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STATE OF OREGON
LEGISLATIVE COUNSEL COMMITTEE

April 20, 2015

Senator Arnie Roblan
900 Court Street NE S417
Salem OR 97301

Re: Impairment of Contract issues in Senate Bill 819 (2015)

Dear Senator Roblan:

You asked us whether Senate Bill 819 (2015), as amended by the -1 amendments, would be an unconstitutional impairment of contracts under both the United States and Oregon Constitutions. We conclude that the answer is no, and that SB 819 as modified by the -1 amendments would not impermissibly impair the obligation of any contract in effect between a school district and a public charter school.

Background

SB 819, in part, amends ORS 338.155 to direct a school district to enter into a contract with a public charter school that provides for payment to the public charter school for the provision of educational services to the students of the public charter school. The payment must equal or exceed a specified amount, unless one of two exceptions applies.[1] Significantly, section 2 of the introduced version of SB 819 limits application of the amendments to ORS 338.155 to contracts entered into or renewed on or after the effective date of SB 819. The -1 amendments alter section 2 to provide that the changes to ORS 338.155 proposed by SB 819 apply to all contracts between school districts and public charter schools, whether the contract is in existence prior to or executed[2] after the effective date of SB 819.

When the -1 amendments were prepared, they were accompanied by a March 19, 2015, memorandum from the Office of Legislative Counsel advising that the -1 amendments, if incorporated into the bill, would likely result in an unconstitutional impairment of contracts. At your request we have looked more closely at the impairment of contracts issue and now conclude that for the reasons set forth below, adoption of the -1 amendments would not result in an unconstitutional impairment of contracts.

[1] The payment must equal or exceed 95 percent of the school district's General Purpose Grant per weighted average daily membership (ADMw), if the public charter school's sponsor is the school district board, or 95 percent of the General Purpose Grant per ADMw of the school district where the public charter school is located, if the charter school's sponsor is the State Board of Education or an institution of higher education. SB 819, sec. 1 (amending ORS 338.155).

[2] In the context of impairment of contract analysis, a contract "renewal" is the same as the execution of a new contract.

Constitutional prohibitions on the impairment of contracts

Federal and state provisions interpreted similarly

Article I, section 21, of the Oregon Constitution, provides, in part, that no law "impairing the obligation of contracts shall ever be passed." Article I, section 10, of the United States Constitution, is similarly worded, providing, in part, that "No State shall . . . pass any . . . Law impairing the Obligation of Contracts." The Oregon Supreme Court has held "that the framers of the Oregon Constitution intended to incorporate the substance of the federal provision, as it was . . . interpreted by the Supreme Court of the United States [at the time the Oregon Constitution was adopted in 1859], though not necessarily every case decided under the federal provision." *Eckles v. State*, 306 Or. 380, 390 (1988).

General analysis of whether a law impairs the obligation of contracts

Courts employ a three-level analysis to determine if a law unconstitutionally impairs an obligation of a contract between private parties. A threshold question is whether the law operates to create a substantial impairment of a contractual relationship. The total destruction of the contractual relationship is not necessary for substantial impairment, but regulation that restricts a party to gains it reasonably expected from the contract often may not constitute a substantial impairment. If the law at issue constitutes a substantial impairment, the impairment may nevertheless be constitutionally justified if the state has a significant and legitimate public purpose behind the law creating the impairment. Once a significant and legitimate public purpose has been identified, the final inquiry is whether the adjustment of the rights and responsibilities of the contracting parties is based upon reasonable conditions and is of appropriate character to the public purpose justifying the regulation. *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411-412 (1983).

Impairment of contracts claims can arise in the context of contracts to which the state is a contracting party and in particular in the context of contracts created by legislative act. *See, e.g., Hughes v. Oregon*, 314 Or. 1 (1992). The analysis undertaken to determine if a law unconstitutionally impairs the obligation of contract, under either the federal Constitution or the state Constitution, is modified when the contract at issue is one established by legislation or in which the state is a party. Initially, a contractual obligation will be inferred from legislation only if the legislature has unambiguously expressed an intention to create that obligation. *Eckles*, 306 Or. at 390. In circumstances in which a legislative intent to create a contractual obligation through statute can be inferred, however, a court will not consider the balancing of a legitimate public purpose against an impaired contract right to uphold legislation that alters contractual obligations. *Energy Reserves,* 459 U.S. at n.14. Balancing and deference to a legislative assessment of reasonableness and necessity is inappropriate in these circumstances as well, because the state's self-interest is at stake. *United States Trust Co. v. New Jersey*, 431 U.S. 1, 25-26 (1977). Rather, a court will consider only whether the statute in question changes contractual obligations in existence at the time of the statutory enactment, without regard to balancing any countervailing public purpose behind the enactment. *Hughes*, 314 Or. at 56.

Statutory contracts between state and political subdivisions not subject to protection from impairment of obligation of contract

Early federal cases rejected the principle that a local government could obtain protection from a legislative impairment of a contractual agreement between the state and the local government. Rather, local governments or other political subdivisions of a state are "mere

organizations for public purposes," for which powers, rights and duties may be modified or abolished at any moment by a state legislature. *East Hartford v. Hartford Bridge Co.*, 51 U.S. 511, 534 (1850). Later Oregon cases applied the same line of reasoning to conclude that counties, cities and other political subdivisions are instrumentalities of the state established for the convenient administration of government and therefore subject at all times to legislative control. *Stovall v. State by & through Oregon DOT*, 324 Or. 92, 117-119 (1996). As such, legislation subsequently modifying a statutory provision that otherwise would be considered a statutory contract is not limited by Article I, section 21, of the Oregon Constitution, because the relationship between the state and its political subdivisions necessarily lacks private stipulations that the prohibition against impairment of contracts is designed to protect, and instead is composed solely of public objects that the Legislative Assembly may alter through enactment of general laws. *Stovall*, 324 Or. at 116-119.

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Under *Stovall* and related decisions, a school district is considered a local political subdivision. *See also* ORS 332.072 et seq.

ORS chapter 338 provides the statutory framework to establish and operate a public charter school. Before a school may operate as a public charter school, it must be approved by a sponsor,[4] be established as a nonprofit organization under the laws of this state and have applied to be an exempt organization under section 501(c)(3) of the Internal Revenue Code. ORS 338.035. In other words, a public charter school is an entity that is independent of the state and its local subdivisions. To be approved by a sponsor, an applicant seeking to establish a public charter school must submit a written proposal setting forth specified items, the sponsor must evaluate the application and the sponsor must approve the application if, in the sponsor's judgment, the applicant has demonstrated compliance with listed criteria. ORS 338.045 and 338.055. Upon approval, the sponsor and applicant negotiate a charter—the principal organizing document of the public charter school—which must contain certain requirements and may contain other specifics. ORS 338.065. The charter itself is arguably a type of contract. However, the contractual terms at issue in SB 819 are in a different agreement from the charter.

ORS 338.155 (2) provides that "[a] school district shall contractually establish, with any public charter school that is sponsored by the board of the school district, payment for provision of educational services" with the amount of payment being 80 percent of the school district's General Purpose Grant per [student][5] for kindergarten through grade eight and 95 percent of the school district's General Purpose Grant per [student] for grade nine through grade 12. The school district and public charter school may negotiate a payment that is more than the minimum amount specified in ORS 338.155 (7). We conclude that ORS 338.155 evidences an unambiguous legislative intent to supply contract terms for contracts between a sponsoring school district and a public charter school.

[3] This and all subsequent references to SB 819 in this opinion refer to SB 819 as amended by the -1 amendments.
[4] The sponsor of a public charter school is usually the school district in which the public charter school is located, though under certain circumstances not relevant to this opinion, the sponsor may be the State Board of Education or an institution of higher education. ORS 338.005 (5).
[5] ORS 338.155 (2) actually provides that the amount of the mandated payment to public charter schools is computed as a percentage of the General Purpose Grant per weighted average daily membership (ADMw) of the district. Other adjustments may also be required. ADMw is loosely equivalent to student population. ORS 327.006. For clarity, this opinion substitutes the term "student" for ADMw and omits discussion of other required payments under ORS 338.155 that do not bear on the impairment of contracts issue.

SB 819 amends ORS 338.155 to, among other things, increase the minimum payment that a sponsoring school district must by contract agree to pay, from 80 percent of the General Purpose Grant to 95 percent of the General Purpose Grant, for students in kindergarten through grade eight, unless the public charter school is a virtual public charter school. If SB 819 is to apply to existing contracts, passage of SB 819 will cause many payments under existing contracts to increase from 80 to 95 percent.

Stovall and related cases are not directly applicable to contracts required under ORS 338.155, either as constituted under current law or as contemplated under SB 819, because each public charter school is an independent nonprofit corporation under Oregon law and an exempt organization under section 501(c)(3) of the Internal Revenue Code. ORS 338.035 (2). Accordingly, if the legislature were to enact legislation that required a reduction in the amount of payments made to public charter schools under ORS 338.155, such a change would be an unconstitutional impairment of the obligation of contracts and public charter schools would be able to avail themselves of the protections of Article I, section 21 of the Oregon Constitution. But that is not the case with SB 819. By increasing the amount of payments due to public charter schools under existing contracts, the Legislative Assembly is modifying the State School Fund moneys and local property tax revenues a sponsoring school district has available to it, which is purely a question of public policy for which the Legislative Assembly is the sole judge. *Stovall*, 324 Or. at 118.

Please advise if you have further questions.

The opinions written by the Legislative Counsel and the staff of the Legislative Counsel's office are prepared solely for the purpose of assisting members of the Legislative Assembly in the development and consideration of legislative matters. In performing their duties, the Legislative Counsel and the members of the staff of the Legislative Counsel's office have no authority to provide legal advice to any other person, group or entity. For this reason, this opinion should not be considered or used as legal advice by any person other than legislators in the conduct of legislative business. Public bodies and their officers and employees should seek and rely upon the advice and opinion of the Attorney General, district attorney, county counsel, city attorney or other retained counsel. Constituents and other private persons and entities should seek and rely upon the advice and opinion of private counsel.

Very truly yours,

Dexter A. Johnson
Legislative Counsel