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SCHOOL LAW BUZZ

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Judicial Decision

Pretend This Court Opinion Does Not Exist

By Adam Courtin

You might hear about a February 27, 2019 opinion issued by the Texas Court of Criminal Appeals (the highest court in Texas that hears state law criminal matters). Go ahead and pretend that the opinion does not exist, please. In the opinion, the Court took issue with specific language in the Texas Open Meetings Act ("TOMA"), and effectively struck one provision of the TOMA that makes it a crime if a member or group of members of a governmental body "knowingly conspires to circumvent this chapter by meeting in numbers less than a quorum for the purpose of secret deliberations in violation of this chapter."

Why disregard the opinion?

It does not change the fact that actions taken by a governmental body in violation of the TOMA are still voidable (and open the door to embarrassing and expensive lawsuits). It also does not change the fact that non-compliance with the TOMA is a material breach of charter under TEA regulations.

What to do?

Keep up the good work with your diligent compliance with the TOMA.

Finally, a prediction: the impact of the opinion will probably be short-lived because the Texas Legislature will likely pass an amendment to the TOMA that replaces the language that the Court did not like.

Rule Amendments

Disclosure Requirements Change for Bond Issuers

By Janet Robertson

Charter schools and other obligors on municipal bonds issued in an aggregate principal amount of $1,000,000 or more, with respect to which a continuing disclosure agreement ("CDA") is entered into on or after February 27, 2019, are required by amendments to Securities Exchange Commission ("SEC") Rule 15c2-12 to provide prompt public notice on the Electronic Municipal Market Access ("EMMA") website of two new types of events. Briefly summarized, new item #15 requires disclosure within ten (10) days of incurrence of new financial obligations and terms that affect bondholders, if material. Also, new item #16 requires disclosure within ten (10) days of occurrence of defaults and similar events under any financial obligation that reflect financial difficulties. These new events are in addition to the 14 events previously included under Rule 15c2-12. The disclosure requirements last for the life of the municipal bonds.

I. Financial Obligations

The SEC's stated purpose for these amendments is to address the need for timely disclosure of important information related to an obligated entity's financial obligations. For purposes of these amendments to Rule

15c2-12, "financial obligation" is defined to mean: (1) a debt obligation; (2) a derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or (2) a guarantee of the foregoing. The term financial obligation does not include municipal securities as to which a final official statement has been provided to the MSRB consistent with Rule 15c2-12. The SEC has further clarified that a "financial obligation" does not "include ordinary financial and operating liabilities incurred in the normal course of an issuer's or obligated person's business, only an issuer's or obligated person's debt, debt-like, and debt-related obligations." SEC Release No. 34-83885 (August 20, 2018), 83 Fed. Reg. 44700 (August 31, 2018) (the "Adopting Release") at 44709.

What does this mean in practice? It means that, if material, bank loans and other types of debt, including guarantees, derivative instruments that are entered into in connection with or pledged as security for or a source of payment for a debt obligation and leases that operate as vehicles to borrow money must be disclosed within ten (10) days of incurrence. In addition, the act of agreeing to covenants, events of default, remedies, priority rights or other similar terms of a financial obligation, any of which affect bondholders, if material, must be disclosed. Much discussion has already been had in the bond community about what makes a financial obligation or related terms and conditions "material" for purposes of these amendments, but the fact of the matter is that the SEC uses the same standard for materiality under the new amendments as it always has: would this financial obligation or the terms of a financial obligation that affect bondholders "be important to a reasonable investor when making an investment decision?" Adopting Release at 44706. This is fundamentally the same analysis that is made when determining whether or not to include information in an offering document, otherwise stated as "whether there is a substantial likelihood that a reasonable security holder would consider the information important in deciding whether to buy or sell a security." Adopting Release n. 76 at 44706, quoting *Basic, Inc. v. Levinson,* 485 U.S. 224 (1988).

II. Events that Reflect Financial Difficulties

New item #16 requires the disclosure within ten (10) days of the occurrence of a "default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the obligated person, any of which reflect financial difficulties." While the use of the term "default" instead of "event of default" seems very broad at first glance, the SEC states in the Adopting Release that the clause "any of which reflect financial difficulties" is intended to limit the scope of the new event to focus on the creditworthiness of the reporting issuer or obligated person. Adopting Release at 44716. One example provided by the SEC would be a situation in which the issuer or obligated person has covenanted to provide a notice of change of address to its lender but may not promptly comply with the covenant. "A failure to comply with such a covenant may not reflect financial difficulties; therefore, absent other circumstances, this event likely does not raise the concerns the amendments are intended to address. On the other hand an issuer or an obligated person could agree to replenish a debt service reserve fund if draws have been made on such fund. In this example, if an issuer or obligated person fails to comply with such covenant, then such an event likely should be disclosed to investors and other market participants." Adopting Release n.187 at 44716, *quoting* SEC Release No. 34-80130 (March 1, 2017), 82 Fed. Reg. 13928 (March 15, 2017).

The Adopting Release further states that issuers and obligated persons "may consider disclosing the occurrence of events that do not reflect financial difficulties as a matter of best practice if they believe investors would find those occurrences important." *Id.*

As previously mentioned, the amendments only affect obligors on bonds subject to CDAs entered into after February 27, 2019. Therefore, only material financial obligations entered into after that date need be disclosed under new item #15. However, the Adopting Release clarifies that the default-type events listed in item #16 must be disclosed regardless of whether the obligation to which they relate was incurred before or after the compliance date. Adopting Release at 44717.

III. The Takeaway

This discussion of the new event disclosure requirements is only a brief summary. The decision as to whether or not to disclose must be determined on the basis of a thorough legal analysis of the much more detailed SEC releases referenced above under the specific circumstances of each situation. And the 10-day timeline is very short. If you are confronted with one of these situations, please contact us immediately to help you make the decision in an appropriate and efficient manner. Indeed, any school that is obligated on bonds issued after the February 27th effective date would be well-advised to contact us and/or its financial advisor any time it is contemplating incurring a debt obligation, entering into a guarantee or issuing a derivative instrument (such as an interest rate swap, cap or collar) - as well as any time it encounters a potential compliance situation under any of its financial obligations.

Cost Plus Fee Contracting Shenanigans

By Bryan Dahlberg

Construction contracts based on the Cost of the Work plus a fee can be a great option for charter schools that have adopted Chapter 44 of the Education Code and can be used in either the Construction Manager at Risk or Design-Build delivery methods.

Under this compensation structure, the parties agree at the outset of a project that the contractor will be reimbursed for actual expenses incurred in performing the work (*e.g.,* subcontractor costs, materials, utilities, etc.), and will additionally be paid a percentage fee for the contractor's profit and overhead. Once design work has been completed and subcontractor bids have been accepted, the parties will then execute a Guaranteed Maximum Price ("GMP") amendment before beginning the construction phase. The GMP amendment sets a total ceiling for the entire cost of the project and should include a line item breakdown of all component costs and fees. Unlike contracts based on a stipulated sum, this structure allows charter schools to realize significant savings if the project comes in under budget, while also protecting them from cost overruns. This structure also provides a level of transparency that is not available in a contract for a stipulated sum.

However, contractors are always looking to reduce risk and increase profits, and some use less than upstanding means. The GMP amendment is one place they try to do so, and it is critical that schools pay close attention at this stage. Each line item should correspond to the accepted low bid for a given trade, but we have recently seen contractors submit GMP amendments that inflate the expected subcontractor costs. Since the contractor is getting paid a percentage of the Cost of the Work, it has no reason to keep costs low, except to avoid going over the GMP. Thus, an inflated GMP gives the contractor more

room for error and can ultimately cost the school more money.

Another method contractors use is to calculate their fee as a percentage of the total GMP, as opposed to the Cost of the Work, which is a term that is strictly defined in the contract language. To illustrate, a contractor charging a 10% fee for profit and overhead will say that, if the GMP is $1,000,000, his fee should be $100,000. However, in this scenario, the Cost of the Work is only $900,000, and the contractor's 10% fee should only be $90,000. On larger multi-million dollar projects, this trick can really add up.

Additionally, when contractors bid their percentage fee as the sum of two components, profit and overhead, they will sometimes try to compound one on top of the other. For instance, when the contractor's 10% fee is the sum of 7% overhead and 3% profit, a contractor might calculate its 3% profit based on the sum of the Cost of the Work plus the 7% overhead. Stacking fees like this should not be allowed. Both the overhead and profit should separately be computed upon the Cost of the Work.

In sum, schools should remain vigilant throughout the course of a project, particularly at the GMP amendment stage and any time a contractor proposes a deviation from the standard contract terms, or even makes a progress payment application.

New Guidance on Holding MDRs for Students Not Yet IDEA-Eligible

By Chris Schulz

If a parent or teacher has requested a special education evaluation, or an evaluation for special education services is pending, it seems strange that a student who is not yet eligible under the IDEA has the right to full ARD committee and manifestation determination if there is a violation of the Student Code of Conduct resulting in a removal for ten (10) or more school days. However, that has long been the law for students not yet eligible for special education services. The problem has been how does the ARD committee determine whether the conduct is a manifestation when the committee does not have a completed evaluation opon which to base its decision. Some schools would delay the MDR until the evaluation was completed.

This was the situation in *Letter to Nathan*, a guidance letter issued by the Office of Special Education Programs in January 2019. A school delayed a manifestation determination until the student's evaluation was completed. OSEP stated that the manifestation determination must be conducted within ten (10) school days of the proposal to remove the student, even if the evaluation is in progress. In those circumstances, the school must use the evaluation data in its possession to determine whether the conduct is a manifestation of the student's disability. This would include evidence of prior conduct, reports from the parent on any private diagnoses, and input from the assessment personnel based on the current status of the Full Individual Evaluation. If the student's Code of Conduct violation is a new or different behavior than previously seen, it is not as likely the student's behavior is a manifestation. If the student's behavior is consistent with behaviors for which the student was referred for an evaluation, the committee could potentially determine that the behavior is a manifestation of the student's suspected disability. In any event, the fact that the evaluation is not completed should not be a barrier to holding a proper MDR.

Using Indirect Cost Rates to Support Administrative Activities

By Ramón Medina

On February 14, 2019, TEA issued a To The Administrator Addressed letter informing charter school administrators that the annual online survey to request an indirect cost rate must be submitted by March 29, 2019. Go to https://tea.texas.gov/About_TEA/News_and_Multimedia/Correspondence/TAA_Letters/2019–2020_Process_for_Requesting_Indirect_Cost_Rates_(Charter_Schools_Only)/ for a copy of the letter.

Why request an indirect cost rate?

Because your school uses funds to support activities that further the federal programs that it administers.

This simple regulatory authority should enable your school to use some of the federal funds that it receives to support accounting, facilities management, payroll, personnel, and purchasing functions. Depending upon the amount received, the school may benefit from requesting, receiving and applying an indirect cost rate to recover some of the administrative expenses incurred to support the federal programs. Even if the current federal funding amounts do not warrant the use of an indirect cost rate, you may want to consider requesting one in the event that a federal grant opportunity presents itself that may require significant administrative support and expense. Otherwise, the school's local and state fund sources will be left footing the bill for this new effort.

Have Questions? We'll Answer.

If you have any questions concerning the content in this e-newsletter or any other school law matter, please contact Lori Madla at lmadla@@slh-law.com or at (210) 538-5385.