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August 2, 2002

Representative Philip Cressey, Jr.
Representative Brian M. Duprey
Maine House of Representatives
2 State House Station
Augusta, Maine 04333

Re: State liability on Maine Learning Technology Endowment contract

Dear Representatives Cressey and Duprey:

This is in response to your request of July 9, 2002, regarding the State's liability to Apple Computer, Inc. ("Apple"), in the event the Legislature fails to appropriate funds or de-appropriates funds thereby precluding the Maine Department of Education ("DOE") from meeting its obligations under the contract for the Maine Learning Technology Endowment initiative between DOE and Apple

Background

The Maine Learning Technology Endowment was created by enactment of Public Laws, 2001, chapter 358, to "enable the full integration of appropriate learning technologies into teaching and learning for the State's elementary and secondary students." 20-A M.R.S.A. § 19102. The law directed the Commissioner of Education ("the Commissioner") with the advice of the Advisory Board of the Maine Learning Technology Endowment to develop a Learning Technology Plan, which was to begin in school year 2002-2003 "with a phase-in approach that begins with 7th grade students and extends in school year 2003-2004 to 8th grade students in public schools..." Public Laws 2001, chapter 358, Sec. II-7 (3). The law anticipated that the Commissioner would use the Endowment Fund to purchase portable computing devices or acquire portable computing devices through appropriate financing arrangements, including leases. 20-A M.R.S.A. § 19105 (3).

The Contract

Pursuant to this law, the Commissioner entered into a contact with Apple on December 27, 2001, and into a subsequent amendment on April 4, 2002. Under the contract, Apple is to provide 7th and 8th grade students and teachers with personal, portable computers; install wireless networks in each school; provide intensive training to teachers; and provide support and warranty services. The amendment to the contract made significant changes to the payment provisions of the contract and bifurcated the contract for payment purposes. The first part, the Hardware Purchase Component, sets forth the terms and conditions for the purchase of the devices (the laptops), network cards and device software. The second part, the Services Component, sets forth provisions for payment for services and equipment other than devices, provided by Apple and third party software not included in the Hardware Purchase Component The Services Component also includes the wireless networks installed in each school.

Hardware Purchase Component

The Hardware Purchase Component is being purchased under a Master Lease Purchase Agreement between Apple and DOE, although Apple has stated that it intends to assign the lease to a third party financer. The Master Lease Purchase Agreement provides for DOE to purchase the devices under one or more schedules, with DOE obligated to pay rent only for the devices that have been accepted and included on a schedule. This provision was intended to allow DOE to order devices only as needed. To date, DOE has ordered and accepted 2,868 devices; an additional 16,780 devices have been ordered but not accepted and therefore are not yet included on a schedule. Together, these 19,648 devices represent approximately 55% of the total devices to be ordered for the laptop program.[1] As Commissioner Albanese explained in his July 11, 2002 letter to you, payments for these devices, as well as for services and equipment provided under the Services Component, are being made quarterly over the life of the contract. The first payment is due in the first quarter of fiscal year 2003.

The Master Lease Purchase Agreement includes a non-appropriation clause, which relieves DOE from the obligation to make further rent payments in the event the Legislature fails to appropriate funds or de-appropriates funds necessary for DOE to meet its payment obligations. In addition, DOE has the right to return the devices to Apple at its expense and "terminate the lease on the last day of the fiscal period for which sufficient appropriations were received without penalty or expense to [DOE]..."[2] DOE would be obligated to pay "the portion of rent for which funds have been appropriated and budgeted."[3]

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[1] These are the 19,648 laptops referenced in Commissioner Albanese's letter to you of July 11, 2002 (2,868 units for demonstration sites and teachers and 16,780 for the balance of 7th grade students).

[2] However, in the event of such a termination, under the return section of the Agreement, DOE is obligated to return the devices.

[3] The Master Lease Purchase Agreement states that failure to pay rent when due is a default under the agreement and that upon default title to the devices reverts to Apple free and clear of any interests the State may have.

For example, should the Legislature de-appropriate funds during the first quarter of FY03, thereby precluding DOE from meeting its obligations under the Hardware Purchase Component of the Master Lease Purchase Agreement, DOE would be obligated to pay Apple $100,000 for rental of the 2,000 of the 2,868 devices that it has already accepted.[4] DOE could then terminate the contract and return the devices, at DOE's expense, to Apple. Apple may argue that DOE should also pay rental fees for the 868 devices accepted in the first quarter of FY03 and for the additional 16,780 devices if the devices are accepted prior to the end of the first quarter of FY03. The Agreement, however, does not require that additional rental payments be made to Apple in the event of de-appropriation.

Services Component

The Services Component of the contract, as amended, is being purchased under the terms of the basic contract and the associated payment schedule. According to DOE, Apple has substantially completed the work required under the Project Management/On-Site Training, Support and Spares, Network/Storage and Software categories of the Services Component of the contract.[5]

Rider B of the contract contains a non-appropriation clause that states that:

> [I] f the State does not receive sufficient funds to fund this Agreement and other obligations of the State, if funds are de-appropriated, or if the State does not receive legal authority to expend funds from the Maine State Legislature or Maine courts, then the State is not obligated to make payment under this Agreement. The State's failure to make payment as provided under this section shall be deemed to be a default under this Agreement.[6]

Thus, should the Legislature decide not to appropriate funds or to de-appropriate funds, DOE would be relieved of the obligation of making further payments under the Services Component of the contract. Whether or not the State would incur further liability to Apple for services already provided under the Services Component of the contract as a result of failure of funding is not clear, however some guidance has been provided by the Law Court in the 1996 *SC Testing Technology* case.[7]

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[4] The rent schedule attached to Commissioner Albanese's July 11, 2002 letter to you reflects $100,000 in rent for 2,000 devices due in the first quarter of FY03. According to the State Budget Office, $100,000 is also the amount that has been appropriated, budgeted and allocated for device rentals for the first quarter of FY03.

[5] The value of these services is $5,645,000, which is to be paid over the life of the contract in accordance with the payment schedule.

[6]It is our understanding that the last sentence in this section was intended to give Apple the opportunity to terminate the Contract in the event of non-appropriation or de-appropriation of funds. In such an event, Apple would have no further obligation to provide goods or services under the contract.

[7] DOE's liability for payment to Apple under the non-appropriation section of the contract must be distinguished from its liability under the section of the contract that grants DOE the right to terminate the contract when DOE simply determines that termination "is in the best interest of the Department." If DOE terminates the contract under this latter provision, it is obligated to equitably adjust the contract to compensate Apple for such termination.

In *SC Testing Technology, Inc. v. Department of Environmental Protection*, 688 A. 2d 421 (1996), the Law Court held that the Department of Environmental Protection was not liable for damages when the Legislature repealed the Motor Vehicle Emissions Inspection Program because the contract language and the circumstances surrounding the agreement showed that SC Testing Technology bore the risk of loss in the event of the repeal of the program. In the course of its opinion, the Court stated that:

> [W] hen a party enters into a contract with a state agency, it does so with the understanding that the Legislature may at some future time take action that nullifies the subject matter of the contract and, necessarily, the respective performance obligations of the parties.

SC Testing, 688 A. 2d at 424. Although *SC Testing Technology* involved the repeal of a program by the Legislature where the contactor had expressly assumed the risk of such repeal, the reasoning of the Court appears to apply to a situation where the Legislature fails to provide funding for a program and such failure effectively terminates the program. With regard to the Maine Technology Endowment contract, Apple expressly assumed the risk of program termination due to non-appropriation of funds and thus may have no recourse against DOE.

Summary

To summarize, the payment provision of the contract between DOE and Apple has two parts – one part is for the laptop devices and the other part for services and equipment other than laptops, third-party software, service support and training. With respect to the first part, the Hardware Purchase Component, in the event of non-appropriation, DOE is relieved from the obligation to make further rent payments except for the portion of rent for which funds have been appropriated and budgeted. In this event, DOE, at its expense, must also return the devices to Apple. With respect to the second part, the Services Component, if the Legislature does not appropriate funds, DOE is not obligated to make payments under the contract beyond what is owed under the payment schedule. Apple may well argue that, notwithstanding the non-appropriation provisions, DOE is obligated to pay for services and equipment already provided by Apple and that have been of a benefit to the State. The Law Court's holding in *SC Testing Technology* appears to apply here, and if so, DOE would have no obligation to pay Apple for any of the services or equipment beyond what is owed under the payment schedule.

While *SC Testing Technology* may provide some guidance in determining the financial impact on the State in the event of non-appropriation or de-appropriation of funds, there are obviously other consequences that may flow from such a course of action. In particular, failure to fund a program after a contractor has expended considerable resources in fulfilling its obligations under a contract may adversely affect

the State's creditworthiness as well as its ability to contract in the future, undermine its credibility at the bargaining table and/or increase the costs of its agreements. [8]

Finally, we must keep in mind that, because this precise situation has not been presented to the courts, we cannot predict with absolute certainty the outcome of any litigation. Moreover, depending on the circumstances that exist at the time of any non-appropriation or de-appropriation of funds, there could very well be new issues that we have not considered.

Sincerely,

G. Steven Rowe
Attorney General

GSR/djp

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[8] Several of these possible consequences were noted by then Maine Law Court Justice Kermit Lipez (now a Judge on the United States Court of Appeals for the First Circuit) in his dissent in the *SC Testing Technology* case.