rep. Schye stated that he doesn't think we can really guarantee that either. I think we can make the recommendation, but I don't think we can come out with a press release to say that because there are 142 other people that are going to have to vote on that.

Andrea Merrill presented a list of duties that Madalyn Quinlan, Dave Cogley and she can perform for individual members of the Committee. (See Exhibit 5).

Ms. Quinlan stated that members of the legislative staff, OPI and the Budget Office will try to work out the common data base that the committee can use. We are trying to use fiscal 1988 figures. We hope we can come up with consistent numbers to give the committee and other legislative committees.

Rep. Peck asked did you reach any agreement in terms of the source of that data and what year to use? Ms. Quinlan said all of this information originates from OPI and from county treasurers' and the county superintendent reports. OPI will gather the information and the legislative auditors will review or verify it to make sure that the numbers are transferred appropriately from the forms to the data base.

Ms. Merrill said she made a chart that shows the components of the various bills and how they compare with the current situation we can include all bills on that chart with the person's permission.

ADJOURNMENT

Adjournment At: 5:00 p.m.



Handwritten signature of Ray Peck in cursive script, written over a horizontal line.

REP. RAY PECK, Chairman

RP/jf

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EXHIBIT 1
DATE 1-17-89
HB _____



STATE OF MONTANA
Office of the Legislative Fiscal Analyst

STATE CAPITOL
HELENA, MONTANA 59620
406/444-2986

JUDY RIPPINGALE
LEGISLATIVE FISCAL ANALYST

January 17, 1989

TO: House Select Committee on Public School Funding
FROM: Madalyn Quinlan, Staff *mjq*
SUBJECT: Revenue Options for Funding the Public School Foundation Program

I. Foundation Program Estimates

The attached Table 1 shows a comparison of public school foundation program revenue estimates under current law as prepared by the Office of Budget and Program Planning and the Legislative Fiscal Analyst.

While there are variations within the revenue categories, the estimate of total available revenues for the 1991 biennium is \$511.490 million for OBPP and \$511.024 million for the LFA, a difference of .09 percent.

Table 1
Comparison of Executive and LFA Public School Revenue Estimates
1991 Biennium
(Millions)

	Executive	LFA	Difference
Beginning Fund Balance	\$0.000	\$0.000	\$0.000
State Equalization			
Individual Income Tax	\$156.950	\$156.857	(0.093)
Corporation License Tax	22.603	23.526	0.923
Coal Severance Tax	3.746	3.865	0.119
U.S. Mineral Royalties	46.180	37.847	(8.333)
Common School I & I	67.838	70.226	2.388
Education Trust Interest	2.074	3.377	1.303
Education Trust Transfer	0	0	0.000
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Total State Equalization	\$299.391	\$295.698	(\$3.693)
County Equalization			
45 Mill Levy	\$169.641	\$167.657	(\$1.984)
Forest Funds	2.930	2.326	(0.604)
Taylor Grazing	0.204	0.216	0.012
Cash Re-appropriated	5.613	4.760	(0.853)
Miscellaneous	8.620	12.889	4.269
Elem Transportation	(7.434)	(7.400)	0.034
High School Tuition	(1.676)	(1.518)	0.158
	-----	-----	-----
Total County Equalization	\$177.898	\$178.930	\$1.032
District Share of Permissive	\$34.201	\$36.396	\$2.195
	-----	-----	-----
Total Non-General Fund	\$511.490	\$511.024	(\$0.466)
Maximum General Fund w/o a Vote	\$571.778	\$572.650	\$0.872
	-----	-----	-----
General Fund Required	\$60.288	\$61.626	\$1.338
	=====	=====	=====

II. Net Lottery Revenues

The estimate of net lottery revenues available for equalization of retirement is \$15.5 million in the Executive Budget and \$13.8 million in the LFA Budget Analysis.

III. Property Tax Revenue Estimates

The statewide taxable valuation fell from \$2.0 billion in tax year 1987 to \$1.94 billion in tax year 1988 and is projected to continue to decline in tax years 1989 and 1990. The largest declines in tax years 1989 and 1990 are expected in the categories of net and gross proceeds. Table 2 shows statewide valuations for tax years 1987 and 1988 as certified by the Department of Revenue and LFA estimates for tax years 1989 and 1990. The table also shows the value of one mill levied against the statewide valuation and an estimate of the miscellaneous revenues that are distributed with the mill levy. These miscellaneous revenues include motor vehicle property taxes, net proceeds taxes paid on new oil and gas production, fees in lieu of taxes, and 80 percent of the corporation license taxes paid by financial institutions. These miscellaneous revenues are allocated to each taxing jurisdiction within a county in the proportion that its mill levy bears to the total mills levied by all taxing jurisdictions within the county. The LFA estimate of miscellaneous revenues statewide is \$38.1 million for fiscal 1989, \$38.5 million for fiscal 1990, and \$39.7 million for fiscal 1991.

Table 2
Property Valuations and Tax Revenues
Tax Years 1987 through 1990

<u>Tax Year</u>	<u>Taxable Valuation</u>	<u>Value of a Mill</u>	<u>Miscellaneous Revenue (1)</u>	<u>Total Revenue Generated</u>
1987	\$2,000,744,543	\$2,000,745	\$134,000	\$2,134,745
1988	1,942,949,796	1,942,950	139,000	2,081,950
----- Projected -----				
1989	1,867,369,000	1,867,369	141,000	2,008,369
1990	1,858,324,000	1,858,324	145,000	2,003,324

(1) Miscellaneous revenues are estimated values.

Tax year 1988 valuations generate fiscal 1989 revenues. For example, one mill levied in fiscal 1989 against tax year 1988 valuations is estimated to generate \$2.08 million. Twenty mills would generate \$41.6 million in fiscal 1989.

IV. Income Tax Surcharge

Among the options for funding the school foundation program is a surtax on individual income tax liabilities. For tax years 1987 and 1988, a 10 percent surtax was in effect. If the 10 percent surtax were continued in tax years 1989 through 1991, revenue would be expected to increase by \$6.2 million in fiscal 1989, \$22.9 million in fiscal 1990, and \$25.3 million in fiscal 1991. A revenue gain in fiscal 1989 is dependent on enactment of the surtax early enough in the year that withholding tables can be adjusted to reflect the surtax. Otherwise, the fiscal 1989 increase would be received as revenue in fiscal 1990. Higher surtaxes would be expected to generate proportionately more revenue. For example, a 20 percent surtax would raise \$12.4 million in fiscal 1989, \$45.8 million in fiscal 1990, and \$50.6 million in fiscal 1991.

EXCERPT FROM FINAL INTERIM REPORT PREPARED FOR
THE REVENUE OVERSIGHT COMMITTEE -- DECEMBER 1988
By Jeff Martin, Legislative Researcher
Legislative Council

COMPARATIVE REVENUE SUMMARY BY SECTOR

This section presents a summary of potential revenue according to some general provisions regarding the tax base. The first scenario is a broad-based sales tax on most goods and services. The second is a narrow-based tax that primarily applies to goods, with some major exemptions, and to very few services. The third shows the revenue potential from the tax system proposed by the Senate version of House Bill No. 377 (1987), with some important variations. This information is shown in Table 13.

BROAD-BASED TAX

The revenue potential from a broad-based tax is simply a recapitulation of the broad-based estimates developed in this report. The estimates essentially represent a gross receipts tax on the sale of goods and services, with a few exemptions (e.g., food stamp purchases) and deductions (e.g., sales for resale).

The summary excludes, for the reason noted in the financial sector (i.e., state sales taxes do not apply to insurance premiums), the estimates for insurance premiums but includes that portion from hotels, motels, and lodging already covered by the accommodations tax.

TABLE 13

**Potential Revenue From a 1 Percent Sales Tax
Under Three General Provisions of the Tax Base**

(In Thousands of Dollars)

	<u>Broad Based</u>	<u>% of Total</u>	<u>Narrow Based</u>	<u>% of Total</u>	<u>HB 377</u>	<u>% of Total</u>
Agriculture	282	0.3	87	0.2	282	0.4
Mining	1,097	1.2	75	0.2	1,097	1.5
Contract Construction	7,142	7.6	1,267	2.5	7,142	9.6
Manufacturing	2,200	2.3	2,200	4.3	2,200	3.0
TCPU	6,755	7.2	541	1.1	6,755	9.1
Wholesale Trade	8,614	9.1	3,144	6.2	6,417	8.6
Retail Trade	50,517	53.6	38,419	75.3	39,986	53.9
Food Stores	10,956	11.6	4,429	8.7	4,429	6.0
FIRE	2,116	2.2	355	0.7	689	0.9
Services	15,595	16.5	4,908	9.6	9,613	13.0
Government	NA	NA	NA	NA	NA	NA
Total	94,318	100.0	50,996	100.0	74,181	100.0

Source: Montana Legislative Council

Note: Percentage detail may not add to 100 percent due to rounding.

A broad-based sales tax of this kind could generate about \$94 million per year for each 1 percent of tax.

NARROW-BASED TAX

The narrow-based tax scenario contains many more exemptions from the sale of goods and services. For the most part, the tax base includes only the sale of tangible personal property. Food, prescription drugs, motor fuel, and home heating fuel are all exempt. The amount from lodging already committed to tourism promotion is excluded.

The figures for mining, construction, TCPU, and FIRE were derived on the basis of their relative contribution to total taxable sales (excluding use tax) in Idaho. This method of apportionment is particularly important as it relates to construction. In Idaho, construction contractors generally pay the sales tax on building materials, and those sales are recorded in retail or wholesale trade. To not adjust construction estimates in this fashion would result in double counting the tax base. The estimate for agriculture is derived from the ratio of taxable sales to gross sales from agricultural services in Idaho applied to the estimate of gross receipts (\$64 million) developed in the preceding section under the agriculture sector.

The only services generally taxed in this scenario are recreation and amusement services. In the first year, the narrow-based tax would generate about \$51 million for each 1 percent of tax.

HOUSE BILL NO. 377 (1987) TAX BASE

House Bill No. 377 provided for broad taxation of most goods and services. As a tax reform measure, its primary purpose was to allocate most of the revenue from the sales tax to property tax relief. This part describes what could be raised in sales tax revenue if legislation similar to House Bill No. 377 were to be enacted by the 1989 Legislature. The Senate version of the sales tax component of the bill is in the appendix. The version of House Bill No. 377 presented in the paragraphs below includes public utilities--a major deviation from the Senate version.

The estimates for agriculture, mining, construction, manufacturing, and TCPU are the same under House Bill No. 377 as they are under the broad-based tax.

Wholesale trade (derived from trends in New Mexico) is reduced by 90 percent of the estimate for machinery and equipment. The 90 percent figure was chosen somewhat arbitrarily, but it shows that the exemption of machinery and equipment does not mean there are no taxable sales in this category.

Retail trade contains exemptions for food, prescription drugs, and gasoline, but not for home heating fuel. It also excludes the deduction for trade-in value, another variation from House Bill No. 377.

The estimates for FIRE include that portion available from financial institutions. Real estate and stockbroker commissions are generally exempt.

The tax base for services is basically the same as the broad-based tax, except lodging and most advertising and health services are exempt. The potential revenue from this version of House Bill No. 377 (including utilities and home heating fuel) would initially raise about \$74 million for each 1 percent of tax.

M5024 9016JFHA

Exhibit #3
Date Jan. 17, 1989

PARTNERSHIP FOR PROGRESS

An Economic Development Proposal

of the



Office of Budget & Program Planning
 Coal Severance Tax Reallocation
 Governor Schwinden's Proposal

	Current Proposed Distribution	Current Proposed		Diff. FY 90	Current Proposed		Diff. FY 91	Current Proposed		Diff. FY 90-91	FY 90-91	FY 90-91	Diff. FY 90-91
		FY 90	FY 90		FY 91	FY 91		FY 90-91	FY 90-91				
Local Impact Account	6.65%	\$3.516	\$0.000	(\$3.516)	\$3.038	\$0.000	(\$3.038)	\$6.554	\$0.000	(\$6.554)			
Education Trust Account	7.60%	\$4.019	\$0.000	(\$4.019)	\$3.472	\$0.000	(\$3.472)	\$7.491	\$0.000	(\$7.491)			
Park Acquisition Account	1.90%	\$1.005	\$0.000	(\$1.005)	\$0.868	\$0.000	(\$0.868)	\$1.873	\$0.000	(\$1.873)			
Sub-Total	16.15%	\$8.540	\$0.000	(\$8.540)	\$7.378	\$0.000	(\$7.378)	\$15.918	\$0.000	(\$15.918)			
School Foundation Program	3.80%	\$2.010	\$10.550	\$8.540	\$1.736	\$9.114	\$7.378	\$3.746	\$19.664	\$15.918			

Office of Budget & Program Planning
 Education Trust Transfers
 Governor Schwinden's Proposal

	Actual		Proposed		Total	
	FY 87	FY 88	FY 89	FY 90		FY 91 Transfers
School Foundation Program	\$35.000	\$9.350	\$24.650	\$0.000	\$9.575	\$78.575

January 17, 1989

TO: House Select Committee on Public School Funding

FROM: Madalyn Quinlan, Associate Fiscal Analyst, Office of
the Legislative Fiscal Analyst

Andrea Merrill, Staff Researcher, Legislative Council

Dave Cogley, Staff Attorney, Legislative Council

Madalyn Quinlan will perform the following functions in support of the committee:

- (1) provide the committee with fiscal data relating to school district budgets, expenditures, revenue, and mill levies;
- (2) work with the Legislative Auditor, the Office of Public Instruction, and other interested parties in developing a common/consistent database that can be used by legislators;
- (3) research legislative requests regarding the impact of public school funding proposals;
- (4) provide the committee with information on the school funding mechanisms used by other states;
- (5) provide the committee with estimates of foundation program revenues; and
- (6) prepare committee agendas and perform other staff functions as necessary.

Madalyn Quinlan's office is located on the first floor of the Capitol on Room 109. Her telephone extension is 2952.

Andrea Merrill and Dave Cogley will perform the following functions in support of the House Select Committee on Public School Funding:

- (1) Review proposed legislation and advise the committee as to constitutionality, internal consistency, possibility of conflict with or duplication of existing provisions, and compliance with other bill drafting provisions such as grammar, punctuation, word choice, and statutory sentence structure;

(over)

#5

No. 88-381

RECEIVED

IN THE SUPREME COURT OF THE STATE OF MONTANA

JAN - 1 1989

1989

LEGISLATIVE
FISCAL ANALYST

HELENA ELEMENTARY SCHOOL DISTRICT NO. 1 AND HIGH SCHOOL DISTRICT NO 1 OF LEWIS & CLARK COUNTY; BILLINGS ELEMENTARY SCHOOL DISTRICT NO 2 AND HIGH SCHOOL DISTRICT NO 2 OF YELLOWSTONE COUNTY; et al.,

Plaintiffs and Respondents,

and

MONTANA EDUCATION ASSOCIATION et al.,

Intervenors/Plaintiffs and Respondents,

-vs-

THE STATE OF MONTANA; and THE MONTANA BOARD OF PUBLIC EDUCATION; and THE MONTANA SUPERINTENDENT OF PUBLIC INSTRUCTION,

Defendants and Appellants,

and

C. J. HOLJE, BERNT WARD and ROBERT FREDERICH on behalf of the residents and taxpayers of Sheridan County, Montana, and all others similarly situated,

Intervenors/Defendants and Appellants

HAYS-LODGE POLE ELEMENTARY SCHOOL DISTRICT NO 50 AND HIGH SCHOOL DISTRICT NO 50, AND BLAINE COUNTY; et al. and the ASSOCIATION OF INDIAN IMPACT SCHOOLS OF MONTANA,

Intervenors/Defendants and Appellants

APPEAL FROM: The District Court of the First Judicial District,

In and for the County of Lewis and Clark,
The Honorable Henry Loble, Judge presiding.

COUNSEL OF RECORD:

For Appellant:

- Terry G. Spear, Crowley Law Firm, Billings, Montana
- Hays-Lodge Pole School Dist #50, et al.
- Beda Lovitt, Helena, Montana, Montana Superintendent of Public Instruction
- Benjamin Hilley, Hilley & Loring, Bigfork, Montana for Montana Education Association
- Hon. Marc Racicot, Attorney General, Helena, Montana
- Clay R Smith, Assistant Attorney General, Helena, for State of Montana
- W. William Leaphart, Helena, Montana
- Loren O'Toole, Plentywood, Montana
- Donald A. Garrity, Helena, Montana

For Respondent:

James H. Goetz, Goetz, Madden & Dunn, Bozeman, Montana

For Amicus Curiae:

Charles E. Erdmann, Helena, Montana

Bruce W. Moerer, Helena, Montana

Dennis Lopach, Helena, Montana

Submitted: January 13, 1989

Decided: February 1, 1989

Filed:



Clerk

Mr. Justice Fred J. Weber delivered the Opinion of the Court.

In this action for declaratory judgment, plaintiffs challenge the constitutionality of the 1985-86 method of funding public elementary and secondary schools in the State of Montana. The District Court for the First Judicial District, Lewis and Clark County, ruled in its primary holding that the system of funding violated the 1972 Montana Constitution. We affirm the holding of unconstitutionality, although on a narrower ground than that used by the District Court.

The issues upon which we decide this case and our conclusions are:

1. Does Montana's system of funding the public schools violate the education article, Art. X, of the Montana Constitution? We conclude that the system of funding does violate Art. X. We do not find it necessary to consider the equal protection analysis under Art. II, Sec. 4, of the Montana Constitution.

2. Should this Court clarify the District Court's findings regarding the accreditation standards promulgated by the Montana Board of Public Education? We conclude that some clarification is required.

3. Did the District Court err in its findings and conclusions relating to consideration in the equalization process of federal "874" funding? We affirm the holding of the District Court that Montana presently may not factor "874" revenue into the equalization formula because our system does not meet the federal definition of an equalized program. In its review of Montana's system of funding for public schools, the Legislature may desire to review the nature and extent of "874" funding, even though it may not in

any manner factor that into an equalization formula without meeting federal requirements.

4. Did the District Court err in denying plaintiffs' attorney fees? We affirm the denial of attorney fees.

In the 1985-86 school year, there were 545 school districts in Montana with a total student enrollment of 153,869. These included 382 elementary and 163 secondary districts. Nearly 45% of Montana schools have enrollments of less than 100 students.

The six-week-long trial included extensive evidence and testimony about the complex combination of federal, state, and local sources through which Montana's public elementary and secondary schools are funded. In addition to the General Fund, each school district uses up to nine other types of budgeted funds. These include transportation funds, teacher retirement funds, debt service funds, and building reserve funds. Some of these depend upon voted levies and all are primarily funded on a district or county level. School districts also have nonbudgeted funds including food service, traffic education, rental funds, sick leave reserves, block grants, building funds, endowment funds, and interlocal agreement funds. Expenditures from these nonbudgeted funds may only be made from cash on hand.

The General Fund, which provides 70% of school funding in Montana, includes several components. In 1949, the Montana Legislature enacted the Montana School Foundation Program. Under that program, every two years the legislature sets "Maximum General Fund Budget Without a Vote" (MGFBWV) schedules for elementary and secondary school districts in the state. Eighty per cent of the MGFBWV is funded by county and state equalization revenues. These equalization revenues are derived from levies of 45 mills on all taxable property in each county and state aid from such sources as earmarked

revenues, surplus county Foundation Program revenue, and direct legislative appropriations.

The remaining 20% of the funding of MGFBWV is through permissive mill levies of up to 6 mills for elementary districts and 4 mills for high school districts. These levies are made without a vote. If the school district is unable to obtain the MGFBWV level through permissive levies and other specified nonlevy revenue, state permissive equalization revenues are used to make up the difference.

The evidence shows that, in 1985-86, most school districts adopted budgets in excess of the MGFBWV. They utilized a third stage of funding under which monies were obtained primarily from property tax levies voted by each school district. Other revenues which were used in this third level of funding included vehicle taxes, interest income, tuition income, and federal "874" funds. By 1985-86, 35% of all General Fund budgets were obtained from this level of funding. In contrast, in 1950, the Foundation Program furnished 81.2% of all general fund revenues in Montana, leaving less than 20% of revenues to be obtained by local levies and other sources.

Plaintiffs presented voluminous evidence to support their theory that the system of funding public education in Montana is unconstitutional. The evidence established great differences in the wealth of the various school districts and, more significantly, established disparities of spending per pupil as high as 8 to 1 in comparisons between similarly-sized school districts. We affirm the following unchallenged findings of the District Court:

214. Several Plaintiff witnesses had experience either as teachers or administrators in other Montana districts, including some relatively wealthier districts. Mr. Walt Piipo, for example,

currently Superintendent at Drummond, was previously Superintendent for Geraldine schools. The two school districts are very close in size, at both the elementary and high school levels. Geraldine's taxable valuation, however, is more than twice that of Drummond's. The tax efforts for the elementary schools are comparable, while Geraldine levies more General Fund mills than does Drummond at the high school level. Consequently, Geraldine spends approximately \$1,000 more per ANB than Drummond at the elementary level, and over \$2,000 more per ANB at the high school level. Approximately 40% of Geraldine's General Fund revenues derive from the voted levy, while at Drummond, the voted levy supplies approximately 15% of General Fund revenue. This illustrates the fact that wealthier districts are able to rely to a greater extent on the voted levy to generate revenues for the General Fund.

215. Mr. Piipo testified unequivocally that Geraldine schools have advantages, and offer opportunities, which Drummond schools cannot afford. Geraldine has much greater budget flexibility to address educational needs and goals than does Drummond. Mr. Piipo testified that there is no question that the educational opportunities afforded students in Drummond could be improved if the district had the same amount of money as Geraldine.

216. The fact that spending disparities result in unequal educational opportunities was established more systematically by Plaintiffs' experts Dr. Ron Mattson, Mary Pace, and Dr. John Picton. Each of these individuals has many years' experience in Montana public education. They comprised a "Study Team" which was commissioned by the Plaintiffs to do a comparative study of several pairs of school districts in the State. They compared three pairs of elementary districts, and three pairs of secondary districts. Schools in each pair were of similar size, with one spending considerably more per pupil than the other. In addition to analyzing the budget data for each of these districts, members of the Study Team visited all 12 districts to observe the schools first hand, and to conduct interviews with administrators and teachers.

217. The Study Team identified clear differences between the schools in each of the pairs. They found that the better funded schools tended to offer more enriched and expanded curricula than

those offered in the schools with less money. The richer schools were also better equipped in the areas of textbooks, instructional equipment, audio-visual instructional materials, and consumable supplies. With respect to buildings and facilities, the districts with more money were better able to maintain their facilities than were the poorer districts. The Study Team concluded:

*Availability of funds clearly affect the extent and quality of the educational opportunities.

*There is a positive correlation between the level of school funding and the level of educational opportunity.

*The better funded districts have a greater flexibility in the reallocation of resources to programs where there is a need.

*The differences in spending between the better funded and underfunded districts are clearly invested in educationally related programs.

*All 12 school districts in this study exhibited a responsible and judicious use of their financial resources.

R. Mattson, M. Pace, and J. Picton, Does Money Make a Difference in the Quality of Education in the Montana Schools?

218. Intervenor-Plaintiff MEA commissioned a study similar to that conducted by Plaintiffs' Study Team. Dr. Gary Gray, an assistant professor in Eastern Montana College's School of Education, studied educational opportunities in a number of high and low spending school districts in Montana. His methodology differed from that of the Plaintiffs' Study Team, but he arrived at essentially the same conclusions. Dr. Gray used an extensive checklist of indicators to compare educational opportunities among school districts within two expenditure classifications, a low expenditure category, and high expenditure category.

219. Dr. Gray concluded that there are substantial differences in educational opportunities among Montana school districts, which are manifested significantly between the high versus low expenditure categories which he studied. More specifically, he found that wealthier districts offered more science classes, in labs which were

typically larger, better stocked with more equipment and consumable supplies, with more storage, and generally more functional than those in poorer districts. Consequently, students in wealthier districts had more "hands on" learning experiences than students in poorer districts. Dr. Gray found the same things to be true in the home economics and industrial arts programs. Similarly, schools with more money tended to offer a wider and more enriched range of courses in the language arts, including foreign languages.

220. In the specialty areas of physical education, music, and art, the wealthier schools offered more opportunities. Gifted and Talented Programs were much stronger in the high expenditure districts. Consistent with the situation in many Plaintiff districts, Dr. Gray found that many of the low expenditure districts could not even afford to offer a Gifted and Talented Program.

221. With respect to computers, he found significant differences, with the high expenditure districts having more and better computers and computer labs. He also found significant differences between the two expenditure categories for library and media center services, with the high expenditure districts having larger and newer book collections, larger periodical collections, larger reference collections, larger audio-visual collections, and better special collections.

222. With respect to facilities, high expenditure districts reported that they have not had to defer necessary maintenance or work projects due to a lack of funds, as have low expenditure districts.

223. Wealthier districts also offer a wider range of extracurricular activities to students than low expenditure districts.

224. In sum, the comparative evidence establishes that spending differences among similarly sized school districts in the State result in unequal educational opportunities for students. Furthermore, the comparative evidence verifies the fact that the deficiencies and problems identified by Plaintiff witnesses are part of a consistent pattern in lower-spending districts, and that such deficiencies and problems are not consistently found in relatively higher spending districts.

[footnotes and citations to exhibits omitted]

The problems were compounded by the adoption of Initiative 105 in the November 1986 general election. In 1987 the Legislature adopted Senate Bill 71. See, §§ 15-10-401, -402, -411, and -412, MCA. The District Court correctly found that the net effect was to freeze property tax levies at 1986 levels, which resulted in the locking in of any disparities and inequities.

Federal "874" funding is not presently included in the State's computations for the funding of schools. However, plaintiffs' experts did include "874" funds in some of their studies comparing the wealth of various school districts. Intervenor-defendant Hays-Lodge Pole Elementary School Dist., et al., (Hays-Lodge Pole) is an association of Montana public schools which receive "874" funds by reason of the attendance of Indian students on and around the 7 federal treaty reservations in Montana. Hays-Lodge Pole argued that "874" funds should remain outside of the State's budgetary process.

The District Court concluded that education is a fundamental right under Montana's Constitution. It concluded that, under the 1985-86 system of funding public elementary and secondary schools, disparities in per pupil spending among schools as a result of disparities in local property wealth do not even pass the rational basis test of equal protection analysis. It concluded that the concept of local control is not related to the spending disparities now present. It further concluded that the State's budgetary difficulties do not constitute a legal defense to these inequalities.

The court also concluded that the Montana School Accreditation standards do not define the constitutional right to education. It concluded that the treatment of federal "874" funding for schools with Indian enrollment exacerbates the inequalities present in the school finance system. The court

ordered that the present system of school funding may remain in effect until October 1, 1989, and retained jurisdiction, but left to the Legislature the task of fashioning a constitutional funding system.

The State of Montana and defendants Holje, Ward, and Frederich appeal the District Court's determination that the present system of school funding is unconstitutional. The Montana Board of Public Education asks this Court to clarify the comments in the District Court's findings concerning the role of accreditation standards which the Board establishes. Hays-Lodge Pole raises five allegations of error in the District Court's ruling that federal "874" funding should be considered for purposes of equalization. Plaintiffs cross-appeal on the denial of their request for attorney fees.

I

Does Montana's system of funding the public schools violate the education article, Art. X, of the Montana Constitution?

Art. X, Sec. 1, Mont.Const., provides:

(1) It is the goal of the people to establish a system of education which will develop the full educational potential of each person. Equality of educational opportunity is guaranteed to each person of the state.

(2) The state recognizes the distinct and unique cultural heritage of the American Indians and is committed in its educational goals to the preservation of their cultural integrity.

(3) The legislature shall provide a basic system of free quality public elementary and secondary schools. The legislature may provide such other educational institutions, public libraries, and educational programs as it deems desirable. It shall fund and distribute in an equitable manner to the school districts the state's share of the cost of the basic elementary and secondary school system.

By referring to the discussions in the transcript of the 1972 Montana Constitutional Convention, the State contends the provision in subsection (1) that "[e]quality of educational opportunity is guaranteed to each person," is an aspirational goal only. We disagree with that contention. In interpreting the Constitution, as in statutory construction, this Court must first look to the plain meaning of the words used. *State ex rel. Cashmore v. Anderson* (1972), 160 Mont. 175, 184, 500 P.2d 921, 926. In the first sentence of Art. X, Sec. 1(1), the framers of the Constitution clearly stated the "goal" of the people to establish a system of education which will develop the full educational potential of each person. In the next sentence, the framers did not use the term "goal." Instead they stated that equality of educational opportunity "is guaranteed" to each person of the state. As we review our Constitution, we do not find any other instance in which the Constitution "guarantees" a particular right. We conclude that the plain meaning of the second sentence of subsection (1) is that each person is guaranteed equality of educational opportunity. The plain meaning of that sentence is clear and unambiguous.

The State argues that the last sentence of subsection (3) limits the Legislature's duty in connection with the guarantee of equal educational opportunity. It points out that Foundation Program funds are conceded by all parties to have been distributed in an equitable manner, and then suggests that because the State has distributed such funds in an equitable manner as required under the last sentence of subsection (3), the Legislature has met its constitutional obligations as required under Art. X, Sec. 1.

Art. X, Sec. 1(3), Mont.Const., requires that the Legislature shall provide a basic system of free quality education, that it may provide various types of educational

institutions and programs, and that the state's share of the cost of the basic system shall be distributed in an equitable manner. There is nothing in the plain wording of subsection (3) to suggest that the clear statement of the obligations on the part of the Legislature in some manner was intended to be a limitation on the guarantee of equal educational opportunity contained in subsection (1). The guarantee provision of subsection (1) is not limited to any one branch of government. Clearly the guarantee of equal educational opportunity is binding upon all three branches of government, the legislative as well as the executive and judicial branches. We specifically conclude that the guarantee of equality of educational opportunity applies to each person of the State of Montana, and is binding upon all branches of government whether at the state, local, or school district level. We hold that the last sentence of subsection (3) is not a limiting provision on the guarantee of equal educational opportunity contained in subsection (1).

The evidence presented at the trial of this case clearly and unequivocally established large differences, unrelated to "educationally relevant factors," in per pupil spending among the various school districts of Montana. The evidence also demonstrated that the wealthier school districts are not funding frills or unnecessary educational expenses. Plaintiffs' expert witnesses testified that discrepancies in spending as large as the ones present in Montana translate, in their opinions, into unequal educational opportunities. There was also unrebutted testimony that Foundation Program funding falls short of even meeting the costs of complying with Montana's minimum accreditation standards.

The State attempted to present an argument at trial that equality of educational opportunity is more appropriately measured by output, that is, by analysis of the success of

students from the different school districts, rather than by input of dollars. The District Court concluded that the State had failed to submit convincing evidence on the output theory of measurement. We agree with that conclusion on the basis of this record. The District Court found similarly unpersuasive the argument that statewide fiscal difficulties in the last few years somehow excuse the disparities in the spending per pupil in the various school districts. We agree with the District Court that such fiscal difficulties in no way justify perpetuating inequities.

The State also argued that the Constitutional directive of local control of school districts, Art. X, Sec. 8, Mont. Const., requires that spending disparities among the districts be allowed to exist. That section provides:

School district trustees. The supervision and control of schools in each school district shall be vested in a board of trustees to be elected as provided by law.

While Section 8 does establish that the supervision and control of schools shall be vested in the board of trustees, there is no specific reference to the concept of spending disparities. Further, as made especially apparent after the passage of Initiative 105, the spending disparities among Montana's school districts cannot be described as the result of local control. In fact, as the District Court correctly found, the present system of funding may be said to deny to poorer school districts a significant level of local control, because they have fewer options due to fewer resources. We conclude that Art. X, Sec. 8, Mont. Const., does not allow the type of spending disparities outlined in the above quoted findings of fact.

In 1972, when our Constitutional Convention met, approximately 65% of General Fund revenues were funded through the

Foundation Program. Con.Con. Tr. 2157. The transcript of the debate on Art. X, Sec. 1(3), Mont.Const., clearly expresses the delegates' concern with that level of funding. See, for example, Con.Con. Tr. 1981-86, 2152-59.

We conclude that as a result of the failure to adequately fund the Foundation Program, forcing an excessive reliance on permissive and voted levies, the State has failed to provide a system of quality public education granting to each student the equality of educational opportunity guaranteed under Art. X, Sec. 1, Mont.Const. We specifically affirm that portion of the District Court's Conclusion of Law 17 which holds that the spending disparities among the State's school districts translate into a denial of equality of educational opportunity. We hold that the 1985-86 system of funding public elementary and secondary schools in Montana is in violation of Article X, Section 1 of the Montana Constitution.

In analyzing school funding under an equal protection analysis pursuant to the provisions of Art. II, Sec. 4, Mont.Const., the District Court concluded that education is a fundamental right and also made numerous and extensive findings of fact and adopted a number of conclusions of law. Because we have concluded that the school funding system is unconstitutional under Art. X, Sec. 1, Mont.Const., we do not find it necessary to consider the equal protection issue. We therefore make no decision with regard to the findings of fact and conclusions of law relating to the equal protection of the laws analysis of the District Court, and in particular do not rule upon the determination by the District Court that education is a fundamental right.

Several of the parties suggested that in the event we concluded the school funding was unconstitutional, we should spell out the percentages which are required on the part of

the State under the Foundation Program and for the districts under the voted levy system. We are not able to reach that type of a conclusion. As previously indicated, the 1985-86 school funding involved more than 20 different funds. The control of such funds is primarily in the Legislature. Our opinion is not directed at only one element of the system of funding public schools in Montana, as we recognize that the Legislature has the power to increase or reduce various parts of these elements, and in addition to add other elements for such funding.

While this opinion discusses spending disparities so far as pupils are concerned, we do not suggest that financial considerations of that type are the sole elements of a quality education or of equal educational opportunity. There are a number of additional factors which are a significant part of the education of each person in Montana, including but not limited to such elements as individual teachers, classroom size, support of the parents of students, and the desire and motivation on the part of the student which moves him or her to seek earnestly after an education. By not discussing these elements, we do not in any way suggest they are irrelevant, for the financing of education is only one aspect of equal educational opportunity. Our opinion is intentionally limited to the elements discussed in the opinion.

II

Should this Court clarify the District Court's findings regarding the accreditation standards promulgated by the Montana Board of Public Education?

Under Art. X, Sec. 9(3), Mont. Const., the Montana Board of Public Education (Board) has general supervisory power over the public school system. The Board has adopted state-wide accreditation standards for elementary and secondary schools. Those standards require teachers to be certified by

the State, limit teachers' class loads, outline a minimum instructional program (for example, courses required for high school graduation), and establish minimum size, maintenance, and safety standards for school facilities. The Board argues that these standards establish the instructional component of a basic system of free quality public elementary and secondary schools. It objects to the District Court's findings no. 262 and 270, which read as follows:

262. The testimony of superintendents, teachers, and trustees clearly establish that from a professional educators' perspective, the minimum Accreditation Standards in no way define a quality education.

. . .

270. In sum, the Montana School Accreditation Standards are minimum standards only, and do not provide the basis for defining quality education.

The Board also objects to the last sentence of the court's conclusion no. 18:

18. . . . Thus, the Montana School Accreditation Standards do not define either the constitutional rights of students or the constitutional responsibilities of the State of Montana for funding its public elementary and secondary schools.

The Board moved the District Court to amend the above findings, but the motion was deemed denied after 45 days had passed, under Rule 59(d), M.R.Civ.P. None of the parties disagree with finding no. 261 of the District Court that the accreditation standards establish a minimum upon which quality education can be built.

After reviewing the Board's argument and the transcript, we conclude that the findings and conclusion in question should be amended as requested. We therefore hold that

findings of fact 262 and 270 and conclusion of law 18 shall be amended to read as follows:

[Finding of Fact 262.] The testimony of superintendents, teachers, and trustees clearly establishes that from the professional educators' perspective, the minimum accreditation standards do not fully define a quality education.

[Finding of Fact 270.] In sum, the Montana School Accreditation Standards are minimum standards upon which quality education must be built.

[Conclusion of Law 18.] Thus, the Montana School Accreditation Standards do not fully define either the constitutional rights of students or the constitutional responsibilities of the State of Montana for funding its public elementary and secondary schools.

III

Did the District Court err in its findings and conclusions relating to consideration in the equalization process of federal "874" funding?

Public Law 81-874 ("874") was enacted by the United States Congress in 1950. It provides federal payments to school districts which serve children who reside on or whose parents are employed on federal property, including Indian lands, or who have a parent on active duty in the military.

Hays-Lodge Pole asserts that, contrary to the District Court's finding, Public Law 81-874 has as one of its purposes assisting with the special problems in Indian education and is not only a federal effort to replace lost tax revenue resulting from the federal presence. It argues also that the court's finding that, in some districts, "874" funding has been used as tax relief is irrelevant and shows only the State's neglect of the special needs of Indian children. It contends that "874" funding is closely tied to the need on

and near Indian reservations for additional school funding because of the extraordinary educational difficulties present - language barriers, poverty, unemployment, and cultural differences. It maintains that any inequity present in "874" districts will vanish when the Montana funding system is equalized without consideration of "874" funding and that the history of neglect of Indian education justifies judicial protection of the benefits provided by "874" funding. Hays-Lodge Pole argues that the District Court erred in ruling that the Legislature may consider "874" funding in equalization.

This issue is resolved by the federal statutory requirement that the United States Secretary of Education must approve of Montana's equalization plan before "874" funding may be taken into account. 20 U.S.C.A. § 240(d) (Supp. 1988). The District Court recognized this requirement in its finding no. 235, and found that Montana's system had not secured that federal approval. We specifically affirm the District Court's Conclusions No. 20:

20. A state may factor P. L. 81-874 revenue into its school finance equalization system only if the system meets the federal definition of an equalized program, subject to the determination of the Secretary of Education. [See Gwinn Area Community Schools v. State of Michigan, 741 F.2d 840 (6th Cir. 1984)] Montana presently does not and may not factor P. L. 81-874 revenue into the Foundation Program equalization formula, because Montana's system does not meet the federal definition of an equalized program.

Art. X, Sec. 1(2), Mont.Const., states as follows with regard to our American Indians:

The state recognizes the distinct and unique cultural heritage of the American Indians and is

committed in its educational goals to the preservation of their cultural integrity.

That provision establishes a special burden in Montana for the education of American Indian children which must be addressed as a part of the school funding issues. We do invite the attention of the Legislature and the executive branch to Montana's failure to meet the federal equalization requirements. As a part of the changes to be made in Montana's school funding system, it may be appropriate to meet the federal equalization requirements in order that "874" funding may be factored into the State's equalization formula.

IV

Did the District Court err in denying plaintiffs' attorney fees?

Plaintiffs argue that they are entitled to recover their reasonable attorney fees under the "common fund" doctrine. This Court has described that doctrine as one which:

. . . provides that when a party through active litigation creates, reserves or increases a fund, others sharing in the fund must bear a portion of the litigation costs including reasonable attorney fees. The doctrine is employed to spread the cost of litigation among all beneficiaries so that the active beneficiary is not forced to bear the burden alone and the "stranger" (i.e., passive) beneficiaries do not receive their benefits at no cost to themselves.

Means v. Montana Power Co. (Mont. 1981), 625 P.2d 32, 37, 38 St.Rep. 351, 355-56. See also Serrano v. Priest (Cal. 1977), 569 P.2d 1303, 1310-11.

The District Court concluded that the common fund doctrine did not apply in this case because no common fund was created from which attorney fees and expert witness fees could be paid. In a similar manner, under the "substantial

benefit" concept which has grown out of the common fund doctrine, the District Court concluded that no substantial benefit had resulted from its opinion and that no such benefit would accrue unless the Legislature acts. We conclude that the District Court properly denied attorney fees. We affirm the District Court's denial of plaintiffs' request for attorney fees.

V

We approve the District Court's rationale that "in order to provide the Legislature with the opportunity to search for and present an equitable system of school financing," the holdings in this case should not become immediately effective. We modify the reservation of jurisdiction by the District Court to provide that this Court specifically retains jurisdiction until July 1, 1989, and on that date the holdings of this opinion shall become fully in effect for all school terms commencing after that date.

We Concur:



Justice

J. A. Turnage
Chief Justice

John Conway Harrison

John L. Sheehy

R. C. Sulbrandon

William H. Hentley

R. C. Sulbrandon
Justices

Justice John C. Sheehy, concurring:

I concur emphatically with the foregoing opinion but wish to comment respecting the entitlement of plaintiffs to attorney fees.

We cite *Serrano v. Priest* (Cal. 1977), 569 P.2d 1303, 1310-1311, to the effect that the common fund theory and the substantial benefit theory do not, at this time present a basis for attorney fees. Not to be forgotten, however, is that in *Serrano*, the court awarded the plaintiffs attorney fees on the "private attorney general" theory. If, as we all hope, because of the efforts of the plaintiffs an equitable funding of education is eventually established, all of the requisites for an award of attorney fees on the private attorney general theory would be present in my view.


Justice