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July 21, 1988

TO: Richard Crabtree, Chairman
SEED Board

FROM: Jeffrey Frankel
Assistant Attorney General

RE: State guarantee of SEED Plan contracts

Issue

One of the questions raised in your February 26 letter to me is whether the SEED Plan's contractual obligations are guaranteed by the State of Maine. From our May 4 meeting and March 11 telephone conversation I understand the focus of your inquiry to be the hypothetical situation of the SEED Plan's investment portfolio failing to generate the funds necessary to actually purchase tuition for plan beneficiaries upon commencement of their college education. Potential plan purchasers should be informed prior to purchase whether the SEED Plan's commitment to pay college tuition many years in the future is backed by the assets of the Plan alone or by the assets of the State Treasury.

Conclusions

For the reasons that follow, my conclusions are that under the enabling legislation, the obligations of the SEED Plan are also the contractual obligations of the State of Maine. This result, however, will run afoul of the Maine Constitution's $2,000,000 limitation on the State's long-term, unbonded indebtedness if the program is successful. The overall statute is saved by severing the unconstitutional provisions (i.e., the direct State obligation) from the bulk of the statute. The effect of this severance is that advance payment tuition contracts will be backed only by the assets of the SEED Plan once the $2,000,000 limitation on the State's overall long-term, unbonded indebtedness is reached. From that point on, the State

will have no direct or indirect obligation to defray the SEED Plan's payment obligations to state institutions of higher education or to beneficiaries.

For reasons discussed in the text I recommend that the statute be amended to expressly provide that the State is neither a party to nor guarantor of advance tuition payment contracts. A draft amendment is provided.

Facts

The SEED Plan created by the Student Educational Enhancement Deposit Act, P.L. 1987, c. 527, 20-A MRSA section 12601 et seq. (Supp. 1987-88) is established as a "public body politic and corporate" for the purpose of implementing the prepaid tuition plan described in the Act.

The Plan's powers and duties are vested in a Board of Directors consisting of the Treasurer of State ex officio and six members appointed by the Governor. No more than two of the six appointed members may be State officers or employees. The Board's enumerated powers contained in section 12611 are typical of those granted to quasi-public corporations. The Plan is administratively placed within the State Treasury, but is sanctioned to "exercise its prescribed statutory powers, duties and functions independently of the Treasurer of State." (section 12603).

Assets held by the fund for investment are not considered "state money, common cash of the State or revenue." (section 12609(1)) Section 12617 further provides that "[t]he assets of the fund shall be preserved, invested and expended solely pursuant to and for the purposes set forth in this Act and shall not be loaned or otherwise transferred or used by the State for any purpose other than the purposes of this Act."

The SEED Plan was appropriated $10,000 for start-up costs. Beyond that, it is expected that purchasers' contributions to the Plan and the investment income on same will generate revenues for payment of tuition at University of Maine System institutions when Plan beneficiaries reach college age. 1/ See the Statement of Fact accompanying L.D. 779 (113th Legis., First Reg. Sess.). In this regard, section 12613 provides that "[t]he plan shall be administered in a manner reasonably designed to be actuarially sound so that the assets of the plan will be sufficient to defray the obligations of the plan." Section 12604(3) further provides that "[t]he plan shall make any arrangements that are necessary or appropriate with State

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1/ Section 12604(3) also permits the Plan to pay the institution its actual in-state tuition cost on behalf of the beneficiary at the time the purchaser and Plan make an advance tuition payment contract.

institutions of higher education in order to fulfill its obligations under advance tuition payment contracts . . . ." (emphasis added).

As part of the annual actuarial review of the Plan, the Board is directed to determine any additional assets needed to defray the obligations of the Plan. If the necessary funds are unavailable, the Board is directed to "adjust payments of subsequent purchases to ensure its actuarial soundness." (section 12613(2)).

Section 12604 is of a different stripe from the foregoing. The unnumbered introductory paragraph provides:

> "The plan, on behalf of itself and the State, may contract with a purchaser for the advance payment of tuition by the purchaser for a qualified beneficiary to attend a state institution of higher education to which the qualified beneficiary is admitted, without further tuition cost, to the qualified beneficiary." (emphasis added)

Section 12604(1)(G) provides:

> "1. Advance tuition payment contract. In addition, an advance payment tuition contract shall set forth all of the following:
>
> * * *
>
> G. The assumption of a contractual obligation by the plan to the qualified beneficiary on its own behalf and on behalf of the State to provide for credit hours of higher education, not to exceed the credit hours required for the granting of a baccalaureate degree, at a state institution of higher education to which the qualified beneficiary is admitted. The advance payment tuition contract shall provide for the credit hours of higher education that a qualified beneficiary may receive under the contract if the qualified beneficiary is not entitled to in-state tuition rates;" (emphasis added)

Discussion

The Act does not explicitly state whether or not the State of Maine is obligated to purchase tuition from General Fund revenues in the event that Plan assets are insufficient to meet the Plan's obligations to beneficiaries as they arise.

Key provisions of the Act, summarized above, indicate that the Plan was established to be both politically and financially independent from (but not unaccountable to) State government and the State Treasury. As a corollary of this independence, the Legislature apparently intended the Plan to be self-sustaining. See the excerpts from sections 12604(3) and 12613 quoted above. If the Plan's ability to fulfill its obligations is doubtful, the

only stipulated avenues of recourse, as provided by section 12613(1), are (1) to procure, presumably from the Legislature, the funds needed to make the program actuarially sound, or (2) if such funds are unavailable, to increase the amount of contract payments required of new purchasers. Compare 10 MRSA section 1024(1), which requires the Governor to transfer funds from the State Contingent Account or other specified sources if necessary to meet payments due under revenue obligations insured by the Finance Authority of Maine.

Modern statutory drafting practice is to expressly state, whenever the issue conceivably arises, whether or not the obligations of a quasi-public corporation like the SEED Plan are backed by the credit of the State or otherwise made obligations of the State. E.g., 10 MRSA section 1021 (Supp. 1987-88) (credit pledged); 10 MRSA sections 1044(9) and 1064(6) (credit not pledged). In the absence of any statutory directive, the financial obligations of quasi-public corporations do not constitute obligations of the State. See Appendix A attached hereto.

The lack of any explicit state guarantee in the Act, coupled with the contemplated self-sufficiency of the Plan, suggest that purchasers of advance payment tuition contracts can look only to the assets of the Plan for actual performance of those contracts. However, section 12604, quoted in relevant part above, provides otherwise.

The omnibus paragraph of section 12604 directs the Plan to contract for advance payment of tuition on the part of both the Plan and the State. Section 12604(1)(G) reiterates that the contract document adopted by the Board pursuant to section 12604(2) must also state this assumption of a contractual obligation on the Plan's behalf and on behalf of the State. The impact of this language is that the State is made a primary party to all advance tuition payment contracts. Performance of these contracts is hence a direct obligation of the State as well as the Plan.

One may legitimately ask if this interpretation overstates the importance of these two brief references to "the State". I think not. In construing statutory language, Maine courts place great emphasis on the plain meaning of the law (e.g., Town of York v. Cragin, Dec. No. 4766, 5/26/88) and are reluctant to treat any words of a statute as surplusage unless doing so would lead to illogical results. E.g., State v. Leonard, 470 A.2d 1262, 1264 (Me. 1984). In the present case, this conclusion of a direct State obligation is also consistent with the intent of the law, as expressed in the Statement of Fact to L.D. 779 (113th Leg., First Reg. Sess.):

> "The purpose of this bill is to specifically offer a mechanism that makes it easier for parents to ensure their child of a university education. The bill creates a fund into which parents can deposit a lump sum or a succession of

payments over a period of time. The contributions are then invested in a financial portfolio meant to strike a balance between security and high interest rates. Parents who pay into the fund are guaranteed a 4-year, tuition-free education for their child at any of the University of Maine System institutions." (emphasis added)

The question of legislative intent is complicated by the drafting history of the Act. My understanding is that the SEED Act was modeled after the Michigan Education Trust Act, Mich. Comp. Laws section 390.1421 et seq. (1988). Discounting variations for drafting style and governmental organization, many provisions of the SEED Act are copied word-for-word from the Michigan law. But some substantive changes were made by the Maine Legislature.

The provisions of 20-A MRSA section 12604 quoted above repeat nearly verbatim the provisions of Mich. Comp. Laws section 390.1426(1) and (1)(h). However, the Michigan law's authorization for its administering board to "enter into contracts on behalf of the state" (section 390.1431(k)) was enacted in Maine to authorize the SEED Board to "enter into contracts on behalf of the plan." (section 12611(10)).

Another difference in the two laws is shown by a comparison of Mich. Comp. Laws section 390.1433(2) and 20-A MRSA section 12603(1). Section 390.1433(2) deals with steps to be taken in the event the Michigan educational trust is deemed actuarially unsound. The first and second steps, reiterated in section 12603(1) of the Maine law, are for the trust to seek additional funds and if those are unavailing, to adjust the payments required of subsequent purchasers.

The Michigan law goes on to provide that if insufficient numbers of new purchasers can be found, the available assets shall be prorated among existing contracts. The prorated funds shall either be refunded or applied "towards the purposes of the contract for a qualified beneficiary."

This third provision of section 390.1433(2) apparently contemplates dissolution of the trust due to actuarial unsoundness and lack of continued participation. The Maine Legislature did not incorporate any analog to this subsection in the SEED Act. The inference I draw from this omission, when read in tandem with section 12604, is that the State will defray any shortfall when the time to purchase tuition for any beneficiary arrives.

The Michigan law has not received any judicial interpretation of which I am aware as to whether or not advance tuition contracts issued thereunder constitute obligations of that state. The motivations for the alterations made by the Maine draftsmen to the Michigan model are not mentioned in the legislative history of the SEED Act. For these reasons, comparison of the two laws does not shed much light on the issue

under discussion. My opinion, though, is that the Maine text presents a stronger inference of a State guarantee than does the Michigan text.

Finally, the State's obligation under the advance tuition payment contracts must be examined under Art. 9, section 14 of the Maine Constitution. Art. 9, section 14 reads in relevant part as follows:

> "The credit of the State shall not be directly or indirectly loaned in any case, except as provided in sections 14-A, 14-C, 14-D and 14-E. The Legislature shall not create any debt or debts, liability or liabilities, on behalf of the State, which shall singly, or in the aggregate, with previous debts and liabilities hereafter incurred at any one time, exceed $2,000,000, except to suppress insurrection, to repel invasion, or for purposes of war, and except for temporary loans to be paid out of money raised by taxation during the fiscal year in which they are made; and excepting also that whenever two thirds of both Houses shall deem it necessary, by proper enactment ratified by a majority of the electors voting thereon at a general or special election, the Legislature may authorize the issuance of bonds on behalf of the State at such times and in such amounts and for such purposes as approved by such action; but this shall not be construed to refer to any money that has been, or may be deposited with this State by the Government of the United States, or to any fund which the State shall hold in trust for any Indian tribe...."

This examination is twofold. First, do the advanced payment tuition contracts constitute the loan of the State's credit, prohibited by the first sentence of Art. 9, section 14? If not, must the amount of these contracts be included in the $2,000,000 limitation on long-term unbonded debt contained in the second sentence?

The operation and history of the credit clause (i.e., first sentence) of Art. 9, section 14 were reviewed extensively by the Law Court in Common Cause v. State, 455 A.2d, 27-29 (Me. 1983). There the Court held that the credit clause bars the State from acting as surety, guarantor or insuror except as specifically permitted by the other constitutional sections cited in the clause. (None of these apply to the SEED Act.) Conversely, the Court construed the credit clause as inapplicable to debts contracted directly by the State. Inasmuch as section 12604 makes the state a prime party to advance payment tuition contracts, the contracts fall in the latter category. The SEED Act thus does not involve an unconstitutional loan of the State's credit to the Seed Plan or the beneficiaries of the Plan.

The scope of the $2,000,000 limitation on long-term unbonded indebtedness is more troubling. Other than tax anticipation loans, this is the maximum amount of debt the State can ordinarily incur beyond current appropriations without

authorizing a bond issue for ratification by the electorate. See Opinion of the Justices, 53 Me. 587 (1867).

In Opinion of the Justices, 146 Me. 183, 79 A.2d 753 (1951), the Court ruled that a long-term purchase obligation under which public funds in the nominal form of lease payments were to be paid by the State of Maine to the Maine State Office Building Authority for construction and operation of an office building fell within the $2,000,000 prohibition. The Court took a broad reading of the type of "debt or debts, liability or liabilities" that are subject to the limitation:

> "Being a contract of purchase, obligating the State to pay the purchase price, unless the entire amount thereof is to be paid pursuant to an appropriation presently made from funds or revenues currently available therefor, such contract of purchase would in the constitutional sense be a liability created by the Legislature on behalf of the State. It would constitute a liability which would have to be included with the existing debts and liabilities of the State in determining whether or not they exceed the $2,000,000 limit set forth in Section 14 of Article IX of the Constitution. If such contract price in and of itself, or together with the existing debts and liabilities of the State, should exceed the constitutional debt limit, the so-called lease would be void.
>
> A contract which obligates the State to pay money over a period of years for the purchase of property creates a liability. . . ."
>
> 146 Me. at 188-189 (emphasis added).

Many differences exist between the arrangement invalidated by Opinion of the Justices and advance tuition payment contracts. Unlike the fixed schedule of appropriations due the State Office Building Authority, the State's financial obligation under the tuition contracts is executory and in actuality, contingent upon the SEED Plan's inability to perform. Nor is the SEED Plan the evasion of constitutional debt limitations that the Supreme Judicial Court perceived the office building arrangements to be.

However, I do not believe that these differences are substantial enough to distinguish SEED contracts from the effect of Opinion of the Justices. The contracts do create promises of payment which are not made pursuant to any appropriation of currently-available funds. And although the State's liability may in actuality be contingent or secondary to that of the Plan, section 12604 binds the State to the same degree that it binds the Plan. Moreover, any construction of the Act as contemplating a State guarantee of the debts of the Plan would most likely contradict the prohibition against loaning the State's credit contained in the first sentence of Article 9, section 14.

Presumably, the actuarial evaluations underlying the tuition contracts will be based on anticipated tuition charges for each

beneficiary. The Statement of Fact to L.D. 779 estimated that by the year 2005 the yearly tuition bill at University of Maine institutions will be almost $6000. There is little doubt that the entire $2,000,000 limit could be accounted for by advance payment tuition contracts if the SEED Plan is successful. Unless the SEED Board's rules were to provide that no contract could be executed unless sufficient debt "cushion" existed, 2/ the contracts would at some point exceed the available debt. From this point on the direct State obligation created by the contracts would be ineffective as being in contravention of Art. 9, section 14.

The invalidity of the direct State obligation once the $2,000,000 threshhold is passed does not necessarily invalidate the entire SEED Plan. As the Law Court held in Bayside Enterprises, Inc. v. Maine Agricultural Bargaining Board, 513 A.2d 1355, 1360 (Me. 1986):

> The invalidation of one statutory provision will not result in the remainder of the statute being invalidated if the remainder can be given effect without the invalid provision. 1 MRSA section 71(8); Lambert v. Wentworth, 423 A.2d 527, 535 (Me. 1980). If the invalid provision is such an integral part of the statute that the Legislature would only have enacted the statute as a whole, then the entire statute is invalid. Town of Windham v. LaPointe, 308 A.2d 286, 291 (Me. 1973).

In the instant case, the sole unconstitutional provisions are the words "and the State" in the first unnumbered paragraph of section 12604 and the words "and on behalf of the State" in section 12604(1)(G). If these words were excised from the statute, the net effect would be that the State has no obligation, direct or indirect, on the advance tuition payment contracts.

Under the twin formulations ratified in Bayside Enterprises, supra, the SEED Act can stand with the unconstitutional portions removed. The Plan can certainly "be given effect" without the direct financial backing of the State Treasury, although the risks to the purchaser and beneficiary are greater. The Statement of Fact to L.D. 779 quoted in part above, plus the bill's amendment for enactment on an emergency basis, testify to the Legislature's strong commitment to the SEED Plan and indicate that passage would have been likely even if the Legislature had been informed that the State itself could not be a party to the contracts. See Lambert v. Wentworth, supra.

My informal understanding at this point is that the State keeps no accounting of "available" debt within the $2,000,000 limitation of Art. 9, section 14. If there currently is no such

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2/ Title 20-A MRSA section 12611(3) permits the Board to "impose reasonable limits on the number of participants in the Plan."

outstanding debt subject to this limitation, the first $2,000,000 tuition value of SEED contracts would not violate Article 9, section 14. If this can be verified, one option for the SEED Board is to consider the wisdom of proceeding to execute contracts up to this limit and keeping the State Treasurer (an ex officio member of the Board) informed of its progress.

One difficulty of this approach is the Board's inherent uncertainty of knowing exactly how much tuition it is obligating the State and itself to pay. I also suspect that a legislative resolution to this situation would put the SEED Plan on a more solid footing in the eyes of the banks, investment firms, etc. that it will be dealing with.

My recommendation is that the SEED Act be amended by removal of the phrase "on behalf of itself and the State" from the first, unnumbered paragraph of section 12604 and removal of the phrase "on its own behalf and on behalf of the State" from section 12604(1)(G). The surviving text of sections 12604 and 12604(1)(G) would create no inference that the State is a party to the contracts.

Additionally, the following provision should be added as a new section to the SEED Act. The text is based on 10 MRSA sections 1044(9) and 1064(6):

> "Advance tuition payment contracts issued under this chapter shall not constitute any debt or liability of the State, its political subdivisions or any municipality; shall not constitute a pledge of the faith and credit of the State, its political subdivisions or any municipality; shall constitute debts and liabilities of the Fund alone; and shall contain in their text a statement to that effect. Advance tuition payment contracts issued under this chapter shall not directly or indirectly or contingently obligate the State, its political subdivisions or any municipality to levy or to pledge any form of taxation whatever or to make any appropriation for their payment."

In connection with this new provision, the list of required contract terms set forth in section 12604(1)(A)-(I) should be augmented by the following:

> "The statement required by section _____."

I also see the statute in need of several minor amendments stemming from the carryover of several Michigan provisions that don't mesh well with Maine law. I will be glad to discuss these with you.

JF:lm

cc: Eve M. Bither
David Brown
Fred Douglas

Appendix A

The Maine courts have long acknowledged the independent legal existence and financial status of quasi-public corporations created by the State:

> The principle that the Legislature may establish public authorities which exist as distinct and separate corporate bodies the obligations of which are not debts of the state or municipalities is fully accepted in this state.
>
> Maine State Housing Authority v. Depositors Trust Company, 278 A.2d 699, 707 (Me. 1971).

See also Kennebec Water District v. City of Waterville, 96 Me. 234, 52 A. 774 (1902).

In Maine State Housing Authority the Law Court held that MSHA bonds did not constitute debts of the State for purposes of the non-bonded debt limitation provision of Art. 9, section 14 of the Maine Constitution. But unlike the SEED Act, the legislation then before the Law Court expressly declared that the bonds at issue would not constitute debts of the State.

A fair number of cases from other jurisdictions have similarly held that quasi-public corporations are separate entities from the states which created them and that the financial obligations of those bodies did not constitute debts of the State. Almost invariably, however, the statutes construed contained the declaration that bonds issued by the authority involved would not constitute state obligations. E.g., Opinion of the Justices, 270 Ala. 147, 116 So.2d 588 (1959); Thompson v. Municipal Electric Authority of Georgia, 238 Ga. 19, 231 S.E.2d 720 (1976); Berger v. Howlett, 25 Ill.2d 128, 182 N.E.2d 673 (1962).

Little precedent exists with respect to statutes which are silent as to whether or not the obligations of quasi-state corporations constituted debts of the state. Loomis v. Keehn, 400 Ill. 337, 80 N.E.2d 368 (1948), though, is on point. There the court held:

> "We consider the provisions of the State Armory Board Act, authorizing a pledge of the income or property of the Board, as creating a debt against the property of the Board, and to which, alone, the holders of its bonds may look, and this does not create a debt against the State, as the statute does not so designate and we have frequently held that under similar statutes the public body benefiting from such a corporation is in no way obligated to pay the bonds secured by income, such projects being self-liquidating, and the pledge of

the property partakes of the nature of the purchase-money mortgage . . . ." (emphasis added). 80 N.E.2d at 371. 3/

Despite this lack of state-level precedent, Maine case law dealing with municipally-created public corporations strongly suggests that obligations of State-created public corporations should not generally be considered debts of the State.

Me. Const. Art. 9, section 15 formerly provided that municipal indebtedness could not exceed a set proportion (first 5%, later 7 1/2%) of the valuation of town property. In Carlisle v. Bangor Recreation Center, 150 Me. 33, 103 A.2d 339 (1954) the Court held that construction bonds issued by the Center, a quasi-municipal corporation, would not constitute indebtedness of the City of Bangor for purposes of the ceiling contained in former Art. 9, section 15. In Opinion of the Justices, 153 Me. 469, 145 A.2d 250 (1958), the Court similarly held that indebtedness of a school administrative district would not be considered indebtedness of the member towns for purposes of the constitutional debt limitation. See also Hamilton v. Portland Pier Site District, 120 Me. 15, 112 A. 836 (1921); Kennebec Water District v. City of Waterville, 96 Me. 234, 52 A. 774 (1902).

The statutes construed in the cases cited in the preceding paragraph contained no provision stating whether or not the indebtedness of the special purpose district should be allocated to the member towns. These cases teach that in the absence of any legislative intent to the contrary, the debt obligations of quasi-public corporations are separate and apart from the debt obligations of the political bodies that create them.

3/ Loomis' precedental value is undercut by its inconsistency on another point with Opinion of the Justices, 146 Me. 183, 79 A.2d 753 (1951). As in Loomis, the Supreme Judicial Court was there confronted with a state-created building authority which planned to lease its projects to state government and meet its bond obligations from annual state appropriations of the rental payments. While this source of project revenues caused the Illinois court no great difficulty, the Maine court held the appropriation of the rental payments from general funds to be a thinly-disguised end run around the non-bonded debt limitation of Me. Const. Art. 9, section 14. See also Opinion of the Justices, 231 A.2d 431, 436 (Me. 1967) (tax revenues could not be used to supplement project revenues for making payment under municipal parking system revenue bonds.). My research suggests that Maine may stand in the minority on this issue.