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## KEEPING THEM HONEST: PROACTIVELY PREVENTING FRAUD IN PENNSYLVANIA'S CYBER CHARTER SCHOOLS\*

### I. INTRODUCTION

Pennsylvania Auditor General Jack Wagner characterized the Pennsylvania Cyber Charter School's (PA Cyber) financial numbers as "out of whack."<sup>1</sup> His choice of words was not unwarranted: an audit of the 2009–10 school year showed that the school somehow commanded a \$13.8 million surplus.<sup>2</sup> PA Cyber, like all charter schools in Pennsylvania, is a privately operated institution that depends on taxpayer dollars to function.<sup>3</sup> Society expects taxpayer funding to be used responsibly and for the ends to which it was intended.<sup>4</sup> Accordingly, accountability is a key policy concern in the exercise of oversight of cyber charter schools.<sup>5</sup> Accountability becomes difficult, however, when nonprofit corporations can garner huge surpluses, oversight is a tangled web of state and local bureaucracies, and money can be shifted through complicated networks of corporations—corporations that serve distinct but related purposes and are formed by the same incorporators.<sup>6</sup> This is the legal landscape surrounding Pennsylvania's cyber charter schools, and it needs to change.<sup>7</sup>

This Comment argues that the temptations to commit fraud are strong for cyber charter school leaders. The legal system as it currently exists perpetuates these temptations. It follows that reforms involving steps to proactively prevent fraud are worth considering. Given the steady expansion of cyber charter schools over the past decade and the continued push to privatize public education, the issue is pressing.<sup>8</sup> This

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1. Bill Vidonic, *Auditor General Criticizes PA Cyber Charter School Surplus, Urges Changes in State Funding*, TRIBLIVE (Dec. 6, 2012, 2:20 PM), <http://triblive.com/news/adminpage/3090525-74/charter-cyber-schools#axzz2JxUSHgMy>.

2. *Id.*

3. See *Charter School FAQs*, SCH. DIST. OF PHILA. CHARTER SCHS. OFFICE, <http://webgui.phila.k12.pa.us/uploads/4f/4t/4f4tzsINrIXsHmaVik1XF/Charter-School-FAQs.pdf> (explaining that charter schools operate as "separate, independent educational institutions" and are "publicly funded").

4. See Marjorie E. Kornhauser, *Legitimacy and the Right of Revolution: The Role of Tax Protests and Anti-Tax Rhetoric in America*, 50 BUFF. L. REV. 819, 823 (2002) (exploring the linkage between the use of tax revenue and taxpayers' corresponding buy-in to the legitimacy of the taxation system).

5. See *infra* note 62 and accompanying text for a discussion of accountability as a policy goal.

6. See *infra* Part II.A for a discussion of the causes of these phenomena.

7. See *infra* Part III.A for a comprehensive argument regarding why change from the status quo is both needed and desirable.

8. See *infra* Part II.A for a timeline of charter school expansion and the policy justifications that have driven this expansion.

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Comment proposes statutory reforms whereby cyber charter school executives would be motivated to use taxpayer dollars responsibly.<sup>9</sup>

Part II.A of this Comment provides a chronology of the development of charter schools in Pennsylvania with a particular emphasis on cyber charter schools. This Part also describes the key statutory provisions governing both brick-and-mortar and cyber charter schools. Part II.B summarizes corporate law governance concepts that relate to Pennsylvania's cyber charter schools, all of which have the legal status of nonprofit corporations.<sup>10</sup> This Part examines directorial duties in some depth, as well as the common-law limitations on the scope of those duties. Part II.C details PA Cyber's history and the events that culminated in a federal investigation of the school's books in 2012, which looked into potentially self-dealing transactions entered into by the school's directors, and a grand jury indictment of the school's former CEO in 2013. This Part functions as a case study to illustrate the practical realities that the legal underpinnings discussed in Parts II.A and II.B help to create.

Part III.A of this Comment argues that current common-law and statutory provisions inadequately prevent fraud among cyber charter school operators. Part III.B analyzes the broad categories of potential reform: extrinsic regulation and oversight, internal self-regulation, and a hybrid category that contains elements of both. This Comment argues that the first two categories each have profound flaws and may well create more problems than solutions. This being the case, Part III.B.3 argues that the best hope for reform lies in creating regulations that strongly encourage compliance among cyber charter school directors. This Part concludes by proposing ideas for statutory reform in this direction: creating a different funding algorithm for cyber charter schools and imposing strict liability for directors of cyber charter schools engaging in self-dealing transactions.

## II. OVERVIEW

This Section is divided into three parts. Part II.A discusses charter schools generally and the technological and policy factors that led to the development and subsequent rise of cyber charter schools in particular. The steady nationwide increase in the number of charter schools has been well documented,<sup>11</sup> so this Comment focuses exclusively on Pennsylvania charter schools. Additionally, rather than presenting a minitreatise on what charter schools are and how they operate, the analysis here is limited to facts that are required to understand a more precise focus: the financial accountability of charter schools.

Part II.B discusses the corporate implications of charter schools and addresses corporate separation more generally. Again, this area of the law is expansive, so the intent is to give the "bare essentials" needed to understand the context in which many cyber charter schools are founded and how the law structures their accountability. To the extent that corporate relationships outside the realm of education are described, the

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9. See *infra* Part III.B.3 for a proposal of reforms that aim to prevent fraud.

10. 24 PA. CONS. STAT. ANN. § 17-1703-A (West 2014).

11. E.g., Alyssa M. Simon, Comment, "Race" to the Bottom?: Addressing Student Body Diversity in Charter Schools After Parents Involved, 10 CONN. PUB. INT. L.J. 399, 402 (2011).

purpose is to analogize—not to analyze substantively the nature of the particular corporations described.

Finally, Part II.C presents a case study that illuminates the problems in this area of the law. Many of the events discussed in this Part have occurred quite recently; indeed, some are still playing out. However, as Section III makes clear, the outcome of these events does not concern this Comment; rather the focus is instead on how and why these events happened in the first place, and how the law might be structured so that they do not happen again.<sup>12</sup>

A. *The History, Nuances, and Policy Justifications That Define Pennsylvania's Cyber Charter Schools*

1. *Origins of Cyber Charter Schools*

Charter schools in Pennsylvania are creatures of statute. The Pennsylvania General Assembly first passed a law authorizing their creation in 1997.<sup>13</sup> Since this statutory inception, 176 charter schools have been formed in Pennsylvania.<sup>14</sup> The argument that drove the creation of the first charter schools and their rapid growth is fairly simple: school districts with centralized power lead to waste and poor student achievement results.<sup>15</sup> The subsequent explosion of charter schools is also attributable to this argument, which tracks the long-held American belief that education, at least in terms of accountability, should be a local concern.<sup>16</sup> This same belief posits that individual schools best know how to spend taxpayer money to achieve an optimal balance of efficiency and high student achievement.<sup>17</sup> Additionally, proponents of charter schools argue that autonomy breeds creativity, and such creativity might in turn spawn educational tactics that are worthy of emulation in public schools.<sup>18</sup>

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12. I proceed with certain fundamental positions regarding the use of public funds to fund schools in mind. While a debate continues to rage regarding whether privatization of public education is desirable, I start with the proposition that accountability is generally a worthy goal, and that because reports are required of charter schools under Pennsylvania law, the education system demands it.

13. Charter School Law, 1997 Pa. Legis. Serv. 1997-22 (West).

14. See PA. DEP'T OF EDUC., 2013–14 CHARTER AND CYBER CHARTER SCHOOLS (2013), available at [http://www.portal.state.pa.us/portal/portal/server.pt/community/charter\\_schools/7356](http://www.portal.state.pa.us/portal/portal/server.pt/community/charter_schools/7356) (listing 162 brick-and-mortar charter schools and 14 cyber charter schools).

15. See KARA FINNIGAN ET AL., EVALUATION OF THE PUBLIC CHARTER SCHOOLS PROGRAM: FINAL REPORT 3 (2004), <http://www2.ed.gov/rschstat/eval/choice/pcsp-final/finalreport.pdf> (positing that “[a]lthough state charter laws vary, all share a common set of assumptions: (1) that accountability for outcomes will improve school performance and (2) that high levels of autonomy will allow schools to better meet student needs and, as a result, improve performance”).

16. William Haft, *Charter Schools and the Nineteenth Century Corporation: A Match Made in the Public Interest*, 30 ARIZ. ST. L.J. 1023, 1041 (1998).

17. See Nathaniel J. McDonald, Note, *Ohio Charter Schools and Educational Privatization: Undermining the Legacy of the State Constitution's Common School Approach*, 53 CLEV. ST. L. REV. 467, 482 (2005) (noting that charter school proponents often posit that privatization “will improve public schooling and equal opportunity through school choice, economic efficiency, and competition among local schools”).

18. See, e.g., PA DEP'T OF EDUC., CYBER CHARTER SCHOOLS: BASIC EDUCATION CIRCULAR § 1 (2006), [http://www.portal.state.pa.us/portal/server.pt/community/purdon%27s\\_statutes/7503/cyber\\_charter\\_schools/507354](http://www.portal.state.pa.us/portal/server.pt/community/purdon%27s_statutes/7503/cyber_charter_schools/507354) (noting that the intent of the Charter School Law is for cyber charter schools to “serve as laboratories of innovation” for all Pennsylvania schools).

In Pennsylvania, for a brick-and-mortar charter school to be formed, a local board of school directors must grant the applicant school a charter.<sup>19</sup> Charters last between three and five years and may be renewed every five years.<sup>20</sup> While Pennsylvania's charter school statute cedes considerable decision-making authority to local school boards, the statute provides that the school district in which each charter school student resides must pay the per capita funding it receives from the state to educate that student.<sup>21</sup> As of the 2010–11 academic year, this amount was \$14,675 per student on average.<sup>22</sup> This amount has steadily risen with each passing year.<sup>23</sup> The Pennsylvania charter school statute also requires charter schools to submit annual reports to the local school boards that granted their charters.<sup>24</sup> These reports are accessible to the public and can be found at the Pennsylvania Department of Education's (PDE) website.<sup>25</sup> The reports serve two major purposes: they allow the local board to confirm (1) "that the charter school is in compliance with its charter" and (2) "that [the state's] requirements for testing, civil rights and student health and safety are being met."<sup>26</sup>

## 2. The Development of Cyber Charter Schools

After Pennsylvania's charter school law was enacted, the Internet quickly became ubiquitous as a means to deliver information.<sup>27</sup> The parallel—though extrinsically unrelated—development of charter schools and the Internet sparked educational entrepreneurs' interest.<sup>28</sup> These entrepreneurs hypothesized a digital school where students could be educated within the comfort of their own homes.<sup>29</sup> The prospect of cyber charter schools developed accordingly.<sup>30</sup> Digital education married the potential advantages of traditional charter schools—namely, better accountability and

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19. 24 PA. CONS. STAT. ANN. § 17-1717-A(c)–(e)(1) (West 2014).

20. *Id.* § 17-1720-A(a).

21. *Id.* § 17-1725-A(a)(2).

22. *PA Spending and Enrollment Trends*, OPENPAGOV.ORG, [http://www.openpagov.org/education\\_revenue\\_and\\_expenses.asp](http://www.openpagov.org/education_revenue_and_expenses.asp) (last visited Mar. 1, 2014).

23. *Id.*

24. 24 PA. CONS. STAT. ANN. § 17-1728-A(b).

25. *Charter School Annual Reports and Enrollment Data*, PA. DEP'T OF EDUC., [http://www.portal.state.pa.us/portal/server.pt/community/annual\\_reports\\_and\\_statistics/7357](http://www.portal.state.pa.us/portal/server.pt/community/annual_reports_and_statistics/7357) (last visited Mar. 1, 2014).

26. 24 PA. CONS. STAT. ANN. § 17-1728-A(a).

27. See *The Rise of the Internet*, USA TODAY (Mar. 10, 2003, 8:35 AM), [http://usatoday30.usatoday.com/money/industries/technology/2003-03-10-time-line\\_x.htm](http://usatoday30.usatoday.com/money/industries/technology/2003-03-10-time-line_x.htm) (stating that in 1997 over one million websites existed and for the first time ever "more e-mails [were] sent than letters"). At the end of 2011, one estimate indicated that nearly 582 million websites existed. Lucian Parfeni, *The Number of Websites Doubled in 2011, to Reach 582 Million*, SOFTPEDIA (Jan. 3, 2011, 11:41 PM), <http://news.softpedia.com/news/There-Were-582-Million-Websites-At-the-End-of-2011-244205.shtml>.

28. *Cyber Charter Schools*, REACH FOUNDATION, <http://www.paschoolchoice.org/school-choice/cyber-charter-schools/> (last visited Mar. 1, 2014).

29. See NAT'L CTR. FOR THE STUDY OF PRIVATIZATION IN EDUC., *CYBER AND HOME SCHOOL CHARTER SCHOOLS: HOW STATES ARE DEFINING NEW FORMS OF PUBLIC SCHOOLING 2*, [http://www.ncspe.org/publications\\_files/Cyber%20and%20Home%20Charters.pdf](http://www.ncspe.org/publications_files/Cyber%20and%20Home%20Charters.pdf) (comparing the standards and policies of the cyber charter school model and the traditional school model).

30. *Cyber Charter Schools*, *supra* note 28.

administrability—to the wide-open technological frontier that the Internet represented in the late 1990s.<sup>31</sup> Not surprisingly, it was not long before a push began to digitize education.<sup>32</sup> Digital education carried with it the potential not only to break through traditional geographic and demographic limitations on the makeup of a classroom but also to drastically reduce the cost of education.<sup>33</sup>

Although the pooling of resources and breaking through of geographic and demographic boundaries represented an intriguing possibility for cyber charter schools, another advantage lay in the cost savings they could provide.<sup>34</sup> Schools are expensive institutions to run.<sup>35</sup> Aside from costs for employees, supplies, and other forms of overhead, schools require upkeep and maintenance.<sup>36</sup> Because many school buildings are quite old, utilities alone represent a significant cost.<sup>37</sup> Cyber charter schools therefore presented a major cost advantage: while there would be considerable start-up costs in creating an online platform, schools would not incur the yearly costs of upkeep that brick-and-mortar schools have.<sup>38</sup> If cyber charter schools would be funded according to the same per capita basis that brick-and-mortar charter schools used, this equality in funding, but disparity in cost, could save a cyber charter school a significant amount of money over several years of operation.<sup>39</sup> This is exactly what happened in

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31. *Id.*

32. See Kevin P. Brady et al., *Unchartered Territory: The Current Legal Landscape of Public Cyber Charter Schools*, 2010 BYU EDUC. & L.J. 191, 197 (2010) (describing the linkage between charter schools and online technology as an “inevitable merger”).

33. TERRY M. MOE & JOHN E. CHUBB, *LIBERATING LEARNING: TECHNOLOGY, POLITICS, AND THE FUTURE OF AMERICAN EDUCATION* 77–80 (2009) (arguing that digital education promotes higher teacher quality through reducing the number of teachers that a school requires and therefore makes it more feasible to attract top-quality teaching talent); Brady et al., *supra* note 32, at 197 (positing that cyber charter schools “rely considerably less on the use of teaching personnel and physical facilities”). Some policy rationales that support cyber education include, among others, that cyber schools “will be more customized to students,” “will be more accountable,” and “will do a better job of promoting social equity.” *Id.* at 173–76.

34. See AMY BERK ANDERSON ET AL., 20/20: COSTS AND FUNDING OF VIRTUAL SCHOOLS 36 (2006), [http://heartland.org/sites/all/modules/custom/heartland\\_migration/files/pdfs/28390.pdf](http://heartland.org/sites/all/modules/custom/heartland_migration/files/pdfs/28390.pdf) (stating that replication and scaling up can allow “institutions [to] save money in the long term”).

35. See, e.g., Adam Schaeffer, *They Spend WHAT? The Real Cost of Public Schools*, CATO INSTITUTE POLICY ANALYSIS, Mar. 10, 2010, at 14 (asserting that over one-fourth of tax dollars go to public school funding).

36. See ANDERSON ET AL., *supra* note 34, at 8 (listing maintenance as one type of “other cost[]” incurred by various school districts).

37. See XCEL ENERGY, *MANAGING ENERGY COSTS IN SCHOOLS: A GUIDE TO ENERGY CONSERVATION AND SAVINGS FOR K–12 SCHOOLS* 3 (2007), <http://www.xcelenergy.com/staticfiles/xcel/Marketing/Managing-Energy-Costs-Schools.pdf> (asserting that U.S. school districts spend more than \$6 billion on energy per year).

38. See MOE & CHUBB, *supra* note 33, at 110 (“It is also true and enormously significant that budget constraints, limited capacity, and constituency demand will give public officials persuasive reasons (in some cases) to turn to virtual schools as new, less costly providers of a wider array of services.”); Terrie Morgan-Besecker, *Controversy Swirls About Cyber Schools*, TIMES LEADER, July 17, 2011, at A1 (stating that cyber charter schools do not require as many yearly “fixed costs” as traditional schools to operate).

39. JACK WAGNER, PA. DEP’T OF THE AUDITOR GEN., *SPECIAL REPORT: THE COMMONWEALTH SHOULD REVISE ITS CHARTER AND CYBER CHARTER SCHOOL FUNDING MECHANISMS* 4 (2010), <http://www.auditorgen.state.pa.us/reports/performance/special/specharterfundingreport100510.pdf> (concluding that “cyber charter schools educate students at a lower cost than brick-and-mortar charters, and [that] many charter schools are carrying large unreserved-undesignated fund balances”).

Pennsylvania.<sup>40</sup>

### 3. Legislative Approval of Cyber Charter Schools

Pennsylvania added a statutory code section dealing with cyber charter schools, known as the Cyber Charter School Statute, in 2002.<sup>41</sup> This section came into existence as a result of the inability of the general charter school law to provide for the creation and oversight of institutions offering cyber education.<sup>42</sup> The Pennsylvania General Assembly gave broad authority to the PDE to grant charters for cyber charter schools and oversee their operations.<sup>43</sup>

The Cyber Charter School Statute identifies a broad class of people who may found a cyber charter school.<sup>44</sup> The statute also identifies five criteria that are used to evaluate a potential school's candidacy:

- (i) The demonstrated, sustainable support for the cyber charter school plan by teachers, parents or guardians and students.
- (ii) The capability of the cyber charter school applicant, in terms of support and planning, to provide comprehensive learning experiences to students under the charter.
- (iii) The extent to which the programs outlined in the application will enable students to meet the academic standards under 22 Pa. Code Ch. 4 (relating to academic standards and assessment) or subsequent regulations promulgated to replace 22 Pa. Code Ch. 4.
- (iv) The extent to which the application meets the requirements of section 1747-A [specifying, *inter alia*, courses required, minimum time students must spend online, and how the cyber charter school will monitor student activity].
- (v) The extent to which the cyber charter school may serve as a model for other public schools.<sup>45</sup>

Once a school has been established, it must submit annual reports to the PDE that detail the state of the school.<sup>46</sup> Key to this Comment is the fact that the document template

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40. See *infra* notes 56–58 and accompanying text for the statutory authority that provides for equal funding of brick-and-mortar and cyber charter schools.

41. Act of June 29, 2002, 2002 Pa. Legis. Serv. 2002-88 (West).

42. See MOE & CHUBB, *supra* note 33, at 122 (noting that although some states implicitly grant states the ability to authorize cyber charter schools through omission of specific language to the contrary in their charter school statutes, explicit authorization of cyber charter schools can resolve this “gray area of legal ambiguity”).

43. See 24 PA. CONS. STAT. ANN. § 17-1741-A(a)(1)–(3) (West 2014) (empowering the PDE to “[r]eceive, review and act on applications for the creation of a cyber charter school” and granting the department the ability to renew or revoke previously granted charters).

44. See *id.* § 17-1745-A(a) (permitting individuals, teachers, parents or guardians of students, nonsectarian Pennsylvania colleges, museums, nonprofit entities, corporations, partnerships, and associations to establish charter schools).

45. *Id.* § 17-1745-A(f)(1)(i)–(v); see also *id.* § 17-1747-A.

46. *Id.* § 17-1743-A(f). The General Assembly ceded responsibility to the PDE to actually enumerate what these reports must contain. See *id.* (stating that the report must be delivered “in the form prescribed by the department”). See PA. CYBER CHARTER SCHOOL, CHARTER ANNUAL REPORT (2012), [http://www.portal.state.pa.us/portal/server.pt/document/1286467/pennsylvaniacybercs-annualreport\\_pdf](http://www.portal.state.pa.us/portal/server.pt/document/1286467/pennsylvaniacybercs-annualreport_pdf), for an example of an annual report containing myriad details that range from insurance information to student

requires no disclosure regarding potential director conflicts of interest.<sup>47</sup> Charters are only granted for three- to five-year periods.<sup>48</sup> After the initial charter expires, a school must petition for a charter renewal every five years in order to maintain operations.<sup>49</sup> Because each cyber charter school serves students from beyond the local school district where it is headquartered, oversight of cyber charter schools falls to the PDE.<sup>50</sup>

Aside from the PDE analyzing the renewal application and the annual reports, the renewal decision-making process is cryptic.<sup>51</sup> The PDE requires a list of information to be readily accessible in the case of a site visit, which may occur at random.<sup>52</sup> Because of the (non)relationship between a cyber charter school and the school district in which it is headquartered, the PDE is tasked with the accountability and bookkeeping duties that a local school district assumes for brick-and-mortar charter schools.<sup>53</sup> However, unlike local school districts, the PDE is a state-based organization that is also tasked with managing individual schools.<sup>54</sup> This result is arguably at odds with the aforementioned notion that educational institutions are best managed locally.<sup>55</sup>

The most critical piece of the cyber charter school legislation is that it funds cyber charter schools in exactly the same way as brick-and-mortar charter schools.<sup>56</sup> This decision on the part of the legislature realized the possibility discussed above: cyber charter schools could potentially garner financial surpluses due to their reduced overhead costs.<sup>57</sup> There is no clear record in the legislative history of the cyber charter school law that this possibility was discussed or debated.<sup>58</sup> In sum, a cyber charter

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scores on diagnostic assessments.

47. See PA. CYBER CHARTER SCHOOL, *supra* note 46 (demonstrating the lack of a disclosure requirement on potential director conflicts of interest).

48. 24 PA. CONS. STAT. ANN. § 17-1720-A(a).

49. *Id.*

50. *Id.* § 17-1742-A.

51. See CYBER CHARTER SCHOOLS: BASIC EDUCATION CIRCULAR, *supra* note 18, § 5 (describing procedural steps but not substantive guidelines for renewal decisions).

52. *Id.* § 3.

53. Compare 24 PA. CONS. STAT. ANN. § 17-1728-A(a) (empowering local school districts to annually monitor the operations of brick-and-mortar charter schools), with CYBER CHARTER SCHOOLS: BASIC EDUCATION CIRCULAR, *supra* note 18, § 3 (noting the Pennsylvania legislature's intent to have charter schools "operate independently" from school districts and enable the PDE to collect records from cyber charter schools and ensure that they are meeting the goals of their charters).

54. See *supra* notes 41–43 and accompanying text for the statutory authority that authorizes the PDE to oversee cyber charter schools.

55. See *supra* notes 16–17 and accompanying text for support for the notion that educational accountability is best overseen at the local level. Because local school districts do not oversee cyber charter schools, it is difficult to conceptualize them under the traditional American idea that education is a matter of local concern.

56. See 24 PA. CONS. STAT. ANN. § 17-1749-A(a)(1) (providing that various parts of the charter school statute apply to both brick-and-mortar charter schools and cyber charter schools, including § 17-1725-A, which details how charter schools are funded).

57. See *supra* notes 34–40 and accompanying text for a discussion of how, despite initial start-up costs, cyber charter schools can generate surplus revenues.

58. See, e.g., S. 186-50, 2002 Sess., at 2064 (Pa. 2002) (providing a transcription of a vote but no debate on the cyber charter school bill). In December 2012, Pennsylvania Auditor General Jack Wagner criticized the identical funding of brick-and-mortar charter schools. Press Release, Pa. Dep't of the Auditor Gen., Auditor

school can have large amounts of surplus cash on hand after several years of operation. Where and how this money might be spent raise pressing questions regarding financial accountability.

### B. Corporate Implications of Charter Schools

Concerns regarding the existence of financial surpluses are compounded by the fact that corporate law doctrines governing cyber charter schools' directors are generally permissive. Charter schools may be incorporated under the auspices of existing corporate structures.<sup>59</sup> While charter schools in Pennsylvania must be founded as nonprofit corporations,<sup>60</sup> their founders are not prohibited from having founded or founding other, for-profit corporations that may be involved with educational products.<sup>61</sup> Given this messy corporate framework, financial accountability can be a major problem for cyber charter schools.<sup>62</sup> This Part addresses how the law deals with separate corporations that reside under a common umbrella of corporate ownership. In doing so, it provides some foundation for how the legal system currently deals with issues relating to corporate governance that affect nonprofit cyber charter schools.

#### 1. Corporate Governance and Directors' Fiduciary Duties

Traditionally, the law has treated corporations—regardless of for-profit or nonprofit status—as separate legal “beings.”<sup>63</sup> Despite their similar legal status, for-profit and nonprofit corporations pursue very different goals. Most notably, the goal of for-profit corporations is to make money.<sup>64</sup> Nonprofit corporations, however, exist for reasons other than the pursuit of financial gain, including the liability protections stemming from incorporated status.<sup>65</sup> Notwithstanding these very different goals,

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General Jack Wagner Says Pennsylvania Cyber Charter School's Reserve Funds Highlight Need to Fix Funding Formula (Dec. 6, 2012). He noted that this funding symmetry costs Pennsylvania taxpayers \$365 million annually. *Id.* He specifically pointed out PA Cyber's finances as emblematic of the problem. *Id.* See *infra* Part II.C for a discussion of PA Cyber's suspicious financial dealings.

59. See Robin Cheryl Miller, Annotation, *Validity, Construction, and Application of Statute or Regulation Governing Charter Schools*, 78 A.L.R.5TH 533, § 12 (2000) (indicating that Pennsylvania law does not prohibit a for-profit entity from establishing and operating a charter school as long as the school itself is not for-profit).

60. 24 PA. CONS. STAT. ANN. § 17-1703-A.

61. See *id.* § 17-1745-A(a) (providing broad language regarding who may establish a cyber charter school).

62. See Martha Minow, *Public and Private Partnerships: Accounting for the New Religion*, 116 HARV. L. REV. 1229, 1259 (2003) (positing that “[t]he urgent question posed by a shifting mix of public and private providers of education, welfare, and prison services is how to ensure genuine and ongoing accountability to the public”).

63. The law's attitude toward corporations has evolved significantly over the past few centuries. See Ronald J. Colombo, *The Corporation as a Tocquevillian Association*, 85 TEMP. L. REV. 1, 6–16 (2012) (describing the various views the law has taken in attempting to define the essence of a corporation).

64. See, e.g., *Am. Baptist Churches of Metro. New York v. Galloway*, 710 N.Y.S.2d 12, 15 (N.Y. App. Div. 2000) (explaining that “[j]ust as the goal of a for-profit corporation is to make money for its investors, the goal of a not-for-profit is to make money that can be spent on furthering its social welfare objectives”).

65. See *Cassady V. Brewer, A Novel Approach to Using LLCs for Quasi-Charitable Endeavors (A/K/A “Social Enterprise”)*, 38 WM. MITCHELL L. REV. 678, 693 (2012) (noting that “like their for-profit

Pennsylvania law treats for-profit and nonprofit corporations similarly in many ways.

According to Pennsylvania law, for-profit and nonprofit corporations must be structured similarly in terms of leadership.<sup>66</sup> Every corporation must have a board of directors, which serves to govern the corporation.<sup>67</sup> A corporation must have at least one director.<sup>68</sup> In for-profit corporations, all directors serve one-year terms, after which they must be re-elected by the other board members.<sup>69</sup> Nonprofit corporations, however, are empowered to fix board members' term lengths in their corporate bylaws.<sup>70</sup> Cyber charter schools' boards of directors are elected in this way.<sup>71</sup>

Directors of a corporation—again, regardless of the corporation's for-profit or nonprofit status—owe certain fiduciary duties under law to the corporation. In particular, each director owes a duty of care and a duty of loyalty to the corporation.<sup>72</sup> The duty of care requirement is perhaps better described as a “duty of attentiveness” because most of its requirements are procedural in nature.<sup>73</sup> Directors are expected to have a minimum level of knowledge regarding the dealings of the corporation and to be reasonably apprised of the corporation's affairs.<sup>74</sup> The duty of care may seem like a

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counterparts, nonprofit corporations provide liability protection for those individuals conducting the activities of the organization”).

66. See 15 PA. CONS. STAT. ANN. § 1721(a) (West 2014) (indicating that all general powers vested in a for-profit corporation are exercised by or under the authority of the board of directors); *id.* § 5721 (indicating that all general powers vested in a nonprofit corporation are exercised by or under the authority of the board of directors).

67. *Id.* §§ 1721(a), 5721.

68. *Id.* §§ 1723, 5723.

69. *Id.* § 1724.

70. *Id.* § 5724(a).

71. *E.g.*, 21ST CENTURY CYBER CS, CHARTER ANNUAL REPORT 98 (2011) (noting that the “bylaws of 21CCCS mandate the annual election of the Board of Trustees officers and members”). A cyber charter school sometimes may refer to its board of directors as a “board of trustees.” 24 PA. CONS. STAT. ANN. § 17-1716-A (West 2014).

72. Christopher M. Bruner, *Good Faith, State of Mind, and the Outer Boundaries of Director Liability in Corporate Law*, 41 WAKE FOREST L. REV. 1131, 1167 (2006). Some commentators have posited the existence of a separate duty not to waste corporate assets. *E.g.*, Jamie L. Kastler, Note, *The Problem with Waste: Delaware's Lenient Treatment of Waste Claims at the Demand Stage of Derivative Litigation*, 95 MINN. L. REV. 1899, 1907 (2011). However, it is not entirely clear that this duty is conceptually distinguishable from a director's other fiduciary duties. See Julian Velasco, *How Many Fiduciary Duties Are There in Corporate Law?*, 83 S. CAL. L. REV. 1231, 1254–55 (2010) (positing that “the waste doctrine can be seen as a proxy for breach of other fiduciary duties”). For the purposes of this Comment, a director's duty of care will encompass his duty to refrain from committing waste.

73. JAMES D. COX & THOMAS LEE HAZEN, CORPORATIONS 187 (2d ed. 2003); Andrew D. Appleby & Matthew D. Montaigne, *Three's Company: Stone v. Ritter and the Improper Characterization of Good Faith in the Fiduciary Duty “Triad”*, 62 ARK. L. REV. 431, 440 (2009).

74. *Francis v. United Jersey Bank* provides an illustration of this concept:

Directors are under a continuing obligation to keep informed about the activities of the corporation. . . . Directors may not shut their eyes to corporate misconduct and then claim that because they did not see the misconduct, they did not have a duty to look. The sentinel asleep at his post contributes nothing to the enterprise he is charged to protect.

432 A.2d 814, 822 (N.J. 1981). Pennsylvania requires a director to exercise oversight “in a manner he reasonably believes to be in the best interests of the corporation and with such care, including reasonable inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances.” 15 PA. CONS. STAT. ANN. §§ 1712(a), 5712(a).

high bar, but courts have shied away from aggressively imposing liability on directors for breach of the duty.<sup>75</sup> Because the phrase “duty of care” seems to be quite expansive at first glance, one might reasonably inquire as to the policy bases for limiting directorial liability.

Limiting the liability of corporate directors by defining their duty of care to corporations is favorable for two reasons. First, courts are generally loath to involve themselves with the inner workings of a corporation.<sup>76</sup> Many courts realize that they do not have the requisite expertise to understand the complex factors that influence business decisions.<sup>77</sup> Secondly, many business decisions are simply close calls with strong arguments on both sides.<sup>78</sup> Given these factors, courts often defer to boards’ positions on business matters.<sup>79</sup> This rule—often referred to as the business judgment rule—presumes that a corporation’s board of directors “act[s] on an informed basis, in good faith and in the honest belief that [an] action taken [is] in the best interests of the company.”<sup>80</sup> While the business judgment rule is certainly not absolute and has been overcome in some circumstances, it represents a policy decision that judges will normally hold that the boardroom (and not the courtroom) is the correct forum to determine the wisdom of particular business decisions.<sup>81</sup>

Directors of a corporation also owe a duty of loyalty to their corporation, which prevents them from acting in certain ways that harm the corporation.<sup>82</sup> Although this duty possesses strong theoretical appeal, it has proved challenging to define the duty in a way that clearly distinguishes it from the duty of care.<sup>83</sup> Delaware courts have described the duty of loyalty as follows:

Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his

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75. COX & HAZEN, *supra* note 73, at 184–85.

76. *See id.* at 185 (stating that courts generally “will not undertake to review the expediency of contracts or other business transactions authorized by the directors”).

77. *See, e.g.,* Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) (“[J]udges are not business experts.”).

78. *See* Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L. Q. 821, 831 (2004) (noting that business decisions are inherently risky and often made with “imperfect information,” and therefore second-guessing of business decisions by courts is particularly dangerous).

79. COX & HAZEN, *supra* note 73, at 184–85.

80. *In re Abbott Labs. Derivative S’holders Litig.*, 325 F.3d 795, 807 (7th Cir. 2003) (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

81. Lael Daniel Weinberger, *The Business Judgment Rule and Sphere Sovereignty*, 27 T.M. COOLEY L. REV. 279, 290 (2010).

82. THOMAS A. GOTTSCHALK ET AL., *SUCCESSFUL PARTNERING BETWEEN INSIDE AND OUTSIDE COUNSEL* § 46:15 (2013).

83. *See* COX & HAZEN, *supra* note 73, at 203 (“The divide between the duty of care and loyalty is not a sharp one, and the courts frequently blur the distinction between these twin obligations.”).

charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers. The rule that requires an undivided and unselfish loyalty to the corporation demands that there be no conflict between duty and self-interest.<sup>84</sup>

The Pennsylvania legislature adopted similar language in its statute defining a nonprofit director's duty of loyalty: a director must act in such a way that "he reasonably believes to be in the best interests of the corporation."<sup>85</sup> As one might expect, parties frequently litigate over the meanings of "reasonably" and "best interests."<sup>86</sup>

Courts hold that a director may violate his duty of loyalty when he takes part in self-dealing transactions.<sup>87</sup> This bright-line rule has provided some direction, but the scope of a "self-dealing transaction" is ambiguous—particularly in regards to questions involving conflicts of interest between corporations that are linked through common director and officer presence. Few clear answers exist in analyzing conflicted transactions, and courts generally adopt a very fact-specific analysis when analyzing potential conflict-of-interest claims.<sup>88</sup> Further complicating matters is the broad protection from legal scrutiny each corporation is offered due to a concept known as the "corporate veil."<sup>89</sup>

## 2. Disregarding the Corporate Entity

A person or group of people can form many corporations—all of which the law considers to be distinct legal entities. As one scholar has written, "[u]nder the law of corporations, each of the incorporeal beings of a corporate family are typically treated as separate entities—unless the corporate veil is pierced."<sup>90</sup> Veil piercing can be a powerful investigatory vehicle into the relationships between corporations, but a court will not normally pierce the veil without good cause.<sup>91</sup> While fraud is not a required element of veil piercing, it is ordinarily sufficient to cause a court to take this step.<sup>92</sup> Although there are other reasons for veil piercing, the following Part concentrates on

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84. *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939); *see also Pfeiffer v. Toll*, 989 A.2d 683, 695 (Del. Ch. 2010) ("*Guth v. Loft* remains the seminal Delaware decision addressing the duty of loyalty."), *abrogated on other grounds by Kahn v. Kolberg Kravis Roberts & Co.*, 23 A.3d 831 (Del. 2011).

85. 15 PA. CONS. STAT. ANN. § 5712(a) (West 2014).

86. *E.g., Neal v. Neumann Med. Ctr.*, 667 A.2d 479, 481–83 (Pa. Commw. Ct. 1995).

87. *See, e.g., In re Orchard Enters., Inc.*, No. 7840-VCL, 2014 WL 811579, at \*24 (Del. Ch. Feb. 28, 2014) ("A plaintiff can call into question a director's loyalty by showing that the director was interested in the transaction under consideration or not independent of someone who was.").

88. *See Beam v. Stewart*, 845 A.2d 1040, 1049 (Del. 2004) ("Independence is a fact-specific determination made in the context of a particular case.").

89. COX & HAZEN, *supra* note 73, at 103.

90. Ronald D. Rotunda, *Sister Act: Conflicts of Interest with Sister Corporations*, 1 J. INST. FOR STUDY LEGAL ETHICS 215, 215 (1996).

91. *See COX & HAZEN, supra* note 73, at 104 ("The facts presented must demonstrate some misuse of the corporate privilege or establish a need to limit it in order to do justice.").

92. *See HOK Sport, Inc. v. FC Des Moines, L.C.*, 495 F.3d 927, 936 (8th Cir. 2007) (explaining that "fraud is a sufficient, but not necessary, condition for piercing the corporate veil").

fraud because it encompasses common themes presented in other theories of veil piercing—particularly dishonesty and deceitfulness. Self-interested transactions, like those alleged in the PA Cyber investigation, indicate such dishonesty and deceitfulness.<sup>93</sup>

Fraud is a fairly common phenomenon in the nonprofit world.<sup>94</sup> “While the details of each incident differ, the perception is that the scandals in both the for-profit and nonprofit sectors were all aided and prolonged by the same core problems: questionable accounting, complacent boards, and a lack of independent monitoring.”<sup>95</sup> The common-law action of fraud requires a showing “(1) that a false representation of a material fact was made, (2) with the intent to deceive, (3) which induced the deceived party to act in justifiable reliance on the misrepresentation, and (4) which caused injury that would not otherwise have occurred.”<sup>96</sup>

For an organization that receives public funding, a troubling question arises in determining exactly who should investigate fraud. The Internal Revenue Service (IRS) is ill equipped to do so.<sup>97</sup> While state attorneys general and other regulatory mechanisms exist, such agencies are often overworked, and tracking expenditures among corporations (especially seemingly legitimate endeavors like the buying and selling of property, both real and intellectual) can be an enormous and potentially fruitless time drain.<sup>98</sup> Therefore, an odd paradox results: while the law allows (and to some degree encourages) the erection of complicated corporate structures, its lofty requirements for veil piercing require diligent regulation. However, government agencies can rarely provide such regulation, in large part because of the complicated corporate relationships the law allows to exist in the first place. It is perhaps not surprising, then, to see the same issues of fraud and other abuse that exist in the broader corporate world appear in the area of cyber charter schools.

C. *PA Cyber: A Case Study in Corporate Educational Relationships (Or, Arguably, Dysfunction)*

Having provided a capsule summary of corporate governance, the business judgment rule, and veil piercing, this Part turns to an exploration of recent events involving one of Pennsylvania’s cyber charter schools. In describing these events, this

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93. See *infra* Part II.C for a detailed description of the ongoing PA Cyber investigation.

94. Janet Greenlee et al., *An Investigation of Fraud in Nonprofit Organizations: Occurrences and Deterrents*, 36 *NONPROFIT & VOLUNTARY SECTOR Q.* 676, 676–78 (2007).

95. Nicole Gilkeson, Note, *For-Profit Scandal in the Nonprofit World: Should States Force Sarbanes-Oxley Provisions onto Nonprofit Corporations?*, 95 *GEO. L.J.* 831, 833 (2007).

96. *C.R. Bard, Inc. v. M3 Sys., Inc.*, 157 F.3d 1340, 1364 (Fed. Cir. 1998). Although this case deals with patent law, it provides an articulate, concise synopsis of the required elements of a fraud claim.

97. See Gilkeson, *supra* note 95, at 838 (explaining that the primary focus of the IRS is maximizing tax revenue—not rooting out fraud—and that the IRS may lack the impartiality necessary for uniform enforcement of fraud prohibitions).

98. See *id.* at 839–40 (explaining that attorneys general are only able to pursue the “worst offenders” given their “limited resources and vast responsibilities”). For every illegitimate corporate transaction, there are scores of perfectly legitimate corporate transactions. An investigatory agency cannot possibly hope to analyze every transaction, so without an inside tipster or other source that signals corporate impropriety, actively seeking out fraudulent activity is akin to searching for a needle in the proverbial haystack.

Part illustrates the corporate relationships that can form under Pennsylvania law. Additionally, this Part seeks to provide some context in which to frame the previous Part's theoretical discussion of corporate law. This framework should allow the reader to compare the legal system's goals to the results formed under it within the context of cyber charter schools.

By the metric of student enrollment, the largest cyber charter school in Pennsylvania is PA Cyber.<sup>99</sup> The school boasts an enrollment of over 11,000 students ranging from kindergarten to twelfth grade.<sup>100</sup> In addition to providing students with an opportunity to meet the educational objectives required for a high school diploma, PA Cyber aims "to give [students] the opportunity to grow beyond the normal curriculum and confines of a traditional school setting."<sup>101</sup>

PA Cyber's story requires some historical and geographical context. The school came about indirectly as a result of the collapse of the steel industry.<sup>102</sup> During the 1970s, steel manufacturing declined, and many Rust Belt communities accordingly suffered significant losses of wealth.<sup>103</sup> The Western Pennsylvania town of Midland numbered among these suffering towns.<sup>104</sup> Realizing that the golden age of steel had passed, and suffocated by the reality of living in a town with a dying job market, many Midland residents fled to other communities.<sup>105</sup> Predictably, the town could not replace those who moved away with new residents, and the initial trickle of fleeing residents quickly snowballed into a major population loss.<sup>106</sup> As residents left, Midland's tax base dropped dramatically, and tax revenue fell to the point where the town was forced to shutter its only public school in 1986.<sup>107</sup> The ensuing years witnessed a scramble for the remaining families to find public institutions to educate their children.<sup>108</sup> After several years of negotiations, a small town in Eastern Ohio agreed to educate Midland's children.<sup>109</sup> However, this arrangement quickly led to controversy because Pennsylvania tax dollars were being shuttled to an out-of-state beneficiary.<sup>110</sup>

The peculiar and unstable arrangement enacted to educate Midland's youth sowed the seeds for a creative solution. After Pennsylvania passed its cyber charter school law in 1997, an opportunity dawned for Midland.<sup>111</sup> In 1998, the town received a \$25,000

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99. Press Release, PR Newswire, PA Cyber Charter School Begins Enrolling Students for 2012–2013 School Year (Apr. 25, 2012).

100. *Our History*, PA CYBER, <http://www.pacyber.org/about.jsp?pageId=2161392240601286973678471> (last visited Mar. 13, 2014).

101. *Our Mission and Vision*, PA CYBER, <http://www.pacyber.org/about.jsp?pageId=2161392240601301473074778> (last visited Mar. 13, 2014).

102. *PA Cyber and Midland*, PA CYBER, <http://www.pacyber.org/about.jsp?pageId=2161392240601291297846033> (last visited Mar. 1, 2014).

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.*

108. *See id.* (explaining the failure of nearby communities to educate Midland's young people).

109. *Id.*

110. *Id.*

111. *Id.*

grant to address its educational problem and recruited a local education professional named Nick Trombetta to develop a plan to fix it.<sup>112</sup> Two years later, PA Cyber opened to educate approximately fifty students in Midland.<sup>113</sup> Over the years, PA Cyber has grown to be an institution that educates both children and young adults throughout the state.<sup>114</sup>

Prior to his founding and subsequent leadership of PA Cyber, Trombetta served in various educational leadership capacities in Western Pennsylvania communities.<sup>115</sup> He created a number of educational entities over the years, all of which provided different functions.<sup>116</sup> In addition to founding PA Cyber and a brick-and-mortar charter school with a performing arts focus,<sup>117</sup> he also founded and served as the first president of the National Network of Digital Schools Management Foundation (NNDS), a nonprofit organization that develops and provides curricula for traditional public schools, charter schools, and cyber charter schools.<sup>118</sup> One of the most successful curriculum services NNDS provides is the Lincoln Interactive, a self-paced curriculum that boasts “more than 250 courses in math, language arts, science, social studies, and a wide variety of electives.”<sup>119</sup> Over the years, Trombetta’s various organizations have become intertwined in terms of both leadership and finances.<sup>120</sup>

During the summer of 2012, the *Pittsburgh Post-Gazette* attempted to trace the complex flow of money among Trombetta’s organizations.<sup>121</sup> Through an analysis of annual reports and information gathered from Right To Know requests,<sup>122</sup> the newspaper pieced together a report on PA Cyber’s financial dealings with various other organizations with which Trombetta was involved.<sup>123</sup> The report uncovered a long history of dealings between NNDS and PA Cyber.<sup>124</sup> In particular, shortly after

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112. *Id.*

113. *Id.*

114. *Id.*

115. See David Conti, *Feds Charge Pa. Cyber School Founder with 11 Counts of Fraud, Conspiracy*, TRIBLIVE (Aug. 23, 2013, 10:53 AM), <http://www.wpxi.com/news/news/local-education/feds-charge-pa-cyber-school-founder-11-counts-fraud/nZZws/> (noting that Trombetta served as a principal in the Aliquippa school district, was the superintendent for Midland Borough schools, worked for over a decade in the East Liverpool School District, and started PA Cyber in 2000).

116. See James Hilston, *Cyber Charter Schools: Following the Money*, PITT. POST-GAZETTE (July 15, 2012), [http://old.post-gazette.com/pg/images/201208/20120812cyber\\_charter\\_schools1000.png](http://old.post-gazette.com/pg/images/201208/20120812cyber_charter_schools1000.png) (noting that among the entities launched by Trombetta are PA Cyber and the Lincoln Park Performing Arts Charter School).

117. *History*, LINCOLN PARK PERFORMING ARTS CHARTER SCHOOL, <http://www.lppacs.org/about/history.php> (last visited Mar. 13, 2014).

118. *About NNDS*, NAT’L NETWORK OF DIGITAL SCHOOLS, <http://www.nndsonline.org/about/> (last visited Mar. 1, 2014).

119. LINCOLN INTERACTIVE, <http://www.lincolninteractive.org/> (last visited Mar. 1, 2014).

120. See Hilston, *supra* note 116 (exhibiting a flow chart detailing the interconnectedness of Trombetta’s various organizations).

121. Rich Lord & Eleanor Chute, *Millions Flow to School’s Spinoffs PA Cyber Charter School’s Former Executives Are Running Companies Getting the Funds*, PITT. POST-GAZETTE, July 15, 2012, at A1.

122. Pennsylvania’s Right to Know law provides residents with the ability to access information relating to Pennsylvania agencies and their activities. 65 PA. CONS. STAT. ANN. § 67.301 (West 2014).

123. Lord & Chute, *supra* note 121, at A1.

124. *Id.*

NNDS's founding in 2005, it entered into an agreement with PA Cyber whereby NNDS would manage PA Cyber in exchange for twelve percent of the school's income.<sup>125</sup> Despite the fact that Trombetta and several others were involved with both PA Cyber and NNDS, PA Cyber soon sold its online curriculum to NNDS.<sup>126</sup> The *Pittsburgh Post-Gazette* learned that NNDS has been selling the curriculum back to PA Cyber for a number of years. As an example of the dealing between the two organizations, the paper reported that "[d]uring the 2010–11 school year, PA Cyber paid NNDS \$13.1 million as a management fee, and \$31 million for curriculum."<sup>127</sup> Additional complications arose from NNDS's handling of its money: it paid almost \$7 million to for-profit Avanti Management Group, a corporation headed by several former PA Cyber executives.<sup>128</sup> The *Pittsburgh Post-Gazette* created and published a powerful graphical representation of the interconnectedness of the finances and leadership of Trombetta's various organizations.<sup>129</sup>

Pursuant to PA Cyber's most recent charter renewal request in 2010, the Pennsylvania Secretary of Education, Thomas Gluck, advised the school that it "must provide more transparency in their agreement with an Educational Management Organization [such as NNDS]."<sup>130</sup> The report requested more details regarding "services rendered" from NNDS to PA Cyber, including requests for itemized cost breakdowns and the identity of those who performed the services.<sup>131</sup> This report, dated June 9, 2010, gave PA Cyber until March 31, 2011 to make and provide notice of the changes contained in the document.<sup>132</sup> PA Cyber eventually responded on March 31, 2011.<sup>133</sup> However, by this point, Governor Ed Rendell, under whom Gluck served, had been replaced by Governor Tom Corbett, and a new Secretary of Education had been appointed.<sup>134</sup> In responding to the information request made back in June, Trombetta stated that NNDS was ill equipped to provide the information and that the costs of changing its systems could be prohibitive.<sup>135</sup> The Corbett PDE acquiesced, stating that it did not have the authority to impose such requirements as part of the charter renewal process.<sup>136</sup> In May 2012, Trombetta officially resigned from his official capacity as

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125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.*

129. Hilston, *supra* note 116.

130. THOMAS E. GLUCK, PA. DEP'T OF EDUC., IN RE: PENNSYLVANIA CYBER CHARTER SCHOOL CYBER CHARTER RENEWAL APPLICATION 6 (2010), [http://www.portal.state.pa.us/portal/http://www.portal.state.pa.us;80/portal/server.pt/gateway/PTARGS\\_0\\_123531\\_1245524\\_0\\_0\\_18/pa\\_cyber.pdf](http://www.portal.state.pa.us/portal/http://www.portal.state.pa.us;80/portal/server.pt/gateway/PTARGS_0_123531_1245524_0_0_18/pa_cyber.pdf).

131. *Id.*

132. *Id.* at 2, 9. The bulletin contained other requirements as well, such as changes related to meeting No Child Left Behind proficiency benchmarks. *Id.* at 2–5. These other requests are beyond the scope of this Comment.

133. Lord & Chute, *supra* note 121, at A1.

134. Eleanor Chute, *Meet Some Key Corbett Cabinet Picks: Ron Tomalis, Secretary of Education*, PITT. POST-GAZETTE, Jan. 30, 2011, at B1.

135. See Lord & Chute, *supra* note 121, at A1 ("Mr. Trombetta wrote that NNDS's 'internal systems and structure are not set up to provide some of the information.' Changing its systems 'may create a higher cost for services to their customers and put their organization at a competitive disadvantage.'").

136. *Id.*

CEO of PA Cyber.<sup>137</sup>

On July 12, 2012, Federal Bureau of Investigation (FBI) agents raided Trombetta's offices.<sup>138</sup> Although the U.S. Department of Justice stated that PA Cyber was not the target of an investigation, the agents were looking for contracts involving PA Cyber and other entities, particularly those in which Trombetta was involved.<sup>139</sup> There is speculation among scholars regarding the terms and conditions of these contracts.<sup>140</sup> The language of the contracts may limit the extent to which Trombetta could move taxpayer money among his various corporate structures.<sup>141</sup> It remains to be seen whether Trombetta breached these contracts.

Following the dramatic events during the summer of 2012, PA Cyber's leadership structure changed. On September 17, 2012, the school's board of directors fired the school's director, finance director, personnel director, and compliance officer.<sup>142</sup> The school also disposed of the law firm that had been providing legal counsel.<sup>143</sup> The board did not comment on the reasons for its actions, and it has not been determined with certainty that the terminations related to the FBI investigation.<sup>144</sup>

On August 24, 2013, the FBI investigation culminated with a federal grand jury indictment against Trombetta for fraud, tax conspiracy, and false tax returns.<sup>145</sup> The forty-one-page indictment was followed by a press conference where U.S. Attorney David Hickton asserted that Trombetta's conduct represented "a conscious, intentional scheme to steal money that was to be used to educate our children."<sup>146</sup> Hickton also described even more layers of Trombetta's corporate network: when the investigation into PA Cyber and its corporate siblings gathered momentum in July 2012, Trombetta created a new corporation called Presidio Education Network, LLC to drain money

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137. Patrick O'Shea, *Trombetta Leaves a Diverse Legacy*, ELLWOOD CITY LEDGER (May 15, 2012, 12:15 AM), [http://www.ellwoodcityledger.com/news/local\\_news/trombetta-leaves-a-diverse-legacy/article\\_b6d5a1a5-ee68-523d-840f-65539e5c705c.html?TNNNoMobile](http://www.ellwoodcityledger.com/news/local_news/trombetta-leaves-a-diverse-legacy/article_b6d5a1a5-ee68-523d-840f-65539e5c705c.html?TNNNoMobile).

138. *Nick Trombetta, Pennsylvania Cyber Charter School Founder, Has Office Raided By FBI Agents*, HUFFINGTON POST (July 13, 2012, 3:46 PM), [http://www.huffingtonpost.com/2012/07/13/fbi-agents-raid-office-of\\_n\\_1671829.html](http://www.huffingtonpost.com/2012/07/13/fbi-agents-raid-office-of_n_1671829.html).

139. Bill Vidonic, *Tax Records Disclose Cyber School's Odd Deal with Nonprofit*, TRIBLIVE (July 14, 2012, 12:01 AM), <http://triblive.com/news/2200813-74/cyber-agents-nnds-records-federal-curriculum-departm-ent-served-education-million#axzz2jhW5QIN3>.

140. *See id.* (quoting Bruce Antkowiak, a law professor and former prosecutor, as stating, "If you tell me that a (school) that potentially received Department of Education funds and used that to create a commercial product that they're now leasing back (from NNDS), and a lot of people are making money, that may not be the terms and conditions under which they got the money from the federal government.").

141. *See id.* (quoting scholars who speculate that the actions taken by Trombetta may not have been authorized under the school's agreement with the federal government).

142. Patrick O'Shea, *Four Officials Fired at PA Cyber Charter School*, ELLWOOD CITY LEDGER (Sept. 19, 2012 12:15 AM), [http://www.ellwoodcityledger.com/news/local\\_news/four-officials-fired-at-pa-cyber-charter-school/article\\_7671aebf-fa79-599d-bd57-693a7da3d5d0.html?TNNNoMobile](http://www.ellwoodcityledger.com/news/local_news/four-officials-fired-at-pa-cyber-charter-school/article_7671aebf-fa79-599d-bd57-693a7da3d5d0.html?TNNNoMobile).

143. *Id.*

144. *Id.*

145. Indictment, *United States v. Trombetta*, (W.D. Pa. 2013), available at <http://ae3b703522cf9ac6c40a-32964bea949fe02d45161cf7095bfea9.r89.cf2.rackcdn.com/2013/235/627/41-page-federal-indictment-of-nicholas-trombetta-and-neal-prence.pdf>.

146. Jonathan D. Silver & Paula Reed Ward, *Feds: PA Cyber Charter School Founder Trombetta Schemed to Steal \$1 Million*, PITT. POST-GAZETTE, Aug. 24, 2013, at A1.

from Avanti.<sup>147</sup> A few days after the indictment, Trombetta pleaded not guilty to the charges filed against him.<sup>148</sup> Trombetta's attorney asserted that Trombetta was "mystified" that he was named a defendant in the case and that his client "fully intends to go to trial."<sup>149</sup> Regardless of the eventual outcome of the trial, the entire affair has brought PA Cyber's story into the media limelight. The question is what legal lessons society can draw from the ordeal.

### III. DISCUSSION

Although the FBI raid, investigation, and indictment represent a step forward in terms of adding transparency to how cyber charter schools are governed and spend money, they are reactive steps. Time will tell exactly what, if anything, Trombetta was doing illegally and for how long he was doing it. Nevertheless, the entire situation reveals a potential gap in the law's approach to dealing with the problem of using taxpayer dollars to fund various educational ventures under a common corporate umbrella. From a policy perspective, the question that logically follows asks whether the law can provide a more proactive framework to prevent these types of problems from happening in the first place. The remainder of this Comment addresses this question.

Part III.A forms the basis of a policy argument in response to PA Cyber's story: while the legal system is equipped to deal with fraud upon its discovery, it does not provide a sufficient motivation for a nonprofit corporation's actors to refrain from committing fraud. This Part posits that proactive reform is desirable for a number of reasons, especially within the context of digitized education. Part III.B presents suggestions on how the legal system can be reformed with an eye towards preventing fraudulent activity by those involved in the creation and operation of cyber charter schools. This Part is divided into three subparts that reflect three categories of proactive solutions to the fraud problem: increased regulations by governmental agencies, legal reforms designed to promote effective internal regulations carried out by the cyber charter schools themselves, and a hybrid category where external rules are imposed so as to encourage self-monitoring.

#### A. *The Desirability of Proactively Preventing Fraud*

PA Cyber's story is not uncommon. Research demonstrates that many charter schools commit or are under investigation for fraud.<sup>150</sup> While nonprofit fraud in general continues to be a significant issue,<sup>151</sup> fraud within the charter school system presents a

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147. Indictment, *supra* note 145, at 27–28. According to the indictment, Trombetta and his sister used another corporation called One2One Enterprises to drain money from Avanti from 2006 onward. *Id.* at 5. Hickton characterized One2One as Trombetta's "own personal MAC machine." Silver & Ward, *supra* note 148, at A1.

148. Rich Lord, *Cyber School Pioneer Pleads Not Guilty*, PITT. POST-GAZETTE, Aug. 29, 2013, at B5.

149. *Id.*

150. See Susan L. DeJarnatt, *Follow the Money: Charter Schools and Financial Accountability*, 44 URB. LAW. 37, 49–51 (2012) (providing numerous examples of charter schools that engaged in fraudulent or suspect financial activity).

151. See Greenlee et al., *supra* note 94, at 677 (providing statistical evidence of fraud committed by

particularly pressing problem. For one thing, charter schools' status as laboratories of educational tactics leads to large amounts of intellectual property in the form of curricula and other educational methods.<sup>152</sup> Because of this tendency, those who form cyber charter schools sometimes seek to sell the intellectual property and form corporations to do so.<sup>153</sup> Furthermore, given the fact that cyber charter schools appear to be a growing phenomenon nationwide<sup>154</sup> and the relative novelty of the concept of digital education,<sup>155</sup> a market exists for the buying and selling of online curricula.<sup>156</sup> On a separate note, the fact that charter schools receive an overwhelming proportion of their annual budget from public money<sup>157</sup>—unlike many other nonprofit organizations<sup>158</sup>—broadens the implications of fraudulent dealing among corporate structures. Instead of involving the financial contributions of a small, select group of donors, fraud in the context of cyber charter schools implicates all of a state's taxpayers, whether or not they have children who actually attend the school in question. Finally, the unique ability of cyber charter schools to generate surpluses increases the potential for fraudulent activity.<sup>159</sup>

As a preliminary matter, the idea of proactively preventing fraud needs to be justified. An opponent of proactive reform might posit the following: the legal system

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nonprofit corporations).

152. See *supra* note 18 and accompanying text for a description of the idea that charter schools can serve as testing grounds for innovative teaching methodologies. One example of valuable intellectual property stemming from the operation of a charter school can be found in Doug Lemov's book, *Teach Like A Champion*, which describes a set of skills that the author claims all highly effective teachers possess. This book has become a foundational component of programs that train new teachers for service in high-needs classrooms. See, e.g., Josh Sarracino, *PTF Weekly Update 3-26-13*, PHILA. TEACHING FELLOWS (Apr. 2, 2013, 5:54 AM), <http://ptfweeklybuzz.blogspot.com/2013/04/ptf-weekly-update-3-26-13.html> (requiring Teaching Fellows to read the book as part of preservice training).

153. See *supra* notes 124–29 and accompanying text for an example of this type of transaction taking place within Nick Trombetta's network of nonprofit corporations.

154. See Weintana Abraha, *Cyber Charter Schools: The End of Public Education or a New Beginning?*, MADAME NOIRE (Nov. 22, 2010), <http://madamenoire.com/105928/cyber-charter-schools-the-end-of-public-education-or-a-new-beginning/> (reporting that 217 of the nearly 5,000 charter schools across the country are virtual or cyber).

155. See *supra* Part II.A.2 for more information on the relative novelty of the idea that the Internet can be used as a tool to deliver education.

156. See *supra* note 119 and accompanying text for a description of Lincoln Interactive—just one company that sells online curricula for a number of grades and academic subjects.

157. See *supra* notes 21–23 and accompanying text for a description of how charter schools receive public money. In 2009–10, Pennsylvania's eleven cyber charter schools received over \$250 million. JACK WAGNER, PA. DEP'T OF THE AUDITOR GEN., SPECIAL REPORT: CHARTER AND CYBER CHARTER EDUCATION FUNDING REFORM SHOULD SAVE TAXPAYERS \$365 MILLION ANNUALLY 4 (2012), <http://www.auditorgen.state.pa.us/Department/Press/CyberCharterSpecialReport201206.pdf>.

158. Compare Hee Soun Jang & Richard C. Feiock, *Public Versus Private Funding of Nonprofit Organizations: Implications for Collaboration*, 31 PUB. PERFORMANCE & MGMT. REV. 174, 177 (2007) ("Government funding accounts for 66 percent of the revenues of health related nonprofits and 52 percent of revenues of social welfare organizations."), with U.S. DEP'T OF EDUC., OFFICE OF EDUC. RESEARCH & IMPROVEMENT, VENTURESOME CAPITAL: STATE CHARTER SCHOOL FINANCE SYSTEMS 80 n.36 (2000) (calculating that in 1997–98 private funding totaled just \$8 per pupil in school districts that included charter schools).

159. See *supra* notes 34–39 and accompanying text for a description of why cyber charter schools can generate more excess revenue than their brick-and-mortar counterparts.

already penalizes fraud, does this not serve as a sufficient deterrent to the temptation to engage in fraudulent activity?<sup>160</sup> This argument misses the mark on two fronts. It is true that, although PA Cyber and other instances of suspect activity may suggest a broken system, they do not necessarily prove one.<sup>161</sup> However, the repeated instances of fraud within existing charter schools and the rapid expansion of charter schools serve as persuasive indicators that the current legal scheme for dealing with fraud does not serve as a strong deterrent.<sup>162</sup>

Secondly, other benefits aside from deterrence will accrue from reform in this area. The potential financial benefits alone are significant,<sup>163</sup> as fraud investigations drain the time, financial resources, and manpower of investigative agencies.<sup>164</sup> Gathering the resources required for a sufficient evidentiary basis to allege fraud is no small feat; successfully proving fraud grows this cost even further.<sup>165</sup> With well-reasoned reform that aims to take the law in a proactive direction, these institutions would have fewer potential fraud cases to pursue in the realm of cyber charter schools. With fewer fraud cases, they could use their limited resources for other purposes.

### B. *Types of Proactive Reform*

It is clear that Pennsylvania should restructure its legal system so that it better prevents fraud from happening in the first place. This Comment now transitions to how exactly this goal might be accomplished. Ideas to proactively prevent fraud in cyber charter schools fall into three broad camps. The first camp centers on increased administrative oversight, either by consolidating current administrative agencies' power or creating new agencies with new powers.<sup>166</sup> The second camp proposes to combat nonprofit fraud through encouraging self-regulation on the part of the corporation's actors.<sup>167</sup> Self-regulation works quite well within the for-profit corporate

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160. See Jessica M. Erickson, *Overlitigating Corporate Fraud: An Empirical Examination*, 97 IOWA L. REV. 49, 77 (2011) (discussing how traditional theories of deterrence indicate that corporate managers contemplating committing corporate fraud will weigh expected benefits of the act against expected costs, including penalties and sanctions).

161. See Michael A. Gillen & Steven M. Packer, *While Markets Continue to Fall, Fraud Activity Continues to Rise*, N.J. LAW. MAGAZINE, June 2009, at 66, 68 (explaining that “[t]he premise of fraud deterrence presumes fraud is not a random occurrence, but rather occurs when conditions are weak and fraud-motivating factors are present”).

162. See DeJarnatt, *supra* note 150, at 40 (noting that the U.S. Attorneys' Office has investigated nineteen charter schools in Philadelphia alone for fraud).

163. See Mary Kreiner Ramirez, *Prioritizing Justice: Combating Corporate Crime from Task Force to Top Priority*, 93 MARQ. L. REV. 971, 1007 (2010) (explaining that “[c]orporate fraud cases are time-consuming to investigate and costly to prosecute, relative to other criminal and civil matters”). It follows that numerical reduction of fraud cases will save some costs.

164. See Miriam H. Baer, *Linkage and the Deterrence of Corporate Fraud*, 94 VA. L. REV. 1295, 1305 (2008) (observing that, because corporate fraud crimes are complex and take a long time to investigate, delays in identification and prosecution of perpetrators are a likely result).

165. See 41 AM. JUR. 2D *Indictments and Informations* § 26 (2013) (reviewing procedural requirements required for a criminal fraud indictment); Baer, *supra* note 164, at 1305–06 (using the trial of Enron's Jeffrey Skilling and Kenneth Lay to illustrate the difficulty of successfully pursuing a criminal fraud prosecution).

166. See *infra* Part III.B.1 for a thorough description and critique of this camp.

167. See *infra* Part III.B.2 for a thorough description and critique of this camp.

community through self-interested shareholders, so this camp seeks to devise similar motivation for those involved with nonprofits.<sup>168</sup> The idea of increasing penalties for fraud, either statutorily or through discretionary means like punitive damages, also falls within this camp.<sup>169</sup> The third camp proposes a hybrid of the other two camps—heightened legislative and administrative regulation, but with a goal of encouraging corporate self-regulation.<sup>170</sup> The following subparts examine each of these camps in turn and particularly concentrate on their respective deficiencies. The final subpart concludes that the third camp offers the best promise for substantive reform. Two specific statutory changes are recommended: cyber charter schools should be funded according to a different algorithm, and directors should be held to a stricter standard for negligent administration of their duties.

### 1. Increased Oversight

Increased administrative oversight seems to be a commonsense response to deal with the potential for cyber charter schools to engage in fraudulent activity. The argument proceeds as follows: there already exists a patchwork of authority delegated to agencies that proposes to investigate and litigate potentially fraudulent activity, but increasing these agencies' power—and budgets—will ensure better responsiveness.<sup>171</sup> This line of argument may also call for new administrative agencies that have clearer mandates of power and more focused missions than the current agencies tasked with policing fraud among cyber charter schools.<sup>172</sup>

Three entities regulate the conduct of Pennsylvania's cyber charter schools: the IRS, the PDE, and the office of the state Attorney General. The PDE possesses the most direct link to cyber charter schools, as it initially grants a school's charter, reviews a school's annual reports, and decides whether or not to renew a particular school's charter every five years.<sup>173</sup> Despite having this authority, the PDE's decisions are largely procedural. The statutory factors governing charter renewal read like a checklist, and given the PDE's high rate of charter renewals, the factors are of questionable stringency.<sup>174</sup> Furthermore, the PDE handles many other tasks, all of

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168. See Richard J. Zeckhauser & John Pound, *Are Large Shareholders Effective Monitors? An Investigation of Share Ownership and Corporate Performance*, in *ASYMMETRIC INFORMATION, CORPORATE FINANCE, AND INVESTMENT* 149, 153 (R. Glenn Hubbard ed., 1990) (arguing that "large outside shareholders can play an important role by monitoring management actions and influencing management decisions").

169. See *supra* Part III.A for a description of how legal penalties can shape behavior.

170. See *infra* Part III.B.2 for a description of the interaction between legal rules and internal compliance.

171. See, e.g., Ezra Ross & Martin Pritikin, *The Collection Gap: Underenforcement of Corporate and White-Collar Fines and Penalties*, 29 *YALE L. & POL'Y REV.* 453, 496 (2011) (arguing that insufficient resources is a contributing factor to the undercollection of fines levied upon corporate actors).

172. See, e.g., Robert J. Martin, *Rigid Rules for Charter Schools: New Jersey as a Case Study*, 36 *RUTGERS L.J.* 439, 522–23 (2005) (arguing that New Jersey's Department of Education has failed to effectively oversee charter schools and that another agency should assume oversight responsibilities).

173. 24 PA. CONS. STAT. ANN. §§ 17-1741-A(a)(1)–(3), 17-1742-A (West 2014).

174. See PA. CLEARINGHOUSE FOR EDUC. RESEARCH, *CHARTER SCHOOL AUTHORIZATION AND ACCOUNTABILITY: AN OVERVIEW FOR STATE POLICYMAKERS* 11 (2011), <http://www.researchforaction.org/wp-content/uploads/2011/12/RFA-PACER-brief-Charter-school-authorization.pdf> (noting that the charter reauthorization process generally produces low school closure rates).

which spread its resources thin: it must manage all state public schools, all state charter schools, various postsecondary institutions, and more.<sup>175</sup>

Because the PDE already possesses considerable decision-making authority, it is difficult to imagine a way in which to increase its power. Cyber charter schools are already required to submit detailed annual reports, and the PDE is supposed to conduct site visits to ensure a cyber charter school's operations function properly.<sup>176</sup> Given these statutory arrangements, some suggest that a better answer would be to increase the PDE's resources so that it might be able to dedicate more time and energy to policing cyber charter schools.<sup>177</sup>

As a practical matter, this tactic will likely fail to be enacted. It is no secret that Pennsylvania underfunds education,<sup>178</sup> and funding has decreased during the Corbett administration.<sup>179</sup> Empirical evidence is conflicted regarding the correlation between better funding and increased competence in carrying out administrative duties.<sup>180</sup> Furthermore, the harsh political battle likely to occur following a formal proposal to increase funding arguably requires an exceedingly persuasive justification for that funding.<sup>181</sup> All of the above militates against increasing the power of the PDE, despite the fact that it is the primary regulator of cyber charter schools.

Other potential regulators exist, but increasing their powers or budgets would not solve the problem of cyber charter school fraud. The state Attorney General's office serves as the body that investigates and litigates fraud claims after they have been alleged.<sup>182</sup> However, increasing the office's power or budget does not *proactively* prevent fraud.<sup>183</sup> Post hoc investigation or litigation initiated by a law enforcement

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175. See PA. DEP'T OF EDUC., PDE ORG. CHART (2012), [http://www.portal.state.pa.us/portal/http://www.portal.state.pa.us;80/portal/server.pt/gateway/PTARGS\\_0\\_123531\\_1298337\\_0\\_0\\_18/PDE%20ORG%20CHART%2011%205%202012.pdf](http://www.portal.state.pa.us/portal/http://www.portal.state.pa.us;80/portal/server.pt/gateway/PTARGS_0_123531_1298337_0_0_18/PDE%20ORG%20CHART%2011%205%202012.pdf) (providing a useful flow chart that shows the broad scope of the PDE's administrative duties); *Programs*, PA. DEP'T OF EDUC., <http://www.pde.state.pa.us/portal/server.pt/community/programs/7240> (last visited Mar. 1, 2014) (providing a list of the many programs provided by the PDE).

176. 24 PA. CONS. STAT. ANN. § 17-1743-A(f)–(g).

177. See EDUC. LAW CTR., ANALYSIS OF 2012–13 EDUCATION BUDGET PROPOSED BY GOVERNOR CORBETT 12 (2012), [http://www.elc-pa.org/wp-content/uploads/2013/11/ELC\\_Analysis\\_EducationBudget\\_2\\_16\\_12.pdf](http://www.elc-pa.org/wp-content/uploads/2013/11/ELC_Analysis_EducationBudget_2_16_12.pdf) (arguing that the Corbett administration has underfunded the PDE).

178. See Press Release, Pa. School Funding Campaign, PA Senate Severely Underfunds Education (June 18, 2008) (positing that state lawmakers ignored their own commissioned study regarding the requisite financial costs to properly educate Pennsylvania's young people).

179. See EDUC. LAW CTR., *supra* note 177, at 12, for statistics regarding this funding decrease.

180. See FRANCOIS BOUVARD ET AL., MCKINSEY & CO., BETTER FOR LESS: IMPROVING PUBLIC SECTOR PERFORMANCE ON A TIGHT BUDGET 11 (2011), [http://www.mckinsey.com/client\\_service/public\\_sector/people/~media/mckinsey/dotcom/client\\_service/public%20sector/pdfs/better\\_for\\_less\\_improving\\_public\\_sector\\_performance\\_on\\_a\\_tight\\_budget.ashx](http://www.mckinsey.com/client_service/public_sector/people/~media/mckinsey/dotcom/client_service/public%20sector/pdfs/better_for_less_improving_public_sector_performance_on_a_tight_budget.ashx) (describing comparative research results that show an increase in funding does not always correlate to increased service performance).

181. *Cf.* EDUC. LAW CTR., *supra* note 177, at 12 (“Given the difficult economic climate and the state budget deficit, large increases in state funding for education cannot be expected for the 2012–13 fiscal year.”).

182. The Attorney General's office normally receives referrals regarding fraudulent activities involving state agencies from the Inspector General. See *Pennsylvania's Inspector General, Kenya Mann Faulkner*, PA. OFFICE OF INSPECTOR GEN., [http://web.archive.org/web/20120229051922/http://www.oig.state.pa.us/portal/server.pt/community/meet\\_the\\_inspector\\_general/3784](http://web.archive.org/web/20120229051922/http://www.oig.state.pa.us/portal/server.pt/community/meet_the_inspector_general/3784) (last visited Mar. 1, 2014) (describing the Inspector General's role in relation to law enforcement authorities).

183. *Compare id.* (“Alleged criminal activity discovered during an investigation by the Office of

agency represents a *reaction*. Moreover, aside from the dubious deterrence that increased law enforcement presence may bring to the table,<sup>184</sup> Pennsylvania stands to gain little from broadening the power of the Attorney General's office. The fact that the FBI involved itself in the PA Cyber raid creates an inference that Pennsylvania law enforcement failed.<sup>185</sup> Similar logic applies to the IRS, which only has tangential involvement due to nonprofits' status as tax-exempt organizations.<sup>186</sup> Recent statistics indicate that the IRS lacks the ability to conduct widespread, in-depth audits of organizations.<sup>187</sup>

An alternative to increasing current bodies' power or budget could be the creation of a new governmental body that specifically regulates cyber charter schools. This idea has some theoretical appeal because brick-and-mortar charter schools are overseen by both the PDE and the local school district in which they reside.<sup>188</sup> Cyber charter schools have no secondary counterpart exercising administrative oversight.<sup>189</sup> In creating a conceptual framework for this external organization, one might expect that the organization would be hierarchically subservient to the PDE but would function autonomously from it.<sup>190</sup>

But the idea of creating a regulatory agency to govern cyber charter schools has significant drawbacks. Creating an organization that shares duties with, but is subservient to, a state department could quickly devolve into a bureaucratic

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Inspector General is referred to the appropriate law enforcement agency.”), with *Mission Statement*, PA. ATT'Y GEN., <http://www.attorneygeneral.gov/theoffice.aspx?id=168> (last visited Mar. 1, 2014) (describing the Attorney General as “the Commonwealth's chief law enforcement officer charged with the responsibility for the prosecution of organized crime and public corruption).

184. See *infra* Part III.B.2 for a discussion of the deterrence effect that law enforcement officers have on fraudulent activity.

185. Indeed, while the IRS's reporting requirements led the federal government to become aware of the financial relationship between PA Cyber and NNDS, Pennsylvania law enforcement made no public inquiry into the relationship. See *supra* notes 138–40 and accompanying text for a description of the FBI raid on Nick Trombetta's offices. Many nonprofit organizations must file annual 990 forms with the IRS; these forms detail the nonprofit organizations' programs and finances. *FAQs: Form 990*, GUIDESTAR, <http://www.guidestar.org/rxg/help/faqs/form-990/index.aspx> (last visited Mar. 1, 2014). The 2010 990 form submitted by the NNDS shows that the organization sold curricula to both PA Cyber and Lincoln Park Performing Arts Charter School. NAT'L NETWORK OF DIGITAL SCHOOLS MGMT. FOUNDATION, RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX (2010), available at [http://990s.foundationcenter.org/990\\_pdf\\_archive/260/260125828/260125828\\_201106\\_990.pdf](http://990s.foundationcenter.org/990_pdf_archive/260/260125828/260125828_201106_990.pdf). Pennsylvania law enforcement made no public inquiry into this financial relationship.

186. *Types of Tax-Exempt Organizations*, INTERNAL REVENUE SERV., <http://www.irs.gov/Charities-&-Non-Profits/Types-of-Tax-Exempt-Organizations> (last visited Mar. 1, 2014).

187. See, e.g., INTERNAL REVENUE SERV., 2012 DATA BOOK 21, <http://www.irs.gov/pub/irs-soi/12databk.pdf> (“[T]he IRS examined [only] 0.9 percent of all returns filed in Calendar Year (CY) 2011 . . . and 1.6 percent of corporation income tax returns.”).

188. See *supra* notes 19–26 and accompanying text for a more detailed description of how brick-and-mortar charter schools are governed by both the local school district and the state department of education.

189. See *supra* notes 41–43 and accompanying text for the Pennsylvania legislature's decision that cyber charter schools are to be regulated solely by the PDE.

190. Such a body would be analogous to the relationship between the Office of the Inspector General and the Office of the Attorney General. See *supra* notes 182–83 for a description of the relationship between these two agencies.

nightmare.<sup>191</sup> A separate regulatory body would not be perfectly analogous to a local school district's management because the organization would be a state-run, rather than local, institution. Perhaps most damningly, the costs required to form a distinct body would likely kindle political infighting among legislators, so the practicality of such a new organization is suspect.

## 2. Encouraging Self-Regulation

Another potential approach to dealing with the problem of suspicious financial dealings by cyber charter schools uses the law as a vehicle to motivate internal compliance by creating a stronger deterrent to fraud.<sup>192</sup> In the abstract, there are strong arguments for the idea of encouraging self-regulation. From an economic perspective, self-regulation implies fewer administrative costs, which in turn increases systemic efficiency.<sup>193</sup> Aside from easing the burdens on the IRS and the Pennsylvania Attorney General's office, an internal check on fraud also eases pressure on courts' dockets, the flooding of which is an ever-worsening problem.<sup>194</sup>

However, while appealing in theory, changing the law to promote self-regulation among nonprofits is easier said than done. Some motivations for honest dealing and internal regulation of conduct already exist.<sup>195</sup> At a fundamental level, a corporation has an interest in its own longevity.<sup>196</sup> Because of this basic interest in continued existence, there is some baseline motivation for self-regulation.<sup>197</sup> Nevertheless, corporations and the people directing them are not coterminous.<sup>198</sup> The idea that a

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191. See Todd S. Aagaard, *Regulatory Overlap, Overlapping Legal Fields, and Statutory Discontinuities*, 29 VA. ENVTL. L.J. 237, 237 (2011) ("Lawmakers and scholars alike criticize regulatory overlap on the ground that giving administrative agencies overlapping jurisdiction leads to duplicative or conflicting regulation which is inefficient and unduly burdensome.").

192. See Michael Goldsmith & Chad W. King, *Policing Corporate Crime: The Dilemma of Internal Compliance Programs*, 50 VAND. L. REV. 1, 3 (1997) (stating that "[i]n recent years, federal and state laws have sought to promote good corporate citizenship by encouraging business entities to establish internal compliance programs designed to avoid—or at least detect—illicit conduct").

193. See Robert W. Hahn & John A. Hird, *The Costs and Benefits of Regulation: Review and Synthesis*, 8 YALE J. ON REG. 233, 235 (1990) (stating that the recent increase in governmental regulations has increased the cost of doing business and may have an impact on the economy as a whole).

194. See R. LAFONTAIN ET AL., NAT'L CTR. FOR STATE COURTS, EXAMINING THE WORK OF STATE COURTS: AN ANALYSIS OF 2010 STATE COURT CASELOADS 2 (2012), [http://www.courtstatistics.org/Other-Pages/~media/Microsites/Files/CSP/DATA%20PDF/CSP\\_DEC.ashx](http://www.courtstatistics.org/Other-Pages/~media/Microsites/Files/CSP/DATA%20PDF/CSP_DEC.ashx). (stating that although total caseloads fell in 2010, statistics since 2001 indicate an increase in the amount of litigation state courts handle).

195. See Renee M. Jones, *Law, Norms, and the Breakdown of the Board: Promoting Accountability in Corporate Governance*, 92 IOWA L. REV. 105, 120 (2006) (asserting that market competition increases the need for effective internal management of corporations because "any corporation with ineffective management will fail to thrive in competitive markets"). Although charter schools are nonprofits and do not compete in the marketplace in the same way as for-profit corporations, some element of competition does exist due to a school's desire to attract more students and receive more taxpayer funding.

196. Scott H. Segal & Ricardo Reyes, *Masks and Mystification: The Challenges of Media Relations and Public Relations for Lawyers*, 67 TEX. B.J. 752, 755 (2004).

197. See Usha Rodrigues, *From Loyalty to Conflict: Addressing Fiduciary Duty at the Officer Level*, 61 FLA. L. REV. 1, 23 (2009) (exploring why corporations implement internal codes in an attempt to self-regulate).

198. See *supra* Part II.B.1 for a description of the idea that although a corporation exists as a legal entity,

corporation has an interest in its own continued existence does not necessarily ensure that the directors and officers making decisions on the corporation's behalf prioritize this same concern.<sup>199</sup> At some point, in situations where fraudulent activity has taken place, a corporation's decisionmakers may decide that breaking the law can be a profitable endeavor that is unlikely to threaten the corporation's continued existence.<sup>200</sup>

Because nonprofits lack shareholders who police fraudulent activity through self-interest, one may well wonder whether it is possible to achieve self-regulation without self-interested internal actors.<sup>201</sup> Nonprofit corporations have boards of directors who owe fiduciary duties to the corporation. In addition to their duties of care and loyalty, board members may be under some social pressure to monitor the goings-on of a corporation.<sup>202</sup> If a corporation engages in actionable fraud, board members may have to deal with the subsequent publicity fallout.<sup>203</sup> In severe instances, they may be forced to resign.<sup>204</sup> However, this social pressure and the duty of care may not serve as enough of an impetus for a director to know the goings-on of a corporation.<sup>205</sup> Usually, a board member for a nonprofit receives little or no compensation for services provided.<sup>206</sup> Although intelligent and successful people usually serve on boards, the law does not require that they be particularly active.<sup>207</sup> Furthermore, given that nonprofit board members are often busy people, the amount of time and interest they can possibly dedicate to keeping an active tab on the corporation's affairs is necessarily limited.<sup>208</sup>

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its decisionmakers are humans who owe fiduciary duties to the corporation.

199. The recognition that a corporation and its directors may not have the same interest is one reason why the law requires directors to carry fiduciary duties toward a corporation in the first place. Bruner, *supra* note 72, at 1133–34.

200. Although no empirical study has been conducted that analyzes the cost-benefit analysis that a person considering committing fraud undertakes, one may consider entrenched behavior theories that individuals act in a self-interested way. See Jonathan Z. Berman & Deborah A. Small, *Self-interest Without Selfishness: The Hedonic Benefit of Imposed Self-interest 3* (Wharton Sch., Univ. of Pa., Working Paper No. 2012-09, 2012) (“Traditional economic theory assumes that human behavior is driven by self-interested pursuits.”).

201. See *supra* note 168 and accompanying text for an explanation of why shareholders serve as an internal check on fraudulent activity in for-profit corporations.

202. See, e.g., KAIROS PRISON MINISTRY, BOARD OF DIRECTORS RESPONSIBILITIES AND EXPECTATIONS 2–5 (2012), [http://www.mykairos.org/docs/kpmi/BoD\\_responsibilities\\_expectations.pdf](http://www.mykairos.org/docs/kpmi/BoD_responsibilities_expectations.pdf) (explaining one nonprofit's take on directors' legal duties in addition to a detailed expectation that directors play an active role within the organization).

203. E.g., *PA Cyber's Board Needs to Get Its Act Together*, TIMES ONLINE (Oct. 20, 2013, 12:15 AM), [http://www.timesonline.com/opinion/editorials/pa-cyber-s-board-needs-to-get-its-acttogether/article\\_4fd4fda5-a387-5f4f-85dd-e9c6f9c2733f.html?TNNNoMobile](http://www.timesonline.com/opinion/editorials/pa-cyber-s-board-needs-to-get-its-acttogether/article_4fd4fda5-a387-5f4f-85dd-e9c6f9c2733f.html?TNNNoMobile).

204. See, e.g., Tom Fontaine, *PA Cyber Charter School Board Head Resigns Amid Scrutiny*, TRIBLIVE (Oct. 11, 2013, 3:21 PM), <http://triblive.com/news/adminpage/4867738-74/charter-jaskiewicz-resignation#axz z2vFKTvFh2>.

205. This is particularly true given the egregious conduct a director must commit before he can be held to violate his duty of care. See *supra* notes 73–81 and accompanying text for a description of directors' duty of care.

206. *Q & As*, BOARDSOURCE, <http://web.archive.org/web/20060422164441/http://www.boardsource.org/Knowledge.asp?ID=3.96> (last visited Mar. 1, 2014).

207. See *supra* notes 73–81 and accompanying text for a discussion of a director's requirements under the fiduciary duty of care.

208. See James Fanto, *A Social Defense of Sarbanes-Oxley*, 52 N.Y.L. SCH. L. REV. 517, 526 (2007)

Because of all this, while present stimuli for a director to proactively govern a corporation exist, they are not particularly strong.

The law could encourage more involved corporate governance by raising the standards of the duty of care. By requiring more diligence from directors or by preventing corporations from limiting directorial liability through their bylaws, the law might encourage directors to be more aware of suspicious financial dealings on the part of a corporation's officers or other directors. However, this solution would require passage of some significant legal barriers. A well-developed body of case law largely neuters the duty of care.<sup>209</sup> Furthermore, increasing the parameters of the duty of care may serve to disincentivize intelligent, successful people from serving on boards for fear of liability if the corporation engages in fraud.<sup>210</sup>

A final means to encourage better behavior by the officers and directors of a corporation involves increasing the penalties for fraudulent behavior. In theory, more severe penalties could deter behavior that society deems improper, like fraud. The idea is rooted in basic psychology: people refrain from making decisions that they know will be harmful.<sup>211</sup> However, in making any decision, a person weighs risk.<sup>212</sup> Although penalties of getting caught may increase, this possibility does not necessarily mean that the risk itself of getting caught increases.<sup>213</sup> This simple discrepancy seems to weigh against the idea that increasing the penalties for engaging in or being complicit in fraud would be a proactive and productive means of addressing the fraud problem.<sup>214</sup>

In sum, the primary hurdle to creating an effective system of self-regulation for nonprofit institutions is their lack of shareholders. In for-profit corporations, the shareholders act as a check on fraud. Barring a radical restructuring of authority and power among nonprofit corporations, they will continue to lack shareholders. Alternative means of promoting self-regulation include increasing the expectations governing the directors' fiduciary duties or simply increasing the penalties for fraud.<sup>215</sup> However, both of these arguments present problems. The fiduciary duties, although codified, have a long body of case law that has hashed them out over the years. Redefining the duties would require significant judicial revision, which violates broader principles of stare decisis and the interest in legal continuity.<sup>216</sup> Increasing the

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(describing the tension between theoretical best practices for corporate directors and the reality that they tend to be very busy people).

209. See *supra* notes 75–81 and accompanying text for a description of how the duty of care has largely been defanged by court decisions over time.

210. See Darian M. Ibrahim, *Individual or Collective Liability for Corporate Directors?*, 93 IOWA L. REV. 929, 953 (2008) (arguing that “the law must maintain a balance between deterring too little and overdetering to the point that directors do not take risks or serve on boards”).

211. See Berman & Small, *supra* note 200, at 4 (“Traditional economic theory assumes that human behavior is driven by self-interested pursuits.”).

212. See Amos Tversky & Craig R. Fox, *Weighing Risk and Uncertainty*, 102 PSYCHOL. REV. 269, 269 (1995) (exploring decision-making theory through the prism of risk).

213. Of course, this statement assumes constancy of resources dedicated to enforcement.

214. See *infra* Part III.B.3 for a discussion of the alternative: altering the grounds for punishment rather than the penalties themselves, which merely determine the severity of punishment.

215. See *supra* notes 207–14 and accompanying text for a broader description of these points.

216. See E. Norman Veasey, *Musings from the Center of the Corporate Universe*, 7 DEL. L. REV. 163, 174 (2004) (noting the role of stare decisis in corporate law, particularly in relation to the “time-honored

penalties for fraud represents a reactive solution to the problem. The legal system already punishes fraud severely, and an actor who thinks he can get away with fraud is likely to commit it regardless of any consequences.

### 3. The Best of Both Worlds: External Means That Encourage Internal Compliance

Having surveyed various proposals that serve to externally and internally deal with fraud, it is worth considering solutions that marry external regulations with internal effects. Some of the puzzle pieces are in place for systemic reform that accomplishes this goal,<sup>217</sup> and important remaining pieces have appeared in draft legislation.<sup>218</sup> However, two key pieces are missing that should serve as powerful deterrents to fraudulent behavior on the part of cyber charter school executives: providing a strict liability regime for entering into conflicted transactions and addressing the funding surpluses garnered by cyber charter schools.<sup>219</sup>

Conflicted transactions plague charter schools,<sup>220</sup> so any effective reform must strengthen Pennsylvania's conflict-of-interest laws. Nonprofits are permitted to and often do draft their own internal conflict-of-interest procedures.<sup>221</sup> Internal conflict-of-interest statements can be powerful tools to encourage compliance, but current law provides an inadequate framework for encouraging the creation of solid accountability codes. In March 2009, the Pennsylvania Coalition of Charter Schools adopted a Code of Accountability on behalf of its member schools.<sup>222</sup> This Code speaks largely in generalities and reads more like a vague code of ethics than a concrete plan to address administrative malfeasance.<sup>223</sup> Aside from open-ended statements about establishing reporting mechanisms,<sup>224</sup> the Code of Accountability contains no means for actually accomplishing the accountability that it seeks to promote.

Laws can influence the creation of effective internal codes; any future reform the Pennsylvania General Assembly attempts to write should be undertaken with this idea in mind. The year 2012 carried much talk of reform within the Pennsylvania education community. A bill was introduced in the Pennsylvania General Assembly that proposed

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principles of fiduciary duty").

217. See *infra* notes 233–38 and accompanying text for statutory mechanisms that could serve to encourage proactive fraud prevention.

218. See *infra* notes 233–35 and accompanying text for draft legislation that serves to encourage proactive fraud prevention.

219. See *infra* notes 233–38 and accompanying text for a discussion on why these two statutory mechanisms should be essential components of any attempt at comprehensive charter school reform.

220. See DeJarnatt, *supra* note 150, for a detailed study of charter school fraud.

221. *Conflict of Interest*, NAT'L COUNCIL OF NONPROFITS, <http://www.councilofnonprofits.org/conflict-of-interest> (last visited Mar. 1, 2014).

222. PA. COALITION OF CHARTER SCHOOLS, CODE OF ACCOUNTABILITY: "TRUST AND TRANSPARENCY" (2009).

223. Examples of such generalized statements include the following: "Financial interests of Trustees must not conflict with public interests;" "[w]e will remain good stewards of school finances;" and "[w]e will not abuse public funds in any regard whatsoever." *Id.* at 4, 7.

224. See, e.g., *id.* at 7 ("We will establish an organizational chart that includes precise details such as who has check signing authority, who has banking privileges, and who reconciles financial transactions. The same person can hold no more than one of the aforementioned responsibilities.").

to significantly amend the state's charter school law, but election-year politicking and bipartisan gridlock prevented the General Assembly from passing this comprehensive reform.<sup>225</sup> Though ultimately unsuccessful, the bill contained promising language prohibiting conflicts of interest among board members.<sup>226</sup> The bill also explicitly grants courts the power to void self-interested contracts and commands the PDE to take a more active regulatory role in overseeing cyber charter schools.<sup>227</sup>

Some legislators have pledged to resume the fight for amending the charter school law in 2013 and beyond,<sup>228</sup> but the bill as written suffers from some major deficiencies. First, the bill only provides penalties for those who “knowingly” violate its terms regarding entering into conflicted transactions.<sup>229</sup> Such a requirement is unnecessary and would be unproductive. The network of Trombetta organizations that PA Cyber money flowed through shows the ease with which a complex corporate scheme may be enacted.<sup>230</sup> A knowledge requirement might simply reinforce the tactic of erecting complicated corporate structures in order to confound regulators in their attempts to prove that knowledge of the conflicted transaction existed among one or more cyber charter school executives.<sup>231</sup> The legislative history of the proposed bill shows that all of the bill's drafts contained this knowledge requirement,<sup>232</sup> so there is no indication that the bill's drafters seriously considered scrapping it.

Instead of providing that directors may be held liable only if they “knowingly” violate the statute's terms, the drafters of any future legislation would be wise to include language like “knowingly or otherwise.” Such powerful language would be akin to a strict liability system and would provide directors with a powerful incentive to closely monitor any and all transactions they enter into.<sup>233</sup> The ambiguity of the current

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225. Karen Langley, *Charter School Bill Falls Apart*, PITT. POST-GAZETTE, Oct. 18, 2012, at B1.

226. See S. 1115, 196th Gen. Assemb., Reg. Sess. (Pa. 2012) (providing that “no administrator of a charter school entity may participate in the selection, award or administration of a contract if the person has a conflict of interest as that term is defined in 65 Pa.C.S. § 1102”).

Pennsylvania defines a conflict of interest as:

Use by a public official or public employee of the authority of his office or employment or any confidential information received through his holding public office or employment for the private pecuniary benefit of himself, a member of his immediate family or a business with which he or a member of his immediate family is associated. The term does not include an action having a de minimis economic impact or which affects to the same degree a class consisting of the general public or a subclass consisting of an industry, occupation or other group which includes the public official or public employee, a member of his immediate family or a business with which he or a member of his immediate family is associated.

65 PA. CONS. STAT. ANN. § 1102 (West 2014).

227. Pa. S. 1115. Indeed, the bill contains sections that will also impact the charter granting and renewal processes and directs the PDE in other ways that are beyond the scope of this Comment.

228. Langley, *supra* note 225, at B1.

229. See Pa. S. 1115 (stating that administrators are subject to penalty if they “knowingly violate[]” the clause prohibiting conflicted transactions).

230. See Hilston, *supra* note 116, for a visual description of the relationship between PA Cyber and other corporate entities related to Nick Trombetta.

231. See *supra* Part II.B.2 for a description of how the law's protections for corporations encourage dispersions of money among entities run by a single or small group of individuals.

232. Pa. S. 1115.

233. Of course, one may counter that raising the liability standard for directors may serve to deter people

charter school law's take on the idea of self-dealing is reflected in the current weak Code of Accountability that has been adopted by almost all of Pennsylvania's charter schools.<sup>234</sup> A more definitive charter school law that omits a knowledge requirement would probably lead to the creation of a more demanding Code of Accountability. In other words, the law can and should be used as a vehicle to shape the behavior of cyber charter schools' corporate actors for the better.

Eliminating the knowledge requirement from any future statute would pay dividends in terms of corporate compliance, but the proposed bill also suffers from another flaw: it fails to take into account the different costs of brick-and-mortar charter schools and cyber charter schools.<sup>235</sup> While any algorithm devised to fund cyber charter schools would be more complicated than the current system of equivalent funding,<sup>236</sup> it is a tactic worth pursuing. The proposed bill already contains provisions that would expand the PDE's regulatory authority, and controls are in place that require cyber charter schools to submit detailed annual financial reports.<sup>237</sup> As an additional statutory means to preclude the existence of excess money, the cyber charter school statute could also be amended to mandate that each cyber charter school that runs a surplus return this money to the state treasury. The relatively low number of cyber charter schools in Pennsylvania means that this solution would probably not be an unwieldy administrative burden. A different funding algorithm and an affirmative duty to return any excess funds might well prevent a reprise of the PA Cyber investigation for financial impropriety.<sup>238</sup>

In sum, it is possible to craft a bill that encourages self-reliance among cyber charter schools' board members. But such a law must possess a bite that is just as

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from joining boards. See *supra* notes 227–30 and accompanying text for this deterrence effect in the broader context of directors' fiduciary duties. However, the enormous amount of money at stake and the rampancy of suspect financial activity in the charter school context overpower the concern that potential board members will be deterred from serving. Honest directors will have nothing to worry about within this proposed system. The sting of liability needs to minimize the temptation to commit fraud; strict liability is a vehicle to accomplish this objective.

234. See *supra* notes 222–24 and accompanying text for a description of this Code of Accountability. Additionally, the *Pittsburgh Post-Gazette* reported that:

PA Cyber's internal policy defines a conflict of interest as "when you are in a position to influence a decision or have business dealings on behalf of PA Cyber that might result in a personal gain for you or for one of your relatives." It requires that any officer facing "an actual or potential conflict of interest" contact the Human Resources Department so they "can set up safeguards to protect everyone involved."

Rich Lord, *School CEO's Consulting Work Questioned PA Cyber Leader Steered Employees to Program He Helped Manage*, PITT. POST-GAZETTE, Nov. 18, 2012, at A1. The equivocal language contained within this policy may represent an outgrowth of the knowledge requirement for self-dealing.

235. See *supra* notes 34–40 and accompanying text for a discussion of this cost differential.

236. See *supra* note 56 and accompanying text for a description of this funding mechanism.

237. See *supra* note 46 for an example of the information contained within cyber charter schools' annual financial reports.

238. A potential concern with this solution would be whether it motivates cyber charter schools to become profligate spenders. However, some controls are already in place to deal with this problem. Schools must account for their spending in their annual reports. See *supra* note 46 for an example of such a report. Because these reports have been filed annually since the cyber charter school statute came into effect, regulators likely have developed a keen eye toward noticing spending that is wasteful and unnecessary.

severe as its bark. Two indispensable items should be included in any reform bill. First, there should be no knowledge requirement for a director to be found liable for self-dealing. Ignorance should not excuse conflicted behavior. A statutory provision that penalizes every conflicted transaction, whether or not it is entered into knowingly, would provide a powerful deterrent for cyber charter school executives to avoid testing the legal waters that govern conflicted transactions. Secondly, cyber charter schools should be subject to a different funding mechanism than brick-and-mortar charter schools. At the very least, cyber charter schools that receive funding in excess of their budgetary needs should be required to return this excess funding at the end of each year. Together, these two reforms would make it much more difficult for charter school executives to move money between a complicated network of nonprofit and for-profit corporations.

#### IV. CONCLUSION

Cyber charter schools have steadily grown over the last decade in Pennsylvania, and that trend shows few signs of slowing down. Both the number of cyber charter schools and the number of students they educate continue to ascend. Accordingly, cyber charter schools receive an ever-increasing sum of taxpayer dollars to educate their students. Despite the large amount of money at stake, cyber charter schools receive funding in exactly the same manner as their brick-and-mortar counterparts. This funding symmetry has the potential to create large surpluses for cyber charter schools, given their reduced costs.

Large surpluses garnered by cyber charter schools should concern legislators and taxpayers alike. The law allows for a common incorporator to create a network of corporations—both for-profit and nonprofit. In the context of cyber charter schools, taxpayer money can then be shuttled among corporations and used for different purposes than those for which the money was intended. Proactive reform is needed. Statutory amendments that provide for different funding algorithms between cyber charter schools and brick-and-mortar charter schools are needed. Additionally, to ensure that any sum of money is spent responsibly, cyber charter schools' directors should be held to a strict liability standard regarding entering into self-interested transactions. Cyber charter school technology represents an intriguing possibility to educate students in a manner commensurate with the twenty-first century. It is time for the law to catch up.

