California Supreme Court finds that Charter Schools (and not School Districts) are Subject to the California False Claims Act and Unfair Competition Laws

On August 31, 2006, in the matter of ***Joey Wells v. ONE2ONE Learning Foundation,*** the California Supreme Court found that "charter schools, and the individuals, corporations, entities, or organizations that operate them" are subject to suit under both the California False Claims Act and the unfair competition laws.

In this matter, certain non-site based charter schools, their corporate operators, and the chartering school districts were sued on multiple grounds by some of the schools' students and their parents or guardians. The gravamen of all of the claims was that the schools -- designed to provide and facilitate home instructions through use of the Internet (distance learning programs) -- failed to deliver instructional services, equipment, and supplies as promised, and as required by law. In effect, the plaintiffs asserted, among other things, that the schools functioned only to collect "average daily attendance" forms, on the basis of which the schools, and the districts, fraudulently claimed and received public education funds from the state.

California False Claims Act (CFCA):

The California False Claims Act (CFCA; Gov. Code §12650 *et seq*.) provides that "[a]ny person" who, among other things, "[k]nowingly presents or causes to be presented to… the state…a false claim for payment or approval," or "[k]nowingly makes, uses, or causes to be made or used a false record or statement to get a false claim paid or approved by the state," or "[c]conspires to defraud the state …by getting a false claim allowed or paid by the state" "shall be liable to the state… for three times the amount of damages" the state thereby sustained, as well as the state's cost of suit, and may also be liable for a civil penalty of up to $10,000 for each false claim. Generally, a CFCA claim is brought and prosecuted by the California Attorney General (but may be brought by an individual "on behalf of the government" under limited circumstances).

Unfair Competition Laws (UCL):

As pertinent to this matter, the unfair competition laws (UCL; Bus. & Prof. Code § 17200 *et seq.*) provides relief by civil lawsuit against "[a]ny person who engages, has engaged, or proposes to engage in unfair competition." "Unfair competition" is defined to include "any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising[.]" A UCL claim can be brought by the California Attorney General or a private individual.

The Supreme Court's Decision:

The applicability of both the CFCA and UCL turn on whether the charter school defendants were deemed "persons" under the statutes. The defendant charter schools argued that they were entitled to "public entity" immunity enjoyed by school districts, but the Supreme Court was not persuaded. The Supreme Court found that "though charter

schools are deemed part of the system of public schools for purposes of academics and state funding eligibility, and are subject to some oversight by public officials (citation omitted), they are *operated*, not by the public school system, but by distinct outside entities -- including nonprofit public benefit corporations with independent legal identities[.]" As such the Court reasoned that:

> "The CFCA was designed to help the government recover public funds of which it was defrauded by outside entities with which it deals… the statutory purpose is equally served by applying the CFCA to the independent corporations, organizations, and associations that receive public monies under the [Charter Schools Act] to operate schools on behalf of the public education system."

Interestingly, the Supreme Court also concluded that school districts are not "persons" who may be sued under the CFCA. The Supreme Court cited to legislative history that indicated there was no intent in the law to include school districts and other public and governmental agencies. Moreover, the court found public policy reasons related to the limited resources of school districts did not warrant application of the CFCA to school districts; the Court concluded that:

> "exposing [school districts] to the draconian liabilities of the CFCA would significantly impede their fiscal ability to carry out their core public mission. In the particular case of public school districts, such exposure would interfere with the state's plenary power and duty, exercised at the local level by individual districts, to provide the free public education mandated by the Constitution."

Unfortunately, as they relate to charter schools, the court found that "CFCA's monetary remedies, however harsh, to a particular charter school or its operator presents no fundamental threats to maintenance, within the affected district, of basically adequate free public educational services." Thus, the Court determined that "application of the CFCA to charter school operators cannot be said to infringe the exercise of the sovereign power over public education."[1]

Turning to the application of the unfair competition laws, the court similarly found that the charter school defendants either are, or are operated by, "corporations", and they also constitute "associations" or "organizations" under the UCL definition of a "person." The Court held that "… charter schools are operated, pursuant to the [Charter Schools Act] by *nongovernmental* entities…. insofar as their nongovernmental operators

[1] While the Court's findings will allow the plaintiffs to pursue a CFCA action against the defendant charter schools, the Court did not address "whether a charter school's breaches of promises to students, parents, or guardians, or its violations of its charter or applicable law, may cause any related funding claims the school makes upon the state to be "false" within the meaning of [the CFCA]."

used deceptive business practices to further [their] efforts, the purposes of the UCL are served by subjecting them to the provisions of that statute."

Summary:

The Supreme Court's decision appears to be inconsistent with prior appellate court decisions and state agency decisions which have clearly found charter schools, whether or not operating as a nonprofit public benefit corporation, to be public entities for the application of certain laws. Most troubling is the disparate treatment the Court applies to charter schools essentially finding that school districts could theoretically submit false claims without CFCA liability. The opinion raises more questions than it answers. For example, because none of the charter defendants were conversion or dependent schools, would the same outcome apply for these types of charter schools? Will this decision have any affect on the applicability of other public sector laws to charter schools (for example, the Brown Act, Public Records Act, Political Reform Act etc.)? Unfortunately, a legislative fix may be in order to clarify and eliminate this disparate treatment.

In sum, this case emphasizes that scrutiny of charter schools will continue to increase.

SMYM will continue to monitor this case and provide further updates.

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