

Special Education Cost Model Task Force

Final Report

July 11, 2019

Respectfully submitted,

Matthew Galligan, Chair  
Town Manager, South Windsor  
Designee, Connecticut Conference of Municipalities

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*Unless otherwise cited, the information in this report is a summary of the expert opinions of task force members, as documented in the minutes of task force meetings, or is derived from the reports, commissioned by the task force, and attached in the appendices to this report.*

## **Task Force Membership**

1. Kathy Demsey, Chief Financial Officer, State Department of Education (SDE), and designee of the Commissioner of Education
2. Stephen DiCenso, Consulting Actuary, Milliman, Inc., and representative of the Connecticut Captive Insurance Association (CCIA)
3. Liz Donohue, Deputy Chief of Staff to Governor Dannel P. Malloy and designee of the Secretary of the Office of Policy and Management (OPM)
4. John Flanders, Executive Director and representative of the Connecticut Parent Advocacy Center (CPAC)
5. Matthew Galligan, Town Manager, South Windsor, and representative of the Connecticut Conference of Municipalities (CCM) (Chair)
6. Michael Grove, Assistant Superintendent for Operations and Finance, Meriden Public Schools, and representative of the Connecticut Association of School Business Officials (CASBO)
7. Jeffrey Kitching, Executive Director, EdAdvance, and representative of the Regional Education Service Center (RESC) Alliance
8. Patrice McCarthy, Deputy Director and General Counsel and representative of the Connecticut Association of Boards of Education (CABE)
9. Marie Salazar Glowski, Assistant Executive Director and representative of the Connecticut Association of Schools (CAS)
10. Jan Perruccio, Superintendent, Old Saybrook Public Schools, and representative of the Connecticut Association of Public Schools Superintendents (CAPSS)

11. David Scata, Executive Director and representative of the Connecticut Council of Administrators of Special Education (ConnCASE).
  
12. Dr. Jeyaraj Vadiveloo, Director of the University of Connecticut (UConn) Goldenson Center for Actuarial Research, and representative of the UConn actuarial science program



## Legislative Charge of the Task Force

The Special Education Cost Model Task Force (“the task force”) was formed under Public Act 17-2 (June Special Session), to study the feasibility of a special education predictable cost cooperative (“the cooperative”).<sup>1</sup>

Under statute, the cooperative aggregates special education costs at the state level to compensate for volatility at the local level through the following means:

1. Providing predictability to local and regional boards of education for special education costs;
2. Maintaining current state funding for special education services;
3. Differentiating funding based on student learning needs;
4. Equitably distributing special education funding;
5. Providing boards of education with flexibility and encouraging innovation; and
6. Limiting local financial responsibility for students with extraordinary needs.<sup>2</sup>

Statute further defines the cooperative as being funded by:

1. A community contribution from each school district, calculated based on the number of special education students enrolled in the school district and the school district’s previous special education costs, with each town paying the community contribution of its resident students, reduced by an equity adjustment based on the town’s ability to pay;
2. The state contribution, which is a reallocation of the special education portion of the equalization aid grant<sup>3</sup> and the Excess Cost grant;
3. Provides all school districts with some state support for special education;
4. Ensures a school district’s community contribution will be lower than the actual special education costs of the school district; and
5. Reimburses school districts for 100 percent of their special education costs for a fiscal year.<sup>4</sup>

The authorizing legislation requires the task force to conduct a feasibility study on the cooperative and other alternative models for funding special education that are used in other states. The feasibility study must include, for the cooperative and any alternative models:

1. An actuarial analysis;
2. An explanation and demonstration of how towns would contribute to and be compensated from the cooperative, and how a town’s compensation would affect its required contribution in the subsequent fiscal year;
3. A consideration and analysis of the legal status of the entity;

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<sup>1</sup> Conn. Acts 17-2 § 70 (June Special Session).

<sup>2</sup> Ibid.

<sup>3</sup> The equalization aid grant is also commonly referred to as the Education Cost Sharing (ECS) grant.

<sup>4</sup> Conn. Acts 17-2 § 70 (June Special Session).

4. A consideration of the potential governance structure;
5. A consideration of the number of staff and costs associated with administering the entity and funding sources for these costs;
6. Sources of funding for the required initial capital investment, including the impact on state special education funding if state funds are used for the capital investment;
7. A description of the timeline for implementation, key dependencies and prerequisites for implementation, and contingency plans for any foreseeable problems arising from implementation;
8. An identification of state and federal law that would be involved in the creation and administration of a cooperative or alternative model, a framework for complying with regulatory requirements; and the accountability of the cooperative to the General Assembly.<sup>5</sup>

The statute delineates the membership of the task force, and allows the task force to accept funds from any not-for-profit that is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of the United States or accept pro bono services from any public or private entity, and names the Office of Legislative Management as the entity that will assist the task force in the administering of funds received by the task force. The task force's report to the General Assembly was due January 1, 2019.<sup>6</sup>

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<sup>5</sup> Ibid.

<sup>6</sup> Ibid.

## Issues in Special Education Outside of the Scope of the Task Force

The task force recognizes its legislative charge is relatively narrow, and that special education is a complex, multifaceted topic. Therefore, the task force would like to highlight issues in special education that the models discussed herein do not contemplate, but are important and should be considered by state government:

1. Special education costs increase each year, and special education costs associated with the education of students with extraordinary learning needs (“excess costs”) are accelerating at a rate of approximately 4.5 percent per year. The models discussed in this report do not attempt to reduce special education costs because they are financing models only, and it would be both unethical and a violation of the Individuals with Disabilities Education Act (IDEA) to attempt to incentivize cost reductions through mechanisms such as spending caps.
2. Local communities bear the brunt of rising special education costs, as the State of Connecticut funds approximately 30 percent of total special education costs. In addition, the State has historically only appropriated enough money in the Excess Cost grant to fund approximately 70-75 percent of eligible costs under the Excess Cost reimbursement formula.
3. Special education identification rates are rising, meaning an increasing number of students in Connecticut are identified as being eligible for special education services, while at the same time the overall student population in the state is decreasing. The reasons why special education identification rates are rising are unclear.
4. Private special education service providers are largely unregulated, as was noted in a 2017 report by the Connecticut Auditors of Public Accounts.<sup>7</sup> Task force members have expressed concern that school districts do not have oversight over the educational program being offered to students at private placements, but they are required to pay large tuition payments.
5. Other task forces have discussed the potential merits of regionalizing special education service delivery.<sup>8</sup> This topic is outside the scope of this task force, and the models discussed herein do not contemplate the regionalization of service delivery.

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<sup>7</sup> Geragosian, J.C., & Kane, R.J. (2018). *Auditor’s Report: Private Providers of Special Education for the School Year 2015-16*. Hartford, CT: State of Connecticut, Auditors of Public Accounts. Retrieved from [https://www.cga.ct.gov/apa/reports/performance/PERFORMANCE\\_Private%20Providers%20of%20Special%20Education\\_20180222\\_CY2015,2016.pdf](https://www.cga.ct.gov/apa/reports/performance/PERFORMANCE_Private%20Providers%20of%20Special%20Education_20180222_CY2015,2016.pdf).

<sup>8</sup> Connecticut General Assembly, Municipal Opportunities & Regional Efficiencies (MORE) Commission, Special Education Select Working Group. (2015). *Recommendations for Legislative Action*. Hartford, CT: Author. Retrieved from [http://www2.housedems.ct.gov/more/SPED/pubs/2015-02-18\\_Recommendations.pdf](http://www2.housedems.ct.gov/more/SPED/pubs/2015-02-18_Recommendations.pdf).

6. Some task force members have raised what is known as “burden of proof” as an issue that contributes to rising special education costs in some school districts. However, other task force members disagree and believe Connecticut’s “burden of proof” statute provides an essential protection for students with disabilities. Connecticut is one of six states that places the burden of proof on a school district when a disagreement regarding the provision of special education services to a particular student is entered into legal proceedings. In the remaining states, the burden of proof falls on the party bringing suit.<sup>9</sup>
7. Pullman & Comley stated to the task force that case law allows for school districts to take costs into reasonable consideration in determining which special education services to provide a student, as long as the district is meeting its obligation to provide the student a free, appropriate public education. The attorneys also stated that costs cannot be the primary or sole means of determining whether to provide a special education service to a student. However, some task force members remain concerned that, because of financial constraints, some school districts are denying services to students, and basing those decisions primarily on budgetary concerns.

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<sup>9</sup> Griffith, M., & Parker, E. (2018). *Special Education Funding Across the States* [PowerPoint slides]. Denver, CO: Education Commission of the States. Retrieved from <https://portal.ct.gov/-/media/OPM/Secretary/SpecialEd/EducationCommissionoftheStatesPresentationtoSpEdCostModelTaskForcepdf.pdf?la=en>.

## **History of the Task Force's Work**

The task force held its first meeting on January 29, 2018, and elected as chair Matthew Galligan, town manager of South Windsor and representative from the Connecticut Conference of Municipalities. On March 16, 2018, the task force adopted a mission statement to guide its work:

The task force is committed to ensuring that children receive high-quality, appropriate special education services while making special education costs and budgeting more predictable for communities.

### ***Informational Presentations***

Before conducting a formal feasibility study, the task force hosted several presentations regarding special education funding and captive insurance structures.

1. On February 23, 2018, Janet Grace, program manager of the Captive Insurance Division of the Connecticut Insurance Department, gave a presentation to the task force regarding captive insurance formation in Connecticut.
2. On February 23, 2018, Martha Deeds, senior policy analyst at the Connecticut School Finance Project, gave a presentation to the task force regarding the special education predictable cost cooperative, as proposed by the Connecticut School Finance Project.
3. On April 11, 2018, Michael Griffith and Emily Parker of the Education Commission of the States gave a presentation to the task force regarding special education finance systems in other states.
4. On May 17, 2018, Mary Glassman, manager of the Office of Regional Efficiencies at the Capitol Region Education Council (CREC), gave a presentation to the task force regarding CT Prime, a captive insurance company, sponsored by CREC and owned by member towns, which provides medical stop-loss coverage to self-insured towns and school districts.

### ***Vendor Selection***

At the March 16, 2018 meeting, the task force created a subcommittee to draft a request for proposals (RFP) to procure the necessary consultants to perform the feasibility studies. The RFP Subcommittee was comprised of John Flanders, Stephen DiCenso, and Liz Donohue. At the July 12, 2018 meeting, the task force created an RFP Selection Subcommittee to review and score proposals, according to the rubric adopted by the task force on the same date. The RFP selection committee was comprised of Kathy Demsey, Patrice McCarthy, Jeyaraj Vadiveloo, and Matthew Galligan.

At the May 17, 2018 meeting, the task force also agreed to select a vendor with expertise in special education to perform focus groups with the parents and guardians of special education students. The RFP Subcommittee drafted and approved an RFP to select a vendor to perform focus groups with parents, which was released by CPAC in June 2018. The RFP garnered multiple qualified submissions, which were reviewed by the

RFP Selection Subcommittee. At the September 11, 2018 meeting, the RFP Selection Subcommittee recommended, and the task force approved, the State Education Resource Center (SERC) to perform focus groups with parents, and asked CPAC to administer this contract on behalf of the task force.

The RFP for the feasibility study was released by the Office of Policy and Management in July 2018. Unfortunately, the RFP resulted in zero bids from consultants, and the task force identified two likely reasons for the lack of interest:

1. The RFP was lengthy and included multiple types of work to be performed by consultants with differing areas of expertise, including captive insurance law, special education law, actuarial services, and insurance services, which may have discouraged bidders from any one of these areas.
2. The State of Connecticut requires unlimited indemnity by all vendors, even for those performing a study, which task force members from the insurance consulting industry indicated might have been an area of concern for potential bidders.

This disappointing result caused the task force to consider other avenues to complete a competitive, transparent procurement process. Ultimately, the task force determined it would split the original scope of work into three, separate scopes: special education legal services, captive insurance legal services, and insurance/actuarial services. The task force approached CREC about the possibility of administering the RFPs and contracts with potential vendors. CREC agreed to enter into a memorandum of understanding with the Office of Legislative Management (OLM) and Third Sector New England, Inc. (see Appendix VIII), and to manage the competitive vendor selection process and vendor contracts on behalf of the task force.

At the September 17, 2018 meeting, the task force voted to accept pro bono services from Morgan Lewis, LLP for the scope of work related to captive insurance legal services. CREC then issued the two remaining RFPs for the task force in September 2018. The selection committee and scoring rubric remained the same. The second RFP issuance resulted in multiple bids from qualified vendors for each scope of work.

At the November 5, 2018 meeting, the RFP Selection Subcommittee recommended, and the task force approved, AON as the consultant for the insurance and actuarial services feasibility study, and Pullman & Comley, LLP as the consultant for special education legal services. At the same meeting, the task force agreed to ask the Education Commission of the States to perform an analysis of the cost of implementing a 100 percent state-funded special education finance system, similar to that of Wyoming, in Connecticut. Because the State of Connecticut is a member of the Education Commission of the States, no cost was incurred by the task force to produce its report.

### ***Funding of Studies Performed by the Task Force***

The authorizing legislation permitted the task force to accept funds from any not-for-profit that is exempt from taxation under section 501(c)(3) of the Internal Revenue Code

of the United States or accept pro bono services from any public or private entity. Because the State did not appropriate funding to the task force to carry out its charge, the Connecticut School Finance Project, through its fiscal sponsor Third Sector New England, an entity exempt from taxation under section 501(c)(3) of the Internal Revenue Code, provided the funding necessary for the task force to carry out its legislative charge. The source of the funding was unrestricted general operating funding received by Third Sector New England and is not attributable to any specific donor. The funding provided to the task force by Third Sector New England was provided without any requirements other than that the funding be spent to carry out the task force's legislative charge. Furthermore, neither Third Sector New England, or any of its employees, including the staff of the Connecticut School Finance Project, played any role in the selecting the vendors to carry out the feasibility study. As outlined above, the RFP processes were administered by CREC and CPAC, and the vendors were independently selected by appointed members of the task force.

### ***Review of Reports from Vendors***

Between March 12, 2019 and May 20, 2019, the task force heard presentations on each of the reports it commissioned, and task force members were given the opportunity to ask questions of its consultants. These presentations are as follows:

1. On March 12, 2019, Emily Parker of the Education Commission of the States presented her report (see Appendix V) to the task force.
2. On March 12, 2019, Amy Sestito, Scott Sobel, and John Schule of AON presented their feasibility study of the “basic cost” model for the cooperative (see Appendix I).
3. On April 8, 2019, Rakesh Beniwal of Morgan Lewis presented his report on captive formation in Connecticut, and recommendations for the governance structure of a captive insurance company to manage the cooperative (see Appendix III)
4. On April 8, 2019, Mark Sommarruga and Melinda Kauffman of Pullman & Comley presented their report on compliance with state and federal special education laws (see Appendix IV).
5. On May 20, 2019, Amy Sestito, Scott Sobel, and John Schule of AON presented their feasibility study of the “excess cost” model for the cooperative (see Appendix II).
6. On May 20, 2019, Stephen Proffitt and Nitza Diaz of SERC presented their report on parent focus groups (See Appendix VI).

## Models Investigated by the Task Force

The task force studied three potential models for financing special education in Connecticut, each of which would increase predictability for towns and school districts. Each model has potential benefits and costs, which are described below.

1. “Basic Cost” Actuarial Model for a Special Education Predictable Cost Cooperative

This model was developed by the Goldenson Center for Actuarial Research at the University of Connecticut, in collaboration with the Connecticut School Finance Project. The model finances 100 percent of special education costs in the state of Connecticut. Under this proposal, towns would make a community contribution to the cooperative for each resident student, and districts would be reimbursed for 100 percent of their actual special education costs during the current year. The model contains both an experience adjustment, which ensures districts are responsible for their own decision-making and spending, and an equity adjustment, which discounts the community contribution based on a town’s ability to pay. The State’s contribution is comprised of the current Excess Cost grant and the portion of the Education Cost Sharing (ECS) grant that is attributable to special education, for a total of approximately \$568 million dollars.<sup>10</sup> Under the model, all districts receive some state support for special education. The model does not include an increased state contribution, while forecasting that total special education costs will increase,<sup>11</sup> as specified in the legislative charge of the task force.<sup>12</sup>

Through the feasibility study, the task force identified the following benefits of the basic cost model:

1. The model eliminates in-year volatility, whereby towns and school districts have unexpected mid-year special education costs.
2. The model offers greater stability in between-year community contributions than does the “excess cost” model, because it is a larger pool, which increases predictability.
3. The funds in the cooperative will earn investment income, which under the basic cost model will be substantial. AON’s estimates suggest investment

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<sup>10</sup> Connecticut State Department of Education. (2018). *Individuals with Disabilities Education Act (IDEA) 2019-20 State Maintenance of Effort*. Hartford, CT: Author.

<sup>11</sup> Vadiveloo, J. (2018). *UConn Goldenson Center Special Education Policy Model – Working Draft*. Storrs, CT: University of Connecticut, Goldenson Center for Actuarial Research. Available from <https://portal.ct.gov/OPM/Secr-General/Special-Education-Task-Force/Cost-Model-Task-Force-Document-Library>.

<sup>12</sup> Conn. Acts 17-2 § 70 (June Special Session).



income would be sizeable and material.<sup>13</sup> The investment income earned would belong to the cooperative and could be used by the cooperative to pay frictional costs of running the captive, offset future increases in special education costs, or provide additional special education services.

4. A cooperative model will necessarily collect more regular expenditure data from school districts in order to promptly process reimbursements, which could make maintenance of effort calculations and real-time collaboration between school districts easier.
5. The cooperative may be able to negotiate as a bloc with private special education service providers to ensure tuition rates are fair and districts across the state are charged the same fees for the same services.
6. The State's contribution to the cooperative cannot decrease from current levels under the Individuals with Disabilities in Education Act (IDEA), and investment income earned by the cooperative will not be held by the State, and therefore cannot be diverted to the General Fund, and must be used for special education.
7. Some task force members expressed a preference for the basic cost model over the excess cost model, because the larger the pool of costs being financed, and the wider the range of per-pupil costs, the more reliable the actuarial predictions become, based on the law of large numbers.

The task force identified the following challenges related to the basic cost model:

1. The model will require that special education funding be disentangled from the ECS grant, which could pose political and administrative challenges. Some task force members expressed concerns about the impacts of reallocating the portion of ECS funding currently attributable to special education to a categorical grant for special education, paid by the State to the cooperative.
2. Some task force members expressed concerns that implementing the basic cost model could be administratively cumbersome for some school districts because all special education costs would need to be submitted to the cooperative for reimbursement.

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<sup>13</sup> It is important to note that investment returns are dependent on the amount of initial capital invested into the captive, the cash holding period, and the portion of community contributions collected at the beginning of the year. AON's investment income projections are based on current Connecticut law, which governs the amount of initial capital investment, and an average cash holding period of six months. The model currently assumes full funding of the cooperative at the commencement of year one. Under these assumptions, investment income is expected to reach \$27.5 million per year by year four.

3. Some task force members expressed concerns that stakeholders will not understand the model or will feel that belonging to a cooperative could somehow reduce local control, and therefore, will not support its implementation.

The model is a statewide financing system for special education costs and includes all towns in Connecticut. As a part of the feasibility study, the task force asked AON to test the viability of the model if a portion of towns elected not to participate in the cooperative. Based on this parameter, AON removed all school districts that receive less than 10 percent of their special education funding from the State and found the model remained viable.

4. Districts' maintenance of effort requirements must be considered when determining how reimbursements are to be distributed. The attached report from Pullman & Comley discusses this topic in greater detail.
  5. There are components of the administration of a cooperative that have yet to be determined, including a payment schedule that accounts for state and municipal budgeting cycles and cash flows, and the selection by a future board of directors of a vendor to administer the day-to-day operations and reimbursement processing of the entity.
  6. Initial capitalization requirements should be subject to review by the Connecticut Insurance Department, as the current statutes could require more initial investment than is necessary for a captive of this type.
  7. The model does not result in between-year predictability for all districts, because it includes an experience adjustment, which is intended to balance the desire for responsiveness of the community contributions to the actual expenses of each district vs. the desire of cost stability. Year-over-year volatility may increase for some districts, depending on their experience. In addition, the model does not contain a mechanism to control total special education costs, which means overall costs will continue to increase.
2. "Excess Cost" Actuarial Model for a Special Education Predictable Cost Cooperative

After investigating the "basic cost" model, the task force requested the UCONN Goldenson Center create an alternative model that finances only costs associated with students whose programs of study qualify for the Excess Cost grant. Per-pupil special education costs are eligible for Excess Cost reimbursement when the cost of educating a student is in excess of 4.5 times the local average per-pupil

cost.<sup>14</sup> Under the model UCONN created, a number of the components are similar to the basic cost model. Namely, the excess cost model still operates with a community contribution, experience adjustment, and reserve system. The State's contribution is comprised of the current Excess Cost grant of approximately \$139 million dollars,<sup>15</sup> and districts are responsible for the remainder of the costs. However, because excess costs are inherently more volatile than special education costs more broadly, the model uses an actuarial technique known as "credibility weighting" to ensure the smoothing effects that make community contributions less volatile.

Through the feasibility study, the task force identified the following benefits of the excess cost model:

1. The model eliminates in-year volatility related to excess costs, including out-of-district tuitions.
2. The model does not charge districts a community contribution in years when a district does not have a student whose program of study qualifies for excess costs.
3. The funds in the cooperative will earn investment income, the amount of which is expected to be material, which would be available to be spent on special education services for students with high needs. These funds are expected to be more than sufficient to cover the frictional costs of managing the cooperative.
8. The cooperative may be able to negotiate as a bloc with private special education service providers to ensure tuition rates are fair and districts across the state are charged the same fees for the same services.
4. The model does not require removing special education funds from the ECS grant.
5. Some task force members expressed that because excess costs are a major source of concern for school districts, the constituencies they represent may be more likely to support a cooperative funding system that finances only excess costs.

The task force identified the following challenges related to the basic cost model:

1. The data used to build the excess cost model is suppressed by the SDE in order to protect student privacy. This means the calculations and outputs

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<sup>14</sup> Conn. Gen. Statutes ch. 164, § 10-76g.

<sup>15</sup> Connecticut State Department of Education. (2018). *Individuals with Disabilities Education Act (IDEA) 2019-20 State Maintenance of Effort*. Hartford, CT: Author.

of the model are not publicly available, so it would be difficult to maintain the model, explain the model to stakeholders, or allow for peer review of the calculations.

- This issue could be mitigated by creating a model that does not use excess cost students as its exposure base, and instead, uses districts' total special education student count or districts' total student count as an exposure base. While the number of excess cost students in each district is suppressed to protect student privacy, because the number of students is very small, the total special education student count and total student count are not suppressed. Additionally, using one of these larger exposure bases would also reduce year-over-year cost volatility for districts.
2. Because excess costs are inherently more volatile, the State has not reliably or fully funded the Excess Cost grant, and the inclusion of an experience adjustment to the model, year-to-year community contributions are more volatile for some school districts. Two interventions could mitigate the increased year-over-year volatility:
    - The State of Connecticut could increase its contribution to the cooperative, either as a one-time capitalization payment or an annual increase, which would increase investment income.
    - A model could be created that uses a larger exposure base (such as total district enrollment) and removes the experience rating. This would be a pure risk pool, and community contributions would increase each year at a similar rate as the excess costs growth statewide.
  3. The model finances only the most volatile special education costs, which increases the risk that the cooperative could experience a year where costs exceed contributions. This means that, under the excess cost model, additional risk financing will be required.
  4. Special Education Finance System Wherein the State Funds 100 Percent of Special Education Costs, as Seen in Wyoming

The State of Wyoming funds 100 percent of special education costs at the state level. The task force asked that the Education Commission of the States perform an analysis of what it would cost to implement a similar special education finance system in Connecticut.

The task force identified two primary benefits to this model:

1. Both in-year and between-year volatility is entirely removed at the local level, as the State incurs the full cost of educating special education students.

2. If the State were to fully fund special education each year, this would alleviate concern among school district and town officials regarding the increasing costs of special education.

The task force identified the following challenge:

1. The expense to the State would be a total of approximately \$2.23 billion for the 2019 fiscal year, which is unlikely to be absorbed by the state budget under current fiscal conditions.

Any time the State increases special education funding, a new threshold is set under the maintenance of support requirement in the IDEA, which obliges the State to spend no less on special education in the current year than it did last year. This means that, if implemented, the model would require the State to continue providing over \$2 billion in special education funds each year in perpetuity.

## **Benefits of a Captive Insurance Governance Structure for a Special Education Predictable Cost Cooperative**

The task force identified the following potential benefits of using a captive insurance entity to manage the cooperative, if enacted:

1. Forming a captive insurance company to manage the cooperative will create a nonprofit entity that is owned by school districts, municipalities, and the State, thereby protecting special education funds from being used for any other purpose by state or local government, even in financially uncertain times.
2. Captive insurance provides a flexible governance framework that can respond to the needs of its members. For example, additional cells can be formed to address particular issues in special education finance, so a group of districts could separately pool funds to provide group transportation services across school districts, without impacting the actuarial model for community contributions.
3. The proposed governance structure is representative of diverse districts, and can include multiple subcommittees, which will allow a broad array of stakeholders to inform decisions about the management of the cooperative, including quickly addressing any unintended consequences.
4. The cooperative may be able to purchase insurance, on the reinsurance market, for preexisting insurance products, and provide these to members. For example, the cooperative can purchase stop loss insurance, which will ensure the pool never becomes overdrawn.
5. A captive will allow members access to better data, in real time, allowing for better collaboration between districts.

## Findings

If an actuarial model for financing special education were to be adopted, there are numerous issues related to implementation at the local and state level that need to be fully identified and addressed, including the timing of reimbursements to districts, accounting systems needed to identify local costs, and the impact of administrative requirements. It will be critical to obtain input from those charged with the day-to-day implementation before any model is adopted by the legislature. In summary, the task force makes the following findings:

1. Lack of predictability in special education costs at the local level is one area of concern for towns and school districts.
2. Lack of predictability is not the only issue identified in special education that task force members believe needs resolution.
3. Each of the models analyzed have benefits and costs, and all provide additional predictability to school districts and towns, allowing for better budget planning.
4. Based on the feasibility studies commissioned by the task force, if a cooperative model is implemented as a captive insurance company, even a very safe investment strategy is expected to produce sizable interest payments, which are expected to be more than sufficient to pay for the administration of the cooperative, and increase total available funding for special education without increasing costs to local government or the State, or decreasing the level of services.
5. It is important to note each model discussed in this report is a method of financing special education and is not designed to impact special education service delivery. The actuarial models described herein anticipate that total special education costs in the state will continue to rise at a rate that is consistent with historical experience. In addition, if enacted, the cooperative will not have the authority to approve or deny individual claims from school districts, if the claims are for special education services, as defined by the SDE. Any authorizing language should underscore the importance of this provision, in alignment with existing federal law.
6. The actuarial models analyzed by the task force are complicated for lay users to understand, so there will need to be substantial education and outreach to town and district leaders, and families of special education students if one of the models is enacted.
7. The basic and excess cost models do not impact federal requirements for “maintenance of support” for the State or “maintenance of effort” by local education agencies (LEAs), both of which must continue to be met.

8. The initial funding of the captive will likely need to be bonded by the State, but the total amount of that funding for each model needs review. Initial capitalization costs in the feasibility studies are based off of current statutory requirements in Connecticut. However, capitalization amounts should be reviewed by the Connecticut Insurance Department, as the actuaries on the task force believe the current requirements may be overly conservative for a captive with the unique characteristics of the special education predictable cost cooperative.



## **Appendices I – VI: Feasibility Study Reports**

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# Special Education Cost Model Task Force

## Captive Feasibility Study

January 2019

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# 1. Scope & Objectives

## Scope & Objectives

- The objective of this Feasibility Study is to analyze the potential structural, financial, and strategic advantages that could be realized by Special Education Cost Model Task Force through the establishment of a captive insurance company. Aon was engaged to conduct this study and was informed that Connecticut’s special education funding system is not working well for districts. The information provided to Aon conveyed that at the district level, special education costs are unpredictable, causing issues with local budgets. The scope of Aon’s work is not to verify the stated unpredictability and volatility problems associated with Connecticut’s special education finance system, for the Feasibility Study the scope of Aon’s work is specific and includes:
  - Defining Special Education Cost Model Task Force Business Objectives
    - A finance system that allows state and local governments to share in special education costs.
  - Information Gathering & Review
    - Review the two actuarial reports (Basic and Excess) developed by the Goldenson Center for Actuarial Research at the University of Connecticut.
    - Aon’s Actuarial and Analytics team will review these actuarial reports to determine:
      - How districts contributions are calculated on an annual basis.
      - How a district’s experience in a fiscal year would affect its required contribution in the subsequent fiscal year.
      - Review any proposed processes by which districts would be reimbursed for special education costs incurred throughout the fiscal year.
      - How these models would support a Special Education finance system that allows state and local governments to share costs.
    - Stakeholder Input
      - Aon attending six focus group meetings with the Regional Education Service Center areas and one focus group meeting with Special Education teachers.
  - Recommendations for Operations
    - Aon will work with the Task Force to recommend the most efficient captive structure to fund the retained risks.
    - The potential captive structure will be evaluated against the criteria proposed in the actuarial models and Stakeholder Input.
    - The final evaluation will include commentary on the following:
      - Ownership Structure
      - Connecticut Domicile Selection



- Regulatory Requirements
- Operational Requirements
- Anticipated problems for implementing the proposed cost models
- Financial Modeling
  - Aon will prepare 4-year pro-forma financial statements for the captive structure incorporating likely premium, loss forecasts, expense budget, initial capitalization requirements, and other assumptions.

**Disclaimer**

*Please note any statements concerning tax, accounting or legal matters in this document should be understood as general observations based solely on our review of public materials and our experience as insurance brokers and risk consultants, and may not be relied upon as tax, accounting or legal advice which we are neither intending, nor authorized, to provide. All such matters should be reviewed with Special Education Cost Model Task Force’s own qualified advisors in these areas. This report is intended for internal Special Education Cost Model Task Force distribution only. Aon does not accept any responsibility or liability to any third-party recipient of this report.*

## 2. Introduction & Background

Aon was engaged to study the potential utilization and feasibility of a Captive Insurance entity related to unpredictable special education costs for the Special Education Cost Model Task Force. The scope of work for this study is narrowly focused on gathering and reviewing select information; including review of the actuarial analysis developed by the Goldenson Center for Actuarial Research at the University of Connecticut, obtaining stakeholder input from Regional Education Service Centers, and providing recommendations for operations. The assigned scope of work does not address other issues that maybe relevant to special education costs.

The Special Education Cost Model is a new idea for funding special education in Connecticut. According to the Connecticut State Department of Education (2018), over the last five years the total number of students in Connecticut public schools has declined while the number of special education students has increased by approximately 20%. The State of Connecticut currently spends approximately \$785 million annually on special education. The largest source of state special education spending is the Education Cost Share (ECS) grant, representing approximately 57% portion of expenditures.

The Connecticut State Senate passed an act concerning the state budget for the biennium ending June 30, 2019, making appropriations therefore, authorizing and adjusting bonds of the state and implementing provisions of the budget. Conn. Acts 17-2 § 70 established a task force to conduct a feasibility study regarding alternative methods for funding special education in the state, and addressing the factors impacting the increasing cost and predictability of special education services.

Pursuant to Conn. Acts 17-2 § 70, the Feasibility Study shall include an actuarial analysis of the special education predictable cost cooperative model and alternative models. The University of Connecticut Goldenson Center for Actuarial Research and Neag School of Education was engaged to conduct this actuarial analysis.

The proposed Co-op is a special education finance system designed to enable state and local governments to share in special education costs. The Co-op would aggregate special education costs together at the state level and is designed to leverage the fact that special education costs are predictable on a statewide basis, however they are volatile at the district level. The plan proposes that state and local governments make contributions to the Co-op, and districts are reimbursed 100% of their actual special education costs. Components of the plan call for the State contributing to special education costs by re-allocating the Excess Cost Grant (ECS) and special education portion of ECS to the Co-op. Local governments make a Community Contribution to the Co-op for each special education student who lives in their town.

The Special Education Cost Model Task Force is interested in the value that can be created from the formation of a captive insurance company. The Special Education Cost Model Task Force is also interested in determining whether the models developed by The University of Connecticut Goldenson Center for Actuarial Research can be utilized as a methodology that allows the state and local governments to share in special education costs and aggregate these costs together at the state level, where the captive would be utilized as an entity to receive contributions and distribute reimbursements.

In this report we will determine the financial viability of the captive by:

- Analyzing the different captive structural options available to Special Education Cost Model Task Force;

- Utilizing the actuarial loss forecasts provided by Special Education Cost Model Task Force;
- Quantifying the potential funding requirements to finance the retained loss costs of this risk in a captive using the provided actuarial analysis;
- Demonstrating the financial operation of the captive;
- Outlining the flexibility that a captive might provide to Special Education Cost Model Task Force now, and in the longer term.

The purpose of this evaluation is to:

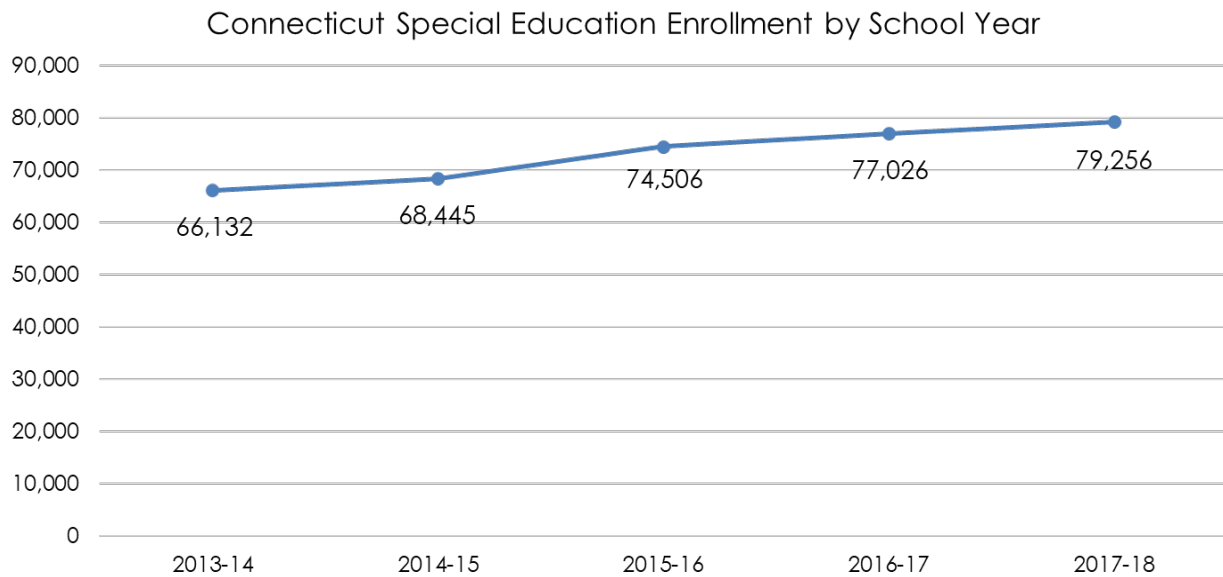
- Determine if there are any strategic and financial benefits of using a captive as part of the risk financing arrangements of the proposed Co-op;
- Identify the key issues that will need to be investigated further, overcome or, at worst determine that a captive is not a suitable choice for the proposed Co-op.

### 3. Defining Business Objectives:

The primary proposed use of the Captive is to facilitate a special education finance system that allows state and local governments to share in and aggregate special education costs.

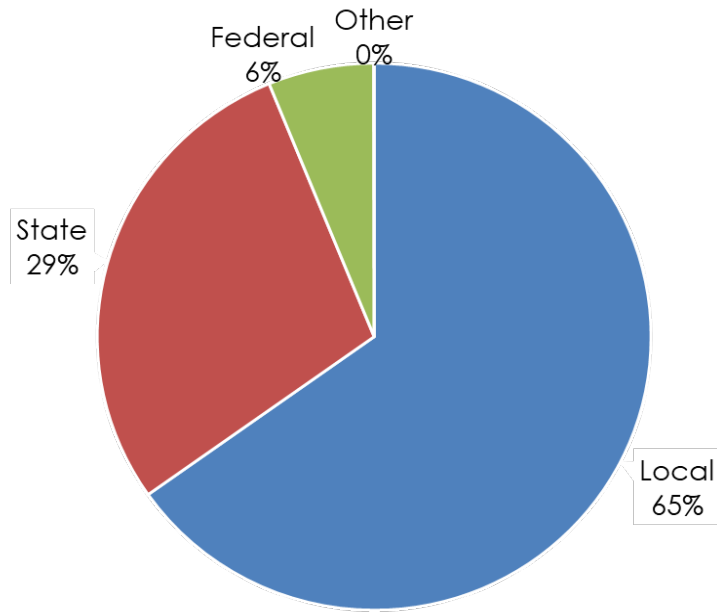
*The source of the information for the illustrations is the Connecticut State Department of Education (2018)*

Enrollment for total number of students in Connecticut schools has declined, however the total number of special education students has increased, as illustrated in below.

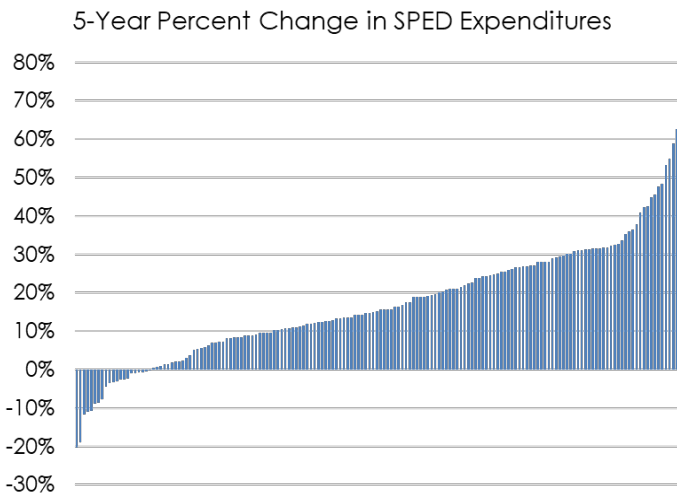




At the state level, special education spending has been predictable over the past five years, the following illustration shows Connecticut special education funding by source.



The State of Connecticut currently spends approximately \$785 million annually on Special Education and the following illustration shows how school districts in the state have experienced changes in special education spending over the past five years.



District	% Change in SPED Expenditures
1	70%
2	63%
3	59%
4	55%
5	53%
...	...
6	-11%
7	-11%
8	-12%
9	-19%
10	-20%

The Co-op captive would be utilized to:

- Provide a structured, regulated entity to manage contributions, claims, and reimbursements.
- The contributions from the State and local districts would be utilized for Special Education funding, the functionality of the proposed captive is designed to:
  - Aggregate costs together at the state level.
  - Ensure adequate special resources remain available during financial uncertainties.
  - Improve predictability for districts and towns, enabling better budget planning
  - Increasing equity by ensuring towns with need receive more state support for special education costs.

What risks are Captives typically used for?

A captive can respond to any insurable risks facing an organization, whether or not the commercial insurance marketplace has yet found a way to finance them. Many captives are designed to respond to specific circumstances:

- High frequency/low severity risks – avoid paying profit loadings and expenses charged by commercial insurers associated with losses that are statistically certain to occur;
- Risks where claims are settled over an extended period – some captives create tax- deductible reserves – a benefit normally only associated with insurance company status;
- Low frequency/remote severity risks – where the captive writes premiums that might otherwise be absorbed by commercial insurers (expenses, investment income, profit);
- Potential revenue generation opportunities;

- Risks uninsurable in the commercial markets;
- Insurance pricing volatility – captives can partially insulate their parents from cyclicity in the commercial markets;
- Direct access to reinsurance markets.

### The Opportunity Cost of a Captive

The potential advantages previously described will also need to be balanced against the opportunity costs of captive operation:

- Districts will be required to pre-fund their special education costs;
- There are frictional costs of captive ownership and operation which need to be offset against any savings/efficiencies made
- Members would need to provide accommodations in their budgeting and funding processes to meet the requirements of the Captive.

Should the Co-op decide to utilize a captive in the future for insurance purposes it may obtain additional risk management benefits including:

#### Budget Stability

As Special Education Cost Cooperative (Co-op) will be designing its own insurance program, which will be based on its own loss experience, it can avoid the impact of the insurance industry's major price fluctuations.

#### Claims Handling (Claims = Reimbursements)

The captive insurance arrangement may enable the Special Education Cost Cooperative (Co-op) to drive cost efficiencies for processing reimbursements.

*Per the Aon GRMS, 51% of Aon captive owners believe the captive significantly improved their claims adjustment process.*

#### Funding of non-insurable risks

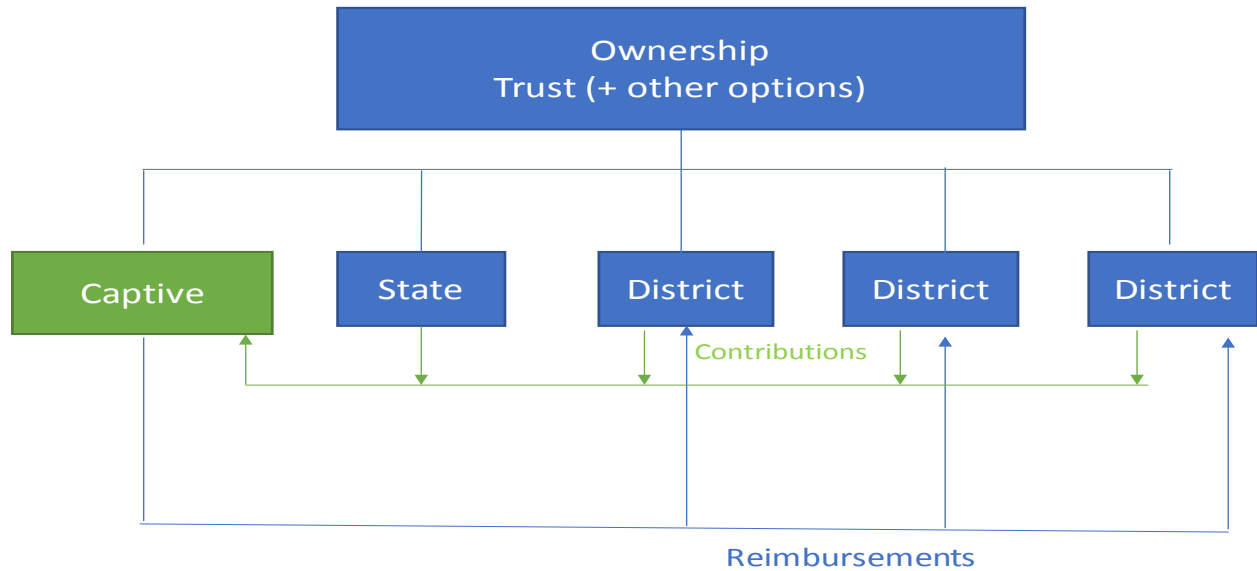
Captives are often used to provide coverage for risks that are difficult to insure via commercial markets and this flexibility may be beneficial to the Special Education Cost Cooperative (Co-op) in the future.

#### Direct Access to the Reinsurance Market

Captive Insurance Companies have direct access to global reinsurance markets, this benefit may provide access to additional underwriting capacity, tailored coverage, and cost savings when compared to primary commercial markets. Based on the scope and size of a potential Special Education Cost Cooperative (Co-op) captive, this reinsurance market access may provide members material benefits in the future.

## Optional Captive Structures for the Proposed Co-op

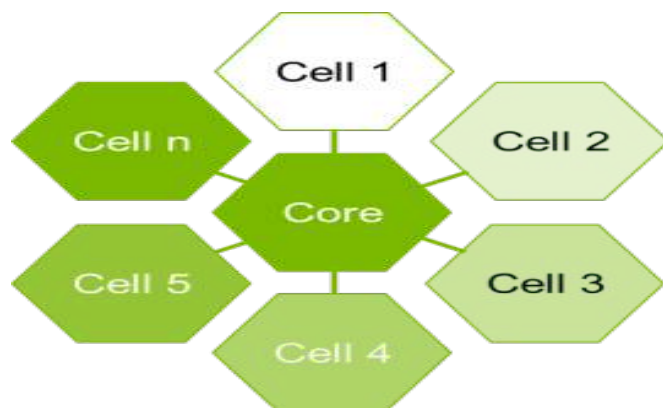
### Single Parent Captives



Single parent captives are owned by a single entity; and exist primarily to underwrite the risks of their parent and affiliated entities. Under controlled circumstances they may be permitted to underwrite risks of unrelated parties.

A single parent captive may provide a suitable structure for the proposed Co-op as it could be owned the Districts and the State, or by a Trust.

### Protected/Segregated Cell Captives



Protected cell captives (or segregated cells) are captives where the assets and liabilities of one participant are segregated from those of the others, and from the owner. Such structures are usually used

by rent-a-captives, however can be found in other forms e.g. in single parent entities where there is a desire to segregate operational divisions, lines of cover or geographies in a very formal manner.

These structures are either allowed by specific legislation, private act or rely on contracts between each member. Some uncertainty exists about the ability of the contractual structure to withstand judicial scrutiny in the event of a bankruptcy of one or more of the cells. Members cannot be certain that some court, somewhere, might require them to pay the losses of other rent-a-captive participants in the event that they were financially unable to meet their contractual commitments to pay losses. This has never been tested, but the structures have been in existence for over a decade.

This concern has led a number of domiciles to introduce “incorporated” cell legislation to formalize the acknowledgement that each cell is a distinct legal entity.

A Segregated Cell Captive may also be a viable structure for the proposed Co-op, as cell facilities may be structured to meet specific needs and objectives.

Based on the proposed purpose along with criteria provided in the actuarial models, and potential ownership options, we would recommend either a Single-Parent or Segregated Cell Captive structure for the Co-op.

*As of January 2019, the ownership of the potential Co-op Captive has not been determined. Options currently under consideration include having the districts and State jointly own the captive, along with having a Trust own the entity. Law firms have been engaged to explore potential solutions, other ownership options may also be considered.*

## 4. Information Gathering and Review

Aon was engaged to conduct a Captive Feasibility Study, our scope of work included gathering information from the UCONN Goldenson Center for Actuarial Research, Connecticut State Department of Education, the Connecticut School Finance Project, input from Regional Education Service Center areas, data relevant to Connecticut captive regulations, along with information on special education funding in Connecticut. Aon was informed that Connecticut's special education funding system is not working well for districts. The information provided to Aon conveyed that at the district level, special education costs are unpredictable, causing issues with local budgets. The scope of Aon's work was not to verify the stated unpredictability and volatility problems associated with Connecticut's special education finance system, it called for reviewing the Basic and Excess Actuarial Models provided by the UCONN Goldenson Center and commenting on these models.

According to Conn. Acts 17-2 § 70, (<https://www.cga.ct.gov/2017/act/pa/pdf/2017PA-00002-R00SB-01502SS1-PA.pdf>)

*"special education predictable cost cooperative" means a special education funding model that*

*(1) aggregates special education costs at the state level to compensate for volatility at the local level by*

- (A) providing predictability to local and regional boards of education for special education costs,*
- (B) maintaining current state funding for special education services,*
- (C) differentiating funding based on student learning needs,*
- (D) equitably distributing special education funding,*
- (E) providing boards of education with flexibility and encouraging innovation, and*
- (F) limiting local financial responsibility for students with extraordinary needs,*

*(2) is funded by:*

*(A) A community contribution from each school district, calculated based on the number of special education students enrolled in the school district and the school district's previous special education costs, with each town paying the community contribution of its resident students, reduced by an equity adjustment based on the town's ability to pay, and*

*(B) the state contribution, which is a reallocation of the special education portion of the equalization aid grant and the excess cost grant,*

*(3) provides all school districts with some state support for special education services,*

*(4) ensures that a school district's community contribution will be lower than the actual per pupil special education cost of the school district, and*

*(5) reimburses school districts for one hundred per cent of their actual special education costs for a fiscal year."*

### **Aon's actuarial team reviewed the Basic Model created by the UCONN Goldenson Center for Actuarial Research and provided the following review and commentary:**

The portion of funding for the Co-Op captive that would come from the schools is called the Community Contribution. Community contributions would be made annually and presumably known in time to be included in the entities' budgets. Community contributions vary by entity and would change from year to year. The paragraphs below describe the methodology for determining the community contributions in the UCONN Goldenson Center model.

## HOW IS THE COMMUNITY CONTRIBUTION CALCULATED?

### Step 1:

The first step is to calculate the Margin Adjusted Community Contribution (CC) per student. This figure is the same for all entities in the model and the methodology used to calculate the Margin Adjusted CC is described in the paragraphs below.

First, the total statewide special education costs for the prior year, excluding federal funding, is multiplied by a growth factor. Next, state funding is subtracted, and the result is divided by the number of special education students in the prior year, in order to arrive at a figure that is on a per student basis.

The growth factor referred to in the paragraph above is determined by the total special education costs for the current year divided by the total special education costs for the prior year. The result is multiplied by 1.13, to account for further growth. This formula excludes federal funding.

### Step 2:

The second step in the model is to calculate an experience adjustment for each entity. The experience adjustment is equal to the difference between the entity's prior year average special education cost per student and the prior year statewide average cost per student. In other words, the statewide average cost per student is used as a benchmark for the experience adjustment. This calculation of the experience adjustment includes both Basic and Excess Special Education costs. It is important to note that the discount received by any single entity for good experience is limited to \$4,000 per student, however the surcharge for those entities whose experience is above the benchmark is unlimited.

### Step 3:

The third step in calculating the CC is to determine the equity adjustment. The purpose of this adjustment is to vary the CC based on an entity's relative wealth. The model currently has four options for calculating an equity adjustment. All four options rely on Public Investment Community (PIC) Index, published by the Office of Policy and Management. A PIC Index ranges from 0-500. A score closer to zero equates to relatively wealthier communities and a score closer to 500 equates to less wealthier communities.

The model we received on January 18, 2019 had selected Option 1, and our discussions throughout this report are based on the assumption that Option 1 will be used. *If Options 2-4 are selected in the model, the discounts become too large and there are not enough funds in the Co-op to cover the special education costs.*

The four options are described in the following paragraphs:

#### Option 1:

The PIC Index determines the discount based on the table below.

PIC Index	Discount
0-100	5%
101-160	10%
161-250	15%
251-300	20%
301-500	25%

Option 2:

The table in Option 1 has been smoothed using an exponential curve. This option removes the sharp changes that can occur if the PIC Index of an entity changes by only a few points. For example, if a PIC index changes from 250 to 252, the discount under Option 2 will move from 15% to something slightly above 15%, whereas under Option 1 the discount would increase more significantly from 15% to 20%.

Option 3 and Option 4, described in the following paragraphs, introduce different equity adjustments for entities that are part of an Alliance district or part of an Educational Reform (Ed Reform) district.

*According to the Connecticut State Department of Education, “The Alliance District program is a unique and targeted investment in Connecticut’s 33 lowest-performing districts. Connecticut General Statute Section 10-262u establishes a process for identifying Alliance Districts and allocating increased Education Cost Sharing (ECS) funding to support district strategies.”*

*According to the State of Connecticut, Senate Bill No. 458, Public Act No 12-116 Educational Reform district means a school district that is in a town that is among the ten lowest district performance indices when all towns are ranked highest to lowest in district performance indices scores.*

These districts are eligible for additional funding from the state.

Option 3:

“Alliance” entities are eligible for a 35% discount and “Ed Reform” entities are eligible for a 45% discount. All other entities would revert back to a discount based on exponential smoothing, similar to Option 2. Note that the exponential smoothing results in Option 3 are not exactly the same as Option 2. All entities receive a discount of at least 2%.

Option 4: “Alliance” entities are eligible for a 35% discount and “Ed Reform” entities are eligible for a 45% discount. All other entities would revert back to a discount based on a linear smoothing. This is similar to Option 3 except that the smoothing is slightly different and the minimum discount of 2% is removed.

The PIC Indices of the 21 Alliance entities in the model range from 199-323, with an average of 268. The PIC Indices of the 10 Ed Reform entities in the model range from 323-491 with an average of 384.

Step 4:

The fourth step in calculating the final CC is the state refund. The calculation in the model is based on the prior year results of the Co-Op and is comprised of two pieces:

1. Any reserve balance at the end of the previous year that is in excess of the minimum required reserve balance, plus
2. Any premium paid by the state in the prior year that was not used to pay special education costs



Note that the minimum required reserve balance is equal to 2.5% of the prior year statewide total special education costs. The state refund is distributed using the same calculation as the experience adjustment (second model step). Only districts with experience below the statewide benchmark receive a portion of the state refund.

Step 5:

From the four steps above, the *Initial* CC per student is calculated as the Margin Adjusted CC per Student + Experience Adjustment. The result is multiplied by the Equity Discount and the State Refund is then subtracted.

Step 6:

The final step in determining each entity's CC per student is to incorporate a smoothing effect, which is meant to ensure that it is not possible for the CC of an entity to increase if their average special education costs are decreasing, and vice versa. The formula appears to accomplish this within the constraints of the model.

Mathematically, the CC per Student is adjusted upward or downward by 7.5% of the difference between (i) the entity's actual average cost per special education student in the prior year and (ii) the entity's actual average cost per special education student two years ago. For example, assume an entity's average cost per student decreased \$1,000 from one year to the next. The following year, \$75 ( $=7.5\% \times \$1,000$ ) would be subtracted from that entity's *Initial* CC per student. Conversely, if an entity's average cost per student increased \$1,000 from year to the next, the following year that entity would have \$75 added to their *Initial* CC per Student.

It is important to note that both Basic and Excess costs are included in the calculation of this adjustment.

Step 7:

The results of Step 6 (Adjusted Final CC per student) is multiplied by the prior year's special education student count, in order to determine the amount to be charged to each entity.

## USER INPUTS IN THE UCONN GOLDENSON MODEL

The table below summarizes the user inputs in the model. The inputs shown are judgmentally determined and we have not been provided any information with which to validate the reasonableness of the inputs. Our commentary assumes the inputs remain as stated in the table.

UCONN Goldenson Center Model Inputs		
User Inputs	Description of Input	Model Value as of 01/18/19
Growth Factor	Additional year-over-year growth assumption used in the calculation of the Margin Adjusted CC.	1.13
Excess Cost Factor	Factor multiplied by the Excess Cost paid by the state in order to estimate the Total Excess Costs, ie. implies 100% of the Excess Cost is paid by the state.	1
Individual LEA Experience Cap	Maximum experience credit per student allowed in the model	\$4,000
Equity Discount Option 1 Table	See four Equity Adjustment option described above	see table
Alliance School Equity Discount	Discount for Equity Options 3-4 for Alliance Schools (Options 3-4 are not viable)	35.0%
Ed Reform School Equity Discount	Discount for Equity Options 3-4 for Ed Reform Schools (Options 3-4 are not viable)	45.0%
Refund Factor	How much of available money will be returned to entities	100%
Adjustment Factor	"Smoothing" factor that is applied to the year-over-year change in each entity's special education costs. The result is added to or subtracted from the entity's CC	7.5%
Required Reserve Balance Percentage	Percentage of the prior year's total special education cost that is required to be held as the Co-Op's minimum reserve.	2.5%
Percent of State Fund to Reserve	Percentage of the total State Contribution that is allocated to the reserve balance each year	7.0%

## Additional Points that Pertain to the Actuarial Model

- 1) Timing of Data Availability:  
The data used in the model is segregated by school budget year. For example, “2017” in the model is the 2016-17 school year. The model assumes the prior year data will be used for the upcoming year. In reality, we think the model will not be able to utilize data from the prior year due to a lag in gathering the appropriate data. Note that this timing will impact most of the calculations in the model, including but not limited to the CC and the state refund. As a result, the responsiveness of the CC calculation to changes in the special education spending will have a longer delay than what is represented by the model. The significant concern is that the single year growth assumptions in the model will not compensate for the two-year lag in data, and therefore the final CC for a given year will not be sufficient to cover the special education costs.
- 2) Equity Discount:  
There are four possible Equity Discount options within the model. All four methods have been described in detail previously. It is important to note that in the January 18, 2019 version of the Basic model, the only viable Equity Discount option is Option 1. The final CC collected is not sufficient to cover the SE Costs if Equity Discount Option 2, 3 or 4 is used.
- 3) Year 1 Investment:  
The statewide summary exhibit of the model shows 2011 as the first year. In actual implementation, a decision would need to be made about whether to calculate an experience adjustment based on information from the year prior to the formation of the Co-op. In making this decision, it is important to note that the experience adjustment increases the total CC collected statewide. Therefore, if an experience adjustment is not included in the first year of the Co-op, the difference would need to be supplemented from another source of funds.
- 4) Growth Factor:  
Step 1 of the calculation the CC utilizes the total special education costs for the current year divided by the total special education costs for the prior year. This portion of the calculation will have to be changed for practical use, since it relies on the total special education costs for the year that has not yet occurred in the formula. The growth factor should be the total special education costs for the previous year divided by the total special education costs from two years ago. It should be noted that this is another instance where the lag in data may impact the responsiveness of the model.
- 5) Student Count as Exposure Base:  
The special education student count is an area that could cause the calculations in the model to be skewed or perhaps manipulated. If the special education student count is a snapshot at one point in time during the year, it could skew the “average special education cost per student”. Average costs per students affect the statewide benchmarks that are used for both the CC calculation and refund allocation. For example, if the prior year special education student count is the count at the beginning of the school year, but special education children move into the district during the school year, the average costs per student will be artificially inflated. Theoretically, the fact that the statewide benchmarks and the

entities are calculated with the same data, this approach is acceptable. However, it could cause anomalies for individual entities, and is an area that is susceptible to manipulation. Ideally, an “earned student” concept would be used, or alternatively an average of students counts at various times during the year.

We also believe using student count as the base exposure in the model may create an incentive to for schools to identify more special education students who previously may have been considered “borderline”. The reason is that if relatively lower cost special education students are added to an entity’s cohort of special education students, that entity’s average cost per special education student will decrease. As a result, the entity’s CC would also decrease by increasing the experience discount (or lowering the experience surcharge) and also by increasing their share of the State Refund. The benefit is that more children may be identified earlier, which could reduce special education costs in the long term.

6) Experience Credit Cap:

Capping the experience credit at \$4,000 per student could create a disincentive for entities who reach the maximum credit to invest in innovative programs to reduce special education costs. The model predicts roughly 35 schools receive the maximum per student credit. This disincentive may be reduced by the fact that the state refund is exclusively allocated to entities with experience credits.

7) Cost Volatility:

We will address two types of volatility. The first is budget volatility for districts within a school year, which is created when special education students move into and out of districts during the school year. The second type of volatility is the volatility in special education budgets from one year to the next, or the year-to-year volatility.

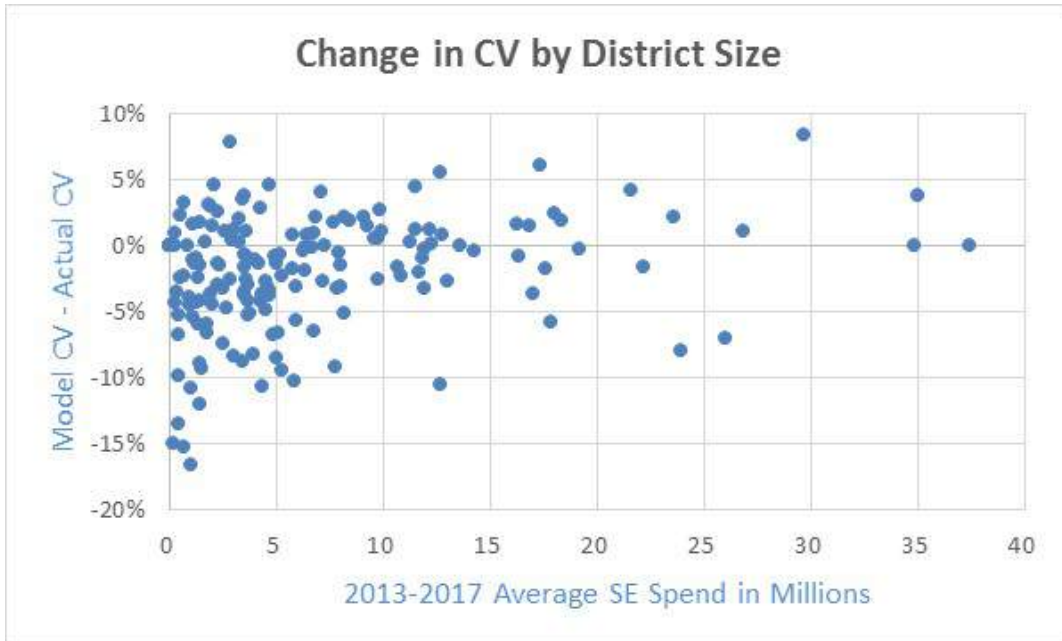
The model completely removes budget volatility within a school year. Each district will pay their contribution to the Co-op once a year, and they will not need to change their special education budget during the next school year, regardless of their actual special education costs. Any volatility within a single school year will be covered by the Co-op.

To investigate the year-to-year volatility of the model results for individual districts, we used a statistical measure called the coefficient of variation. This statistic is useful for comparing variability across groups of differing size. The coefficient of variation (CV) is the standard deviation of data divided by the mean of the data. For each entity, we calculated the CV of the actual special education spending over the 2013 to 2017 period and compared it to the CV of the spend projected for the same period by the model.

We observed that the model does reduce volatility for the majority of the districts, however it increases volatility for others. Approximately 34% of the entities see an increase in their annual cost volatility, 60% see a decrease in their annual cost volatility, and 6% see an insignificant change in their annual cost volatility.

The scatter plot below shows the change in volatility by the average special

education spend in millions for the majority of the entities. Dots above the 0% horizontal line represent entities with an increase in year-to-year volatility, while those below the 0% horizontal line see a decrease in year-to-year volatility.



8) Frictional or Administrative Costs:

Frictional and administrative costs are not addressed in the model. If a portion of any contribution is ear-marked to pay for the frictional or administrative costs of maintaining a Co-op, the model would need to be adjusted to account for that. For purposes of this feasibility study, we have assumed the frictional costs will not be paid by the schools or from the state subsidy.

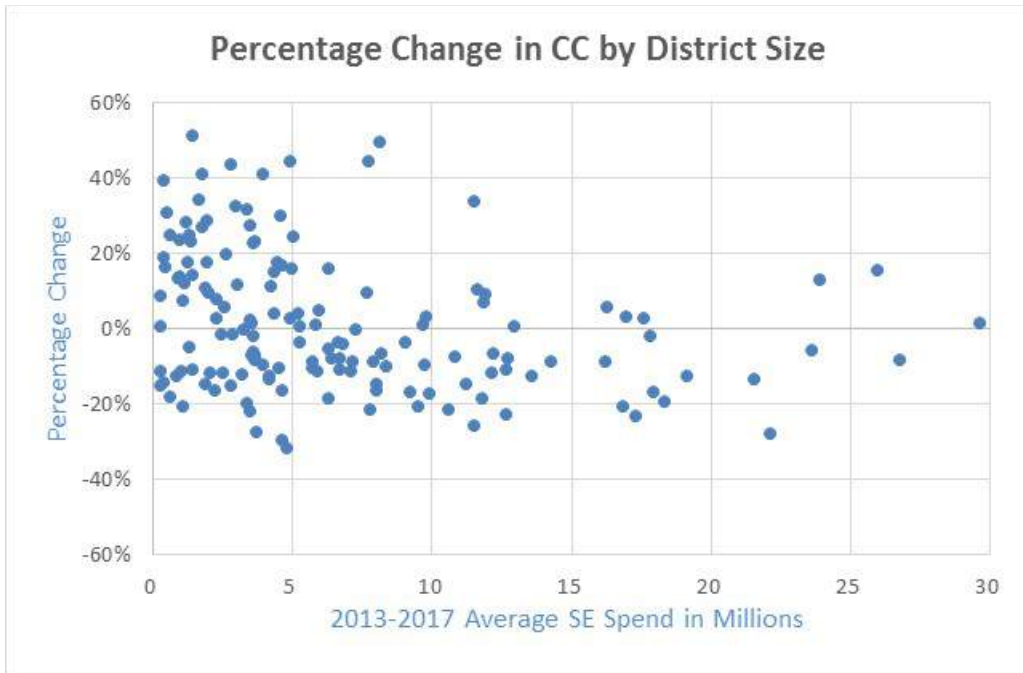
9) Model vs. Actual Community Contribution

We compared the CC calculated by the UCONN model to the actual CC for the historical years. The table below shows our comparison for all entities combined. As you can see, the actual CC is very similar to the model CC.

	<b>Actual Historical CC*</b>	<b>Model CC</b>	<b>Percentage Change</b>
2012	\$1,069,101,875	\$1,072,784,230	0.34%
2013	\$1,098,206,829	\$1,108,808,490	0.97%
2014	\$1,162,740,267	\$1,167,281,700	0.39%
2015	\$1,236,072,241	\$1,252,208,318	1.31%
2016	\$1,306,877,594	\$1,318,039,714	0.85%
2017	\$1,391,785,012	\$1,391,575,387	-0.02%
<b>Total</b>	<b>\$7,264,783,818</b>	<b>\$7,310,697,840</b>	<b>0.63%</b>

*\*Defined as historical special educations costs minus historical state subsidies*

The scatter plot below shows the percentage change in CC by average special education spend in millions for the majority of the entities. A positive percentage change (dots above the 0% line) implies that the model 2013-2017 average CC is higher than actual 2013-2017 average CC, while a negative percentage change implies that the model average CC is lower than the actual average.



10) Federal Funds:

Federal Funds are not part of the model, but special education costs currently paid by federal funds are also subtracted from special education costs. In other words, the implied assumption is that Federal Funds will continue to be received at the current level and used to pay special education costs. Any commentary in this report about the UConn Goldenson Center Model excludes federal subsidies and any special education costs paid by federal subsidies.

12) State Refund:

As noted in Step 4 of the CC calculation, the state refund is calculated only on the prior year's results. It does not account for the cumulative funds that may be accrued over time for paying special education costs. As an example, if the state refund is \$1 million one year and \$2 million the following year, the state refund in the CC calculation at the end of the second year is \$2 million. However, the Co-op has accrued \$3 million on the balance sheet for future special education costs. Similarly, if there is no state refund one year, it does not directly impact the potential for the state refund in the following year. The refund also does not consider any investment income that has been earned on the funds being held in the Co-op.

It is possible that the Co-op could accumulate assets in excess of what is required for financial stability. It may be beneficial to have a mechanism for assessing the adequacy of Co-op surplus and utilizing excess funds that operates over longer than a one-year horizon.

13) Adverse Selection

The Basic Model assumes participation of all districts in the state. At the request of the Special Education Cost Model Task Force, a second model was provided that removed entities who receive 5% or less of their special education funding from the state. The integrity of the model remains intact with the removal of these fifteen entities. Note that this second version of the Basic model needs to be revised. In the version provided on January 18, 2019, the total state funding is reduced by the amount of state funding received by the entities that have been removed. However, the total state funding should remain the same as the first version. Making this correction should improve the financial results in the second model.

### **Basic Model – Actuarial Conclusion**

At its core, the Basic Model using Equity Discount Option 1 does function as a complete and balanced methodology that is possible to implement in a Co-op. Many of our findings above are primarily operational considerations that would need to be addressed practically for implementation to be successful.

The broader issues that we feel need to be addressed regarding the Basic Model are:

- The Community Contribution calculation needs to include a growth assumption that accounts for the fact that the calculation is based on information that is over a year old. Recall that Community Contribution is the portion of funding for the Co-op that would come from the schools. Community contributions would be made annually, vary by entity, and would change from year to year.

According to the historical data in the actuarial model, special education costs have increased at least 4% per year in each of the last four years. The actual Community Contribution calculation needs to account for two (or more if necessary) years of increasing costs, not just one year.

- The model is large and complicated. Maintaining the model and making future changes will be cumbersome. In addition, explaining the numerous parameters within the model and how they respond to varied real-life scenarios to the average listener will be difficult and may give the impression of a “black box” calculation.

Having said that, from an actuarial perspective, the Co-op is feasible as long as a few key elements are understood.

- First, the State must maintain their level of contribution.
- Second, while statewide special education costs are predictable, there is essentially no risk load in the model. Therefore, there will need to be a source of funds to compensate for the years in which special education costs are more than the funds contributed for the year (Total CC + State Subsidy). The Co-op itself would ideally be the source of such funds, and we feel the Co-op will have sufficient financial strength to do so, barring any extreme circumstances.
- The frictional costs of administering a Co-op with over \$2 billion per year of funding and payments, and servicing well over 150 members will be cumbersome.

We believe that with a strong financial foundation and some careful considerations from a practical standpoint, that a Co-op is feasible.

### **The UConn Goldenson Center cited the following sources for their model:**

- i. Connecticut End of Year School Reports (ED001s): Filed annually by each public school district in Connecticut. The ED001 is the primary source of financial information on education in Connecticut and is used in calculating state grants and providing statistical information to local, state, and federal policy makers. Both data sets were provided by Connecticut State Department of Education. The first data set includes data for all local public school districts from 2009-17. This is the source for local public school district special education expenditures.

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- ii. LEA Special Education Expenditures, 2003-17: Data from the Connecticut State Department of Education detailing annual special education expenditures for the state's Local Education Agencies. The data includes total annual special education expenditures from 2003-2017, and breaks down said expenditures by funding source.
- iii. Connecticut State Department of Education. (2016). CT Public School Enrollment\_2000.mdb. Available from <http://edsight.ct.gov/>. This is the school district enrollment data used for special education student counts.
- iv. Connecticut State Department of Education (2016). Grant Payment Report. Available from Connecticut State Department of Education Web site: <https://www.csde.state.ct.us/public/dgm/grantreports1/paydetlMain.aspx>. This is the state and federal grant payment data for school districts.

## Methods of Captive Pricing

A captive is an insurance company and the risks being insured by the captive should be priced in a similar manner as the commercial markets would. It is important to protect a captive, its capital and shareholders from potential claims volatility.

To do so, we would suggest that the captive premium be calculated on a "Cost Plus" basis which includes a buffer on top of the expected loss (equals reimbursement amounts) levels echoing the standard market practices of any commercial insurer.

If the potential volatility is not realized in any one year this additional funding can build as captive surplus, generating further investment income and providing additional protection against deterioration in future years' loss experience. Further it can be used to support underwriting new lines of insurance in the captive.

While there is no single prescribed method of pricing risks in a captive, the premium should strike a balance between funding for expected losses and including a reasonable margin capable of absorbing losses over and above the expected level. While the captive may be protected from the severity of an individual loss through the per-occurrence retention, it could be subject to excessive frequency of losses.

The calculations below are based on the loss analysis results provided by Special Education Cost Model Task Force. The premium calculation methodology would be the same were Special Education Cost Model Task Force to seek pricing at differing levels of retention.

The basic model and excess model costs used to determine the annual premium to fund the captive exposures are taken from the extract below from the model as provided by the UCONN Goldenson Center for Actuarial Research

**Table 4.1 – Total Special Education Costs**

<b>State Information</b>	<b>2018</b>
Total Excess Cost	\$ 140,623,572
Total Basic Cost	\$1,889,483,258

Source: UConn Goldenson Center for Actuarial Research – Model State Output

Aon’s ‘cost-plus’ methodology applies a specific volatility charge to the expected losses (reimbursements) and the volatility charge is generally between 10% and 20% of the expected losses. Due to the split model between base and excess costs, we have only applied a volatility charge to the Excess Cost model as that is where much of any volatility incurred will be experienced. We are proposing to add a 20% volatility charge as a conservative approach to pricing for the captive.

**Table 4.2 – Cost Plus Model**

<b>Calculation</b>	<b>S.E. Costs</b>	<b>S.E. Costs</b>	<b>Totals</b>
	<b>Basic Model</b>	<b>Excess Model</b>	
Expected Losses (A) / Reimbursements	\$ 1,889,483,258	\$ 140,623,572	\$ 2,030,106,830
Volatility Charge (B)	100%	120%	
<b>Premium (A * B) / Total Contributions</b>	<b>\$ 1,889,483,258</b>	<b>\$ 168,748,286</b>	<b>\$ 2,058,231,544</b>

In addition to the premium to fund the expected losses, insurance companies and captives will also adjust premiums to allow for expected administrative expenses. This administrative load is added to the premium.

The anticipated costs to operate the captive in year 1 are estimated as follows:

(Costs may vary, depending upon service provider and scope of work required)

**Table 4.3 – Annual Administrative Expenses**

Regulatory Fees (State of CT)	\$ 375
Captive Management Fees	\$ 150,000
Financial Audit Fees	\$ 40,000
Third Party Administrator (TPA) Fees/Claims Handling Costs	\$ 200,000
Actuarial Analysis Fees	\$50,000
Legal	\$50,000
<b>Totals</b>	<b>\$490,375</b>

By applying an administrative load equivalent to 0.025% of the calculated ‘cost-plus’ premium, the annual administrative costs of the captive will be funded within the contributions made annually to the captive.

**Table 4.4 – Administrative Loading**

	<b>S.E. Costs Basic Model</b>	<b>S.E. Costs Excess Model</b>	<b>Totals</b>
<b>Suggested Captive Premium / Contributions</b>	\$1,889,483,258	\$168,748,286	\$2,058,231,544
<b>0.025% Administrative Load</b>	\$ 472,371	\$ 42,187	\$ 514,558
<b>Final Proposed Captive Premium / Contributions</b>	<b>\$ 1,889,955,629</b>	<b>\$ 168,790,473</b>	<b>\$ 2,058,746,102</b>

The final captive premium / contribution is a decision for Special Education Cost Model Task Force and the captive stakeholders.

## 5. Stakeholder Input

### Stakeholder Input on Captive Utilization:

The Special Education Cost Model Task Force held six focus group meetings in each of the Regional Education Service Center (RESC) regions throughout Connecticut and one focus group meeting with teachers. Details of these meetings are set out in Appendix A of this report. Invitees included superintendents, special education directors, school business officers, employees of RESCs, school board members, and town officials. Discussions with various stakeholders on the financing of special education in Connecticut took place during these meetings, Aon discussed and received feedback on the following:

- Overall needs and concerns of the stakeholders
- Proposed funding models as an alternative to the current funding mechanisms
- Operational requirements specific to districts, school districts, and individual student requirements.
- Financial implications and other concerns of stakeholders
- Benefits of the proposed Co-op model

The following is a summary of themes expressed by stakeholders during the focus groups. There were varying levels of familiarity with the financing model among participants. The themes outlined below represent the statements of the focus groups participants and are not comments or conclusions from Aon.

Concerns and comments related to the co-op model included:

- The model does not address rising special education costs or require the state to increase its funding for special education.
- Will participation in the Co-op be mandatory?
- Which costs are included in the special education costs covered under the model?
- Which entity will own and/or manage the coop?
- How will cash flows be managed at the state, town, and local levels?
- Will this model require uniform budgeting procedures among towns and school districts?
- Concerns that the state will not make its required contribution

Additional questions related to the co-op model, which are addressed in this report included:

- How will the administrative costs be paid, and will these costs be borne by school districts?
- Will administrative costs increase the cost of special education?
- Concerns that the model will reduce incentives for districts to manage costs

Other concerns and topics related to special education service delivery were raised by stakeholders. These issues are not addressed by the financing model and are cataloged below:

- Burden of proof
- The cost of outplacing high-needs students
- Increasing special education costs year over year
- Increasing rates of special education student identification
- The need for more qualified special education teachers

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## 6. Recommendations for Operations



Captive Domicile Selection – Connecticut has been selected

Connecticut makes sense as the selected domicile for the proposed captive. Connecticut passed captive insurance law in 2008 and has established an excellent reputation. The States wealth of insurance industry talent, history of insurance innovation, along with the proposed members of this captive program all being located within the State make Connecticut an excellent choice for domiciling the captive.

There are several factors that must be considered when deciding on a suitable domicile for a captive insurance company, these include but are not limited to the following:

- Capitalization Requirements;
- Geography
- Investment Restrictions;
- Reporting and Audit Requirements;
- Government Fees;
- Regulatory and Legislative Climate;
- Formation Costs;
- Quality of ancillary support services such as audit and legal.

### Common Domicile Features

There are several features that are common to captive domiciles these include:

- Minimum Capitalization (For Connecticut \$250,000 for Single Parent Captives)
- Each regulator will have its own requirements for determining the adequacy of capital funding in a captive. However, typical capital requirements can be summarized as follows:

### Typical Capital Requirements

	Premium	to	Capital
Short Tail Risk	\$2	:	\$1
Medium Tail Risk	\$3	:	\$1
Long Tail Risk	\$5	:	\$1
Mixed Risk	\$4	:	\$1

Connecticut accepts 3:1 and other ratios that are generally acceptable among regulators and the insurance industry. Aon has spoken with the Connecticut Insurance Department; a final determination has not been made regarding capital requirements for the potential Co-op captive. For this study we will

utilize a premium to capital ratio of 5:1, resulting in projected initial capital requirement of \$411,000,000. (Basic Model)

- **Loss Reserves**
  - Loss reserves must be annually certified by a qualified, individually-recognized actuary.
- **Investments**
  - Captives typically take low risk investment strategies including cash and bonds however; some domiciles impose restrictions on the type of investment such as on loan-backs to the parent organization.
  - A 1.5% investment return has been projected for the Captive. This return projection is conservative, and returns may be higher. Income generated from investment returns may be utilized to pay frictional costs and administrative fees for the potential captive. The investment return is impacted by initial capitalization requirements and duration of funds held.
  - Mature captives can invest in more sophisticated investment vehicles subject to regulatory approval.
- **Application Fee**
  - Application fees vary by domicile, for Connecticut the fee is \$800, with the annual license fee set at \$375

*For the remainder of the analysis and the basis of the pro-forma financial statements that follow we have considered the Connecticut as the preferred location for a Co-op Captive.*

## Captive Structure

As discussed previously in this report, we would recommend either a Single Parent or Segregated Cell Captive as the most suitable structure for the Co-op.

## Funding a Captive

### Premiums

As with premiums paid to any other insurer, the premiums (contributions) paid to a captive insurer will be required in cash in order to meet the potential loss (reimbursement) payments. The payment terms however, will be a decision for the Co-op. Premiums can typically be paid in installments throughout the year e.g. monthly or quarterly payments.

### Capital & Surplus

The regulator will require a minimum level of capital and surplus for a captive, in Connecticut for example, this is \$250,000. The level of capital in the captive should never fall below this level.

Based on the suggested premium of \$2,058,746,102 we would estimate initial capital for the captive of approximately \$411,000,000 based on a 5:1 premium to capital ratio. This is subject to review and validation by the Connecticut regulator.

The captive also requires adequate capitalization for the respective level of risk. The regulator will typically prescribe an additional level of capital depending on the risks being written by the captive. The following instruments can be used for capital funding in most US domiciles including Connecticut.

- Cash
- Marketable Securities
- Irrevocable Letters of Credit issued by a bank approved by the Commissioner; and
- A trust approved by the Commissioner
- Other customized options may be available for the proposed Co-op captive

*As of January 2019, options including a potential bond issuance are being considered to meet the capitalization requirements of the proposed captive.*

## Captive Management

After the captive is formed most of the day to day operational responsibilities of the captive are outsourced to a specialist captive manager in the domicile selected. Such services fall within four primary categories:

### **1. Financial Services**

- Preparing interim and year-end financial statements with detailed notes.
- Supporting schedules and comparative data analysis;
- Maintaining of all required books and records;
- Invoicing and collection of premiums;
- Monitoring of investments and investment income.

### **2. Insurance Services**

- Maintaining all required insurance related records in the domicile;
- Liaising with risk management and claims consultants to establish claims reporting procedures;
- Upkeep of all underwriting and statistical records.

### **3. Treasury and Corporate Services**

- Assisting in the procurement of letter of credit;
- Summarizing and evaluating performance of investments selected by Special Education Cost Model Task Force;
- Coordinating board meeting of directors.

### **4. Regulatory Services**

- Representing the captive during regulatory examinations;
- Completing and filing statutory report required by the domicile;
- Ensuring compliance with the domicile's insurance laws and regulations;

- Corresponding with domicile Regulators to notify and implement changes in the captive's operations.

Due to the nature of the (Co-op) program additional operational and staffing requirements may be required for the captive. Responsibilities to properly operate a captive with the purpose and functionality desired by the Co-op include determining premiums (contributions) required by the state and districts, collection of contributions, processing of claims / reimbursements (potentially utilizing a third-party-claims administrator), management of funds, accounting, conducting board meetings, plus other operational and regulatory requirements.



## 7. Financial Modeling

On the following pages we have included sample financial statements for a Co-op Captive to demonstrate the financial operation should it be utilized to finance the program. The following assumptions have been used for this modeling:

- A single parent captive located in the Connecticut.
- The captive will initially write: Special Education Cost Reimbursement Policy
- A captive financial year ending December 31, 2020.

Suggested total written captive premium (contributions) of \$2,058,746,102 for year 1 of the captive.

Total expected losses (reimbursements) of \$2,030,106,830 based on the UCONN Goldenson Center actuarial analysis.

An estimated capital requirement of \$411,000,000 based on a 5:1 Premium to Capital ratio on the first year written policy premium of \$2,058,746,102 inclusive of the minimum capital and surplus requirement in Connecticut;

- We have assumed the minimum capital and surplus level (\$250,000) will be financed in cash while the balance will be financed by method (i.e. Bond) that is currently being investigated and is yet to be determined.
- Estimated Operational & Management Costs (Fees may vary)
  - Regulatory Fee: \$375
  - Annual Management Fees: \$150,000
  - Annual Audit Fees: \$40,000
  - Third Party Administrator: (Claims / Reimbursements) \$200,000
  - Annual Actuarial Fees: \$50,000
  - Annual Legal Fees: \$50,000
  - Should Premium Tax be due, maximum of \$200,000 would be required
  - Inflation Rate: 2.0% per annum; / Investment Yield: 1.5% per annum

### Non-Captive Costs

There may be additional costs that Special Education Cost Model Task Force will be subject to because of the proposed captive structure and specialized operational requirements which are not incorporated into the pro-forma captive financials.

Table 7.1: Sample Connecticut Captive Pro-Forma Financial Statements (Expected Loss forecast) – Income Statement (Basic Model)

Special Education Cost Model Task Force Projected Income Statement YEAR 1 - YEAR 4				
Income	YEAR 1	YEAR 2	YEAR 3	YEAR 4
Premiums Written - Direct	\$ 2,058,746,102	\$ 2,119,110,279	\$ 2,179,474,455	\$ 2,239,838,633
Gross Underwriting Income	2,058,746,102	2,119,110,279	2,179,474,455	2,239,838,633
Loss and Loss Expenses	2,030,106,830	2,090,443,205	2,150,779,579	2,211,115,954
General & Administrative	490,375	459,175	468,151	477,306
Premium Taxes	200,000	200,000	200,000	200,000
Total Underwriting Deductions	2,030,797,205	2,091,102,380	2,151,447,730	2,211,793,260
Net Underwriting Income	27,948,897	28,007,899	28,026,725	28,045,373
Investment Income	19,460,413	24,544,307	26,011,724	27,501,434
Net Income Before Taxes	47,409,310	52,552,206	54,038,449	55,546,807
Net Income	\$ 47,409,310	\$ 52,552,206	\$ 54,038,449	\$ 55,546,807

Notes to Table 7.1:

- **Loss & Loss Expenses:**
  - Based on UCONN Actuarial Model (Basic Model)
- **Premium Taxes:** Connecticut Tax Rates on Captive Insurance Direct Premiums are:
  - First \$20m: 0.38%
  - Next \$20m: 0.285%
  - Next \$20m: 0.19%
  - Over \$60m: 0.72%
  - Maximum premium tax payable: \$200,000
- There is no current statute in Connecticut that would prevent a captive such as the “Co-op” from being required to pay premium tax. Other captives have pursued a letter ruling to override the payment of premium tax, Aon recommends that the “Co-op” discuss such a strategy with its tax and legal advisers.

Table 7.2: Sample Connecticut Captive Pro-Forma Financial Statements (Expected Loss forecast) – Balance Sheet (Basic Model)

Special Education Cost Model Task Force Projected Balance Sheet YEAR 1 - YEAR 4				
	<u>YEAR 1</u>	<u>YEAR 2</u>	<u>YEAR 3</u>	<u>YEAR 4</u>
<u>Assets</u>				
Cash and Equivalents	\$ 250,000	\$ 250,000	\$ 250,000	\$ 250,000
Invested Assets	554,936,018	622,572,318	691,694,860	762,325,761
Total Cash and Invested	555,186,018	622,822,318	691,944,860	762,575,761
Letter of Credit	411,000,000	411,000,000	411,000,000	411,000,000
Total Assets	<u>\$ 966,186,018</u>	<u>\$ 1,033,822,318</u>	<u>\$ 1,102,944,860</u>	<u>\$ 1,173,575,761</u>
<u>Liabilities</u>				
Loss Reserves - Gross	\$ 507,526,708	\$ 522,610,801	\$ 537,694,895	\$ 552,778,989
Total Liabilities	507,526,708	522,610,801	537,694,895	552,778,989
<u>Shareholders' Equity</u>				
Common Stock	250,000	250,000	250,000	250,000
Letter of Credit	411,000,000	411,000,000	411,000,000	411,000,000
Retained Earnings	47,409,310	99,961,517	153,999,965	209,546,772
Total Equity	458,659,310	511,211,517	565,249,965	620,796,772
Total Liabilities & Equity	<u>\$ 966,186,018</u>	<u>\$ 1,033,822,318</u>	<u>\$ 1,102,944,860</u>	<u>\$ 1,173,575,761</u>

Notes to Table 7.2:

- **Cash & Cash Equivalents:**
  - \$250,000 minimum capital & surplus in Connecticut
- **Invested Assets:**
  - Cash from Underwriting + Investment Income
- **Letter of Credit / Bond may be utilized for capitalization**
  - Balance of Initial Capital in excess of \$250,000 minimum
  - Assumes LOC used but can be cash (in which case it would appear in Cash or Invested Assets). Other customized methods such as a Bond may be utilized.
  - Options to meet capitalization requirements are under consideration
- **Loss Reserves**
  - Total (Expected) Incurred Losses – losses paid in the financial year
- **Common Stock**

- Minimum Capital & Surplus in Connecticut
- **Retained Earnings**
  - Net Income for the financial year (see Income Statement)

## Appendix A – Stakeholder / Focus Group Meetings

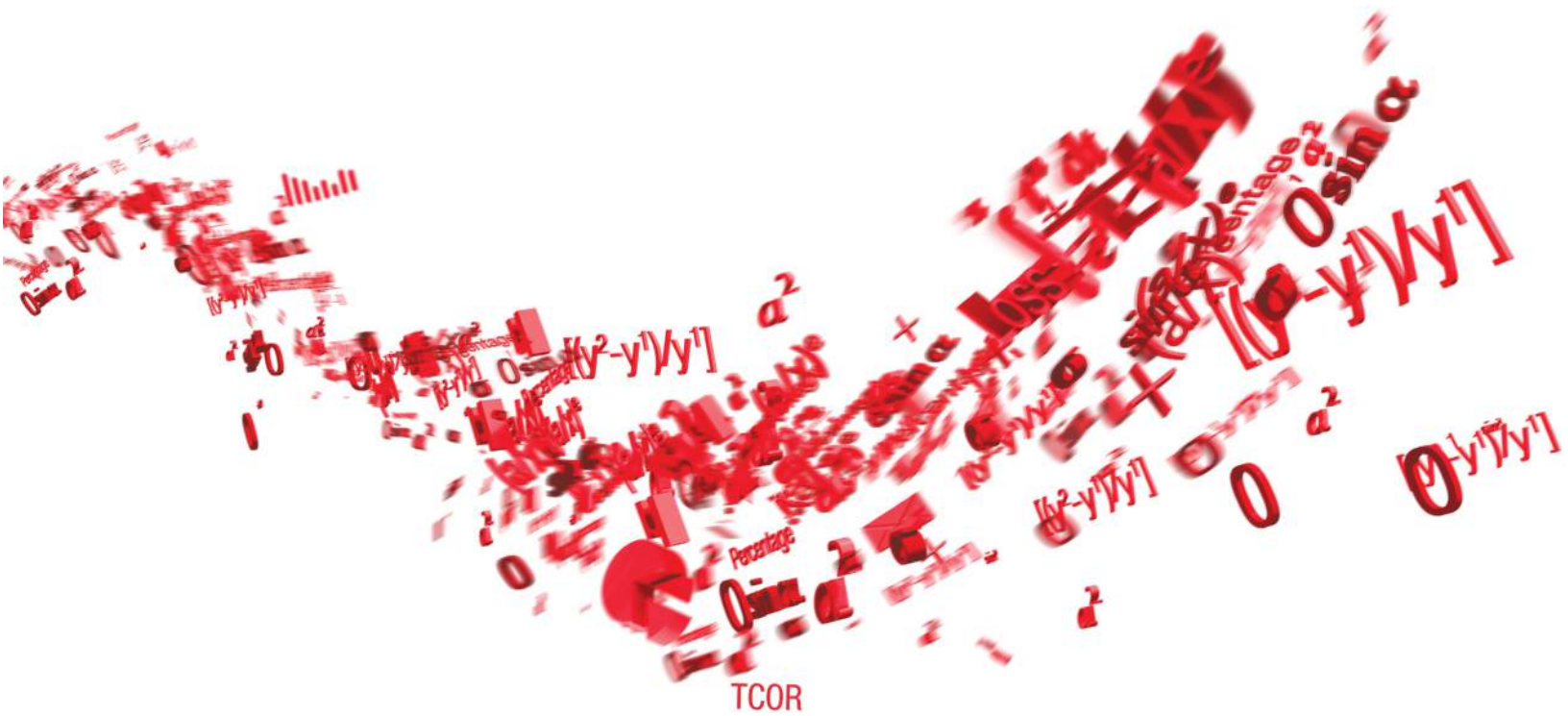
The Special Education Cost Model Task Force held six focus group meetings in each of the Regional Education Service Center (RES-C) regions throughout Connecticut and one focus group meeting with teachers. Meeting dates, Connecticut locations, and number of attendees are as follows:

<b><u>Date</u></b>	<b><u>Location</u></b>	<b><u>Number of Attendees</u></b>
11/8/2018	Old Saybrook	16
11/8/2018	Windham	14
11/9/2018	Norwalk	19
11/9/2018	Litchfield	13
11/13/2018	Hartford (meeting w Teachers)	6
11/13/2018	Meriden	16
11/13/2018	South Windsor	15

## About Aon

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# Special Education Cost Model Task Force

## Captive Feasibility Study Supplement

### Excess Model Analysis and Pro Forma Financials

May 2019

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# 1. Overview

## Feasibility Study Supplement

- Information Gathering & Review
  - Review the Excess actuarial report developed by the Goldenson Center for Actuarial Research at the University of Connecticut.
  - Aon's Actuarial and Analytics team reviewed this actuarial report to determine:
    - How districts contributions are calculated on an annual basis.
    - How a district's experience in a fiscal year would affect its required contribution in the subsequent fiscal year.
    - Review any proposed processes by which districts would be reimbursed for special education costs incurred throughout the fiscal year.
    - How these models would support a Special Education finance system that allows state and local governments to share costs.
  - Financial Modeling
    - Aon has prepared 4-year pro-forma financial statements for the captive structure incorporating likely premium, loss forecasts, expense budget, initial capitalization requirements, and other assumptions utilizing data from the Excess Model.

### **Disclaimer**

*Please note any statements concerning tax, accounting or legal matters in this document should be understood as general observations based solely on our review of public materials and our experience as insurance brokers and risk consultants, and may not be relied upon as tax, accounting or legal advice which we are neither intending, nor authorized, to provide. All such matters should be reviewed with Special Education Cost Model Task Force's own qualified advisors in these areas. This report is intended for internal Special Education Cost Model Task Force distribution only. Aon does not accept any responsibility or liability to any third-party recipient of this report.*

## 2. Actuarial Review

### **Aon’s actuarial team reviewed the Excess Model created by the UCONN Goldenson Center for Actuarial Research and provided the following review and commentary:**

It is important to note that:

1. All commentary regarding the Excess Model refers to the model received on January 19, 2019
2. The 1/19/19 version of the Excess Model included a few different options. This report discusses the version of the Excess Model that includes the smoothing effect that is discussed in Step 5 below. The UCONN Goldenson Center team refers to this portion of the model as a “fairness adjustment”.
3. The Excess Model included an initial capitalization in the first year of the Co-op. The surcharge was equal to 1% of the prior year excess special education costs. At the request of the Special Education Cost Model Task Force, Aon removed the additional capitalization in Year 1, reasoning that additional capitalization should not be part of the Excess Model calculations.
4. The names of the entities have been removed from the Excess Model, as requested by the Connecticut State Department of Education for privacy reasons. Therefore, we cannot comment on the results of the calculation for any specific entities or group of entities.

### **HOW IS THE EXCESS COMMUNITY CONTRIBUTION (XSCC) CALCULATED IN THE EXCESS MODEL?**

#### Step 1:

The first step is to calculate the average excess cost per student over the last four years for each entity as well as statewide.

#### Step 2:

The initial XSCC is calculated using a weighted average of the entity’s average historical excess cost per student and the statewide historical excess cost per student. The ‘weight’ given to the individual entity’s history varies by entity. In other words, one entity’s history may be given 35% percent weight, while another entity’s history will be given 90% weight. In these examples, the statewide history would be given 65% weight and 10% weight, respectively. This methodology is also known a credibility.

The formula used determine the entities’ weights, or credibility, is the following:

$$\frac{\text{Sum of the number of excess students in the last four years for the entity}}{(\text{Sum of the number of excess students in the last four years for the entity} + k)}$$

The value of ‘k’ changes every year, but the value is the same for every entity. Note that entities with more excess students will have a higher credibility, relatively speaking. In addition, entities with a relatively larger value of ‘k’ will have a relatively lower credibility.

Mathematically, ‘k’ is equal to the following ratio:

$$\frac{\text{Average of the variances of excess costs for all school districts}}{\text{Variance of the average excess costs for all school districts}}$$

'k' is calculated using the last four years of history and in any given year is the same for each entity. During the 4 years included in the model, 'k' increases so the weight given to each entity's own historical average decreases and the weight given to the state average increases.

Credibility is a common and accepted approach in actuarial science. By including the data of the entire population, or in this case by including the data of all of the entities, the Excess Model utilizes a more robust history. This makes the model relatively more predictable than using the individual entities' data by itself. At the same time, the approach considers the historical data of the individual entities.

**Step 3:**

The third step adjusts the XSCC for the financial results of the Co-op. The total debit or credit amount to be distributed to the entities in any given year is determined by the amount of surplus in the Co-op at the end of the prior year. In the Excess Model, surplus is determined based on:

- the actual excess costs compared to the community and state contributions for the prior year, plus
- change in the Co-op's Risk Capital during the year. Risk Capital in the Excess Model is defined as 1% of the most recent year's excess costs.

If surplus is positive, and therefore an overall credit will be given in the following year's XSCC calculations, only those entities whose actual excess costs were less than their XSCC in the prior year will receive a credit. The credit is equal to the individual entity's percentage of the total difference between actual excess costs and the XSCC calculation in the prior year. For example, if the actual excess costs for all entities eligible for a credit are \$1 million below the eligible group's XSCC in total, and Entity A's excess costs were \$100 thousand below Entity A's XSCC, then Entity A will receive a 10% credit in the following year (= \$100k/\$1m).

Similarly, if surplus at the end of the year is negative, and therefore an overall increase will be included in the following year's XSCC calculations, only those entities whose actual excess costs were greater than their XSCC in the prior year will receive an upward adjustment. The calculation is similar to the positive surplus calculation. Revisiting the example for Entity A, if Entity A's excess costs were \$100 thousand above Entity A's XSCC and the excess costs for the group in total was \$1 million above the group's CC, then the XSCC for Entity A would increase 10%.

**Step 4:**

To arrive at the final XSCC collected, the result of Step 3 for each entity is multiplied by the number of excess students in the prior year, and a growth factor is applied to account for the fact that the historical data is up to four years old. The annual growth assumptions are:

Contribution Year	Annual Growth
2014	3.5%
2015	4.0%
2016	5.5%
2017	5.5%

**Step 5:**

The final step ensures that the XSCC will not be consistently greater than the actual excess costs for individual entities. If the actual excess cost per student is less than the XSCC per student for an entity in each of the prior two years, then the entity XSCC will not be equal to the calculation described above.

Instead, the entity will pay the actual 2-year average cost per student in the following year, adjusted for inflation.

### **Additional Points that Pertain to the Excess Actuarial Model**

1. *Student Count as Exposure Base*

The excess special education student count is an area that could cause the calculations in the model to be skewed or perhaps manipulated. The excess special education student count is a snapshot at one point in time during the year, on October 1. This one-time count could skew the “average excess special education cost per student”. This is similar to the previous commentary in the Basic Model section, but the potential for skewed results is even greater given the wide range of costs per excess special education student, as well as the relatively smaller excess student count. Mathematically, this approach is acceptable for the solvency of the Co-op. However, it could cause anomalies for individual entities, and is an area that is susceptible to manipulation. Ideally, an “earned student” concept would be used, or alternatively an average of excess students counts at various times during the year.

2. *Surplus and Risk Capital:*

The definition of Surplus and Risk Capital within the Excess Model have been defined in Step 3. These figures will be determined by the Captive Regulators and the State of Connecticut. The amounts will be based on additional considerations such as administrative costs, investment income, and other factors that pertain to maintaining a Co-op. The figures used in the Excess Model are acceptable for the purposes of calculating the XSCC, but the user should be aware that the more robust Co-op financials most likely will not mimic those shown in the model.

3. *Potential for Accumulated Assets*

The surplus adjustment is calculated only on the prior year’s results. It does not account for the cumulative funds that may be accrued over time for paying special education costs. As an example, if the surplus adjustment is \$1 million one year and \$2 million the following year, the surplus adjustment in the XSCC calculation at the end of the second year is \$2 million. However, the Co-op has accrued \$3 million on the balance sheet for future excess special education costs. Similarly, if there is no surplus adjustment one year, it does not directly impact the potential for the surplus adjustment in the following year. The adjustment also does not consider any investment income that has been earned on the funds being held in the Co-op.

It is possible that the Co-op could accumulate assets in excess of what is required for financial stability. It may be beneficial to have a mechanism for assessing the adequacy of Co-op surplus and utilizing excess funds that operates over longer than a one-year horizon.

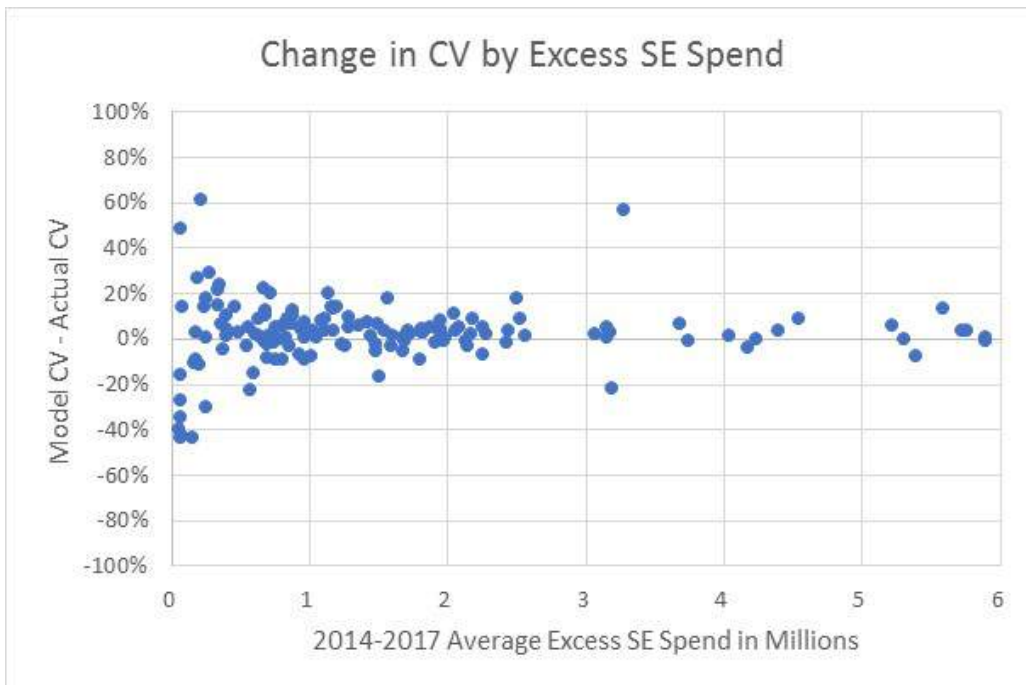
4. *Volatility:*

The two types of volatility have already been described in the Basic Model section. Similar to the Basic Model, the volatility within a school year will be completely removed with the formation of a Co-op. Each district will pay their contribution to the Co-op once a year, and they will not need to change their

excess special education budget during the next school year, regardless of their actual excess special education costs. Any volatility within a single school year will be covered by the Co-op.

To investigate the year-to-year volatility of the model results for individual districts, we again used the coefficient of variation. For each entity, we calculated the CV of the actual special education spending over the 2014 to 2017 period and compared it to the CV of the spend projected for the same period by the model.

We observed that while the model reduces volatility for some districts, it increases volatility for the majority of the districts. Of those districts with XSCC's, approximately 65% of the entities see an increase in their annual cost volatility, 35% see a decrease in their annual cost volatility. The scatter plot below shows the change in volatility by the average excess special education spend in millions for the majority of the entities. Dots above the 0% horizontal line represent entities with an increase in year-to-year volatility, while those below the 0% horizontal line see a decrease in year-to-year volatility.



5. Experience Based

Similar to the Basic Model, the Excess Model is experienced based. That is, the model utilizes the historical excess special education costs of the individual entity in calculating the XSCC each year. The primary benefit of this approach is that the entities who use the funds in the Co-op pay a greater share of the premium. A disadvantage is that the model requires detailed data and the year-to-year premiums can be volatile for an individual entity.

Instead of an experience-based approach, another option would be an exposure-based approach. An exposure-based approach would utilize some agreed-upon measure of each entity's propensity to have higher excess special education costs. For example, total student count would be one option. The benefit of an exposure-based approach is that the XSCC calculation would be significantly more straight-forward, the model inputs would be easier to obtain, and the model could be viewed by everyone. The primary disadvantage is that larger entities would pay a larger portion of premium, regardless of their actual excess special education costs. This could be viewed as larger entities compensating smaller entities.

6. Increasing Excess Special Education Costs

The Excess model assumes excess special education costs growth factor of 3.5% to 5.5% annually, as described in Step 4 above. Actual historical excess special education costs have increased anywhere from 1.5% to 6.2% from one year to the next. The actual growth should be monitored carefully to ensure that the model assumption remains realistic going forward.

7. Frictional Costs

Frictional and administrative costs are not addressed in the model. If a portion of any contribution is ear-marked to pay for the frictional or administrative costs of maintaining a Co-op, the model would need to be adjusted to account for that. For purposes of this feasibility study, we have assumed the frictional costs will not be paid by the schools or from the state subsidy.

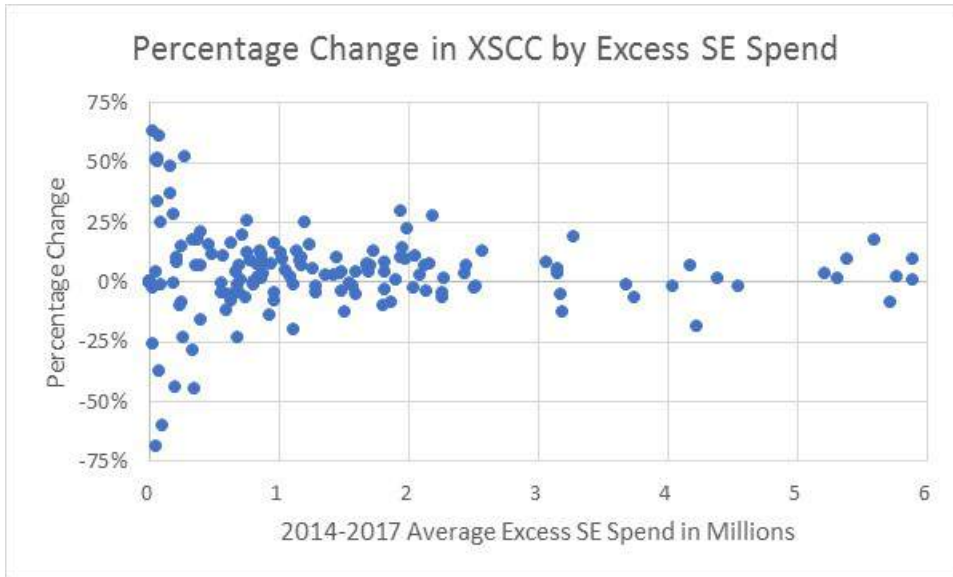
8. Model vs. Actual Excess Community Contribution

We compared the XSCC calculated by the UCONN model to the actual XSCC for 2014-2017. The table below shows our comparison for all entities combined.

	<b>Actual Historical XSCC</b>	<b>Model XSCC</b>	<b>Percentage Change</b>
2014	281,016,117	300,704,593	7.01%
2015	307,139,555	292,319,465	-4.83%
2016	330,801,752	333,862,575	0.93%
2017	361,564,411	359,169,136	-0.66%

As you can see, the comparison is inconsistent from one year to the next. The reasons are: volatile nature of the excess special education costs, inconsistency of the state contribution year-over-year, and the model gives back 100% of surplus (as defined by the model) in the next year's XSCC calculation.

The scatter plot below shows the percentage change in XSCC by average excess special education spend in millions for the majority of the entities. A positive percentage change (dots above the 0% line) implies that the model average XSCC is higher than actual average XSCC, while a negative percentage implies that the model average XSCC is lower than the actual average.



9. No Future Years Are Projected

The Excess Model does not project future years. Instead, historical years 2014-2017 are restated using the XSCC calculation. This report utilizes 2014 as Year 1 of the Co-op, 2015 as Year 2 of the Co-op, etc.

10. Adverse Selection

The Excess Model assumes participation of all districts in the state. If the Co-op were to make participation optional for certain districts, the model will not necessarily produce an actuarially sound premium. Furthermore, the Co-op would be significantly at risk of adverse selection, whereby districts with low expenses decline to participate, which increases the costs to participants.

Recall that we performed a stress test on the Basic Model, removing entities who receive 5% or less of their funding from the state. Because the names of the entities have been removed from the Excess Model, we were unable to perform this test on the Excess Model.

11. Risk Load

There is no implicit risk load in the model. The underwriting results vary year over year, so a risk load should be considered.

**Excess Model – Actuarial Conclusion**

From an actuarial perspective, the Co-op is feasible as long as a few key elements are understood.

- The excess student special education costs are relatively more risky and volatile than the total special education costs. There will need to be a source of funds to compensate for the years in which special education costs are more than the funds contributed for the year (Total XSCC + State Subsidy). The Co-op itself would ideally be the source of such funds, and we feel the Co-op will have sufficient financial strength to do so, barring any extreme circumstances. However, the Co-op may want to consider a risk load, or reducing the XSCC surplus credit to something less than 100%.



- From 2010-2016, the State contributed between 30-35% of the total excess special education costs. In 2017, the contribution percentage decreased to 28%. If the state contribution continues to decrease, the entities will need to compensate for the difference. If the state contribution decreases too rapidly, the model may not respond quickly enough.
- The frictional costs of administering a Co-op with over \$500 million per year of funding and payments, and servicing well over 150 members will be cumbersome.

Having said that, there are some issues that we feel make the Excess Model impractical for use.

- The model is extremely complicated. Maintaining the model and making future changes will be cumbersome. In addition, explaining the numerous parameters within the model and how they respond to varied real-life scenarios to the average listener will be difficult and may give the impression of a “black box” calculation.
- The results by school district can only be viewed by a small group of people, due to state and federal privacy laws. The lack of transparency will add to the “black box” impression and could result in even more practical hurdles in maintaining the model.

We believe that with a strong financial foundation and some careful considerations from a practical standpoint, that a Co-op is feasible, however we would not recommend using this Excess Model.

### 3. Methods of Captive Pricing

A captive is an insurance company and the risks being insured by the captive should be priced in a similar manner as the commercial markets would. It is important to protect a captive, its capital and shareholders from potential claims volatility.

To do so, we would suggest that the captive premium be calculated on a “Cost Plus” basis which includes a buffer on top of the expected loss (equals reimbursement amounts) levels echoing the standard market practices of any commercial insurer.

If the potential volatility is not realized in any one year this additional funding can build as captive surplus, generating further investment income and providing additional protection against deterioration in future years’ loss experience. Further it can be used to support underwriting new lines of insurance in the captive.

While there is no single prescribed method of pricing risks in a captive, the premium should strike a balance between funding for expected losses and including a reasonable margin capable of absorbing losses over and above the expected level. While the captive may be protected from the severity of an individual loss through the per-occurrence retention, it could be subject to excessive frequency of losses.

The calculations below are based on the loss analysis results provided by Special Education Cost Model Task Force. The premium calculation methodology would be the same were Special Education Cost Model Task Force to seek pricing at differing levels of retention.

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The excess model costs used to determine the annual premium to fund the captive exposures are taken from the extract below from the model as provided by the UCONN Goldenson Center for Actuarial Research

**Table 1.1 – Total Special Education Costs / Reimbursements**

<b>Excess Model</b>	<b>Year 1</b>
Total Excess SE Cost / Reimbursements	\$ 420,422,698

Source: UConn Goldenson Center for Actuarial Research

In addition to the premium to fund the expected losses, insurance companies and captives will also adjust premiums to allow for expected administrative expenses. This administrative load is added to the premium.

The anticipated costs to operate the captive in year 1 are estimated as follows:

(Costs may vary, depending upon service provider and scope of work required)

**Table 1.2 – Annual Administrative Expenses**

Regulatory Fees (State of CT)	\$ 375
Captive Management Fees	\$ 150,000
Financial Audit Fees	\$ 40,000
Third Party Administrator (TPA) Fees/Claims Handling Costs	\$ 200,000
Actuarial Analysis Fees	\$50,000
Legal	\$50,000
<b>Totals</b>	<b>\$490,375</b>

By applying an administrative load, the annual administrative costs of the captive will be funded within the contributions made annually to the captive.

**Table 1.3 – Administrative Loading**

	<b>S.E. Cost Excess Model</b>
<b>Suggested Captive Premium / Contributions</b>	\$440,111,174
<b>Administrative Load</b>	\$ 490,375
<b>Final Proposed Captive Premium / Contributions</b>	<b>\$440,601,549</b>

The final captive premium / contribution is a decision for Special Education Cost Model Task Force and the captive stakeholders.

## 4. Recommendations for Operations



Captive Domicile Selection – Connecticut has been selected

Connecticut makes sense as the selected domicile for the proposed captive. Connecticut passed captive insurance law in 2008 and has established an excellent reputation. The States wealth of insurance industry talent, history of insurance innovation, along with the proposed members of this captive program all being located within the State make Connecticut an excellent choice for domiciling the captive.

There are several factors that must be considered when deciding on a suitable domicile for a captive insurance company, these include but are not limited to the following:

- Capitalization Requirements;
- Geography
- Investment Restrictions;
- Reporting and Audit Requirements;
- Government Fees;
- Regulatory and Legislative Climate;
- Formation Costs;
- Quality of ancillary support services such as audit and legal.

### Common Domicile Features

There are several features that are common to captive domiciles these include:

- Minimum Capitalization (For Connecticut \$250,000 for Single Parent Captives)
- Each regulator will have its own requirements for determining the adequacy of capital funding in a captive. However, typical capital requirements can be summarized as follows:

### Typical Capital Requirements

	Premium	to	Capital
Short Tail Risk	\$2	:	\$1
Medium Tail Risk	\$3	:	\$1
Long Tail Risk	\$5	:	\$1
Mixed Risk	\$4	:	\$1

Connecticut accepts 3:1 and other ratios that are generally acceptable among regulators and the insurance industry. Aon has spoken with the Connecticut Insurance Department; a final determination has not been made regarding capital requirements for the potential Co-op captive. For this study we will

utilize a premium to capital ratio of 5:1, resulting in projected initial capital requirement of \$88,000,000. (Excess Model)

- Loss Reserves
  - Loss reserves must be annually certified by a qualified, individually-recognized actuary.
- Investments
  - Captives typically take low risk investment strategies including cash and bonds however; some domiciles impose restrictions on the type of investment such as on loan-backs to the parent organization.
  - A 1.5% investment return has been projected for the Captive. This return projection is conservative, and returns may be higher. Income generated from investment returns may be utilized to pay frictional costs and administrative fees for the potential captive. The investment return is impacted by initial capitalization requirements and duration of funds held.
  - Mature captives can invest in more sophisticated investment vehicles subject to regulatory approval.
- Application Fee
  - Application fees vary by domicile, for Connecticut the fee is \$800, with the annual license fee set at \$375

*For the remainder of the analysis and the basis of the pro-forma financial statements that follow we have considered the Connecticut as the preferred location for a Co-op Captive.*

## Captive Structure

As discussed previously in this report, we would recommend either a Single Parent or Segregated Cell Captive as the most suitable structure for the Co-op.

## Funding a Captive

### Premiums

As with premiums paid to any other insurer, the premiums (contributions) paid to a captive insurer will be required in cash in order to meet the potential loss (reimbursement) payments. The payment terms however, will be a decision for the Co-op. Premiums can typically be paid in installments throughout the year e.g. monthly or quarterly payments.

### Capital & Surplus

The regulator will require a minimum level of capital and surplus for a captive, in Connecticut for example, this is \$250,000. The level of capital in the captive should never fall below this level.

Based on the suggested premium of \$440,111,174 we would estimate initial capital for the captive of approximately \$88,000,000 based on a 5:1 premium to capital ratio. This is subject to review and validation by the Connecticut regulator.

The captive also requires adequate capitalization for the respective level of risk. The regulator will typically prescribe an additional level of capital depending on the risks being written by the captive. The following instruments can be used for capital funding in most US domiciles including Connecticut.

- Cash
- Marketable Securities
- Irrevocable Letters of Credit issued by a bank approved by the Commissioner; and
- A trust approved by the Commissioner
- Other customized options may be available for the proposed Co-op captive

*As of January 2019, options including a potential bond issuance are being considered to meet the capitalization requirements of the proposed captive.*

## Captive Management

After the captive is formed most of the day to day operational responsibilities of the captive are outsourced to a specialist captive manager in the domicile selected. Such services fall within four primary categories:

- **Financial Services**
  - Preparing interim and year-end financial statements with detailed notes.
  - Supporting schedules and comparative data analysis;
  - Maintaining of all required books and records;
  - Invoicing and collection of premiums;
  - Monitoring of investments and investment income.
- **Insurance Services**
  - Maintaining all required insurance related records in the domicile;
  - Liaising with risk management and claims consultants to establish claims reporting procedures;
  - Upkeep of all underwriting and statistical records.
- **Treasury and Corporate Services**
  - Assisting in the procurement of letter of credit;
  - Summarizing and evaluating performance of investments selected by Special Education Cost Model Task Force;
  - Coordinating board meeting of directors.
- **Regulatory Services**
  - Representing the captive during regulatory examinations;
  - Completing and filing statutory report required by the domicile;
  - Ensuring compliance with the domicile's insurance laws and regulations;

- Corresponding with domicile Regulators to notify and implement changes in the captive's operations.

Due to the nature of the (Co-op) program additional operational and staffing requirements may be required for the captive. Responsibilities to properly operate a captive with the purpose and functionality desired by the Co-op include determining premiums (contributions) required by the state and districts, collection of contributions, processing of claims / reimbursements (potentially utilizing a third-party-claims administrator), management of funds, accounting, conducting board meetings, plus other operational and regulatory requirements.

## 5. Financial Modeling

On the following pages we have included sample financial statements for a Co-op Captive to demonstrate the financial operation should it be utilized to finance the program. The following assumptions have been used for this modeling:

- A single parent captive located in the Connecticut.
- The captive will initially write: Special Education Cost Reimbursement Policy
- A captive financial year ending December 31, 2020.

Suggested total written captive premium (contributions) of \$440,111,174 for year 1 of the captive.

Total expected losses (reimbursements) of \$420,422,698 based on the UCONN Goldenson Center actuarial analysis.

An estimated capital requirement of \$88,000,000 based on a 5:1 Premium to Capital ratio on the first year written policy premium of \$440,111,174 inclusive of the minimum capital and surplus requirement in Connecticut;

- We have assumed the minimum capital and surplus level (\$250,000) will be financed in cash while the balance will be financed by method (i.e. Bond) that is currently being investigated and is yet to be determined.
- Estimated Operational & Management Costs (Fees may vary)
  - Regulatory Fee: \$375
  - Annual Management Fees: \$150,000
  - Annual Audit Fees: \$40,000
  - Third Party Administrator: (Claims / Reimbursements) \$200,000
  - Annual Actuarial Fees: \$50,000
  - Annual Legal Fees: \$50,000
  - Should Premium Tax be due, maximum of \$200,000 would be required
  - Inflation Rate: 2.0% per annum; / Investment Yield: 1.5% per annum

### Non-Captive Costs

There may be additional costs that Special Education Cost Model Task Force will be subject to because of the proposed captive structure and specialized operational requirements which are not incorporated into the pro-forma captive financials.

Table 3.1: Sample Connecticut Captive Pro-Forma Financial Statements (Expected Loss forecast) – Income Statement (Excess Model)

Special Education Cost Model Task Force Projected Income Statement YEAR 1 - YEAR 4				
Income	YEAR 1	YEAR 2	YEAR 3	YEAR 4
Premiums Written - Direct	\$ 440,111,174	\$ 431,370,293	\$ 474,041,744	\$ 497,920,527
Gross Underwriting Income	440,111,174	431,370,293	474,041,744	497,920,527
Loss and Loss Expenses	420,422,698	446,190,383	470,980,921	500,315,802
General & Administrative	490,375	459,175	468,151	477,306
Premium Taxes	200,000	200,000	200,000	200,000
Total Underwriting Deductions	421,113,073	446,849,558	471,649,072	500,993,108
Net Underwriting Income	18,998,101	(15,479,265)	2,392,672	(3,072,581)
Investment Income	4,235,362	5,096,334	5,489,462	5,847,281
Net Income Before Taxes	23,233,463	(10,382,931)	7,882,134	2,774,700
Net Income	\$ 23,233,463	\$ (10,382,931)	\$ 7,882,134	\$ 2,774,700

Notes to Table 3.1:

- **Loss & Loss Expenses:**

- Based on UCONN Actuarial Model (Excess Model)

- **Net Income (Loss)**

The Excess Model utilizes underwriting profits (credit) from prior years to reduce premiums (contributions) in following years. A portion of the credit is utilized to pay captive operating expenses; an updated model may want to consider reducing premium by a factor, not total underwriting profits from prior year.

The reduction in premium does not take into account expected losses (reimbursements), which impacts net income (loss).

- **Premium Taxes:** Connecticut Tax Rates on Captive Insurance Direct Premiums are:

- First \$20m: 0.38%

- Next \$20m: 0.285%

- Next \$20m: 0.19%



Over \$60m: 0.72%

Maximum premium tax payable: \$200,000

- There is no current statute in Connecticut that would prevent a captive such as the “Co-op” from being required to pay premium tax. Other captives have pursued a letter ruling to override the payment of premium tax, Aon recommends that the “Co-op” discuss such a strategy with its tax and legal advisers.

Table 3.2: Sample Connecticut Captive Pro-Forma Financial Statements (Expected Loss forecast) – Balance Sheet (Excess Model)

Special Education Cost Model Task Force Projected Balance Sheet YEAR 1 - YEAR 4				
	YEAR 1	YEAR 2	YEAR 3	YEAR 4
<b>Assets</b>				
Cash and Equivalents	\$ 250,000	\$ 250,000	\$ 250,000	\$ 250,000
Invested Assets	128,339,137	124,398,127	138,477,895	148,586,315
<b>Total Cash and Invested</b>	<b>128,589,137</b>	<b>124,648,127</b>	<b>138,727,895</b>	<b>148,836,315</b>
Letter of Credit	88,000,000	88,000,000	88,000,000	88,000,000
<b>Total Assets</b>	<b>\$ 216,589,137</b>	<b>\$ 212,648,127</b>	<b>\$ 226,727,895</b>	<b>\$ 236,836,315</b>
<b>Liabilities</b>				
Loss Reserves - Gross	\$ 105,105,674	\$ 111,547,595	\$ 117,745,229	\$ 125,078,949
<b>Total Liabilities</b>	<b>105,105,674</b>	<b>111,547,595</b>	<b>117,745,229</b>	<b>125,078,949</b>
<b>Shareholders' Equity</b>				
Common Stock	250,000	250,000	250,000	250,000
Letter of Credit	88,000,000	88,000,000	88,000,000	88,000,000
Retained Earnings	23,233,463	12,850,532	20,732,666	23,507,366
<b>Total Equity</b>	<b>111,483,463</b>	<b>101,100,532</b>	<b>108,982,666</b>	<b>111,757,366</b>
<b>Total Liabilities &amp; Equity</b>	<b>\$ 216,589,137</b>	<b>\$ 212,648,127</b>	<b>\$ 226,727,895</b>	<b>\$ 236,836,315</b>

Notes to Table 3.2:

- **Cash & Cash Equivalents:**
  - \$250,000 minimum capital & surplus in Connecticut
- **Invested Assets:**

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- Cash from Underwriting + Investment Income
- **Letter of Credit / Bond may be utilized for capitalization**
  - Balance of Initial Capital in excess of \$250,000 minimum
  - Assumes LOC used but can be cash (in which case it would appear in Cash or Invested Assets). Other customized methods such as a Bond may be utilized.
  - Options to meet capitalization requirements are under consideration
- **Loss Reserves**
  - Total (Expected) Incurred Losses – losses paid in the financial year
- **Common Stock**
  - Minimum Capital & Surplus in Connecticut
- **Retained Earnings**
  - Net Income for the financial year (see Income Statement)

## About Aon

[Aon plc](#) (NYSE: AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

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**FINAL REPORT**

**A COOPERATIVE MODEL FOR  
SPECIAL EDUCATION FUNDING:  
COMPLIANCE WITH  
SPECIAL EDUCATION  
LEGAL REQUIREMENTS**

*by*

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*April 10, 2019*

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## **I. INTRODUCTION**

As further described in the Request for Proposals that was issued by CREC on behalf of the Special Education Cost Model Task Force, our law firm has been asked to furnish legal services regarding the implementation of a captive insurance entity, which is intended to provide fiscal stability to towns and school districts with respect to unpredictable special education costs. We have reviewed the laws governing the provision and funding of special education, based upon Connecticut's current special education funding – as well as its method for distributing state aid for special education - in order to provide legal analysis regarding the adoption of a new model for funding special education costs, such as a special education predictable cost cooperative model.

As per our mission, we have been asked to identify and analyze state and federal laws that may be involved in the creation and administration of a cooperative model for funding special education (including via a public/non-profit captive insurance entity or other risk-pooling model), including:

- a. Addressing the requirements of the Individuals with Disabilities in Education Act, 20 USC 1400, *et seq.*, regarding the implementation of such a cooperative model for funding special education; and
- b. Addressing the impact of existing federal and state statutes and case law on special education funding in Connecticut regarding the implementation of such a cooperative model for funding special education.

In this context, we were tasked with drafting a report on our findings, conclusions and recommendations regarding the legal implications of the formation of such a cooperative model for funding special education.

There are other legal issues that are attached to the creation of a captive insurance entity or other risk pooling model. While we are happy to address those issues pertaining to the legal status and structure of the entity, governance issues, staffing and personnel related matters, and the need for sufficient capital and funding to create a captive insurance entity - and while we may address those issues to the extent that they would create an impediment to compliance with the various special education legal requirements - we otherwise view those matters to be above and beyond the scope of this report. In addition, we are offering no opinions as to the wisdom or benefits of a captive insurance entity, but rather, just the legality of this model in light of special education laws.



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Our major focus is the identification and analysis of pertinent state and federal special education laws that could be implicated in the creation and administration of a special education predictable cost cooperative model or alternative model, including (1) whether the Individuals with Disabilities Education Act, 20 USC 1400, *et seq.*, permits a state to establish such a special education predictable cost cooperative model or alternative model, and (2) a framework for complying with pertinent regulatory requirements, such as the "maintenance of effort" requirements prescribed by federal law.

Section 70(a) of Public Act 17-2 (June Special Session) established the Task Force and set forth its mission. It also set forth the parameters of the entity and eventual product from the Task Force. The Act provided in pertinent part:

For the purposes of this section, "special education predictable cost cooperative" means a special education funding model that (1) aggregates special education costs at the state level to compensate for volatility at the local level by (A) providing predictability to local and regional boards of education for special education costs, (B) maintaining current state funding for special education services, (C) differentiating funding based on student learning needs, (D) equitably distributing special education funding, (E) providing boards of education with flexibility and encouraging innovation, and (F) limiting local financial responsibility for students with extraordinary needs, (2) is funded by: (A) A community contribution from each school district, calculated based on the number of special education students enrolled in the school district and the school district's previous special education costs, with each town paying the community contribution of its resident students, reduced by an equity adjustment based on the town's ability to pay, and (B) the state contribution, which is a reallocation of the special education portion of the equalization aid grant and the excess cost grant, (3) provides all school districts with some state support for special education services, (4) ensures that a school district's community contribution will be lower than the actual per pupil special education cost of the school district, and (5) reimburses school districts for one hundred percent of their actual special education costs for a fiscal year.

The Task Force is assessing the feasibility of a cost cooperative model, largely based upon a "captive insurance" entity model, along with other alternative models.

We have conducted our legal analysis based upon both the general concepts and parameters for the cooperative via the legislation that created this Task Force, along with the reports that have been created and shared with us by AON. Obviously, changes in the following factors may cause us to revisit our legal analysis: (1) how towns would contribute to such special education predictable cost cooperative (or



alternative) model; (2) how towns would be compensated for special education costs under such a model, and (3) how a town's compensation under such a model would affect its required contribution in the subsequent fiscal year. As will be discussed herein, the specifics of these issues arguably may affect whether the towns will be in compliance with, among other things, the IDEA's "maintenance of effort" requirements that apply to local educational agencies.

## **II. THE STATUTORY SCHEME FOR PROVIDING SPECIAL EDUCATION SERVICES**

Briefly, and without turning this report into an overly scholastic dissertation, the key legal enactment governing the provision of special education and related services with students with disabilities is the Individual with Disabilities Education Improvement Act of 2004, 20 USC §1400 *et seq.* ["IDEA"], which was initially enacted in 1975 as the Education of the Handicapped Act, and which has subsequently been reauthorized, under a different title and with amendments, on a number of occasions.

The IDEA "represents an ambitious federal effort to promote the education of handicapped children." *Board of Educ. of the Hendrick Hudson Cent. Sch. Dist. v. Rowley*, 458 U.S. 176, 179 (1982). The IDEA offers federal funds to states to assist in educating students who have one of thirteen, statutorily enumerated disabilities and who, as a result of such disabilities, require specialized instruction. With the provision of these funds, a State must comply with numerous statutory mandates, both of a substantive and procedural nature. Paramount among these obligations is ensuring the availability of a free appropriate public education ["FAPE"] in the least restrictive environment ["LRE"] to all students deemed eligible for services under the IDEA in order to prepare them for further education, employment and independent living. "FAPE" includes both special education and "related services." 20 U.S.C. §1401(9).

Special education is "specially designed instruction . . . to meet the unique needs of a child with a disability" and "related services" are the support services "required to assist a child . . . to benefit from" that instruction, including, among other interventions, speech and language therapy, occupational therapy, and physical therapy. 20 U.S.C. §§1401(26), (29). State educational agencies ["SEAs"] are charged with the obligation to ensure that IDEA students receive special education and related services in conformity with the students' "Individualized Education Program" ["IEP"], a task that the SEA generally delegates to local and regional school districts, or local educational agencies ["LEAs"]. See 20 U.S.C. §1401(9)(D).

The IEP is a comprehensive document that constitutes "the centerpiece of the statute's education delivery system for disabled children." *Honig v. Doe*, 484 U.S. 305, 311



(1988). The IEP is the means by which special education and related services are “tailored to the unique needs” of a student. *Endrew F. v. Douglas Cty. Sch. Dist.*, 580 U.S. \_\_\_, 137 S. Ct. 988, 993 (2017). In accordance with the IDEA and with parallel state law and regulations, an IEP is developed, reviewed and revised by the student’s “Planning and Placement Team” [“PPT”], which consists of designated school district staff, including a representative of the LEA who has sufficient knowledge and authority to commit the LEA’s resources, other individuals with knowledge or special expertise regarding the student,<sup>1</sup> the student’s parents, and *when appropriate*, the student. 20 U.S.C. §1414(d)(1)(B); 34 C.F.R. §321(a). Broadly speaking, in order to provide FAPE, a school must offer an IEP reasonably calculated to enable a child to make progress that is appropriate in light of the child’s circumstances. *Endrew F. v. Douglas Cty. Sch. Dist.*, 137 S. Ct. at 999.

The IEP consists of annual educational goals as well as the short-term objectives by which such goals will be implemented and must be drafted in compliance with a detailed set of procedures. 20 U.S.C. §1414(d)(1)(B). The procedures mandated by the IDEA involve consideration of the student’s individual needs, and must allow sufficient parental participation in the creation of the IEP. 20 U.S.C. §1414. Indeed, courts have found that a student has been deprived of FAPE if parents are deprived of their right to meaningfully participate in the IEP creation process. *Mr. M. ex rel. K.M. v. Ridgefield Bd. of Educ.*, 2007 WL 987483, at \*7 (D. Conn. 2007); *W.A. v. Pascarella*, 153 F. Supp. 2d 144, 154 (D. Conn. 2001). “[P]articipation means something more than mere presence; it means being afforded the opportunity to be an equal collaborator, whose views are entitled to as much consideration and weight as those of other members of the team in the formulation and evaluation of their child’s education.” *W.A. v. Pascarella*, *supra*, quoting *V.W. v. Favolise*, 131 F.R.D. 654, 659 (D. Conn.1990). It is also paramount that the special education be tailored to meet the unique needs of a particular student, as opposed to a one size fits all approach. *P. v. Newington Bd. of Ed.*, 546 F.3d 111, 122 (2<sup>nd</sup> Cir. 2008). See also *Frank G. v. Bd. of Educ. of Hyde Park*, 459 F.3d 356, 363 (2<sup>nd</sup> Cir. 2006).

The PPT is the legal entity that is charged with the sole legal right to determine and craft a student’s IEP. Consequently, once a PPT makes a recommendation and creates an IEP, the IEP *must* be implemented; it cannot be vetoed or amended by someone else within the agency or by any third party. As noted above, the PPT must include a school district representative-- typically a school administrator -- who has “the authority to

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<sup>1</sup>The IDEA also requires that the PPT include an “individual who can interpret the instructional implications of evaluation results.” That person may already be a member of the PPT (assuming that the teacher or LEA representative has such skills). 34 C.F.R. §300.321(a)(5).



commit the agency's resources (i.e., to make decisions about the specific special education and related services that the agency will provide to a particular child)". *W.A. v. Pascarella*, 153 F. Supp. at 155 (citations omitted). Generally, "the IDEA mandates that states cannot avoid their responsibilities under the IDEA by asserting that they lack the resources to provide special education and related services to disabled children." *J.B. v. Killingly Bd. of Ed.*, 990 F.Supp. 57, 77 (D.Conn.1997).

While courts have declined to decide the issue of whether cost ever could be a factor in a PPT's decision making; *P. v. Newington Bd. of Ed.*, 546 F.3d at 120, n. 4; as the law is currently interpreted and implemented, a school district cannot refuse to provide a service necessary for an appropriate program due to cost. Nevertheless, it is well-settled that a school district's obligation is to offer an appropriate educational program, not the exact educational program that a parent may desire (or the best educational program). *K.P. v. Juzwic*, 891 F.Supp. 703, 718 (D. Conn. 1995); *Tucker v. Bay Shore Union Free School District*, 873 F.2d 563, 567 (2<sup>nd</sup> Cir. 1989). Indeed, the IDEA has been interpreted as requiring that school districts "provide the educational equivalent of a serviceable Chevrolet to every handicapped student... . The board [of education] is not required to provide a Cadillac." *Doe v. Board of Education of Tullahoma City Schools*, 9 F.3d 455, 459-460 (6<sup>th</sup> Cir. 1993), cert. denied, 511 U.S. 1108 (1994).

The IEP must include "a statement of the child's present levels of academic achievement and functional performance," describe "how the child's disability affects the child's involvement and progress in the general education curriculum," and set out "measurable annual goals, including academic and functional goals," along with a "description of how the child's progress toward meeting" those goals will be measured. 20 U.S.C. §§1414(d)(1)(A)(i)(I)-(III). The IEP must also describe the "special education and related services . . . that will be provided" so that the child may "advance appropriately toward attaining the annual goals" and, when possible, "be involved in and make progress in the general education curriculum." 20 U.S.C. §1414(d)(1)(A)(i)(IV). The IEP must also list any program modifications for the child, along with an explanation of the extent to which the child will not participate with non-disabled children in regular classes and activities, a projected date for the beginning of any special supplementary services or modifications, and the anticipated frequency, location, and duration of such services and modifications. 20 U.S.C. §§1414(d)(1)(A)(i). In addition, the student's IEP must contain sufficient transition planning -- including employment, post-secondary education/training, and where appropriate, independent living goals -- so that the student can have the opportunity to be successful when he or she graduates from high school.

In developing the IEP, the team must consider the child's strengths, the concerns of the parents, the results of the most recent evaluation of the child, and the academic,



developmental, and functional needs of the child, along with other “special factors” particular to children with certain needs. 20 U.S.C. §1414(d)(3)(A), (B). The local educational agency must ensure that the IEP is reviewed no less than annually, “to determine whether the annual goals for the child are being achieved,” and to revise the IEP as needed based on the child's progress and anticipated needs. 20 U.S.C. §1414(d)(4). A child's parents must be notified of any change in a child's educational program, 20 U.S.C. §1415(b)(3), and if a child's parents are dissatisfied with an IEP, they may file a complaint with the SEA. 20 U.S.C. §1415(b)(6). Such complaints are resolved at an “impartial due process hearing” before an independent hearing officer appointed by the SEA, and any party aggrieved by the outcome may bring an appeal in any state or federal court of competent jurisdiction, 20 U.S.C. §§1415(f) & (i)(2), which will then “fashion appropriate relief based on its assessment of a preponderance of the evidence developed at the administrative proceedings and any further evidence presented by the parties.” *Walczak v. Fla. Union Free Sch. Dist.*, 142 F.3d 119, 122–23 (2d Cir.1998). See also *P. v. Newington Bd. of Ed.*, 546 F.3d at 114.

### **III. THE STATUTORY SCHEME FOR FUNDING SPECIAL EDUCATION SERVICES**

As noted, the United States Supreme Court characterized the IDEA as “an ambitious federal effort to promote the education of” students with disabilities. *Bd. of Educ. of the Hendrick Hudson Cent. Sch. Dist. v. Rowley*, 458 U.S. 176, 179 (1982). This “ambitious” statute provides federal assistance, commonly referred to as “Part B funds,” for educating special education students, in exchange for which states must provide disabled students with FAPE in the LRE. Ostensibly, the IDEA was established as a “funding” statute, but the federal government’s “ambition” is not reflected in its fiscal commitment. The initial federal promise of funding 40% has proven to be illusory. For fiscal year 2018, Connecticut received \$139,540,151 in federal Part B funds.<sup>2</sup> This was not an outlier, and the annual federal financial contribution is roughly 7%.

The State is the next source of funding, followed by the LEAs themselves. Connecticut provides state educational funding to the local and regional school districts via (1) a portion of the education cost sharing [“ECS”] payment to the towns, and (2) so-called “excess cost” payments. The ECS monies (into which the state’s special education grants are incorporated) are established by a formula that is complex, and at least theoretically tied to the wealth ranking of the town<sup>3</sup> as opposed to special education needs. The excess cost payments are attached to high cost programs and placements. Generally, a local educational agency is financially responsible for “the reasonable costs

<sup>2</sup>*The Individuals with Disabilities Education Act (IDEA) Funding*, Congressional Research Service, p. 17 (October 1, 2018).

<sup>3</sup>Connecticut General Statutes §10-262f, *et seq.*



of special education instruction” in an amount equal to four and one-half times the average per pupil educational costs of such LEA; the State Department of Education then “within available appropriations” pays on a current basis any costs in excess of the LEA’s contribution.<sup>4</sup>

The Connecticut State Department of Education reported that it provided the following funding to local educational agencies in the 2017-2018 fiscal year:

ECS: \$428,618,917  
Excess cost: \$138,979,288

In addition, the State provided \$204,545 in “excess costs” funding under a non-special education statute regarding non-resident students, and state agencies other than the State Department of Education provided \$227,851,508 in support. The total special education spending supported by such state revenues was \$795,245,168 for the 2017-2018 school year.<sup>5</sup>

While that may appear, at first glance, a substantial sum, the actual total cost of special education for Connecticut students approaches \$2,000,000,000; thus, the LEAs fund the remaining majority of monies necessary for special education. This is consistent with the general concept that while the SEA has been given the responsibility for ensuring that students receive appropriate special education services, the SEA generally delegates the responsibility both programmatically and financially to the LEAs. The excess cost funding does provide a modicum of protection against high costs placements, but (a) the monies available are subject to available appropriations -- and thus the grant is not fully funded<sup>6</sup> -- and (b) the monies vary based upon the per pupil costs for a particular district, again with no linkage to actual needs or the expenses of a particular placement<sup>7</sup>.

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<sup>4</sup>Connecticut General Statutes §10-76g(b).

<sup>5</sup>Source: Connecticut State Department of Education Finance and Internal Operations Bureau of Grant Management.

<sup>6</sup>We are operating under the assumption that the State’s contribution to the cooperative via the excess cost grants would be based upon the less than fully funded level that currently exists.

<sup>7</sup>The Connecticut School Finance Project has addressed in significant detail its concerns about these grants. In the context of this already existing and well established research, further recitation on these issues in this report would provide little additional value.

**A. “MAINTENANCE OF STATE FUNDING”**

Against this background of the realities of funding are two mandates in the IDEA with respect to the overall financial commitments of both the State and the LEAs. On at least a superficial level, these mandates resemble the State’s “minimum budget requirement.”

With respect to the State, the IDEA sets forth a “maintenance of state funding requirement”. Generally speaking, a State “must not reduce the amount of State financial support for special education and related services for children with disabilities, or otherwise made available because of the excess costs of educating those children, below the amount of that support for the preceding fiscal year.” 34 C.F.R. § 300.163(a). A failure by the State to meet this requirement will lead to reduction of Part B funds in the ensuing fiscal year by the same amount as the State’s shortfall. 34 C.F.R. §300.163(b). In addition, Part B funds paid to the state “must be used to supplement and increase the level of Federal, State, and local funds (including funds that are not under the direct control of SEAs or LEAs) expended for special education and related services provided to children with disabilities ... *and in no case to supplant* those Federal, State, and local funds.” See 34 C.F.R. §300.164(a)(emphasis added); see also 34 C.F.R. §300.162(c).

The Secretary of the United States Department of Education can waive the maintenance of state funding requirements in a particular fiscal year where “equitable due to exceptional or uncontrollable circumstances such as a natural disaster or a precipitous and unforeseen decline in the financial resources of the State.” See 34 C.F.R. §300.163(c). In addition, the Secretary of Education can waive the maintenance of state funding (and non-supplanting) requirements in a particular fiscal year in those limited circumstances where a State provides “clear and convincing evidence that all eligible children with disabilities throughout the State have FAPE available to them.” *Id.*; 34 C.F.R. §300.164(b).

**B. LOCAL “MAINTENANCE OF EFFORT”**

On the local level, and somewhat more complicated, is the “maintenance of effort” requirement. The LEA Maintenance of Effort [“MOE”] requirement was first added to the IDEA in 1997. “The purpose of the requirement is to ensure that LEAs provide the financial support necessary to make a free appropriate public education [‘FAPE’] available to eligible children with disabilities.”<sup>8</sup>

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<sup>8</sup>Questions and Answers on IDEA Part B Local Educational Agency Maintenance of Effort Requirements, July 27, 2015, page 1.



The maintenance of effort requirement is made up of two components: "eligibility" and "compliance". For purposes of **eligibility** to receive federal funds, the SEA must determine that the LEA's **budget** for the education of children with disabilities (unless one of the allowed exceptions applies) is at least the same as the budget from the *most recent fiscal year for which information is available* based on: (1) local funds only; (2) the combination of state and local funds; (3) local funds only on a per capita basis; or (4) the combination of state and local funds on a per capita basis. 34 C.F.R. §300.203(a). Similarly, an LEA meets the **compliance** standard if it does not reduce the level of **expenditure** for the education of children with disabilities made by the LEA from *at least one* of the same funding sources below the level of those expenditures (unless one of the allowed exceptions applies) from the same source for the *preceding fiscal year*, also based on: (1) local funds only; (2) the combination of state and local funds; (3) local funds only on a per capita basis; or (4) the combination of state and local funds on a per capita basis. 34 C.F.R. 300.203(b). An LEA need not use the same MOE methods that it used in a preceding year; however, if the LEA uses alternate methods of compliance from year to year, it may affect what is the baseline for measuring compliance in subsequent years. 34 C.F.R. §300.203(c)(2) and (3). See also *Assistance to States for the Education of Children with Disabilities*, 80 Fed. Reg. 81, p. 23648-23653 (April 28, 2015). "Per capita" for purposes of the MOE requirement refers to "the total amount of local, or State and local, funds either budgeted or expended by an LEA for the education of children with disabilities, divided by the number of children with disabilities served by the LEA."<sup>9</sup>

An LEA may **reduce its level of expenditure only** if the reduction is attributable to any of the following: (1) a voluntary departure, by retirement or otherwise, or a departure for just cause, of special education or related service personnel; (2) a decrease in the enrollment of children with disabilities, (3) the termination of the obligation of the LEA to provide a program of special education to a particular child that is an exceptionally costly program, as determined by the SEA, because the child has left the district, reached the age at which the obligation to provide special education has terminated or the child no longer needs the program of special education; (4) the termination of costly expenditures for long-term purchases, or (5) the assumption of the cost by the high cost fund operated by the SEA under 34 C.F.R. §300.704(c). 34 C.F.R. §300.204.

The consequence of a failure on the part of an LEA to maintain efforts would be a recovery action against the State using non-federal dollars. The State may then recoup the money from the LEA. **PLEASE NOTE:** a failure to meet the MOE does not reduce the baseline for MOE compliance in the subsequent years. 34 C.F.R. §300.203(c).

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<sup>9</sup>*Id.*, p. 5.



#### **IV. CAPTIVE INSURANCE, “RISK POOLING” AND COMPLIANCE WITH THE IDEA (AND THE LEGALITY OF THE PROPOSED COOPERATIVE)**

There is no specific provision of the IDEA that directly or indirectly references the concept of a captive insurance company in general or the cooperative that is being proposed. To some degree, the general concept of a risk pool is built into and/or accepted by the IDEA. Indeed, as noted by the National Association of State Directors of Special Education [“NASDE”]:

Historically, many . . . [SEAs] have formally or informally used risk pools to provide extra funds to . . . [LEAs] serving students *high cost special education needs*. With the 2004 reauthorization of the [IDEA], SEAs have been encouraged to formulize their approach or operating risk pools.

*Risk Pools: State Approaches*, by Eve Muller (NASDE, April 2006), p. 1. What some consider to be a risk pool in most other states is markedly similar to Connecticut's current excess cost scheme for “high cost” students; indeed, Connecticut's excess cost scheme is cited as an example of an existing risk pool. *Id.*, p. 5. Most of these so-called risk pools are based upon the state paying all or some of the educational costs associated with a specific student above and beyond a certain threshold, usually set by a specific multiple of the “typical” per pupil costs. All of these so-called risk pools are limited to addressing the particular issue of “high cost” students. None of these risk pools appear to be designed to pay the entire costs for all special education students in a state, which is contemplated for Connecticut by the proposed cooperative model that has been shared with us at the time of the writing of this report.

The IDEA's regulations specifically recognize that IDEA “Part B” funds may be used to “to establish and implement cost or *risk sharing funds, consortia, or cooperatives* for the LEA itself, or for LEAs working in a consortium of which the LEA is a part, to *pay for high cost special education and related services*”. 34 C.F.R. §300.208(a)(3)(emphasis added). Examples of this include (1) Texas, which operates the Special Education Shared Services Arrangement, which allows LEAs to enter into contracts to jointly operate their special education programs and requires that they designate a fiscal agent to conduct various administrative duties<sup>10</sup>, and (2) North Dakota, which allows districts to voluntarily assign their federal IDEA “Part B” funds to a cooperative, which becomes the grant applicant and fiscal agent for the funds<sup>11</sup>.

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<sup>10</sup>This type of arrangement is a slightly more collaborative version of the cooperative arrangements that exist in Connecticut under Connecticut General Statutes §10-158a.

<sup>11</sup> Nevertheless, an LEA's Part B funds should not be used to finance administrative or “frictional” costs for the cooperative. Part B funds are supposed to be used for paying the costs of providing special education and related services to children with disabilities. 34 C.F.R. §300.202. As such, Part B funds



In addition, the reauthorization of the IDEA brought about a new program. Specifically, in a subsection entitled “Local Educational Agency Risk Pool”, the IDEA provides:

For the purpose of assisting local educational agencies (including a charter school that is a local educational agency) or a consortium of local educational agencies in addressing the needs of high need children with disabilities, each State shall have the option to reserve for each fiscal year 10 percent of the amount of funds the State reserves for State-level activities ...

(I) to establish and make disbursements from the high cost fund to local educational agencies in accordance with this paragraph during the first and succeeding fiscal years of the high cost fund; and

(II) *to support innovative and effective ways of cost sharing by the State, by a local educational agency, or among a consortium of local educational agencies, as determined by the State in coordination with representatives from local educational agencies ...*

...  
20 U.S.C. §1411(e)(3)(A)(i)(emphasis added).

The IDEA then sets forth the parameters of such a state plan for a “high cost fund” risk pool under this provision, including providing for a definition of a “high need child with a disability” that at a minimum “addresses the financial impact a high need child with a disability has on the budget of the child’s local educational agency”; “ensures that the cost of the high need child with a disability is greater than 3 times the average per pupil expenditure in that State”; and “establish eligibility criteria for the participation of a local educational agency that, at a minimum, takes into account the number and percentage of high need children with disabilities served by a local educational agency.” 20 U.S.C. §1411(e)(3)(C). Besides explicitly providing that disbursements under this fund may not be used to pay for the attorneys’ fees or costs associated with a cause of action brought on behalf of a student with a disability to ensure FAPE; 20 U.S.C. §1411(e)(3)(E); this provision states that nothing within it shall be construed to (1) limit the right of a student to receive FAPE within the LRE, or (2) authorize either a SEA or LEA to establish a limit on what may be spent on the education of a student with a disability. 20 U.S.C. §1411(e)(3)(F).

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generally must only be spent on personnel who are supporting or providing services to a student (as opposed to paying for lawyers or accountants). In addition, the SEA is limited to using any Part B funds with respect to certain specified administrative tasks. 34 C.F.R. §300.704. It is doubtful that any such cooperative administrative costs would be an allowable cost under Part B. In any event, it appears that AON envisions that Part B funds will not be a part of the model that it has proposed.

In addition, the IDEA provides that a state may use the funds set forth in this provision for:

implementing a placement neutral cost sharing and reimbursement program of high need, low incidence, catastrophic, or extraordinary aid to local educational agencies that provides services to high need students based on eligibility criteria for such programs that were created not later than January 1, 2004, and are currently in operation, if such program serves children that meet the requirement of the definition of a high need child with a disability [as set forth in the IDEA].

20 U.S.C. §1411(e)(3)(G). As the amount of money set forth in this “Local Educational Agency Risk Pool” program --specifically, 10% of a state’s Part B funds -- would not provide much assistance, most states have simply continued with their pre-existing “risk pool” programs. The contours of this new” (2004) IDEA risk pool program, however, provide a road map of how a state may comply with the IDEA in setting up a risk pool and potentially allow for the administrative costs involved in operating a risk pool to be funded through the aforementioned 10% of a state’s Part B funds.

Of note is the fact that while most of the provisions in the afore-mentioned IDEA subsection address the issue of “high cost” fund/students, at least one provision (in isolation) does indicate an affinity in the IDEA for supporting “innovative and effective ways of cost sharing” by the states. 20 U.S.C. §1411(e)(3)(A)(i)(II). It is unclear whether this broad/laudatory pronouncement has any applicability with respect to a cooperative model that may address all special education expenses (not just those for “high cost” students).

#### **A. COMPLIANCE WITH “FAPE” AND IEP LEGAL MANDATES**

As noted above, the IDEA envisions that schools provide both substantive benefit, or FAPE, and procedural protections, such as ensuring parental participation in the PPT and IEP development process, and mandating that an IEP is developed, reviewed and revised properly based upon an assessment of the student’s unique needs on at least an annual basis. There is no obligation for an LEA to maximize a student’s educational progress, only to provide a program that enables the student to make *reasonable* educational progress. Thus, while, again, an LEA need not offer the “Cadillac” plan, it must offer an appropriate program. Assuming that these IDEA mandates are met, the proposed captive insurance company would not run afoul of the special education statutes.



Under our present special education funding system, there is an obvious and inherent correlation between the decisions made at a PPT meeting and expenses incurred by a school district as a result of the decision. Cost cannot be the determinative factor in a PPT's decision-making – although it is admittedly possible that at least the LEA members of the PPT may consider the expense in weighing potential programs and placements – but rather, its recommendations must be driven by what the PPT deems to provide FAPE in the LRE, with the understanding that LRE is a flexible, student-by-student concept, and while for one student it may be a mainstream classroom, for another it may be an out-of-district, residential placement. Under the present funding system, a PPT could decide to reject a request by the parents for a maximalist (and possibly higher cost) “Cadillac” option, as long as they were offering a “serviceable Chevrolet” option that was appropriate (and in the LRE).

It must be understood that nothing in the proposed cooperative could change the decision-making criteria so as to impact the PPT's compliance with the IDEA and with Connecticut's corresponding law. The IDEA's procedural requirements would also certainly remain in effect. As noted, the PPT is the sole body vested by law with responsibility for determining an appropriate educational program and placement for a special education student. Thus, neither federal nor state law would permit a representative of the captive insurance entity – such as a claims examiner or adjuster (or cooperative legal counsel) – to modify or veto the PPT's recommendations. Indeed, it would seem impermissible even to have such a captive insurance representative present at a PPT meeting; even were such representative to sit mutely through the meeting, the parents or their legal counsel could claim the representative's very presence constituted an attempt to influence the PPT to recommend an inexpensive program, not necessarily an appropriate one. Certainly such representative could not reasonably be considered as an individual “with knowledge or special expertise regarding the child”; 34 C.F.R. § 300.321(a)(6); nor would that person meet the definition of a representative of the LEA with knowledge of *both* the LEA's general education curriculum and the availability of resources of the public agency under 34 C.F.R. §321(a)(4). We have been assured by AON that any references to the role of legal counsel for the proposed cooperative (and the desire for “control over the resolution of [the Co-op's] claims” and “look out for the Task Force's best interests”)<sup>12</sup> would have nothing to do with the PPT programming and placement process (and the resolution of disputes through the PPT and the IDEA's mediation and due process procedures). As such, we have been assured that there will not be a cooperative attorney, claims examiner or other official improperly vetoing the selection or financing of special education programs and placements; such interference would obviously raise legal issues.

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<sup>12</sup> Captive Feasibility Study, (AON, January 2019), “Claims Handling”, p. 10.



Looking again at the IDEA's "new" pooling/high cost fund under 34 CFR 300.704(c) for guidance, an absolute limit on how much may be spent on the education of a particular student with a disability would implicate the IDEA, and must not be a part of the cooperative. As such, it is legally dubious whether the cooperative could even include a schedule of payments/limits for any specific services (for example, limits on reimbursements for evaluations or specific related services).<sup>13</sup> There could also be concerns with the cooperative creating a "menu" of services that would be covered by the cooperative, as the "menu" could exclude services necessary to provide an individual student with a FAPE.<sup>14</sup> There might be exposure even in the LEA's discussion with the insurance entity regarding a student's *prospective* program or placement.

Again, the models discussed must be seen as being akin to a change in the grant formula received by the LEA, not a change in the IEP process. The cooperative **could not** legally interfere with individual PPT decision-making. Simply put, the captive insurance entity could not be involved in the PPT meeting or recommendation, nor could it override the PPT's decision. Consequently, there would be concerns if the cooperative were to set guidelines beyond the accepted threshold eligibility issues for grants, such as a numerical threshold for eligibility.<sup>15</sup> The cooperative should simply be a payor, not a service provider or a decision maker. While it is important to keep these concerns in mind, and assure that the cooperative does not become a *de facto* decision maker or PPT, we see no evidence that the cooperative is a "Trojan horse" for a state takeover of special education. Indeed, any adjustments in the cooperative community contribution for a particular LEA due to an "experience rating" would be no more of a financial disincentive for a PPT to make a programming and placement decision than the current system, whereby the LEA may be fearful of a large jump in its expenditures due to a particular placement.

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<sup>13</sup>Currently, there is some limitation on a school district's ability to access state excess cost grants for placement at private educational programs that have not been approved by the State Department of Education; since the LEA would in fact now be paying for the placement via its community contribution (especially if the contribution is set so that the cooperative will be covering all special education costs, not just "excess costs"), this restriction should be revisited.

<sup>14</sup>Notwithstanding any discussion in the other entities' reports with respect to the auditing of claims, it is assumed that the only clear criteria for reimbursement would be that the cost were actually for special education or related services, as defined under state and federal law, and similar to the standard used now by the state with respect to excess cost grants. See, e.g., *Special Education Excess Cost Grant User Guide* (CSDE-Bureau of Fiscal Services, 2018), pp. 50-51. **See Appendix.** Anything more exacting could be deemed to be an undue interference with the programmatic and placement decision-making power that is rightly given to PPTs.

<sup>15</sup> Parenthetically, a threshold (three times the per pupil expenditure) is recognized in the IDEA's "new" pooling/high cost fund; 34 CFR 300.704(c), not to mention Connecticut's current excess cost grant scheme (albeit at higher threshold); thus, such a type of threshold clearly would not implicate any IDEA mandates if the Task Force were to recommend an excess cost only model.



A couple of comments must be made. While the model may be akin to a “mere” change in the grant funding, payments from the cooperative should be reasonably prompt so as to not negatively affect the delivery of services. Finally, it goes without saying that an LEA’s “child find” obligations should be carried out in accordance with the special education laws (and the child’s needs) and not due to any desire to acquire “bodies” to effect one’s “experience ratings” or per pupil costs.

## **B. DISPUTE RESOLUTION AND RELATED ISSUES**

As previously noted, both the IDEA and the corresponding Connecticut law provides for a dispute-resolution process should disagreements arise between parents and LEAs regarding PPT recommendations. The first step is either a resolution meeting between the relevant district personnel and the parents, or a mediation, which is a more formal – and typically more preferred – vehicle by which the parties attempt to broker their disputes with the assistance of a mediator appointed by the SEA. 34 C.F.R. §300.510. If such settlement attempts prove unsuccessful, then the parties can proceed to what is termed a “due process hearing,” which is held before an independent hearing officer appointed by the SEA. 34 C.F.R. §300.511. See *also* Conn. Gen. Stat. §10-76h. As the ultimate payor, would the cooperative play a role in such mediations or hearings, or would it simply fund whatever financial agreements the parties came to in mediation or the cost of whatever program or placement was ordered by a hearing officer? An ancillary question would be whether if the captive insurance entity played a controlling role in the mediation and declined to meet the parents’ demands, thereby compelling the LEA to proceed to a hearing, and if the LEA lost such hearing, would it have any recourse against the entity for the costs of the parent prevailing-party attorneys’ fees levied against the LEA? As we have indicated, based upon the proposal and assurances from AON, it does not appear that the cooperative/captive would have any direct (or even indirect) role in the decision making process. Indeed, as we have indicated, it is our assumption that the cooperative will pay for all costs of such special education and related services for the student.<sup>16</sup> Any other model will alter the conclusions of this report.

Conversely, and in case anyone may think that a lack of ability of the cooperative to serve as a check (and “deny claims”) may lead to possibly “profligate” LEAs deciding to agree to expensive placements just because it will not be responsible for the costs, it is assumed that the experience adjustment will serve as a negative incentive for such

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<sup>16</sup> See note, 14, *supra*.



behavior<sup>17</sup>. Again, there does not appear to be an overall effect on placement decisions from the proposed cooperative, and the placement process should remain as is.

### **C. MAINTENANCE OF STATE FUNDING REQUIREMENT**

Briefly, the ability of the state to comply with the maintenance of state funding requirement would likely not be impinged upon by the proposed cooperative/cost predictability model. The models being discussed would *not* diminish the state's contribution toward special education, but would rather combine the monies for special education allocated via the ECS grants and the excess cost grants. As the state financial commitment would remain the same (with the two elements used to assess the maintenance of state funding combined into one fund), this would have no effect on the state's compliance with this requirement. Indeed, to the extent that the current allocation to ECS grant funds for special education purposes could be viewed as murky, aggregating these two grants would result in a firm number that is more transparent. Of course, this would **still** require the State to actually comply with this IDEA funding requirement going forward, and not reduce its financial commitment to special education (whether the funds/grants are separated or aggregated).

### **D. THE LOCAL MAINTENANCE OF EFFORT REQUIREMENT**

Somewhat more complicated is how LEAs can still establish compliance with the MOE requirements under a cooperative risk arrangement. As previously noted, while the IDEA and its implementing regulations clearly anticipate such risk sharing cooperatives for the financing of "high cost" special education and related services,<sup>18</sup> and even permit the reduction of the MOE for an assumption of cost by the "new high cost fund operated under 34 C.F.R. §300.704(c)<sup>19</sup>; it is not so clear whether similar risk sharing cooperatives for "regular" special education services 1) are specifically authorized under the IDEA, and 2) fit into the maintenance of effort requirements of the IDEA. However, there is nothing in the IDEA that prohibits such a cooperative or innovative approach to funding.

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<sup>17</sup> As stated previously, while a PPT could never decline to provide services necessary for FAPE and LRE, cost could be viewed as implicitly having being recognized as a permissible *de facto* factor in program and placements even under the current funding system in that an LEA need only provide a "serviceable Chevrolet" as opposed to a "Cadillac". Nothing in the proposed cooperative would alter the LEA's obligations to provide FAPE and LRE, or the obligation of the LEA (as an instrument of the SEA) to fund such necessary programs and placements.

<sup>18</sup>34 C.F.R. §300.208(a)(3) specifically allows IDEA Part B funds to be used "[t]o establish and implement cost or risk sharing funds, consortia, or cooperatives for the LEA itself, or for the LEAs working in a consortium of which the LEA is a part, to pay for high cost special education and related services." See also 34 CFR 300.704(c).

<sup>19</sup>34 C.F.R. §300.204.



As previously discussed, there are four pathways for an LEA to establish compliance with the MOE with respect to both “eligibility” (budget/appropriation) and “compliance” (expenditure). The LEA can choose from any one of these four options: (1) local funds only; (2) the combination of state and local funds; (3) local funds only on a per capita basis; or (4) the combination of state and local funds on a per capita basis. 34 C.F.R. §300.203(a) and (b). It need only comply with **one** of these four criteria. An LEA need not use the same MOE methods that it used in a preceding year; in addition, the LEA is not required to use the same method to meet the compliance standard in a fiscal year that it used to meet the eligibility standard for that same year<sup>20</sup>.

The ability of the LEA to choose among these options appears to provide a manageable way to meet the MOE threshold for “eligibility” (i.e., the budget/appropriation aspect of the MOE). For example, an LEA could safely rely upon the “local funds only” prong (without including the state ECS monies or even projected excess costs monies bundled into the state’s payments) with respect to its eligibility/appropriation for special education. Just as an LEA has to take into account changes in state funding (under the current system) when its budgets for an ensuing year, it will have to take into account changes in its community contribution. In addition, and/or in the alternative, the total appropriations/outlays needed for an LEA’s budget for special education and related services will not be affected by the Cooperative model (should the LEA rely upon the combination of state and local funds prong). There will still be need to appropriate all the monies necessary to provide FAPE to a school district’s students, and nothing in the Cooperative model will affect the total actual costs incurred for programs and placements for such students.

With the MOE, what goes up generally cannot come down, and an LEA may have to budget the same as the previous year for no good reason except to comply with the MOE. This obviously places constraints upon an LEA. However, such constraints already exist with the current special education funding system. To the extent that compliance with the federal MOE “eligibility” requirement presents issues, and thus requires the LEA/municipality to have to appropriate monies that may not be used, the legislature may wish to revisit municipal/school district budget statutes that address how unexpended appropriations<sup>21</sup> can be used at or after the conclusion of a fiscal year.

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<sup>20</sup> *Assistance to States for the Education of Children with Disabilities*, 80 Fed. Reg. 81, p. 23648 (April 28, 2015).

<sup>21</sup> This may also be necessary to the extent that any interest on any investments by the Cooperative are returned as revenue to the LEA. Finally, the timing of the calculation of the community contribution may lead to a need to revise the current statutory budget procedures.



With respect to the LEA's compliance with the expenditure/"compliance" aspect of the MOE: To the extent that the amount of money an LEA is required to put into the cooperative is equal to the amount of funds expended on special education the prior year, the hurdle of demonstrating MOE should be satisfied. Therefore, to the extent, that an LEA's "community contribution" is based on the LEA's expenditure during the prior year, this number would likely meet MOE.<sup>22</sup> The fact that costs for special education inevitably increase will not be changed by this cooperative, as its *raison d'être* is not cost control but rather managing cost volatility (specifically *within* a particular school year, **not** year to year volatility).

In addition, the state funds will now be aggregated to pay for all special educational costs, along with the community contributions. In this context, the LEA could easily combine the monies that it is expending in the aggregate on the community contributions and the State's expenditures for MOE compliance. To the extent that **all** special education costs are being paid by the State (or more precisely, the cooperative that it has established by statute) as the "single payer" via the bundled LEA and bundled State monies, one could simply rely upon all of the monies that the cooperative will now be expending on the LEA's students (which will not change the scenario that LEAs currently face in terms of qualifying expenditures), as per the combined state funds and local funds prongs. In this regard, there would be no changes with respect to the issues with compliance that exist under the current special education funding and expenditure system (i.e., having to spend at least the same amount each year within one of the four options, with limited exceptions/reductions), as nothing in this proposed cooperative would affect the expenditures/outlays that need to be spent on students to provide FAPE.

**Please note:** if the cooperative is to be limited to excess cost/"high cost students", then the cooperative could use the MOE exception provided for whenever there is an assumption of costs by a "high cost fund".

## **V. FINAL THOUGHTS AND REMAINING QUESTIONS**

As we have stated, this legal analysis is predicated upon the information that has been provided us to date. Any further revisions in the Task Force's report (and how the legislature eventually attempts to address the report through any proposed implementing legislation) may necessarily alter this analysis and our consideration of attendant legal issues. For example, the ultimate and final determination of how (1) towns would contribute to such a special education predictable cost cooperative (or

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<sup>22</sup> A decrease in fees from a cooperative for a member LEA is not an allowable exception to the MOE. *Maintenance of Effort: Allowable Exceptions* (Missouri Department of Education) <https://dese.mo.gov/sites/default/files/sef-MOE-AllowableExceptions.pdf>



alternative) model,<sup>23</sup> (2) towns would be compensated for special education costs under such a model, and (3) a town's compensation under such a model would affect its required contribution in the subsequent fiscal year could affect our assessment as to the cooperative's risk of causing towns to be in non-compliance with the MOE.

We also await the final determination by our legislature (or even this Task Force) as to whether the cooperative will cover just expenses for "high cost" students or whether it will cover all special education costs for a school district.<sup>24</sup> Parenthetically, prior attempts to reform/bolster excess cost grants and special education funding have included proposals to reduce the threshold from four-and-one-half-times the per-pupil costs to as low as *two-times* the per-pupil costs. If the goal of the cooperative is solely to deal with "high cost" students, the Task Force should strongly consider recommending that the excess-cost threshold be reduced to the "at-least-three-times" formula the IDEA employs in its "new" high cost pool provision.

Ultimately, there has to be a proper mix of factors in terms of the contribution by school districts/towns. Perverse incentives could arise if a school district is "penalized" financially for (appropriately) committing resources into programs that provide better services, or where such resources may be necessary. As of now, a district is not penalized for these efforts; indeed, the fact that a district received excess cost grants one year does not affect its eligibility or reimbursement during the succeeding year. In the proposed cooperative models, a school district's previous special education costs would affect its "community contribution" in the ensuing year or years.

If the costs of paying special education costs to be fully assumed by this proposed cooperative, could it leverage its size and financial resources to enter agreements with private, special education facilities to obtain more favorable tuition and residential rates? If that information were to be shared with LEAs, and were the LEA's contribution for any fiscal year to be predicated upon its prior-year expenditures, then parents and their attorneys could argue that PPTs were steering students to particular programs based upon monetary, rather than programmatic, considerations, akin to "preferred providers" in the healthcare world. At the same time, such an arrangement might have the

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<sup>23</sup> While we obviously are working with the formula/contours designed by AON in its report, we of course understand that the General Assembly may revisit these recommendations, especially in the context of the larger issue of equity in educational funding. It is also uncertain as to whether the State will just "throw in" a bundled amount equivalent to the combined ECS and excess costs grants totals, without regard to allocation to LEA, and how this would interplay with any equity adjustment via the community contribution calculation.

<sup>24</sup> While we have not seen such a "high cost student only" or "excess cost" cooperative model, in theory, such a model would have pose even fewer issues with IDEA compliance than the proposed "all cost" model, as it theoretically could just mirror the excess cost system regarding appropriation and State effort/MOE compliance,

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opposite effect, making PPTs more open to parent requests for certain out-of-district placements in light of the reduced financial impact. Of course, even that would raise issues as to whether PPTs were basing their recommendations upon impermissible considerations.

Of course, there are some practical questions that will have to be addressed with respect to 1) the frequency and schedule of payments of “premiums” or “contributions” to the cooperative, along with State’s contribution via its bundled grants, and 2) the frequency and schedule (and promptness) of payouts and reimbursement by the cooperative of LEA expenses. A related question is whether the cooperative will directly pay the expenses or just provide reimbursement?

Finally, the determination as to whether this cooperative will be voluntary or mandatory, or whether there will be a middle ground of positive incentives (and negative consequences) to encourage enrollment may affect our analysis. Obviously, any voluntary program may cause “low-cost” districts not to participate. Leaving aside the policy and financial choices that the Task Force, and ultimately the legislature, may make, such a decision will affect the level of contribution from districts necessary to support the cooperative, and could thus affect compliance with, *inter alia*, the MOE requirements.

Respectfully submitted

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## APPENDIX

Excerpts from *Special Education Excess Cost Grant User Guide* (CSDE-Bureau of Fiscal Services, 2018), pp. 50-51

### **LEA Excess Cost (Grant Type 01) – Allowable Costs**

The purpose of this document is to provide guidance to districts when reporting special education and related services for a student educated in the district, which may be eligible for Grant 01 (LEA Placement). A child with disabilities qualifies if the costs, when combined, exceed the local district's basic contribution threshold by four and one half times. To find your districts' threshold, see Net Current Expenditures (NCE) per Pupil (NCEP) and Basic Contributions in the Appendix under SEDAC References.

Before applying you should be aware of the following:

-Report student's actual expenditures supported by local tax dollars.

**-DO NOT include:**

- o the Net Current Expenditures per Pupil (NCEP) for your district
- o Any base amount that is not directly related to the special education pupil
- o federal source funds such as IDEA Part B (611/619)
- o any state funds such as BESB
- o any portion of the Special Education Director's Salary
- o any costs related to running the building
- o legal costs related to the student

-As with out-of-district costs, all are subject to Department audit requirements.

-Districts must maintain detailed, accurate documents for each student to support their claim.

### **Reporting Costs for In-district Staff**

The most challenging costs to report are for staff within the district. One formula may not work for all students. Furthermore, each grant application is based on one child's Individual Education Program (IEP), making it difficult to give specific examples. Therefore, each district must develop a methodology to calculate staff costs that is reasonable, and can be allocated to the student. **These must be documented and based on the costs needed to provide the services to the child as outlined in the IEP.**

It is also reasonable in most cases to include only the cost of those staff members who work with a very small number of students with high needs rather than include a staff

member who works with a large number of students. Costs typically reported are for salary and benefits for teachers, related service personnel and paraprofessionals.

### **Reporting Other Costs**

Other non-staff related costs are easier to report as they are billed to your district. **These must be documented and based on the costs needed to provide the services to the child as outlined in the IEP.** The following list provides some examples and guidelines for calculation.

- District contractor for provision of special education/related services (i.e. Physical Therapy (PT) Services, Occupational Therapy (OT) Services, Speech Services)
- Equipment: purchased, leased, repaired and maintained for one student (for the year purchased or leased)
- Other outside services: nursing, interpreter, consulting, and evaluations
- Home training
- Items to Report under Transportation Costs
- Special Education Transportation (divided by the number of children on the van)

### **Reporting Costs under the Single Cost Accounting System (SCAS)**

The following information is applicable to reporting education costs for students who are attending an approved private special education program located within a private residential treatment program and, therefore, whose daily education rate has been calculated by the State Department of Education under the Single Cost Accounting System (SCAS). The Department monitors the tuition and related services costs reported in the Tuition Cost Field for each SCAS facility. The Bureau of Grants Management limits the amount that can be included in the district's State Agency Placement or Excess Cost Grant computation. This **daily rate, multiplied by the number of tuition days entered, is the maximum amount that the Department will reimburse your school district under either a State Agency Placement grant or an Excess Cost Grant.** For the latest list of programs that are subject to SCAS rate calculations see the Approved Private Special Education Programs Per Diem Rates in the Appendix under SEDAC References

There are three fields to report costs for students: Tuition Cost (which includes tuition and related services excluding transportation), Transportation Cost, and Room and Board Cost. The SCAS-calculated rate is an all-inclusive rate. If a student is placed by a state agency take the approved daily SCAS rate, and multiply it by the number of tuition days. If the student is placed by the LEA and the facility charges a daily rate for the



same tuition and related services that is different from the SCAS rate, report the actual cost in the Tuition Cost field. Any payment in excess of these rates is ineligible for reimbursement by the Department. If the student attends as a day student, fill in transportation costs in the Transportation Costfield.

If a student receives services that are not typically provided by the program and the program believes that the SCAS-calculated rate will not cover the cost of such services, the program may request that the State Department of Education adjust the rate (which is an average rate and applicable to all students within the program). If the student receives services through a source other than the special education program, such as placement in an additional separate program, costs for these services can be reported by entering a second contract.

To report residential services in a SCAS facility (if your local school district places a student in a SCAS facility and pays for residential services), fill in the costs in the Room and Board Cost field. More typically, however, the student is placed in a SCAS facility by a state agency, such as the Department of Children and Families or the Judicial Branch. In these cases, you are not responsible for any residential costs, so the Room and Board Cost field is left blank.

## MEMORANDUM

TO: Special Education Model Task Force  
FROM: Morgan, Lewis & Bockius LLP  
DATE: July 22, 2019  
SUBJECT: DRAFT Special Education Captive Formation in Connecticut

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The Special Education Cost Model Task Force (the “Task Force”) was established to conduct a feasibility study on alternative methods to distributing special education (“SPED”) funds in Connecticut. The purpose of the Task Force is to address the volatility observed when municipalities appropriate funds for SPED services. One of the methods being considered is the use of a cooperative funding arrangement, similar to a captive insurance company (a “SPED Co-Op” or the “Co-Op”) into which individual towns would pay a predetermined contribution, annually, and later receive reimbursement for their actual SPED expenditures. The Task Force goal is to evaluate the mechanisms alone, and is not connected to alternative methods of SPED service delivery.

Section I of this memorandum provides a high-level description of the current system Connecticut uses to distribute SPED funds. Section II describes Connecticut’s captive regime and includes certain recommendations for a SPED Co-Op. Our analysis is based upon the captive regime in its present form though, where appropriate, we observe areas in which legislative amendment may be warranted. Finally, Section III includes our recommendations for the governance structure of the SPED Co-Op.

### **I. Current SPED System in Connecticut**

Connecticut spends nearly \$2 billion on SPED services annually.<sup>1</sup> State revenue resources account for over \$788 million—the majority of which is derived from the Education Cost Sharing (“ECS”) grant.<sup>2</sup> Designed in 1988, the ECS grant is based on a formula that is intended to distribute state funding to municipalities in order to account for the difference between the cost of operating a school and the amount of funds a town is capable of raising.<sup>3</sup> An estimated twenty-percent of the total ECS funding is allocated towards SPED funding.<sup>4</sup>

To help offset the cost of SPED students with extraordinary need, the state provides funding through the Excess Cost grant.<sup>5</sup> This grant reimburses municipalities when the cost of

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<sup>1</sup> EDUCATION COST SHARING GRANT (ECS/MBR), <https://portal.ct.gov/SDE/Fiscal-Services/Education-Cost-Sharing-Grant-ECS-MBR> (last visited Dec. 27, 2018).

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

educating a student exceeds 4.5 times the district's net current expenditures per pupil.<sup>6</sup> The grant has a statutory cap of \$140 million and is not fully funded.<sup>7</sup> The result is that municipalities are not fully reimbursed for their SPED costs.<sup>8</sup>

Year-over-year, Connecticut's aggregate SPED costs enjoy a steady and predictable increase of 3% per annum.<sup>9</sup> At the local level funding SPED services is volatile. Variances of anywhere from a 24% drop in required funding to an increase of 102% over the prior year have been observed.<sup>10</sup> This volatility wreaks havoc on prospective budgeting at the municipal level.

With volatility and scant resources as a backdrop, the Task Force has studied SPED funding mechanisms used in other states. We understand the Task Force has evaluated the use of a cooperative model<sup>11</sup> that would aggregate SPED costs at the state-wide level through an initial contribution. Towns would then submit for reimbursement at the end of the year. This could allow for predictability in the budgeting process at the municipal-level. With a predictable budget, municipalities may be better suited to allocate resources towards finding efficiencies in their use of SPED funds, which, in turn, could lower such costs.

## II. Connecticut Captive Regime

The SPED Co-Op will take some of the characteristics of an insurance-style captive. A captive is an insurance company created and wholly owned by one or more non-insurance entities to insure the risks of its owner-company.<sup>12</sup> Captives are often established in order to meet the risk-management needs of the captive's owners.<sup>13</sup> A captive can be utilized in any dynamic where premium is remitted to insure a future risk—including the risk of a greater level of SPED funding than initially anticipated when prospectively budgeting. This application need not affect the manner in which SPED services are delivered, however.

Connecticut provides a statutory scheme promoting captive formation in one of several different forms depending on the needs of the owner. Connecticut captive law is largely self-contained and provided in Conn. Gen. Stat. § 38a-91aa et seq. (the "Act"). There are several exceptions in which the general insurance law is applicable—though these are largely

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<sup>6</sup> Conn. Gen. Stat. §10-76g(b).

<sup>7</sup> CT SCHOOL FINANCE PROJECT at 13.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> As an alternative to the use of a cooperative for all SPED costs, we understand the Task Force is studying the use of an excess cost model that would be limited to allocating funding for students with particularly significant SPED costs alone, and leave general SPED funding as is. While this may require some nuance in the underlying contractual language between the SPED Co-Op and the municipalities involved, the overall structure of the enterprise should not be affected.

<sup>12</sup> NAT'L ASSOC. OF INS. COMM'R [NAIC], CAPTIVE INSURANCE COMPANIES, [https://www.naic.org/cipr\\_topics/topic\\_captives.htm](https://www.naic.org/cipr_topics/topic_captives.htm).

<sup>13</sup> *Id.*

administrative in nature.<sup>14</sup> While there are a number of forms available, the most relevant form for a SPED Co-Op is likely a “sponsored” captive.

A sponsored captive means any entity in which the majority of the minimum unimpaired paid-in capital and surplus is provided by a single entity, the risk is insured through separate participation contracts with the captive itself and the liabilities and assets are segregated into individual protected cells.<sup>15</sup> We would expect the initial contribution to come through state funding, thereby rendering the state as the sponsor. The sponsor would enter into participation contracts with each municipality or local educational authority (“LEA”). The yearly contributions of each town would be placed in the cell. The cell would then reimburse towns for their actual SPED costs at the end of the year.

The use of a sponsored captive structure is desirable because it prohibits state claw back of the contribution funds. The individual cells are prohibited from distributing their assets to the sponsor without the approval of the Commissioner of the Connecticut Department of Insurance (the “Commissioner”).<sup>16</sup> As an added protection, the participation contracts between the sponsor and the individual towns could prohibit any such action. An added feature in the sponsored structure is that the withdrawal of a participant from the contractual arrangement with the sponsor constitutes a change in the sponsored captive insurance company’s plan of operation and would require prior approval by the Commissioner.<sup>17</sup> Since, as with any risk-pooling endeavor, the SPED Co-Op may take several years to smooth out initial contributions, this feature may prove beneficial.

### *Formation*

A sponsored captive may be incorporated as a stock insurer with shares of stock held by its stockholders, incorporated as a mutual corporation,<sup>18</sup> a non-profit corporation with one or more members, or as a manager-managed limited liability company.<sup>19</sup> A participant in a sponsored captive need not hold the stock of the captive itself.<sup>20</sup> However, the stockholders of the sponsored captive are limited to the participants and/or the sponsor.<sup>21</sup>

A captive’s organizers must petition the Commissioner to issue a certificate setting forth the Commissioner’s finding that the establishment and maintenance of the proposed captive will promote the general good of the state.<sup>22</sup> This petition must occur before incorporation documents are submitted to the Secretary of State.<sup>23</sup> When issuing a certificate, the commissioner will

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<sup>14</sup> See Conn. Gen. Stat. § 38a-91oo (providing that no provision of the title applies to captive insurance company, unless expressly included therein). Exceptions include, but are not limited to, provisions governing investigations, duties of the Commissioner, confidentiality, etc.

<sup>15</sup> *Id.* at § 38a-91aa (32).

<sup>16</sup> *Id.* at § 38a-91rr (a)(5).

<sup>17</sup> *Id.* at §38a-91rr (a)(10).

<sup>18</sup> A mutual corporation is owned and operated by its insureds such that every owner of the company is an insured and that every insured is an owner. See INTERNATIONAL RISK MANAGEMENT INSTITUTE, INC., GLOSSARY OF INSURANCE TERMS, <https://www.irmi.com/glossary/4?taxonomy=alphanumeric&propertyName=alphanumeric&taxon=m>.

<sup>19</sup> Conn. Gen. Stat. §38a-91ff (c)(1).

<sup>20</sup> *Id.* at §38a-91ff (c)(3)(C).

<sup>21</sup> *Id.* at §38-a-91rr (a)(1).

<sup>22</sup> *Id.* at §38a-91ff (g).

<sup>23</sup> *Id.*

consider, inter alia, the character, reputation, financial standing, purposes and insurance experience and business qualifications of the incorporators, officers and directors.<sup>24</sup> A captive formed as a corporation must have a minimum of three incorporators or organizers and at least one such incorporator must be a resident of the state of Connecticut.<sup>25</sup>

To facilitate tax-exempt status, we would expect the SPED Co-Op take the form of a non-stock corporation with members formed pursuant to Conn. Gen. Stat. § 33-1000 et. seq.

### *Licensure*

Since a SPED Co-Op falls within the statutory definition of “doing insurance business”, it will require a license from the Commissioner.<sup>26</sup> To be considered for a license, the SPED Co-Op must file with the Commissioner: (i) a certified copy of its organizational documents, (ii) a statement under oath of its president and secretary showing the captive’s financial condition and (iii) any other documents required by the commissioner.<sup>27</sup> The application for a license must also include: (i) the amount and liquidity of the company’s assets relative to the risks to be assumed, (ii) the adequacy of expertise, experience and character of the persons who will manage the captive, (iii) the overall soundness of the company’s plan of operations, (iv) the adequacy of the loss prevention programs of the company’s insureds and (v) any other factors the commissioner deems relevant by the commissioner in ascertaining whether the captive company will be able to meet its policy obligations.<sup>28</sup> The application requires an eight-hundred dollar fee which is used to conduct the initial examination, though the cost of the commissioner retaining an required legal, financial and examination services would be charged to the captive. In addition, the application must include a licensing fee.<sup>29</sup>

Because of the individual cells that are permitted in a sponsored-captive structure, a sponsored-captive license application has additional requirements designed to protect each cell. It must include a statement which acknowledges that the financial records of the captive, including the records of each individual cell, will be made available to the Commissioner for inspection.<sup>30</sup> It must include materials which demonstrate how the applicant will account for the loss and expense experience of each protected cell, evidence that the allocations of expenses are allocated

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<sup>24</sup> *Id.*

<sup>25</sup> Conn. Gen. Stat. §38a-91ff (f).

<sup>26</sup> The Act provides any captive insurance company may apply to the Commissioner for a license to do the business of insurance against any kind of “loss, damage or liability properly a subject of insurance”. Conn. Gen. Stat. §38a-91bb(a). Connecticut broadly defines “insurance” as any agreement to pay a sum of money ... on the happening of a particular event or contingency....” Conn. Gen. Stat. §38a-1 (11). The SPED Co-Op will require a contribution at the beginning of the year. Reimbursement is based upon the happening of an event—the amount of SPED funding incurred which is contingent upon the scope of SPED services actually offered. Thus, the definition appears to be met.

<sup>27</sup> *Id.* at §38a-91bb (c)(1). In conjunction with the requirement that a certificate be obtained from the Commissioner before filing organizational documents, *see supra* text accompanying note 22, the order of operation appears to be the procurement of the certificate from the Commissioner, followed by the filing of organizational documents with the Secretary of State, and finally, application for a license.

<sup>28</sup> *Id.* at §38a-91bb (c)(2).

<sup>29</sup> As with the Crumbling Foundations captive, we expect such fees could be waived through enabling legislation.

<sup>30</sup> *Id.* at §38a-91bb (c)(3).

to each cell in a fair and equitable manner and all contracts or sample contracts between the sponsored captive and any participants must be provided to the Commissioner.<sup>31</sup>

To obtain a license, a captive must maintain a minimum unimpaired paid-in capital and surplus, the amount of which is contingent upon the type of captive to be formed. In the case of a sponsored captive, the requirement is \$250,000.<sup>32</sup> This can take the form of cash or an irrevocable letter of credit issued by an approved bank.<sup>33</sup>

### *Governance*

Captives formed in Connecticut are subject to the general business law contained in Title 33 (the “Business Code”) common to any Connecticut-based corporate entity.<sup>34</sup> In the event of a conflict between the Business Code and the Act, the Act will control.<sup>35</sup>

The Business Code governs nearly all aspects of company business. While there is general deference to the business judgment of business entities, transactions must always occur in accord with the fiduciary duties common to all business organizations, provided such duties are not waived in the underlying formation document. We would not recommend the waiver of fiduciary duties given the nature of this endeavor. Connecticut has codified the common law duties of good faith and fair dealing by requiring that each director of a corporation act in good faith and in a manner the director reasonably believes to be in the best interests of the corporation.<sup>36</sup> Further, a director must discharge his or her duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.<sup>37</sup> These standards are applicable to the officers of a non-stock corporation,<sup>38</sup> managers of a limited liability corporation<sup>39</sup> and the directors and officers of a stock corporation<sup>40</sup>.

The Act has layered additional provisions with respect to the governing bodies of captives. At least one manager or director, as applicable, must be a resident of the state.<sup>41</sup> Further, with respect to a corporation, the articles of incorporation and/or the bylaws need to specify that a quorum will be met with no fewer than one-third of the prescribed number of directors.<sup>42</sup> This quorum requirement should be carefully considered when determining the composition of the board of the SPED Co-Op since too large a board may prove difficult to marshal to make a quorum.

Any company-wide transactions such as mergers, consolidations and transfers are governed by the general Insurance Code, rather than the Business Code.<sup>43</sup> The licensing

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<sup>31</sup> *Id.*

<sup>32</sup> Conn. Gen. Stat. §38a-91dd (a)(1)(E).

<sup>33</sup> *Id.* at §38a-91dd (d).

<sup>34</sup> *Id.* §38a-91ff (k) & (l).

<sup>35</sup> *Id.*

<sup>36</sup> *Id.* at §33-1104(a).

<sup>37</sup> *Id.*

<sup>38</sup> Conn. Gen. Stat. §33-1111.

<sup>39</sup> *Id.* at §34-255h(i).

<sup>40</sup> *Id.* at §§ 33-756; 33-765.

<sup>41</sup> *Id.* at §38a-91ff (j)(1)(A).

<sup>42</sup> *Id.* at §38a-91ff (j)(1)(B).

<sup>43</sup> *Id.* at §38a-91ff(n).



requirements add that a captive's board of directors or committee of managers must hold meetings at least once per year in the state, its principal place of business must be in the state and it must have a registered agent willing to accept service of process and act on its behalf in state.<sup>44</sup>

The governance of the Co-Op provides an opportunity to create stakeholder involvement that may have the effect of increasing the likelihood of success of the Co-Op. The Business Code permits the creation of any number of committees to aid in the governance of an entity.<sup>45</sup> Committees can be comprised of non-directors, provided such committee is not empowered to take corporation action and acts strictly in an advisory role. The Co-Op could take advantage of this provision by creating advisory committees comprised of members of the municipalities who are not board members to increase buy-in and a sense of collegiality amongst the members of the Co-Op.

As described in the next section, we recommend a robust dispute resolution process to increase the visibility of the Co-Op's operations and raise the comfort of the municipalities. A potential advisory committee could act as a first recourse for such disputes. Additional committees could be formed to study potential collaborations (e.g. transportation, service delivery etc.) amongst the various municipalities that would have the effect of lowering SPED costs. Advisory committees could be utilized to generate the various reports that may be required of a SPED Co-Op, whether to the Commissioner, the Department of Education or otherwise.<sup>46</sup> Still others could be formed to monitor the reimbursement process, advise on financial matters and to study innovations in special education itself. Committees could also be utilized to "season" future board members, such that an individual must serve on a committee in order to be eligible to serve on the board of the Co-Op. In short, the use of advisory committees could be viewed as an opportunity not only to bolster the success of the Co-Op, but to enhance the delivery of special education itself. But, their power can be limited to ensure the Co-Op is never used to dictate how such services are actually delivered since these decisions will be left to the individual municipalities.

### *Dispute Resolution*

The Act does not appear to take a position with respect to a dispute resolution process for captives. Since the SPED Co-Op does not have any oversight of the manner in which services are administered locally, disputes should be kept to a minimum. Nonetheless, a dispute resolution procedure should be outlined in the governing documents of the SPED Co-Op.

When enabling the crumbling foundation captive, the legislature created a simple resolution process in which applications for funding are made to the captive and decisions on assistance are returned to the applicant in writing.<sup>47</sup> Such decisions are subject to approval by the board of directors of the captive, but the decision by the board is final and there is no right of appeal.<sup>48</sup> As opposed to the crumbling foundation captive, any disputes related to the SPED Co-

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<sup>44</sup> See generally, Conn. Gen. Stat. §38a-91bb.

<sup>45</sup> *Id.* at §33-1101.

<sup>46</sup> Such reports would be advisory in nature, unless formally adopted by the board of directors or committee of managers.

<sup>47</sup> *Id.* at §38a-91vv(h).

<sup>48</sup> *Id.*

Op would be between the Co-Op and the participant (*i.e.* the town or the LEA), rather than an individual citizen.

A possible dispute resolution structure could involve a committee of non-board members empowered to hear disputes in an open-forum. This committee could then make a recommendation to the board of directors or committee of managers, which would vote on the ultimate outcome. The board of directors or committee of managers of the SPED Co-Op would have fiduciary duties in favor of the participants themselves since the participants will “own” the SPED Co-Op as members. Thus, a town should feel comfort appealing to the board, with the knowledge that such decisions carry a fiduciary duty in their favor.

The examination and annual report requirements described in the next section create a quasi-dispute forum since the Co-Op will be subject to regulatory review. These reviews can be subject to public comment. Taken together, a dissatisfied town or LEA has a forum in which to voice their concerns with the financial aspects of the SPED Co-Op.

### *Ongoing Obligations*

Captives, like all insurance companies, are subject to significant regulatory oversight by the Commissioner. The Act provides that a captive must submit an annual report of its financial condition to the Commissioner which is verified by two of the captive’s executive officers.<sup>49</sup> These financial reports must also be certified by an independent public accountant which includes a statement of opinion on loss and loss adjustment expense reserves made by a member of the American Academy of Actuaries or a qualified loss reserve specialist.<sup>50</sup> This verification, along with unaudited financial statements, is due to the Commissioner by March 1st of each calendar year.<sup>51</sup> Audited financial statements are due within five-months following the end of the captive’s annual calendar or fiscal accounting period.<sup>52</sup>

In addition to annual reporting, captives are subject to comprehensive examination by the Commissioner at least once every three-years, though the Commissioner has discretion to conduct such examinations more frequently.<sup>53</sup> The Commissioner may conduct examinations every five-years if the Commissioner determines that the captive is subject to comprehensive annual audit by independent auditors approved by the Commissioner.<sup>54</sup> In conducting examinations, the Commissioner may engage a host of service providers such as attorneys, appraisers, independent actuaries, independent certified public accountants or other professionals and specialists.<sup>55</sup> These services are borne by the captive.<sup>56</sup> Additionally, the captive’s officers and agents are required to

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<sup>49</sup> *Id.* at §38a-91gg(b).

<sup>50</sup> Financial Bulletin FS-4C-2017, 2017 WL 6325838 (CT INS BUL).

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> Conn. Gen. Stat. §38a-91hh (a)(1).

<sup>54</sup> *Id.* at §38a-91hh (a)(1), (b). Such auditors are subject to criteria as set forth in the examiner handbook adopted by NAIC as is the examination itself. *Id.*

<sup>55</sup> *Id.* at §38a-91hh(c)(1).

<sup>56</sup> *Id.*

submit any books and papers relating to the business or affairs of the captive to the Commissioner and/or any of the service providers.<sup>57</sup>

Within sixty-days of the completion of the examination, the examiner is required to file a written report of the examination with the Commissioner that is then transmitted to the captive.<sup>58</sup> The captive has thirty-days to submit a rebuttal, after which the Commissioner will either adopt the report (with or without such rebuttals), reject the examination with direction to reopen the examination and cure any defect or conduct an investigatory hearing for the purposes of obtaining additional documentation, data information and testimony.<sup>59</sup> These findings and conclusions are subject to Conn. Gen. Stat. § 38a-19, which in turn provides an avenue for any aggrieved person to seek a hearing on the order or decision.<sup>60</sup> Similarly, the Commissioner is authorized to pursue legal or regulatory action in connection with any violation of the insurance laws.<sup>61</sup> Lastly, the Commissioner has discretion to publish any examination in one or more newspapers of the state.<sup>62</sup> While publication in a newspaper may not be warranted, we would recommended that all reports of the SPED Co-Op be deemed public information in order to facilitate collegiality among the various stakeholders.<sup>63</sup>

### *Grounds for Suspensions*

The Commissioner has latitude to suspend, revoke or renew the SPED Co-Op's license if it becomes insolvent, fails to meet appropriate levels of capital and surplus, fails to submit to or pay the cost of examination or annual reporting requirements or fails to adhere to any provisions contained within its bylaws or charter, operates in a manner that is detrimental with respect to the public or policyholders or otherwise fails to comply with the laws of the state.<sup>64</sup>

### *Investment Limitations*

If the SPED Co-Op is formed as a sponsored captive, it will be subject to the general investment proscriptions of Connecticut Insurance law as set forth Part III of Chapter 698.<sup>65</sup> The general investment law permits investment in categories. These are limited to certain amounts that are calculated in consideration of the amount of capital and surplus that is required under statute. For example, investments of up to ten-percent of admitted assets in obligations issued by any agency, political subdivision or instrumentality of any state in which obligation are not general

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<sup>57</sup> *Id.* at §38a-91hh(c)(2).

<sup>58</sup> *Id.* at §38a-91hh(d)(3).

<sup>59</sup> Conn. Gen. Stat. §38a-91hh(d) (3). The investigatory hearing is subject to limitations as provided in Conn. Gen. Stat. §38a-91hh(e)(2). That section provides that any such hearing is to be non-adversarial and confidential and focused on the resolution of any inconsistencies, discrepancies or disputed issues.

<sup>60</sup> *Id.* at §38a-91hh(e)(1). This too would offer an indirect dispute resolution mechanism for any aggrieved stakeholder, though such action would be limited to any orders of the Commissioner which sanction the behavior at issue.

<sup>61</sup> *Id.* at §38a-91hh(d)(1).

<sup>62</sup> *Id.* at §38a-91hh(f).

<sup>63</sup> *Id.* at §38a-91hh(g) provides that any state agency who receives the examination from the Commissioner must agree, in writing, that documents included in the examination will be kept confidential. We would recommend that, at minimum, the Department of Education be absolved from such a requirement.

<sup>64</sup> *Id.* at §38a-91ii(a)(1).

<sup>65</sup> Conn. Gen. Stat. §38a-91rr(b).

obligation (i.e. municipal bonds that are not GO bonds) or obligations which are issued or guaranteed by certain banks are permitted.<sup>66</sup>

### *Reinsurance*

The SPED Co-Op may take credit for the risk that it cedes to a licensed or accredited reinsurer.<sup>67</sup> Conversely, the Commissioner can give prior written approval allowing the captive to take credit for the reinsurance of a risk.<sup>68</sup> We understand the Task Force is considering the use of either a reinsurance treaty or a stop-loss policy to cover excess risk. If reinsurance were to be employed, we would recommend that enabling legislation take advantage of the prior approval mechanism and permit such credit upon entry of written approval by the Commissioner. This will streamline the process and allow additional oversight over the reinsurer chosen.

### *Tax*

The Act provides captives are subject to a progressive tax rate which is based upon the direct written premium collected.<sup>69</sup> We recommend that any enabling legislation contain a provision exempting the SPED Co-Op from state-level tax assessments on premium. We similarly recommend that an exemption extend to investment income, provided the investment income is used to either offset the individual towns' premium payments,<sup>70</sup> or held in trust for a similar purpose or any other purpose which promotes the overall well-being of the captive itself.

Because of the highly specialized nature of taxation of insurance premium on the federal level, we recommend the SPED Co-Op retain tax attorneys uniquely qualified to practice in this area to evaluate a final structure when seeking a federal tax exemption. Obtaining a federal tax-exemption may require a private letter ruling from the Internal Revenue Service.

In connection with the evaluation of a SPED Co-Op, we reviewed the private letter ruling attached hereto as Exhibit A, which suggests that the income of a risk pool created by a political subdivision of the state could be excluded from gross income under 28 U.S.C. § 115(1). The letter describes a scenario whereby a non-profit organization is to be incorporated under color of state law with the various counties of the state acting as members of the entity.<sup>71</sup> Each county would

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<sup>66</sup> *Id.* at §38a-102c(a). Such banks include the International Bank for Reconstruction and Development, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank or the International Finance Corporation. *Id.*

<sup>67</sup> *Id.* at §38a-91kk(b). There are additional standards that can be met by a reinsurer—apart from licensure or accreditation—as set forth in Conn. Gen. Stat. § 38a-85 through § 38a-88, which would permit a captive to reinsure its risks.

<sup>68</sup> *Id.*

<sup>69</sup> *Id.* at § 38a-91nn(a). The statute goes on to provide certain minimum and maximum assessments which contingent upon the form of captive. *Id.* at § 38a-91mm(a).

<sup>70</sup> We understand that the Individual with Disabilities Education Improvement Act (“IDEA”) “maintenance of state funding requirement” provides that a state must not reduce the amount of state financial support for SPED and related services for children with disabilities below the amount of that support for the preceding fiscal year. As such, it is important to characterize any investment income reimbursements as “offsets” in order to ensure that, while the source of funding may change, the total amount of state financial support, year-over-year, will remain the same, if not increase.

<sup>71</sup> Rev. Rul. 90-74, 1990-2 CB 34.

designate representatives and elect members of the board of directors to govern the entity.<sup>72</sup> The counties would remit an annual fee to the entity, which in turn would reimburse its members for their casualty losses.<sup>73</sup> The entity would also receive investment income.<sup>74</sup> On its face, the factual scenario is remarkably similar to a SPED Co-Op, but there are some distinctions. For example, the facts also indicate that the funds are managed at the state-level—something the Co-Op would seek to avoid. Still, the ruling appears to turn on whether the entity is performing an essential governmental function, which in turn depends on the facts and circumstances of each case.<sup>75</sup> It concludes that the income is exempt because the funds do not benefit private interests<sup>76</sup> and, upon dissolution, any assets would be distributed to the members.<sup>77</sup> Whether these distinctions are substantial enough to vitiate the conclusion of the ruling is beyond the scope of this memorandum and would ultimately require evaluation by a specialist.

### *Confidentiality*

Because of the highly competitive nature of the insurance industry, there are number of provisions in the general insurance code that provide confidentiality for the reports an insurance company submits to the Commissioner. Captives enjoy the same treatment.<sup>78</sup> However, because of the public nature of the SPED Co-Op, the funds therein and the fact that it is not designed to provide insurance, we would recommend that such information be publically available. This would serve to assuage concerns of the municipalities and/or any consumers. Moreover, to the extent that there are disputes, a robust, open system of governance and accountability may limit their virility.

### **III. Specific Recommendations for the SPED Co-Op**

We would recommend that counsel be retained to assist in the ultimate formation of the SPED Co-Op. Such counsel would make the ultimate recommendations on the structure of the SPED entity. That said, having been informed by reviewing the materials and attending meetings with various stakeholders, we would suggest the SPED Co-Op take the form of a sponsored captive, formed as a non-stock corporation with members. These members would be comprised of Connecticut's municipalities or the LEA, depending on the entity responsible for SPED service delivery and the receipt of funding therein. The members would be akin to stockholders in a for-profit enterprise and would be the counterparty to the sponsor in the participation contract outlining the funding mechanism.<sup>79</sup> One of the principal benefits of this structure is the contractual obligation between the Co-Op and the individual municipality. This contractual obligation may

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<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> *Id.* We note that certain exemptions under 28 U.S.C. 501(c)(3) require similar analysis couched as lessening the burdens of government.

<sup>76</sup> This too may serve as a distinction as we understand the SPED Co-Op will reimburse certain private institutions if a student is outplaced to such institution.

<sup>77</sup> *Id.*

<sup>78</sup> *See, e.g.,* Conn. Gen. Stat. § 38a-91bb(c)(6) (providing that information submitted in the licensing process will be kept confidential).

<sup>79</sup> As indicated above, we understand the Task Force is evaluating a potential excess cost model. We believe the overall structure of the Co-Op would not be impacted by this construct. However, the underlying contract between the municipalities and the Co-Op would, necessarily, require certain nuance to capture the distinction.

make it difficult, if not impossible, for the state to claw back any moneys which are poured into the Co-Op. Moreover, each individual member would not be liable to any creditor (*i.e.* any other participant) of the SPED Co-Op.<sup>80</sup> Finally, the contract itself could also be used to eliminate any perception that the Co-Op can dictate how the municipalities deliver SPED services.

The Connecticut non-stock act provides that a non-stock corporation with members must hold an annual meeting of members.<sup>81</sup> The towns should be apportioned into ten to fifteen groups based on relative size and median income. Each group would elect its own director to the board of directors (the (“Board”) of the SPED Co-Op. The Board should be rounded out with representatives from the State Department of Education, as well as specialists in the captive insurance arena (e.g. individuals with actuarial backgrounds). Additional specialist board members should include at least one attorney with a background in the IDEA, as well as general corporate counsel. An expert in claims handling and financial matters may be beneficial to the health of the captive as well. These “special” directorship positions could be elected by the Board itself.

In addition to the general provisions of bylaws (e.g. meetings, quorum requirements, indemnification), the bylaws of the SPED Co-Op should outline the dispute resolution process such that it is clear and readily available to each town. We would also recommend that the voting threshold for amendment to the bylaws be relatively high so that a majority of the towns have representation when voting on an amendment. For convenience, we have provided pro forma bylaws which may serve as a template for the SPED Co-Op attached hereto as Exhibit B. We caution that these bylaws have not been fully adapted for use in a SPED Co-Op and are included for informational purposes only.

The enabling legislation should define the SPED Co-Op as a quasi-state agency which is exempt from state-level taxation. Fees associated with obtaining the appropriate Commissioner approval should be waived. We would recommend that the SPED Co-Op be the only source of state funding for SPED services. Should a particular town not participate, it would be left to its own devices for securing SPED funding. This would ensure maximum participation, with limited incentive to exit the program. We would similarly recommend that any town that participates in the SPED Co-op, and elects to leave the SPED Co-Op, be prohibited from returning for a period of time (e.g. 3-years). This would promote remaining in the co-op, while also assisting in smoothing out volatility.

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<sup>80</sup> *Id.* at § 33-1058(a). This is a feature common to all non-stock corporations.

<sup>81</sup> *Id.* at § 33-1061. Given the number of members, it may be desirable to hold annual meetings by class, rather than the entire state.

**Exhibit A**  
**Revenue Ruling 90-74, 1990-2 CB 34**

Rev. Rul. 90-74 (IRS RRU), 1990-36 I.R.B. 5, 1990-2 C.B. 34, 1990 WL 675384

Internal Revenue Service (I.R.S.)  
Revenue Ruling

RISK-SHARING POOLS OF LOCAL GOVERNMENTS

Published: September 4, 1990

[Section 115](#).--Income of States, Municipalities, Etc.

**\*1** Risk-sharing pools of local governments. The income of an organization formed, operated and funded by political subdivisions to pool their casualty risks, or other risks arising from their obligations concerning public liability, workers' compensation, or employees' health is excluded from gross income under [section 115\(1\)](#) of the Code if private interests do not participate in the organization or benefit more than incidentally from the organization.

ISSUE

If political subdivisions of a state create, fund, and operate an organization to pool the casualty risks of the participating political subdivisions, is the income of the organization excluded from gross income under [section 115\(1\)](#) of the [Internal Revenue Code](#)?

FACTS

X is a non-profit organization incorporated under the laws of State A. County governments may, under the laws of State A, form and become members of X to pool the casualty risks of the participating counties. The governing body of each county must authorize the county to join X and must designate an individual to represent the county at meetings of X. The board of directors, elected by and from the representatives of the counties, controls X.

Each member appropriates funds from its general revenues to pay to X an initial deposit and an annual fee based upon its size and its actuarially determined level of risk. X also receives investment income. X reimburses its members for any casualty losses. In the event of dissolution, X will distribute its assets to its members.

LAW AND ANALYSIS

[Section 115\(1\)](#) of the code provides that gross income does not include income derived from the exercise of any essential governmental function and accruing to a state or political subdivision.

The determination whether a function is an essential governmental function depends on the facts and circumstances of each case. [Rev. Rul. 77-261, 1977-2 C.B. 45](#), concludes that the income of a fund, established under a written declaration of trust to the pool the temporary investments of the state and its political subdivisions, is excludable from gross income under [section 115\(1\)](#) of the code. The fund was authorized by state statute, managed by the state treasurer, and benefited only the state and its political subdivisions. The ruling states that the investment of funds is a necessary incident of the power of governmental entities to raise revenue and meet expenses.



Political subdivisions insure against casualty risks and other risks arising from employee negligence, workers' compensation statutes, and employee health obligations. Insuring against these risks satisfies governmental obligations. Any private benefit to employees from insuring against these various risks is incidental to the public benefit.

Pooling casualty risks through X instead of purchasing commercial insurance fulfills the obligations of the political subdivisions to protect their financial integrity. X is created under authority granted by the governing body of each participating county and State A. Except for the incidental benefit to employees of the participating political subdivisions described in the preceding paragraph, no private interests participate in or benefit from the operation of X. Accordingly, X performs an essential governmental function.

\*2 [Section 115\(1\)](#) of the code also requires that the income accrue to a state or a political subdivision. In [Rev. Rul. 77-261](#), a state and the participating political subdivisions had an unrestricted right to receive a proportionate share of the income earned by a joint investment fund. The ruling states that [section 115\(1\)](#) does not require that the income in question accrue only to a state or a single political subdivision and concludes that the income accrues under [section 115\(1\)](#), does not require that the income in question accrue only to a state or a single political subdivision and concludes that the income accrues under [section 115\(1\)](#), even though more than one governmental entity participated in the fund.

The income of X is used to reimburse casualty losses incurred by the counties or to reduce the annual fees that the member counties would otherwise be required to pay to the organization. The income of X does not benefit private interests. Furthermore, upon dissolution, X will distribute its assets to its members. Therefore, the income of X accrues to a political subdivision within the meaning of [section 115\(1\)](#) of the code.

#### HOLDING

The income of an organization formed, operated, and funded by political subdivisions to pool their casualty risks is excluded from gross income under [section 115\(1\)](#) of the code. Similarly, the income of an organization formed, operated, and funded by one or more political subdivisions (or by a state and one or more political subdivisions) to pool their risks in lieu of purchasing insurance to cover their public liability, workers' compensation, or employees' health obligations is also excluded under [section 115\(1\)](#) if private interests do not, except for incidental benefits to employees of the participating state and political subdivisions, participate in or benefit from the organization.

#### DRAFTING INFORMATION

The principal author of this revenue ruling is Timothy L. Jones of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling contact Timothy L. Jones on (202) 566-3828 (not a toll-free call).

Rev. Rul. 90-74 (IRS RRU), 1990-36 I.R.B. 5, 1990-2 C.B. 34, 1990 WL 675384

**Exhibit B**  
**Pro Forma Bylaws**

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**ARTICLE I**  
*General*

These bylaws are intended to supplement and implement applicable provisions of law and of the certificate of incorporation of [ ] (the “Corporation”). The Corporation shall have such purposes as are now or may hereafter be set forth in the articles of incorporation.

**ARTICLE II**  
*Offices*

The principal office of the Corporation shall be located within or without the state of Connecticut, at such place as the board of directors shall from time to time designate. The Corporation may maintain additional offices at such other places as the board of directors may designate. The Corporation shall continuously maintain within the state of Connecticut a registered office at such place as may be designated by the board of directors.

**ARTICLE III**  
*Membership*

Section 3.1 **Eligibility.** The Corporation shall have [ ] classes of members.<sup>1</sup> Each class of member shall be authorized to vote for one Member Director. Membership in the Corporation shall not be transferable unless otherwise provided in the Corporation’s certificate of incorporation.

Section 3.2 **Term of Membership.** The term of office of any member shall be life or legal existence, or until voluntary resignation. Any member may resign at any time by mailing or delivering written notice to the secretary of the Corporation (any resignation to take effect when such notice is delivered unless the notice specifies a later effective date).<sup>2</sup>

Section 3.3 **Member Representative.** Each member shall designate an elected or appointed officer or employee to act as its representative; shall notify the secretary of the Corporation of the name and address of such representative and his or her relationship to the member; and shall thereafter act in all corporate matters solely through such representative until receipt by the Corporation of written notice from the member of the termination of the authority of the representative to so act; provided, however, that if a representative shall at any time, and from time to time, be temporarily absent or otherwise unable to act, the member may designate an alternative representative by written notice to the secretary of the corporation, on each such occasion or on a standby basis, and such alternate when acting as representative shall, during such period or periods, have all the rights, privileges and obligations of the representative in

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<sup>1</sup> For purposes of the SPED Co-Op, municipalities can be grouped in any number of classes, each of which will be entitled to vote for its own director.

<sup>2</sup> Should the Co-Op be structured to allow municipalities to voluntarily resign from the Co-Op, the provision could include language prohibiting re-entry into the Co-Op for a certain period of time after such resignation.



whose place he may be acting. The rights and privileges of a member representative shall cease upon withdrawal or other termination of the membership of the member; upon the death or incapacity of the representative; or upon termination of his or her authority permanently to act on behalf of the member. The acts of such representative, however, shall be binding upon the member he or she represented until written notice from the member of the termination of its representative's authority shall have been received by the Secretary of the Corporation, which notice shall also include the name and addresses of a successor representative and the other pertinent information required of a Representative nominated to act for the member. Upon the death or incapacity of a representative, his or her resignation, or the termination of his or her authority so to act, the member for which he or she acted as representative shall designate a successor representative as soon as reasonably possible. Immediately upon the receipt by the Secretary of the designation of a successor representative, such successor representative so designated shall be deemed the representative of the member by whom he or she has been designated with all the rights, privileges, duties and obligations of his or her predecessor, and the secretary shall so enter his or her status in the records of the Corporation without the requirement of any further vote of the board of directors or of the members of the Corporation.

**Section 3.4 Annual Meeting.** A meeting of the members shall be held annually as determined from time to time by the board of directors for the election of directors and the transaction of other business as may properly come before the members. Each class of member may hold separate meetings, provided that all classes of members hold at least one meeting annually.<sup>3</sup>

**Section 3.5 Regular Meetings.** Regular meetings of the members may be held as determined by resolution of the members or of the board of directors.

**Section 3.6 Special Meetings.** Special meetings of the members may be called at any time by the chair of the board of directors or by the board of directors. Such meetings may also be convened by members entitled to cast [at least [five] percent][a majority][some other number or proportion] of the total number of votes entitled to be cast at such meeting. Only business within the purpose or purposes described in the meeting notice may be conducted at a special meeting of the members.

**Section 3.7 Place and Time of Meetings.** Meetings of the members may be held at such place, either in or out of the state of Connecticut, and at such hour as may be fixed in the notice of the meeting.

**Section 3.8 Notice of Annual, Regular and Special Meetings.** Notice of each meeting of the members shall be given by the secretary and shall state the date, time and place of the meeting and, if it is a special meeting, shall indicate the purpose or purposes for which the meeting is being called. Notice of any annual or regular meeting need not indicate the purpose or purposes for which the meeting is being called, except that, unless stated in a written notice of such a meeting, (i) no adoption, amendment or repeal of the Corporation's certificate of incorporation or these bylaws, and (ii) no matter, other than the election of directors at an annual

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<sup>3</sup> A legislative amendment limiting the annual meeting requirement may be desirable given the number of members. Alternatively,

meeting, may be brought up which expressly requires the vote of members pursuant to the Connecticut Revised Nonstock Corporation Act.

Notice of any meeting shall be given to each member entitled to vote at such meeting. Unless otherwise provided herein or required by law, notice may be communicated in person, by mail or other method of delivery, or by telephone, voicemail or other electronic means, not less than ten (10) nor more than sixty (60) days before the date of the meeting.

When an annual, regular or special meeting is adjourned to a different date, time or place, notice need not be given of the new date, time or place if the new date, time or place is announced at the meeting before adjournment.

**Section 3.9 Waiver of Notice.** A member may waive any notice required by law, the certificate of incorporation or these bylaws before or after the date and time stated in the notice. The waiver shall be in writing, shall be signed by the member entitled to such notice, and shall be delivered to the secretary of the Corporation for inclusion in the minutes of the meeting or filing with the corporate records. Attendance at a meeting: (1) waives objection to lack of notice or defective notice of the meeting, unless the member at the beginning of the meeting objects to holding the meeting or transacting business at the meeting; and (2) waives objection to consideration of a particular matter at the meeting that is not within the purpose or purposes described in the meeting notice, unless the member objects to considering the matter when it is presented.

**Section 3.10 Record Date.** The board of directors shall, by resolution, fix a record date for the purposes of determining the members entitled to notice of a meeting of the members, to demand a special meeting, to vote or to take any other action. Such record date may not be more than seventy (70) days before the meeting or action requiring determination of members.

**Section 3.11 Members' List or Record for Meeting.** After the board of directors has fixed a record date for the meeting, the secretary shall prepare an alphabetical list of the names and addresses of all of the members who are entitled to notice of the meeting. The members' list so prepared shall be made available for inspection by any member entitled to vote at the meeting, beginning two business days after the notice of the meeting is given for which the list was prepared and continuing through the meeting, at the Corporation's principal office or at a place identified in the meeting notice in the city where the meeting will be held.

**Section 3.12 Proxies.** Every member entitled to vote in person may authorize another person or persons to act for him or her by proxy.<sup>4</sup> Every proxy appointment form must be signed by the member or such member's duly authorized attorney-in-fact. An appointment of a proxy becomes effective when received by the secretary of the Corporation or other officer or agent authorized to tabulate votes. A proxy shall be valid for eleven (11) months from the date of its execution unless a longer period is expressly provided in the proxy appointment form. Every proxy shall be revocable at the pleasure of the member executing it, except as may be otherwise provided by law.

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<sup>4</sup> Given the size of the membership, we recommend proxy voting be permitted, particularly if the annual meeting requirement is left intact.

Section 3.13 **Quorum.** Those members entitled to vote present in person or by proxy, at any meeting of members of the Corporation shall constitute a quorum for such meeting. At least [ ] percentage of the members shall constitute a quorum for any meeting of the members of the Corporation. In the event a single class or classes of members meet, at least [ ] percentage of such class shall constitute a quorum for any meeting of such class.

Section 3.14 **Vote.** Each member shall have one vote. Wherever action other than the election of directors is to be taken by vote of the members, it shall, except as otherwise required by law or the certificate of incorporation, be authorized if approved by a majority of the votes cast. Directors shall be elected by a plurality of the votes cast by the members entitled to vote at a meeting at which a quorum is present or by mail, as set forth in Section 3.16(b) below.

Section 3.15 **Presiding Officer and Secretary.** At any meeting of the members, if neither the chair, nor a vice-chair, nor a person designated by the board to preside at the meeting shall be present, the members present shall appoint a presiding officer for the meeting. If the secretary of the board is not present, the appointee of the person presiding at the meeting shall act as secretary of the meeting.

Section 3.16 **Action without a Meeting.** (a) Any action permitted to be taken at a meeting of the members may be taken without a meeting if all members entitled to vote on the action consent in writing to the action. The action shall be evidenced by a written consent describing the action taken or to be taken, signed by the all of the members entitled to vote on the action, and delivered to the secretary for inclusion in the minutes of the meetings of the members.

(b) Whenever action is to be voted on by members, such elections may be conducted, and such actions voted upon, by mail. A description of the action to be voted upon, as the case may be, shall be mailed to the members entitled to vote thereon not less than [two weeks] prior to the date on which the votes are to be counted. The secretary shall count the votes returned by mail, and report the result of such elections or such vote by mail to the members and the directors. Whenever the certificate of incorporation, these bylaws, or the Connecticut Revised Nonstock Corporation Act requires a designated proportion of voting power of members, such proportion shall be determined from the total number of members who actually vote by mail, rather than from members entitled to vote.

Section 3.17 **[Member's Rights and Powers.** In addition to any other rights and powers which the member may have under law, under these bylaws or by the certificate of incorporation, the member shall have the following rights and powers: (List rights and powers, which might include the election and removal of directors, review and approval/disapproval of operating and capital budgets, approval of strategic plans and others which might otherwise be within the province of the board of directors.)]<sup>5</sup>

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<sup>5</sup> This section is not required, but could serve to bolster the rights of the members and assuage any fears municipalities may have with respect to the Co-Op.

**ARTICLE IV**  
***Board of Directors***

Section 4.1 **Power of Board and Qualification of Directors.** All corporate powers shall be exercised by or under the authority of, and the activities, properties and affairs of the Corporation shall be managed by or under the direction of, the board of directors. A director need not be a resident of the state of Connecticut or a member of the Corporation. The directors shall be divided into two-groups: (i) Member Directors and (ii) Specialist Directors.

Section 4.2 **Number of Directors.** The number of directors constituting the entire board of directors shall be not fewer than [ ] nor more than [ ].<sup>6</sup> The number of directors constituting the board of directors shall be the number prescribed by the directors within the foregoing range or, if no such number has been prescribed, shall be the number of directors then in office. The number of directors may be increased or decreased by action of the board of directors.

Section 4.3 **Election and Term of Directors.** As provided in the certificate of incorporation, the initial directors shall be consist of Member Directors appointed by the incorporator(s)<sup>7</sup>. Thereafter, at each annual meeting of the members, the members shall elect or re-elect the Member Directors, provided that each class of member shall only be entitled to vote for a single Member Director<sup>8</sup>. Each Member Director shall hold office for a term of one year until the next annual meeting of the members and until his or her successor has been elected and qualified.

[The directors comprising the Member Directors shall be staggered, divided into three (3) groups. The initial Member Directors shall be appointed by the incorporators for the terms set forth in the minutes of the incorporator's organizational meeting. Thereafter, at each annual meeting of the members as applicable, the members shall elect or re-elect Member Directors to replace those Member Directors whose terms are expiring provided, for avoidance of doubt, that each class of member shall only vote for the Member Director such member is authorized to vote for, each director thereafter to serve a term of [ ] years and until his or her successor is elected. If the number of Member Directors is changed by the members in accordance with the Articles of Incorporation, any increase or decrease shall be apportioned among the classes of Member Directors so as to maintain the number of Member Directors in each class of Member Director as nearly equal as possible.]<sup>9</sup>

In addition to the Member Directors, the board of directors shall include Specialist Directors. From time to time, the Member Directors may, in their sole discretion, vote to appoint Specialist Directors. Such Specialist Directors shall be subject to and exercise their duties in accordance with these bylaws in like fashion as the Member Directors.

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<sup>6</sup> While the number of member-elected directors is likely to be fixed, we recommend a range of directors to include or remove specialists as need arises.

<sup>7</sup> The certificate should provide the division of directors in accord with each class of member.

<sup>8</sup> Language could be added to include a requirement that potential board members must sit on a committee of the Co-Op in order to be eligible for election.

<sup>9</sup> Staggering the board may be desirable but should be apportioned in a fair manner across the state.

[No director shall serve more than [number] consecutive full [one, two, up to five, as applicable]- year terms, [unless he or she has had an intervening year in which he or she was not a director.]]

**Section 4.4 Removal of Directors.** Except as may otherwise be provided in the certificate of incorporation, any one or more of the directors may be removed with or without cause at any time by action of the members of the Corporation. A director may be removed only at a meeting called for that purpose, and the meeting notice must state that the purpose, or one of the purposes, of the meeting is the removal of the director.<sup>10</sup> If a director is elected by a class of members, only those members may vote to remove him.

**Section 4.5 Resignation.** Any director may resign at any time by delivering written notice to the board of directors, its chair, or the secretary of the Corporation. Such resignation shall take effect when such notice is so delivered unless the notice specifies a later effective date.

**Section 4.6 Newly-Created Directorships and Vacancies.** Newly created directorships, resulting from an increase in the number of directors, and vacancies occurring in the board of directors for any reason shall be filled by the board, provided that vacancies of Member Directors shall be filled by the members authorized to vote for such Member Director. Such vacancy shall be filled until the next annual meeting at which directors are elected or, if the board is staggered, for the unexpired portion of the term, if applicable.

**Section 4.7 Meetings of the Board of Directors; Notice.** An annual meeting of the board of directors shall be held each year [directly after the annual meeting of the members][at such time and place as shall be fixed by the board], for the election of officers and for the transaction of such other business as may properly come before the meeting. Regular meetings of the board of directors shall be held at such times as may be fixed by the board. Special meetings of the board of directors may be called at any time by the chair of the board or a majority of the directors.

Regular and special meetings of the board of directors may be held at any place in or out of the state of Connecticut. Regular recurring meetings of the board may be held without notice of the date, time, place or purpose of the meeting; otherwise, regular meetings of the board shall require five days advance written notice given in person, by mail or other method of delivery, or by telephone, voicemail or other electronic means. Unless stated in a written notice of the meeting, no vote on the removal of a director or the adoption, amendment or repeal of these bylaws or the Corporation's certificate of incorporation may occur. Notice of each special meeting of the board shall include the date, time and place of the meeting and shall be given in person, by mail or other method of delivery, or by telephone, voicemail or other electronic means not less than two (2) days before the date of the meeting and shall state the purpose or purposes for which the meeting is called.

A director may waive any notice required by law, the certificate of incorporation or these bylaws before or after the date and time stated in the notice. The waiver shall be in writing, shall be signed by the director, and shall be delivered to the secretary of the Corporation for inclusion

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<sup>10</sup> Organization may choose to require a super-majority vote.

in the minutes of the meeting or filing with the corporate records. A director's attendance at or participation in a meeting waives any required notice to him or her of the meeting unless at the beginning of such meeting, or promptly upon his or her arrival, such director objects to holding the meeting or transacting business at the meeting, and does not thereafter vote for or assent to action taken at the meeting.

**Section 4.8 Quorum of Directors and Voting.** Unless a greater proportion is required by law or by the certificate of incorporation or these bylaws, [two-thirds] [a majority][one-third]<sup>11</sup> of the number of directors prescribed in accordance with Section 4.2, but in no event fewer than two, directors shall constitute a quorum for the transaction of business or of any particular business. Except as otherwise provided by law or by the certificate of incorporation or these bylaws, the affirmative vote of a majority of the directors present and voting at the meeting at the time of such vote, if a quorum is then present, shall be the act of the board. Voting by proxy is not permitted.

**Section 4.9 Action without a Meeting.** Any action required or permitted to be taken at any meeting of the board of directors may be taken without a meeting if the action is taken by all members of the board. Such action shall be evidenced by one or more written consents describing the action taken, shall be signed by each director and shall be included in the minutes or filed with the corporate records reflecting the action taken. Action taken under this Section 4.9 is the act of the board of directors when one or more consents signed by all the directors are delivered to the Corporation. The consent may specify the time at which the action taken thereunder is to be effective. A director's consent may be withdrawn by a revocation signed by the director and delivered to the Corporation prior to delivery to the Corporation of unrevoked written consents signed by all the directors.

**Section 4.10 Meetings by Conference Telephone.** Any one or more members of the board of directors may participate in any meeting of the board by, or conduct the meeting through the use of, any means of conference telephone or similar communications equipment by which all directors participating in the meeting may simultaneously hear each other during the meeting. A director participating in a meeting by such means is deemed to be present in person at the meeting.

**Section 4.11 Compensation of Directors.** No director shall receive compensation for services rendered to the Corporation in such capacity, but directors shall be entitled to reimbursement for reasonable and necessary expenses actually incurred in connection with the performance of their duties in the manner and to the extent that the board shall determine, consistent with the requirements of Section 33-1092 of the Connecticut Revised Nonstock Corporation Act. Notwithstanding the foregoing, the Corporation shall provide no reimbursement for expenses or compensation other than those reasonable and necessary in furthering the Corporation's purposes. Directors may receive reasonable compensation for services performed in other capacities for or on behalf of the Corporation pursuant to authorization by the board of directors, subject, however, to Article VIII of these bylaws and to Sections 33-1127 through 33-1131 of the Connecticut Revised Nonstock Corporation Act.

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<sup>11</sup> While there is some measure of flexibility in the quorum requirements, we recommend that a quorum be devised to include both Member Directors and Specialist Directors.



Section 4.12 **Minutes.** The secretary shall record or arrange to be recorded the minutes of each meeting of the board of directors and upon adoption by the board of directors shall retain such minutes with the permanent records of the Corporation.

## **ARTICLE V** *Committees*

Section 5.1 **Committees.** The board of directors may create one or more committees and appoint one or more members of the board to serve on them. The creation of a committee and the appointment of directors to a committee shall be approved by a majority of all the directors in office when the action is taken. The board of directors may appoint one or more directors as alternate directors to replace any absent or disqualified director during the director's absence or disqualification. The board may also appoint persons who are not board members to serve in an advisory non-voting capacity on any committee of the board. In addition, the board may create one or more additional advisory committees and appoint such individuals, who may or may not be members of the board, to serve on such committees as the board determines will assist it by providing sound advice, reflecting the views of the community or otherwise serving the best interests of the Corporation.<sup>12</sup>

Section 5.2 **Authority of Committees.** To the extent specified by the board of directors, any committee may exercise the power of the board, provided all the voting members of such committee are directors of the Corporation. Otherwise, all committees shall be advisory only. In no event may a committee do any of the following:

- (i) fill vacancies on the board of directors or, except as provided in this section, on any of its committees;
- (ii) adopt, amend or repeal these bylaws or make changes to the Corporation's certificate of incorporation;
- (iii) approve a plan of merger;
- (iv) approve a sale, lease, exchange or other disposition of all, or substantially all, of the property of the Corporation, other than in the usual and regular course of affairs of the Corporation; or
- (v) approve a proposal to dissolve the Corporation.

Section 5.3 **Committee Rules.** Sections 4.7, 4.8, 4.9 and 4.10 of these bylaws, which govern meetings, action without meetings, participation in meetings by conference telephone, notice and waiver of notice, and quorum and voting requirements of the board of directors, apply to committees and their members as well, except that committees shall not be required to hold annual meetings.

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<sup>12</sup> The use of committees may be desirable for a number of reasons. We do not recommend fixing the committees in the bylaws in order to promote flexibility.

Section 5.4 **Compliance with Standards of Conduct.** The creation of, delegation of authority to, or action by a committee does not alone constitute compliance by a director with the standards of conduct described in Section 33-1104 of the Connecticut Revised Nonstock Corporation Act.

Section 5.5 **Minutes.** Each committee shall keep regular minutes of its proceedings and report the same to the board of directors, and such minutes shall be retained with the permanent records of the Corporation.

## **ARTICLE VI**

### *Officers*

Section 6.1 **Officers; Eligibility.** The board of directors shall elect from among the Member Directors a chair, secretary, treasurer, and such other officers as determined by the board of directors.

Section 6.2 **Election; Term of Office; Removal; Vacancies.** All officers shall be appointed at the annual meeting of the board of directors or at any other meeting of the board as the board may determine. Each officer shall hold office for [one, two, three, etc.] year[s] and until his or her successor has been appointed and qualified. [There shall be no limit to the number of times an officer can be re-elected to a particular office][An officer may serve no more than [number] consecutive terms in a particular office]. Any officer may be removed by the board of directors at any time with or without cause. Any vacancy or vacancies occurring in any office of the Corporation may be filled until the next meeting at which officers are elected by the concurring vote of a majority of the remaining directors, though such remaining directors are less than a quorum, though the number of directors at the meeting is less than a quorum, and though such majority is less than a quorum.

Section 6.3 **Resignation.** Any officer may resign at any time by delivering written notice to the Corporation. Unless the written notice specifies a later effective time, the resignation shall be effective when the notice is delivered to the board of directors, its chair, or the secretary of the Corporation.

#### Section 6.4 **Powers and Duties of Officers.**

A. *Chair.* The chair shall preside at each meeting of the members and of the directors and shall have such powers and duties as usually pertain to the office of chair and shall perform such other duties as may from time to time be assigned to him or her, or specifically required to be performed by him or her, by these bylaws, by the board of directors or by law. [In general, the chair shall consult with and advise the executive director, if any, with respect to the achievement of the mission of the Corporation.] [If there is no executive director, the chair shall assume the duties of the executive director.]

B. *Vice-Chair[s].* In the absence of the chair or in the event of his or her inability or refusal to act, the vice-chair shall perform the duties of the chair, and, when so acting, shall have all the powers of and be subject to all the restrictions upon the chair. If there is more than one vice-chair, the board of directors shall determine which of them shall so perform the duties of the chair under such circumstances. The vice-chair[s] shall perform such other duties and have such

other powers as the board of directors may from time to time prescribe by standing or special resolution, or as the chair may from time to time provide, subject to the powers and the supervision of the board of directors.

C. *Secretary.* The secretary shall be responsible for preparing and maintaining custody of minutes of all meetings of the members and of the board of directors and for authenticating and maintaining the records of the Corporation, and shall give or cause to be given all notices in accordance with these bylaws or as required by law, and, in general, shall perform all duties customary to the office of secretary.

D. *Treasurer.* The treasurer shall have the custody of, and be responsible for, all funds and property of the Corporation. He or she shall keep or cause to be kept complete and accurate accounts of receipts and disbursements of the Corporation, and shall deposit all monies and other valuable property of the Corporation in the name and to the credit of the Corporation in such banks, trust companies or other depositories as the treasurer may designate, subject to approval of the board of directors. Whenever required by the board of directors, the treasurer shall render a statement of accounts. He or she shall at all reasonable times exhibit the books and accounts to any officer or director of the Corporation, and shall perform all duties incident to the office of treasurer, subject to the supervision of the board of directors, and such other duties as shall from time to time be assigned by the board.

## ARTICLE VII

### *Directors' Conflicting Interest Transactions*

Section 7.1 **Conflicts of Interest; Adoption of Policy.** The Corporation shall adopt a conflict of interest policy to assure that any potential "directors' conflicting interest transaction" as that term is defined in Section 33-1127 of the Connecticut Revised Nonstock Corporation Act, or any potential "excess benefit transaction" involving a "disqualified person," (including a director or officer of the Corporation) as those terms are defined in Section 4958 of the Internal Revenue Code, shall only be undertaken after the requisite disclosure, determinations and voting by directors as provided in Sections 33-1129 and 33-1130 of the Connecticut Revised Nonstock Corporation Act and under any relevant regulations of the Internal Revenue Service.

Section 7.2 **Disclosure; Annual Review of Policy.** The conflict of interest policy shall be reviewed by the board at least annually. At the time of their election or appointment, each director or officer of the Corporation may be asked to complete a disclosure statement identifying all related parties of the director or officer who have a conflicting interest with respect to any transaction between such person and the Corporation. These statements shall be kept on file at the Corporation's office. These statements shall be updated annually and any additions or other changes shall be made by the director or officer in writing as they occur.

**ARTICLE VIII**  
***Directors' Duties; Indemnification***

**Section 8.1 Directors' Duties.**

(i) Subject to Sections 33-1104 through 33-1106 of the Act, inclusive, a director shall perform his or her duties as a director, including his or her duties as a member of any committee of the Board upon which he or she may serve:

- A. In good faith;
- B. In a manner which he or she reasonably believes to be in the best interests of the Corporation; and
- C. With such care as an ordinary prudent person in a like position would use under similar circumstances.

(ii) In performing his or her duties, a director shall be entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, in each case prepared by:

- A. One or more officers or employees of the Corporation whom the director reasonably believes to be reliable and competent in the matters presented;
- B. Counsel, public accountants or other persons as to matters which the director reasonably believes to be within such person's professional or expert competence; or
- C. A committee of the Board upon which he or she does not serve, duly designated in accordance with these bylaws, as to matters within its designated authority, which committee the director reasonably believes to merit confidence.

**Section 8.2 Indemnification.** The Corporation shall provide its directors with the full amount of indemnification that the Corporation is permitted to provide pursuant to the Act. In furtherance of the foregoing, the Corporation shall indemnify its directors against liability to any person for any action taken, or any failure to take any action, as a director, except liability that:

- (i) involved a knowing and culpable violation of law by the director;
- (ii) enabled the director or an associate, as defined in Section 33-840 of the Connecticut General Statutes, to receive an improper personal economic gain;
- (iii) showed a lack of good faith and a conscious disregard for the duty of the director to the Corporation under circumstances in which the director was aware that his or her conduct or omission created an unjustifiable risk of serious injury to the Corporation; or
- (iv) constituted a sustained and unexcused pattern of inattention that amounted to an abdication of the director's duty to the Corporation.

The Corporation shall indemnify and advance expenses to each officer, employee or agent of the Corporation who is not a director, or who is a director but is made a party to a proceeding in his or her capacity solely as an officer, employee or agent, to the same extent as the Corporation is required to provide the same to a director, and may indemnify and advance expenses to such persons to the extent permitted by Section 33-1122 of the Act.

Notwithstanding any provision hereof to the contrary, the Corporation shall not indemnify any director, officer, employee or agent against any penalty excise taxes assessed against such person under Section 4958 of the Internal Revenue Code.

**Section 8.3 Determination; Authorization.** In accordance with Section 33-1121 of the Act, any indemnification of directors shall be paid by the Corporation in a specific proceeding only after a determination that the director has met the standards outlined in Section 8.1.

Such determination shall be made:

(i) If there are two or more qualified directors, by the Board by majority vote of all the qualified directors, a majority of whom shall for such purpose constitute a quorum, or by a majority of the members of a committee comprised of two or more qualified directors appointed by such a vote; or

(ii) By special legal counsel (i) selected in a manner prescribed by Section 8.3(A) or (ii) if there are fewer than two qualified directors, selected by the Board, in which selection directors who are not qualified may participate.

Upon a determination that the director is entitled to indemnification, such indemnification shall be authorized by the Board in the same manner as the determination that indemnification is permissible, provided that if there are fewer than two qualified directors, or if the determination is made by special legal counsel, authorization of indemnification shall be made by those entitled to select special legal counsel as provided in Section 8.3(B)(ii).

For purposes of this Section 8.3, the term “qualified director(s)” shall mean a director or directors, not at any time party to the acts or actions which gave rise to the potential indemnification.

## **ARTICLE IX** *Miscellaneous*

**Section 9.1 Fiscal Year.** The fiscal year of the Corporation shall [be the calendar year] [end on [June 30]].

**Section 9.2 Checks, Notes and Contracts.** The board of directors shall determine who shall be authorized from time to time on the Corporation’s behalf to sign checks, drafts, or other orders for payment of money; to sign acceptances, notes, or other evidences of indebtedness; to enter into contracts; or to execute and deliver other documents and instruments.

Section 9.3 **Written Notice or Consent.** Any written notice or consent required hereunder may, without limitation, be issued by regular mail, hand delivery, electronic transmission or facsimile.

Section 9.4 **Books and Records.** The Corporation shall keep at its office correct and complete books and records of the accounts, activities and transactions of the Corporation, the minutes of the proceedings of the members, the board of directors and any committee of the Corporation, and a current list of the members, directors and officers of the Corporation and their business addresses. Any of the books, minutes and records of the Corporation may be in written form or in any other form capable of being converted into written form within a reasonable time.

Section 9.5 **Amendments to Bylaws.** Subject to the notice requirements of Section 4.7, the bylaws of the Corporation may be adopted, amended or repealed in whole or in part by the affirmative vote of a [majority] of the directors present at a meeting of the board of directors at which a quorum is present.

Section 9.6 **References.** Reference in these bylaws to a provision of the Internal Revenue Code is to such provision of the Internal Revenue Code of 1986, as amended, or the corresponding provision(s) of any subsequent federal income tax law. Reference in these bylaws to a provision of the Connecticut Revised Nonstock Corporation Act or any provision of Connecticut law set forth in such statutes is to such provision of the General Statutes of Connecticut, Revision of 1958, as amended, or the corresponding provision(s) of any subsequent Connecticut law.





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**Special Education Cost Model Task Force**  
*Parent Focus Groups*

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**Draft Report**

Submitted to:

John Flanders, Executive Director  
Connecticut Parent Advocacy Center

Submitted by:

Stephen J. Proffitt, Assistant Director for Special Education Programs  
and Instructional Design  
State Education Resource Center

## **Introduction**

### **Organizational background**

The Special Education Cost Model Task Force (the task force) was formed by the Connecticut General Assembly in Public Act 17-2 (June Special Session). The task force is charged with conducting a feasibility study regarding alternative methods for funding special education in Connecticut, and addressing the factors impacting increasing and unpredictable special education costs. The task force has adopted a mission statement as follows: The task force is committed to ensuring that children receive high-quality, appropriate special education services while making special education costs and budgeting more predictable for communities.

### **Project overview**

In support of its charge, the task force contracted with SERC to perform focus groups with parents across the six RESC regions regarding their experiences and concerns related to special education funding and its impact on the special education process.

The purpose of this report is to summarize these parents' experiences and concerns and the impact of special education funding on their children's special education programs. It is intended to provide an understanding of how parents view special education funding processes that may facilitate or hinder how students with disabilities are served.

### **Focus group and statewide survey procedures**

To provide an understanding of parents' experiences and concerns related to special education funding, we collected data through a focus group and statewide survey. A total of five focus groups in English and one in Spanish (simultaneously with one in English at one of the locations) were conducted with parents of students with an Individualized Education Program or a 504 Plan.

Parents representing diverse racial, ethnic, linguistic and socioeconomic backgrounds were invited to participate. The focus groups were conducted in five RESC regions to ensure that parents from urban, suburban and rural areas of the state were all represented. One focus group (LEARN region) was cancelled due to no enrollment for this specific session. All focus groups lasted approximately two hours.

The facilitators for the focus groups were Stephen Proffitt, State Education Resource Center Director for Special Education Programs and Instructional Design, and Nitza M. Diaz, SERC Bilingual Education Consultant. The facilitators provided a brief overview of the task force and its purpose (to explore other special education funding models) and explained that the task force wanted to gain parent input and their perspective on special education funding. Participants were then given a brief introduction of how special education funding in the state currently works.

An online survey with the same focus group questions was disseminated to gain more parental input, with the approval of John Flanders, CPAC executive director and member of the Special Education Cost Model Task Force.

Rather than report separate findings from distinct sources, we present an integrated, thematic summary of common results and considerations from across our focus groups and parent survey.

## **Key Findings**

### **Four dominant themes**

Four major themes emerged from our analysis of the focus groups and the statewide survey:

1. Limited knowledge of special education funding
2. Limited knowledge of the predictability of special education funding
3. Perceived inequities of resources across districts
4. Widespread support for policies that would make special education costs more predictable

### **Knowledge and understanding of special education funding**

- Parents do not have strong knowledge of how special education is funded in their districts. Over 84% of parents responded that their knowledge about special education funding was limited. A full 100% of the Latino parents who participated in the Spanish-speaking focus group said they had no idea how special education was funded.
- Many parents responded that they knew very little about where the money comes from and how much is needed to pay for the services that their child needs.
- Although parents felt that they have little or some knowledge on how special education funding works, 73% believe that costs are taken into account when making special education programming decisions. For example, a parent said that “I know that my district takes cost into account but they would not publicly admit it.”

### **Predictability of special education funding**

- During focus groups, parents spoke about their understanding of their child’s IEP and the special education programming and support options that districts provided. By one account, parents “are not focused on the dollar, but on the child.” They are aware that funding is unpredictable, but they are primarily focused on their children receiving the services they need.
- Parents provided mixed responses about having sufficient funding in school districts to provide appropriate special education services for their children. Fifty-two percent of parents believed funding was sufficient, 36% believed it was not, and 12% replied “don’t know.” A parent who believed that there was sufficient funding suggested the issue was “as much about training as it is funding. You can have all the money in the world, [but] if the teachers aren’t trained in the disabilities, they can’t improve outcomes.”
- Although parents understand that there seem to be funding challenges, they are mostly interested in working with the school to provide the appropriate services for their children. As one parent said, “I just want my child to receive the service he needs. I don’t know about funding, but I do know that my child needs help.”

### **Inequity of resources**

- Parents shared that funding is not equitable across districts based on what they hear from other parents in other communities. Over 80% of parents believed that special education resources are not equitable across districts and even schools. A parent mentioned that “having a special needs child in one town and working in a school system in a different town, I can honestly say they are not equitable! The funding is inadequate! The staff training is minimal! The need for qualified staff is tremendous!”
- During the focus groups, there is a general perception that some districts seem to have more equitable resources in comparison to other districts. For example, a parent said that a “kid in a smaller district might get more services in comparison to a bigger district.” This general perception has caused families to move to smaller-sized districts so that children can get the special education service that parents believe their child needs.
- Over 90% of parents agreed that resources are hard to come by for their children receiving special education services.

### **Policy development**

- Although parents do not fully understand the concept of “predictability of special education funding,” they did want to have policies created that ensure equity of resources and to better understand how funding can help provide better services and supports for their children.
- Even when considering the funding-knowledge question, parents believed that better programs and policies were what they wanted, not necessarily more money.

**Table 1: Parents' Perspectives on Existing Special Education Funding**

**General Knowledge of Special Education Funding**

	<b>A lot</b>	<b>Some</b>	<b>Very little</b>	<b>Not at all</b>
To what extent parents feel they understand how special education is funded in Connecticut	9%	51%	33%	9%

	<b>Agree</b>	<b>Disagree</b>	<b>Don't Know</b>
Cost is taken into account when making decisions	73%	15%	12%

**Special Education Funding Predictability**

	<b>Yes</b>	<b>No</b>	<b>Don't Know</b>
Parents have been told that their school district could not provide a special education service or support because of cost	28%	69%	3%

	<b>Agree</b>	<b>Disagree</b>	<b>Don't Know</b>
There is sufficient funding in school districts for special education services and supports	52%	36%	12%

**Inequity of Resources**

	<b>Agree</b>	<b>Disagree</b>	<b>Don't know</b>
Special education resources are equitable across districts	9%	79%	12%

**Policy Development for Special Education Funding**

	<b>Agree</b>	<b>Disagree</b>	<b>Don't Know</b>
State should create policies to assist districts with making special education costs more predictable	46%	29%	25%



## **Appendix A: Information Provided to Focus Group Participants**

Script for introducing the Focus Group participants:

Welcome! In collaboration with the Connecticut Parent Advocacy Center (CPAC) and the Special Education Cost Model Task Force, Nitza and I from SERC invite you to help us have a better understanding of your experiences and concerns related to special education funding and its impact on the special education process. Your responses will be shared with the Special Education Cost Model Task Force as they continue to examine ways to make special education costs more predictable for school districts.

At no time will your personal information be shared, only the answers that you provide.

Script for inviting parents to participate in the online survey:

Welcome! In collaboration with the Connecticut Parent Advocacy Center (CPAC) and the Special Education Cost Model Task Force, the State Education Resource Center (SERC) invites you to complete this survey, which will help us better understand your experiences and concerns related to special education funding and its impact on the special education process. Your input will be shared with the Special Education Cost Model Task Force as it continues to examine ways to make special education costs more predictable for school districts.

At no time will your personal information be shared.

## Appendix B Parent Demographics

Total Number of Parents	Towns Represented <sup>1</sup>	Ages/Grades of their children
55	Bridgeport, Columbia, Enfield, Hamden, Hartford, Harwinton, New Haven, North Haven, Norwalk, Plainfield, Plymouth, Torrington, Trumbull, Vernon, Watertown, West Hartford	Elementary, Middle and High School  Ages: 6-17

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<sup>1</sup> See RESC Region Map in Appendix D for towns served

## **Appendix C: Focus Group and Statewide Survey Questions**

### **Focus Group Questions**

1. **Please note: Question 1 is an ICEBREAKER Question only.** Tell us what you know about special education as it relates to your child's Individualized Education Program (IEP).
2. To what extent do you feel that you understand how special education is funded in Connecticut?
3. Do you feel that your child's school takes cost for special education services into account when making decisions about your child's special education program and IEP?
4. Do you feel that there is sufficient funding in your district to provide appropriate services to support your child's needs?
5. Have you ever been told that your child could not be provided a special education service or support because of the cost?
6. Do you believe that special education resources are equitable across districts in Connecticut?
7. Do you believe that the state of Connecticut should create policies to assist districts with making special education costs more predictable and equitable?
8. Is there anything else that you would like to tell us that we did not address in the previous questions?

## **Statewide Survey Questions**

1. To what extent do you feel that you understand how special education is funded in Connecticut?
  - a. A lot of understanding
  - b. Some understanding
  - c. Very little understanding
  - d. Not at all
2. My child's school takes cost for services into account when making decisions about my child's special education program
  - a. Agree
  - b. Disagree
  - c. Don't know
3. In my district, I have been told that my child could not be provided a special education service or support because of the cost
  - a. Yes
  - b. No
  - c. Don't know
4. I believe that there is sufficient funding in my district to provide appropriate services and supports for my child
  - a. Agree
  - b. Disagree
  - c. Don't know
5. I believe that special education resources are equitable across districts in Connecticut
  - a. Agree
  - b. Disagree
  - c. Don't know
6. I believe that the state of Connecticut should create policies to assist districts with making special education costs more predictable
  - a. Agree
  - b. Disagree
  - c. Don't know
7. Is there anything else that you would like to tell us that we did not address in the previous questions?

## Appendix D: Locations, Date and Time of Focus Groups

Location (Based on 5 RESC regions)	Date	Time
<b>ACES</b> 205 Skiff Street Hamden, CT 06517	October 25, 2018	9:30 a.m.-11:30 a.m.
<b>CES</b> 40 Lindeman Drive Trumbull, CT 06611	October 24, 2018	6:00 p.m.-8:00 p.m.
<b>CREC</b> 55 Van Dyke Avenue Hartford, CT 06106	October 29, 2018	9:30 a.m.-11:30 a.m.
<b>EASTCONN</b> 376 Hartford Turnpike Hampton, CT 06247	November 9, 2018	9:30 a.m.-11:30 a.m.
<b>EdAdvance</b> 355 Goshen Road Litchfield, CT 06759	October 26, 2018	9:30 a.m.-11:30 a.m.
<b>LEARN</b> 44 Hatchetts Hill Road Old Lyme, CT 06371	November 5, 2018 Cancelled; no registrations	9:30 a.m.-11:30 a.m.





# THE COST OF MOVING CONNECTICUT TO A 100% SPECIAL EDUCATION REIMBURSEMENT SYSTEM

Michael Griffith, Education Commission of the States

## Introduction

Connecticut's **Special Education Cost Model Task Force** has been reviewing how the state could improve its K-12 special education funding system. One option being considered is moving to a fully reimbursable system, similar to the system used in Wyoming. Wyoming is the only state in the country that fully reimburses districts for their special education expenditures. Task force members asked Education Commission of the States to determine the fiscal impact to the state if Connecticut transitioned to a model similar to the Wyoming model and fully reimbursed all school districts in the state for their special education expenditures.

## Connecticut's Current Funding System

The Special Education Excess Cost program is the only separate source of funding for special education students in Connecticut (CGS § 10-76g). The Excess Cost program provides funding to districts when special education expenditures for an individual student exceed "4.5 times a district's average per pupil expenditure for the preceding year, in the case of a resident student, and 100% of that expenditure in the case of a state-agency-placed child with no identifiable home school district." (**Judith Lohman, Office of Legislative Research. 2007**). This program received \$140.6 million in the **FY 2018-19 state budget**.

## The Wyoming Funding System

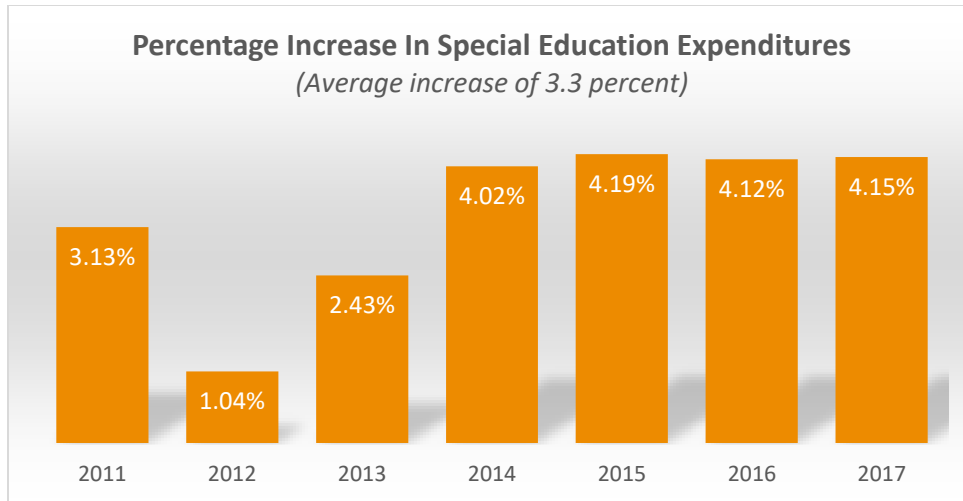
In 1997 the Wyoming State Supreme Court ruled that almost all aspects of the state's school finance system, including its special education funding program, were unconstitutionally underfunded (*Campbell v. Wyoming*). To comply with the court's ruling, Wyoming adopted a special education funding system for the 1998-99 school year that provided school districts in the state with an amount "equal to one hundred percent (100%) of the amount actually expended by the district during the previous school year for special education programs and services" (*Wyoming Statutes: 21-13-321*). According to a **report by the Education Commission of the States**, Wyoming has the most generous special education funding system in the country. In 2018, Wyoming amended the state code to cap their total special education expenditures for fiscal years 2019-20 and 2020-21 at 2018-19 funding levels. This was done in an attempt to reduce education costs to deal in response to a state budget deficit.



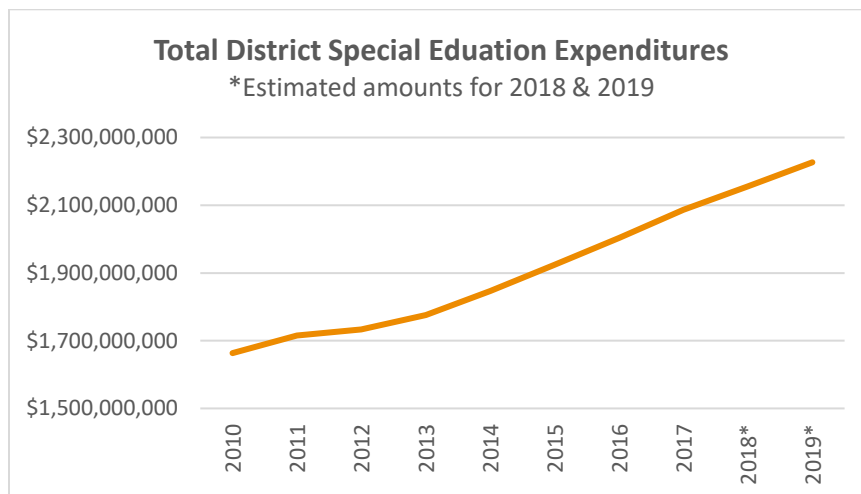


### Connecticut's Cost

To determine Connecticut's financial impact if it moved to a fully reimbursable special education funding system, Education Commission of the States reviewed school district special education expenditure data from FY 2009-10 to FY 2016-17 (the most recent data available). The review found that – during this time – school district special education expenditures increased by an average annual rate of 3.3 percent.



If we assume that school district special education expenditures would continue to increase at this average annual rate over the next two years, then we can estimate that special education expenditures would total approximately \$2.23 billion in the 2018-19 fiscal year.





The state currently spends \$140.6 million on its special education students through its Special Education Excess Cost program. This number represents the state share of special education funding, and does not include the amount covered by the districts. Additionally, the \$140.6 million allocation does not fully cover excess costs as defined in statute, but is the capped grant amount. If the state adopted a program that fully reimbursed districts for their special education expenditures, the state would have to increase special education funding by an additional \$2.086 billion – equating to a 1,484 percent increase – in the 2018-19 school year. To be more affordable, Connecticut could phase this program in over a period of several years. The following table shows the estimated costs of phasing in this program over a five-year period:

### Phasing-In a Special Education Total Reimbursement Program Over Five Years

Fiscal Year	Estimated Additional Special Education Cost*	Percentage Phase-In	Annual Additional Cost of Phasing-In the Program
2018-19	\$2.086 billion	20%	\$417.2 million
2019-20	\$2.16 billion	40%	\$863.9 million
2020-21	\$2.236 billion	60%	\$1.341 billion
2021-22	\$2.314 billion	80%	\$1.851 billion
2022-23	\$2.395 billion	100%	\$2.395 billion

\*Subtracts out the state’s current expenditures for the Special Education Excess Cost program.

### Meeting Federal Mandate

For states to receive federal Individuals with Disabilities Education Act (IDEA) funding, they must maintain their financial commitment to special education funding. A state may only reduce its special education funding from one year to the next if it can prove to the United States Department of Education that it is experiencing an **exceptional or uncontrollable circumstance**. This is important because the state must ensure that any increased funding commitment to special education is sustainable over a period of years. This means that if Connecticut were to increase special education funding, it must maintain the same or higher funding level in perpetuity. If Connecticut could not maintain increased special education funding in the future, their federal IDEA funding would be at risk.

For any questions about this report please contact Michael Griffith at [mgriffith@ecs.org](mailto:mgriffith@ecs.org).

## Appendix VII: Statutory Language

Public Act 17-2 (June Special Session) creates the Special Education Cost Model Task Force,<sup>16</sup> so titled in the bill summary by the Office of Legislative Research.<sup>17</sup> The language concerning the task force is quoted below.

“Sec. 70. (Effective from passage)

(a) For the purposes of this section, "special education predictable cost cooperative" means a special education funding model that (1) aggregates special education costs at the state level to compensate for volatility at the local level by (A) providing predictability to local and regional boards of education for special education costs, (B) maintaining current state funding for special education services, (C) differentiating funding based on student learning needs, (D) equitably distributing special education funding, (E) providing boards of education with flexibility and encouraging innovation, and (F) limiting local financial responsibility for students with extraordinary needs, (2) is funded by: (A) A community contribution from each school district, calculated based on the number of special education students enrolled in the school district and the school district's previous special education costs, with each town paying the community contribution of its resident students, reduced by an equity adjustment based on the town's ability to pay, and (B) the state contribution, which is a reallocation of the special education portion of the equalization aid grant and the excess cost grant, (3) provides all school districts with some state support for special education services, (4) ensures that a school district's community contribution will be lower than the actual per pupil special education cost of the school district, and (5) reimburses school districts for one hundred per cent of their actual special education costs for a fiscal year.

(b) There is established a task force to conduct a feasibility study regarding alternative methods for funding special education in the state, and addressing the factors impacting the increasing cost and predictability of special education services. Such feasibility study shall examine a special education predictable cost cooperative model and other alternative models for funding special education that are used in other states and shall include, but need not be limited to, the following:

(1) An actuarial analysis of such special education predictable cost cooperative model and alternative models;

(2) An explanation and demonstration of how (A) towns would contribute to such special education predictable cost cooperative model or alternative model, (B) towns

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<sup>16</sup> Conn. Acts 17-2 § 70 (June Special Session).

<sup>17</sup> Connecticut General Assembly, Office of Legislative Research. (2017). *OLR Bill Analysis, SB01502: An Act Concerning the State Budget for the Biennium Ending June 30, 2019, Making Appropriations Therefor, Authorizing and Adjusting Bonds of the State and Implementing Provisions of the Budget*. Hartford, CT: Author. Retrieved from <https://www.cga.ct.gov/2017/BA/2017SB-01502-R00SS1-BA.htm>.

would be compensated for special education costs under such special education cost cooperative model or alternative model, and (C) a town's compensation under such special education predictable cost cooperative model or alternative model would affect its required contribution in the subsequent fiscal year;

(3) A consideration and analysis of the possible legal status of the special education predictable cost cooperative model and alternative models, including, but not limited to, an independent state agency, a quasi-public agency, within an existing state agency a not-for-profit organization that is exempt from taxation under Section 501(c)(3) of the Internal Revenue Code of 1986, or any subsequent corresponding internal revenue code of the United States, as amended from time to time, or a private entity;

(4) A consideration of the potential governance structure of such special education predictable cost cooperative model or alternative models, that may include (A) the process for nominating and selecting members of the board of directors and the executive administrator for such special education cost cooperative model or alternative model, (B) the number and composition of the members on the board of directors, (C) the qualifications for an executive administrator, who would be responsible for providing operational, financial and strategic support to such special education predictable cost cooperative model or alternative model, and (D) the accountability of the board of directors and executive administrator to the towns participating in such special education cost cooperative model or alternative model, including procedures for towns or boards of education to bring complaints or issues before the board of directors;

(5) A consideration of (A) the number of staff necessary to administer such special education predictable cost cooperative model or alternative model, (B) the costs associated with the hiring and employment of such staff, and (C) the funding source for hiring and employing such staff;

(6) An analysis of different models and sources for funding the required initial capital investment for such special education predictable cost cooperative model or alternative model, including the impact on state special education funding if fifty million dollars of state funds is used for such initial capital investment;

(7) A description of (A) a timeline for implementation of such special education predictable cost cooperative model or alternative model, (B) key dependencies and prerequisites for such implementation, such as the total number of towns voluntarily participating in such special education predictable cost cooperative model or alternative model needed for such special education predictable cost cooperative model or alternative model to function properly or whether participation in such special education predictable cost cooperative model or alternative model should be mandatory, and (C) contingency plans for any foreseeable problems arising from the implementation of such special education predictable cost cooperative model or alternative model; and

(8) An identification and analysis of state and federal law that would be involved in the creation and administration of such special education predictable cost cooperative model or alternative model, including (A) whether the Individuals With Disabilities Education Act, 20 USC 1400, et seq., as amended from time to time, permits a state to establish such special education predictable cost cooperative model or alternative model, (B) a framework for complying with regulatory requirements, such as underwriting services, legal counsel, actuarial services, investment management, accounting and auditing services, and maintenance of effort requirements prescribed by federal law, and (C) the accountability of such special education predictable cost cooperative model or alternative model to the General Assembly.

(c) The task force shall consist of the following members:

- (1) A representative of the Connecticut Association of School Business Officials;
- (2) A representative of the Connecticut Association of Public School Superintendents;
- (3) A representative of the Connecticut Council of Administrators of Special Education;
- (4) A representative of the Connecticut Association of Boards of Education;
- (5) A representative of the Connecticut Captive Insurance Association;
- (6) A representative of the Connecticut Association of Schools;
- (7) A representative of the Connecticut Parent Advocacy Center;
- (8) A representative of the Connecticut Conference of Municipalities;
- (9) A representative of the RESC Alliance;
- (10) A faculty member from the UConn Actuarial Science Program at The University of Connecticut;
- (11) The Commissioner of Education, or the commissioner's designee; and
- (12) The Secretary of the Office of Policy and Management, or the secretary's designee.

(d) The first meeting of the task force shall be held not later than thirty days after the effective date of this section. The chairperson of the task force shall be elected from among the members at the first meeting of the task force.

(e) In conducting such feasibility study, the task force shall not cause any state agency to incur costs of more than one thousand dollars, exclusive of any costs

associated with reimbursing any staff person of such state agency for mileage expenses. The task force may also receive funds from any not-for-profit organization that is exempt from taxation under Section 501(c)(3) of the Internal Revenue Code of 1986, or any subsequent corresponding internal revenue code of the United States, as amended from time to time, or accept pro bono services from any public or private entity to conduct such feasibility study. The Office of Legislative Management shall assist the task force in administering any funds or services received or sought by the task force pursuant to this section.

(f) Not later than January 1, 2019, the task force shall submit such feasibility study and any recommendations for legislation to the joint standing committees of the General Assembly having cognizance of matters relating to education and appropriations and the budgets of state agencies, in accordance with the provisions of section 11-4a of the general statutes. The task force shall terminate on January 1, 2019.”<sup>18</sup>

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<sup>18</sup> Conn. Acts 17-2 § 70 (June Special Session).



## **Appendix VIII: Disclosure**

At the request of the Office of Governor Dannel P. Malloy and the chair of the task force, the Connecticut School Finance Project provided in-kind staff support to the task force, including staffing task force meetings, drafting reports and other documents, taking minutes, and performing other administrative tasks. The Connecticut School Finance Project, through its fiscal sponsor, Third Sector New England, Inc./TSNE MissionWorks (TSNE), also provided the task force with funding to carry out its legislative charge. TSNE provided to \$150,000 to the Capital Region Education Center (CREC) for the administration of the request for proposals process and disbursement to selected vendors proposals on behalf of the task force. These funds were administered through memoranda of understanding with the Office of Legislative Management, which can be found in Appendix IX. TSNE provided \$15,000 to the Connecticut Parent Advocacy Center (CPAC) for the administration of the request for proposals process and disbursement to selected vendors proposals on behalf of the task force. TSNE provided \$12,000 to the University of Connecticut's Goldenson Center for Actuarial Research to build the "excess cost" actuarial model, a continuation of their prior work, at the request of the task force. Of the \$150,000 originally provided to CREC, \$5,000 was unexpended and returned to TSNE. In addition, The final amount of funding expended by TSNE on task force was \$172,000. As noted above, the Connecticut School Finance Project played no role in selecting the vendors who performed the feasibility studies or did any work on behalf of the task force.

## **Appendix IX: Memoranda of Understanding**

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**MEMORANDUM OF UNDERSTANDING  
BETWEEN  
THE CAPITOL REGION EDUCATION COUNCIL,  
THE CONNECTICUT GENERAL ASSEMBLY,  
AND THIRD SECTOR NEW ENGLAND, INC.**

This Memorandum of Understanding (the "MOU") is entered into by Capitol Region Education Council ("CREC"), a regional education service center; the Connecticut General Assembly (the "CGA"), and Third Sector New England, Inc. (the "TSNE") regarding a transfer of funds from TSNE to CREC to enter into a Personal Services Agreement (the "PSA") with a contractor to assist the Special Education Cost Model Task Force ("Task Force").

**WHEREAS**, in accordance with Sec. 70 of P.A. 17-2, June Special Session, the CGA established the Task Force to conduct a feasibility study regarding alternative methods for funding special education in the State of Connecticut and addressing the factors impacting the increasing cost and predictability of special education services ("Feasibility Study");

**WHEREAS**, in accordance with Sec. 70 of P.A. 17-2, June Special Session, the Regional Education Service Center Alliance, of which CREC is a part, is a member of the Task Force;

**WHEREAS**, pursuant to Connecticut General Statutes §§ 10-66a and 10-66c regional education service centers are established by the State Board of Education for the purpose of cooperative action to furnish programs and services to boards of education and are a public educational authority acting on behalf of the state of Connecticut;

**WHEREAS**, pursuant to Sec. 70 of P.A. 17-2, June Special Session, the TSNE wants to provide the Task Force with \$150,000 to assist with conducting the Feasibility Study and seeking related legal advice and understands that the Office of Legislative Management ("OLM") shall assist the Task Force in administering such funds;

**WHEREAS**, CREC offered to assist CGA and Task Force in the issuing of Requests for Proposals to assist the Task Force in conducting the Feasibility Study and seeking related legal advice; and

**WHEREAS**, CREC, CGA and TSNE agreed that CREC shall act as the fiduciary agent and will provide administrative assistance to the Task Force and shall administer two Requests for Proposals ("RFPs"): an RFP to conduct the Feasibility Study and an RFP seeking related legal advice and as a result of such RFPs, shall enter into a PSA with each of the contractors selected by the Task Force in an amount not to exceed an aggregate \$150,000, including all CREC administrative costs.

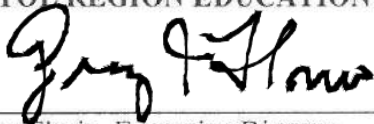
**THEREFORE**, the parties mutually agree as follows:

1. Funding in the amount of \$150,000.00 (hereinafter the "Funds") will be transferred from TSNE to CREC upon receipt of an invoice prepared by CREC upon final execution of this MOU.
2. The Funds will be used by CREC to pay the contractors selected by the Task Force under the terms of the PSA to conduct the Feasibility Study, for related legal advice related to the Feasibility Study, and to cover all CREC administrative costs.

3. The chairperson of the Task Force shall review and approve all requisitions for payment from the contractor and forward approved requisitions to CREC in a timely fashion to process for payment.
4. CREC shall provide to CGA and TSNE a copy of the executed PSAs with the selected contractors, copies of the contractors' progress reports, and a copy of the contractors' final reports to the Task Force related to the Feasibility Study and for related legal advice.
5. The term of this MOU shall be upon execution to August 31, 2019.
6. The prior memorandum of understanding executed on August 7<sup>th</sup>, 2018 between CGA and TSNE is hereby terminated in its entirety and superseded by this MOU.
7. CREC agrees to provide an accounting of all expenditures of the Funds to CGA, TSNE and the Task Force.

**ACCEPTANCE AND APPROVALS**

**CAPITOL REGION EDUCATION COUNCIL**

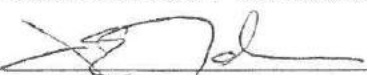


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Gregory Florio, Executive Director

10/23/2018

Date

**CONNECTICUT GENERAL ASSEMBLY**




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James E. Tamburro, Executive Director

10/10/18

Date

**THIRD SECTOR NEW ENGLAND, INC.**



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Elaine Ng, Chief Executive Officer

10/09/2018

Date

## SPONSORED RESEARCH AGREEMENT

**THIS AGREEMENT**, entered into and effective this 6th day of November, 2018 between The University of Connecticut having principal offices at 438 Whitney Rd Ext. Unit 1133, Storrs, Connecticut 06269, hereinafter referred to as the "University" and CT School Finance Project/TSNE MissionWorks having principal offices at 89 South Street, Suite 700, Boston, MA 02111 hereinafter referred to as the "Sponsor."

**WHEREAS**, each party desires to enter into this Agreement for the benefits reasonably expected to be gained therefrom, and

**WHEREAS**, the University is authorized to enter into this Agreement under Section 10a-104, 10a-108, and 10a-110 to 10a-110g of the General Statutes of the State of Connecticut, as amended to date,

**NOW THEREFORE**, the parties mutually agree as follows:

1. **STATEMENT OF WORK.** The Sponsor hereby engages the University to utilize reasonable efforts to carry out a program entitled, "High Cost Special Education Cost Cooperative Model" ("Project"), as detailed in Exhibit A.
2. **PRINCIPAL INVESTIGATOR.** The research will be supervised by Jeyaraj Vadiveloo, PhD ("PI").
3. **DURATION OF AGREEMENT.** The term of this Agreement shall be from October 1, 2018 through December 31, 2018, unless terminated as provided herein or extended by mutual agreement.
4. **COMPENSATION.**
  - 4.1. The total cost to the Sponsor for all direct and indirect costs incurred in the performance of this Agreement shall not exceed \$12,000, unless modified in accordance with Article 13, herein.
  - 4.2. The University must receive advance payment of at least one quarterly payment prior to commencement of work.
  - 4.3. The payment terms shall be as follows:

This is a fixed price agreement. Upon execution of this Agreement, the University will submit an invoice for full payment due within thirty (30) days from receipt of the invoice. No financial reporting of expenditures is required.
  - 4.4. University will submit invoices to Connecticut School Finance Project's attention at Concur Capture (invoicing system) by emailing them to [TSNE\\_InvoiceCapture@concur solutions.com](mailto:TSNE_InvoiceCapture@concur solutions.com). Further details on Concur Capture and invoicing practices may be found in the attached information sheet.
  - 4.5. Sponsor shall make payment to the Director, Sponsored Program Services, Office of the Vice President for Research, 438 Whitney Road Extension, Unit 1133, University of Connecticut, Storrs, CT 06269-1133.
  - 4.6. University may transfer funds within the budget as needed at the discretion of the Principal Investigator without Sponsor's prior approval as long as the scope of work under the Research Project remains unchanged.
5. **OWNERSHIP OF EQUIPMENT.** Unless the funding for the Project does not permit it, all equipment purchased or constructed for use in connection with the work under this Agreement, shall be the property of the University. In the event equipment may be purchased or constructed, the University shall first provide the Sponsor with notice of its intent to do so and shall not proceed until approved by Sponsor
6. **TERMINATION.** This Agreement may be terminated by either party hereto by giving written notice to the

other party sixty (60) days in advance of the specified date of termination. In the case of termination, the University shall be reimbursed for all uncancelable commitments made prior to the effective date of such termination.

**7. INTELLECTUAL PROPERTY.**

- A. **OWNERSHIP OF INTELLECTUAL PROPERTY.** Inventorship shall be determined according to United States patent law. Inventions made during the performance of the Project solely by inventors or authors who are University employees will be owned by University ("University IP"). Inventions made during the performance of the Project solely by inventors or authors who are Sponsor's employees will be owned by Sponsor ("Sponsor IP"). Inventions made during the performance of the Project jointly by inventors who are University's employees and Sponsor's employees will be owned jointly by University and Sponsor ("Joint IP").
- B. **DISCLOSURE OF INVENTIONS.** University will promptly provide Sponsor a copy of any invention disclosure submitted to it by the PI.
- C. **NON-EXCLUSIVE RESEARCH LICENSE.** University grants Sponsor a non-exclusive license to use the results of the Project, including Inventions, for research purposes.
- D. **PATENT FILINGS.** Sponsor may request that University to file a patent application covering University IP or Joint IP, provided Sponsor agrees to reimburse University for all patent costs. Sponsor has the right to review all filings and office actions related to these patent applications.
- E. **OPTION TO EXCLUSIVE LICENSE.** University grants Sponsor an option to an exclusive license to any University IP or Joint IP. Sponsor must exercise the option in writing to University within three (3) months after the University discloses the Invention to Sponsor. The license shall require Sponsor to (1) use commercially reasonable efforts to introduce products utilizing the licensed technology and (2) pay a reasonable royalty to University, and (3) pay for patent costs, as set forth in 7(D). The license will contain other commercially standard terms and conditions. If, after good faith negotiations, a license has not been negotiated, or if the Sponsor decides to forgo the option, University shall be free to offer commercial license rights to any third party or to dispose of University or Joint Inventions as it deems appropriate.
- F. **UNIVERSITY'S RESEARCH AND TEACHING.** University will have the right to practice the Inventions that result from the Project for teaching and research purposes.
- G. **SOFTWARE AND COPYRIGHT.** The copyright and all other rights in any software (if applicable) created in the course of the Project solely by University shall be owned by University. University grants Sponsor an option to license the software for commercial purposes subject to the negotiation of a commercially reasonable license. University also hereby grants Sponsor a perpetual, worldwide, non-exclusive license to the software, without the right to sublicense, for Sponsor's internal non-commercial purposes.

- 8. **PUBLICATIONS.** The University is committed to publishing research results and ensuring that students can complete their academic requirements, including presenting their research. University also acknowledges that the Sponsor may share proprietary information to conduct the Project and the intellectual property protection may be jeopardized in certain circumstances. Accordingly, University may publish and present the Project results, provided that the Sponsor will have thirty (30) days to review each proposed publication or presentation to identify patentable subject matter and to prevent any inadvertent disclosure of the Sponsor's proprietary information. If no response is provided by Sponsor at the end of the specified period, the University may proceed with publication. If necessary to permit the preparation and filing of U.S. patent applications, the Principal Investigator may agree to an additional review period not to exceed sixty (60) days. Any further extension will require subsequent agreement between the Sponsor and University. Additionally, and if academically appropriate, University shall credit Sponsor and the role it played in the



Project in all publications.

9. **RIGHTS IN DATA.** Provided it does not include any Sponsor Confidential Information and subject to the prior written agreement of Sponsor and University, University shall have the right to copyright, publish, disclose, disseminate and use, in whole and in part, any data and information received or developed under this Agreement. Sponsor shall also have the right to duplicate and use for its internal non-commercial purposes the technical reports and information specified to be delivered hereunder.
10. **CONFIDENTIAL INFORMATION.** The parties may wish to disclose confidential information to each other in connection with work contemplated by this Agreement ("Confidential Information"). The parties shall not disclose to third parties or the public any information marked "Confidential" received from the other party under this Agreement, without the consent of the disclosing party. Each party will use reasonable efforts to prevent the disclosure of the other party's Confidential Information to third parties for a period of three (3) years after the termination of this Agreement, provided that the recipient party's obligation shall not apply to information that:
  - i. is not disclosed in writing or reduced to writing and marked with an appropriate confidentiality legend within thirty (30) days after disclosure;
  - ii. is already in the recipient party's possession at the time of disclosure;
  - iii. is or later becomes part of the public domain through no fault of the recipient party;
  - iv. is received from a third party having no obligations of confidentiality to the disclosing party;
  - v. is independently developed by the recipient party; or
  - vi. is required by law or regulation to be disclosed.

In the event that information is required to be disclosed pursuant to subsection (vi), the party required to make disclosure shall notify the other to allow that party to assert whatever exclusions or exemptions may be available to it under such law or regulation.

11. **USE OF NAMES.** Neither party shall use the name of the other or any member of others staff in sales promotion, advertising, or in any other form of publicity without obtaining prior written approval of the other party.
12. **EXPORT CONTROL.** In performing their respective obligations under this Agreement, the Parties will comply with United States export control and asset control laws, regulations, applicable to the export or re-export of goods or services, including software, processes, or technical data ("Items"). Such regulations include without limitation the Export Administration Regulations ("EAR"), International Traffic in Arms Regulations ("ITAR"), and regulations and orders administered by the Treasury Department's Office of Foreign Assets Control (collectively, "Export Control Laws"). If the Sponsor intends to disclose export-controlled technical information to the University, the Sponsor will notify the University prior to such disclosure and identify the controlled data. Sponsor will not disclose such information until the University notifies the Sponsor that it has implemented a technology control plan to manage the information.
13. **MODIFICATIONS.** The Sponsor and the University agree that this Agreement may be modified or changed by mutual consent. Such modification or changes shall be in writing and shall be signed by the original signatories or their successors.
14. **RELATIONSHIP OF THE PARTIES.** This Agreement is made with each party as an independent party and not as an employee of the other party. Each party shall be solely liable for any claims, actions, demands or damages arising out of its performance of this Agreement.
15. **RIGHTS OF THIRD PARTIES.** The Sponsor accepts that this Agreement will not limit the freedom of researchers who are, or are not, participants in this Agreement from engaging in research within the same field

that is covered by this Agreement. Further, the Sponsor accepts that all rights specified herein are subject to rights of other sponsors specified in separate respective agreements.

16. **LIMITS OF LIABILITY.** The University makes no warranties, express or implied, as to any matter whatsoever including, without limitation, the condition of the research or any invention(s) or product(s), whether tangible or intangible, conceived, discovered, and/or developed under this Agreement; or the ownership, merchantability, or fitness for a particular purpose of the research or any such invention or product. Unless caused by the gross negligence or willful misconduct of the University, it shall not be liable for any direct, consequential, or other damages suffered by Sponsor or any licensee or any others resulting from the use of the research or any such invention or product.
17. **CLAIMS AGAINST THE UNIVERSITY.** In the event of loss resulting from acts of omission or commission by University employees in connection with this Agreement, the Sponsor or any third party shall have recourse through the Connecticut Claims Commission as provided under Chapter 53 of the Statutes of the State of Connecticut in which all claims against the State of Connecticut and The University of Connecticut shall be filed with the State of Connecticut Claims Commissioner.
18. **NONDISCRIMINATION.** To the extent applicable under Connecticut law, the parties will comply with Section 4a-60 of the Connecticut General Statutes which prevent discrimination against employees on the grounds of race, color, religion, age, marital status, national origin, sex, mental retardation, physical disability, or sexual orientation.
19. **ASSIGNMENT.** This Agreement shall not be assignable by either party without prior written consent of the other party.
20. **GOVERNING LAW.** This Agreement shall be governed by and construed in accordance with the laws of the State of Connecticut, including all applicable regulations and executive orders. This Agreement constitutes the entire understanding between the parties. No other terms and conditions, be they consistent, inconsistent, or additional to those contained herein, shall be binding upon either party to this Agreement unless and until such terms and conditions shall have been specifically accepted in writing by both parties.

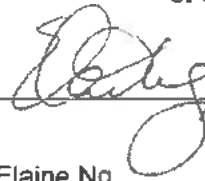
IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their duly authorized officers as of the dates indicated below.

UNIVERSITY

SPONSOR



Signature



Laura Kozma

Typed Name

Elaine Ng

Executive Director

Title

Chief Executive Officer

11/13/18

Date

11/06/2018

## Exhibit A

### High Cost Special Education Cost Cooperative Model

#### Project Scope

The Connecticut School Finance Organization has engaged the Goldenson Center to develop an excess cost funding model for special education in Connecticut. Excess costs for a special education student are defined as costs that exceed a given threshold. The threshold is some multiple of average education costs that varies at the school district level. Currently, costs up to the threshold level are borne by the school district while the costs in excess of this threshold are borne by the state up to a certain percentage based on the state budget for excess costs.

The Goldenson Center funding model will incorporate the following features:

- The determination of an annual contribution at the start of the school year which will be paid by each school district
- An experience adjustment to this annual contribution to recognize the prior year's actual-to-expected excess cost contributions by each school district as well as variations in each school district's economic level (equity adjustment)
- The annual state budget for excess costs

The Cooperative fund at the start of the year which will comprise the school district contributions and the state budget for excess costs will be sufficient to cover the following:

- All special education costs by students who are classified as excess cost students which include costs up to the threshold level and exceeding the threshold level
- Maintain a reserve fund at a pre-specified level to cover periods of bad experience in special education excess costs.
- Incorporate a dividend component that will be proportionately refunded to each school district when actual aggregate excess costs plus any contributions to the reserve fund fall below the Cooperative funding levels.

The model will be back-tested for consistency and reasonableness using actual historical excess cost information provided by the Connecticut Department of Education.

## Attention Invoice Vendor

Effective immediately, please begin to submit invoices to the following options below for processing.

**Please submit invoices one attachment at a time for a faster turnaround.** If you would prefer to submit multiple invoices in an e-mail, we encourage you to utilize the barcode document separator sheet to help our processing team prep the batches accurately. This is especially useful for a batch of invoices with back up documents/pages.



## Submission options

Email: [TSNE InvoiceCapture@concur solutions.com](mailto:TSNE InvoiceCapture@concur solutions.com)

Mail: TSNE MissionWorks  
c/o Concur Invoice Capture  
10700 Prairie Lakes Drive  
Eden Prairie, MN 55344

**Email (Recommended/Fastest Turnaround)** You will get an email confirmation when the invoice has been received. **The subject line should contain the Invoice Number and or Vendor Name.**

### Specifications on electronic Invoice documents:

- We support most common file types, examples include: .tif/.tiff; .jpeg/.jpg; .png; .pdf (with XFA; with embedded fonts); .doc/.docx; .xls/.xlsx; .eml (file saved using MS Outlook); winmail.dat; .csv
- One Invoice per Attachment
- One Attachment per e-mail
- For multiple attachments, insert a barcode document separator sheet (*see attached pdf*)
- Legible images with high contrast
- Non-US currency should have currency code printed on the invoice
- *File must not exceed 10 MB*
- Security Method: No Security
- No Zip files
- No inline images or links to offline invoices – invoice must be attached.

**Mail (Slowest Turnaround).** Invoices should be plain paper and **black** ink. Avoid staples, paper clips and other binders. Clearly indicate which company the invoice is being billed to. Print the e-mail address provided above on the invoice or cover page as reference.

### What NOT to send:

- Statements (*optional*)
- Past Dues (*optional*)
- Examples of File types that are not supported: Compressed & Media files
- Duplicate Invoices
- Invoice with more than 30 back up pages. *Only a max of 30 pages will be scanned.* Work or Purchase orders (*unless relating to an invoice submitted at the same time*)
- Estimates (*unless relating to an invoice submitted at the same time*)
- Invoices with recycled invoice numbers – please use an original invoice number
- Communication must be sent directly to client

**AGREEMENT  
BY AND BETWEEN  
THIRD SECTOR NEW ENGLAND, INC.  
AND  
CONNECTICUT PARENT ADVOCACY CENTER**

This agreement (the "Agreement") dated August 15, 2018 is entered into by Third Sector New England, Inc. ("TSNE MissionWorks"), a Massachusetts corporation having its principal place of business at The NonProfit Center, 89 South Street, Suite 700, Boston, Massachusetts 02111 on behalf of itself and Connecticut School Finance Project (collectively referred to herein as "TSNE MissionWorks") and Connecticut Parent Advocacy Center, located at 338 Main Street, Niantic, CT 06357 ("Consultant"). Each of TSNE MissionWorks and Consultant are sometimes referred to in this Agreement as a "Party" and collectively as the "Parties."

Whereas, TSNE MissionWorks desires to engage Consultant to provide certain services as set forth herein to its fiscally sponsored program, Connecticut School Finance Project;

Therefore, the Parties agree as follows:

**ARTICLE 1. ENGAGEMENT OF CONSULTANT**

TSNE MissionWorks hereby agrees to engage Consultant and Consultant agrees to perform the Services set forth in Article 4 of this Agreement. Consultant shall comply with all rules provided by TSNE MissionWorks with regard to access to and use of TSNE MissionWorks's property, information, equipment, and facilities in connection with his/her performance of the Services.

**ARTICLE 2. INDEPENDENT CONTRACTOR RELATIONSHIP**

It is the express intention of the Parties that Consultant is an independent contractor. Nothing in this Agreement shall in any way be construed to constitute Consultant as an agent, employee, or representative of TSNE MissionWorks, or to create any relationship of an agent, servant, employee, partnership, joint venture, or association among the Parties or their affiliates. Consultant acknowledges and agrees that Consultant is obligated to report as income all compensation received by Consultant pursuant to this Agreement, and Consultant acknowledges and agrees that Consultant is obligated to pay all self-employment and other taxes thereon. TSNE MissionWorks and Consultant are to exercise their own discretion on the method and manner of performing their respective obligations pursuant to this Agreement.

Consultant shall be solely responsible for payment of any and all taxes (including state, federal, or local); worker's compensation insurance; FICA, FUTA, disability payments; social security payments; unemployment insurance payments; insurance; or any similar type of payment in connection with the performance by Consultant or any employee thereof of the Services. Consultant shall hold TSNE MissionWorks harmless from any and all claims for such payments.

**ARTICLE 3. PERIOD OF PERFORMANCE**

This Agreement shall be in effect as of August 15, 2018 and shall terminate on December 31, 2018 unless terminated earlier by the Parties in accordance with Article 9 of this Agreement.

**ARTICLE 4. SCOPE OF WORK**

Connecticut Parent Advocacy Center (CPAC) will hire an education consultant to conduct focus groups with parents of students with disabilities around special education funding to learn more about their questions and concerns.

CPAC is Connecticut's official parent training and information center under the Individuals with Disabilities Act, which makes them nonpartisan, neutral and well qualified to do this.

Deliverable due December 1, 2018: final report.

The services described in this Article 4 are collectively referred to as the "Services".

**ARTICLE 5. COMPENSATION AND INVOICING**

Total compensation payable to Consultant under this Agreement shall be \$15,000.00 and is inclusive of all costs. Compensation shall be paid based on the completion of specific deliverables identified in the Services. Subject to the invoicing requirements contained herein, compensation shall be paid in full in one installment upon execution of this Agreement. Acceptance and approval of invoices by Connecticut School Finance Project is required before payment is issued by TSNE MissionWorks. TSNE MissionWorks reserves the right to withhold payment for any invoice(s) not in compliance with the contract's terms or are submitted greater than 60 days after the relevant billing period.

**ARTICLE 6. DUPLICATION OF FUNDING**

Consultant represents and warrants that Consultant is not and will not during the term of this Agreement receive any duplicate reimbursement from other sources, public or private, for activities carried out under this Agreement.

**ARTICLE 7. EXAMINATION OF RECORDS**

Consultant agrees to keep accurate records of all expenses and costs in connection with this Agreement, which records shall be open for inspection by TSNE MissionWorks or its designated representatives for a period of three (3) years from the date of final payment to Consultant. Notwithstanding the foregoing sentence, Consultant shall retain all records for periods of more than three (3) years from the date of final payment to Consultant if required by any and all applicable laws or funder requirements.

**ARTICLE 8. INTEREST AND REPRESENTATIONS OF CONSULTANT**

Consultant covenants that (i) neither he/she nor any member of his/her immediate family has any financial or business interest, direct or indirect, which would conflict in any manner or degree with the performance of the Services or with any other provision of this Agreement; and (ii) Consultant has no outstanding agreement or obligation that is in conflict with the Services as contemplated hereunder or that would preclude Consultant from complying with the provisions of this Agreement.

Consultant represents and warrants as follows: (i) Consultant will perform the Services with due professional care in accordance with generally accepted industry practices; (ii) Consultant has the authority to enter into and perform under this Agreement; (iii) Consultant will not disclose to TSNE MissionWorks, or use in connection with the performance of Services under this Agreement, any third party confidential or proprietary information unless it receives prior written permission to do so, and (iv) Consultant's performance of the Services will not infringe any intellectual property rights of any third parties.



## **ARTICLE 9. TERMINATION**

This Agreement may be terminated by either Party upon delivery of fourteen (14) days' written notice to the other Party. Notwithstanding anything to the contrary herein, TSNE MissionWorks may terminate this Agreement immediately at any time upon notice to Consultant if TSNE MissionWorks determines, in its sole discretion, that Consultant has engaged in illegal activities or other activities that may be detrimental to TSNE MissionWorks or its affiliates. In the event of termination, Consultant will be reimbursed for those compensation fees and expenses incurred up to the date of termination which may be validly charged under this Agreement and for which funds are available at the time of termination.

## **ARTICLE 10. SURVIVAL**

Notwithstanding the termination of this Agreement, the covenants and obligations of the Parties set forth in Articles 7, 10, 11, 12, 13, 15, 16, 17, and 18 shall remain in effect and be fully enforceable in accordance with the provision thereof.

## **ARTICLE 11. CONFIDENTIALITY AND PUBLICATIONS**

Consultant will not, during or subsequent to the term of this Agreement, use TSNE MissionWorks's Confidential Information (as defined below) for any purpose whatsoever other than the performance of the Services or disclose TSNE MissionWorks's Confidential Information to any third Party without the prior written approval of both the Chief Executive Officer of TSNE MissionWorks and the project director of Connecticut School Finance Project. It is understood that such Confidential Information and any materials containing such Confidential Information shall remain the sole property of TSNE MissionWorks. Consultant further agrees to take all reasonable precautions to prevent any unauthorized disclosure of such Confidential Information. Upon termination of Consultant's engagement for any reason, Consultant will promptly deliver to TSNE MissionWorks all Confidential Information received by it and its affiliates hereunder. "Confidential Information" means any (i) proprietary information, technical data, trade secrets or know-how, including, but not limited to, research, product plans, products, services, customers, customer lists, markets, software, developments, inventions, processes, formulas, technology, designs, drawings, engineering, hardware configuration information, marketing, finances or other business information disclosed by TSNE MissionWorks either directly or indirectly in writing, orally or by drawings or inspection of parts or equipment and (ii) any reports, information, data or other documents given to or prepared or assembled by Consultant under this Agreement, or which Consultant otherwise gains access to in connection with performance of the Services; *provided however*, Confidential Information does not include information which has become publicly known and made generally available through no wrongful act of Consultant.

## **ARTICLE 12. DATA AND PROPERTY RIGHTS**

TSNE MissionWorks shall promptly and without charge provide Consultant with all information and materials necessary for performance of the Services, or as reasonably requested by Consultant in order to perform the Services (the "TSNE MissionWorks Disclosed Materials"). Consultant shall not use TSNE MissionWorks Disclosed Materials for any purpose other than carrying out the Services, unless otherwise agreed to in writing by TSNE MissionWorks. Consultant shall promptly return TSNE MissionWorks Disclosed Materials to TSNE MissionWorks upon completion of the Services.

TSNE MissionWorks is the exclusive owner of any proprietary information or other Confidential Information disclosed hereunder by or on behalf of TSNE MissionWorks, including any improvements, adaptations, derivative works, enhancements and/or modifications with respect thereto and any intellectual property rights of TSNE MissionWorks contained therein (collectively, "TSNE MissionWorks Materials"), and Consultant hereby assigns and transfers to TSNE MissionWorks all rights, title and interest therein and thereto that Consultant may have. TSNE MissionWorks hereby reserves all rights not

expressly granted to Consultant herein with respect to TSNE MissionWorks Materials and any information (including proprietary information) contained herein.

All ideas, concepts, discoveries, inventions, developments, improvements, know-how, trademarks, trade secrets, designs, processes, methodologies, materials, products, formulations, data, documentation, reports, algorithms, notation systems, computer programs, works of authorship, databases, mask words, devices, equipment and any other creations (whether or not patentable or subject to copyright or trade secret protection), developed and/or produced by Consultant, either alone or jointly with others, in connection with or arising out of the Services or this Agreement ("Inventions") shall vest exclusively with TSNE MissionWorks. All copyrightable Inventions created by Consultant in connection with this Agreement shall constitute a work made for hire as contemplated by the United States Copyright Act ("Work for Hire"). In the event any Inventions or any element thereof are not deemed Work for Hire, Consultant agrees to and hereby assigns to TSNE MissionWorks, all right, title and interest (including, without limitation, the copyright therein and all extensions and renewals thereof) in and to such Inventions.

### **ARTICLE 13. INDEMNIFICATION**

All obligations and liabilities which may arise from or be incurred by Consultant as a result of any breach of this Agreement, or the performance of this Agreement, shall be solely the responsibility of Consultant. Consultant agrees to indemnify and hold harmless TSNE MissionWorks and its owners, officers, directors, employees, and affiliates (collectively, the "TSNE MissionWorks Parties") to the fullest extent permitted by law, against all losses, claims, damages, liabilities, costs and expenses (including reasonable attorneys' fees), incurred or sustained by any of the TSNE MissionWorks Parties as a result of or related to the provision of Services hereunder by Consultant or any breach of this Agreement by Consultant.

### **ARTICLE 14. COMPLIANCE WITH LAW**

Both TSNE MissionWorks and Consultant shall abide by the relevant federal and state law and regulations governing the administration of projects of this nature. Neither TSNE MissionWorks nor Consultant shall discriminate in employment, purchasing or subcontracting on the basis of race, color, sex, sexual orientation, gender identity, religious affiliation, national origin, age, veteran status, or disability in connection with the Services or performance of any other provision of this Agreement. In addition, Consultant hereby warrants that Consultant implements and maintains appropriate security measures for the protection of personal information and otherwise complies with 201 CMR 17.00.

### **ARTICLE 15. NO ASSIGNMENT**

This Agreement shall be binding upon and inure to the benefit of the Parties hereto and their respective successors and permitted assigns. Consultant shall not assign any rights, duties, or obligations arising under this Agreement without the prior written consent of TSNE MissionWorks. Any attempt to assign any rights, duties, or obligations under this Agreement without the written consent of TSNE MissionWorks is null and void.

### **ARTICLE 16. FURTHER ASSURANCES**

Consultant shall, at any time during or after the term of this Agreement, upon request of TSNE MissionWorks, execute all documents and perform all lawful acts which TSNE MissionWorks considers necessary or advisable to secure its rights hereunder and to carry out the intent of this Agreement, including in order to obtain any intellectual property rights over any Inventions.

**ARTICLE 17. GOVERNING LAW**

This Agreement is governed by, and is to be interpreted and enforced in accordance with, the Laws of the Commonwealth of Massachusetts without giving effect to any choice of law or conflict of laws rules or provisions.

**ARTICLE 18. SEVERABILITY**

If any portion or provision hereof is to any extent determined to be illegal, invalid, or unenforceable by a court of competent jurisdiction, then the remainder hereof, and the application of such portion or provision in circumstances other than those as to which it is so determined to be illegal, invalid, or unenforceable, as applicable, will not be affected thereby.

**ARTICLE 19. MODIFICATIONS**

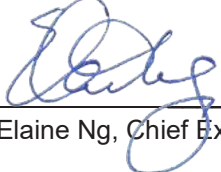
This Agreement, including any attachments, constitutes the entire agreement and understanding between the Parties concerning this subject and as of its date, cancels, terminates, and supersedes all prior written and oral understandings, agreements, proposals, promises, and representations of the Parties respecting any of the subject matter contained herein. This Agreement can be amended if, and only if, such amendment is in writing and is signed by each Party.

**ARTICLE 20. COUNTERPARTS**


This Agreement may be executed in counterparts. For purposes of execution of this Agreement, faxed or electronically transmitted signature pages will be deemed the original signature pages.

To evidence the Parties' agreement to this Agreement, they have executed and delivered it on the date set forth in the preamble.

**THIRD SECTOR NEW ENGLAND, INC.**

By:  \_\_\_\_\_ Date: 08/20/2018  
Elaine Ng, Chief Executive Officer

**CONNECTICUT PARENT ADVOCACY CENTER**

By: **John M. Flanders**  \_\_\_\_\_ Date: \_\_\_\_\_  
Digitally signed by John M. Flanders  
DN: cn=John M. Flanders,  
o=Connecticut Parent Advocacy  
Center, ou=Executive Director,  
email=jflanders@cpacinc.org, c=US  
Date: 2018.08.20 14:54:21 -04'00'