

STATE OF INDIANA )  
 )ss:  
COUNTY OF MARION )

MARION SUPERIOR COURT  
CIVIL DIVISION 10  
CAUSE NO. 49D10-1005-PL-021451

STATE OF INDIANA, )  
acting on behalf of the )  
Indiana Family & Social Services )  
Administration, )  
 )  
Plaintiff )  
 )  
v. )  
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INTERNATIONAL BUSINESS )  
MACHINES CORPORATION, )  
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 )  
Defendant. )

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INTERNATIONAL BUSINESS )  
MACHINES CORPORATION, )  
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Plaintiff, )  
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STATE OF INDIANA, )  
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Defendant. )

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**FINDINGS OF FACT, CONCLUSIONS OF LAW,  
AND JUDGMENT FOR IBM**

**Introduction**

Neither party deserves to win this case. This story represents a “perfect storm” of misguided government policy and overzealous corporate ambition. Overall, both parties are to blame and Indiana’s taxpayers are left as apparent losers.

The largely undisputed evidence shows that the Governor, the Family and Social Services Administration (“FSSA”) and various State of Indiana (“State”) officials set out to fix Indiana’s poorly-performing welfare system by inserting an untested theoretical experiment, and substitute personal caseworkers with computers and phone calls (“remote eligibility”). This is now admitted to be an error, and there is nothing in this case, or the Court’s power, that can be done to correct it, or remedy the lost taxpayer money or personal suffering of needy Hoosiers. All that can be done in this case is to take the first step at setting the final numbers among so many millions already spent.

This case is about nothing but the intent of the parties, performance of the parties, and whether there was a “material breach” of the contract as a whole. Breach of public trust is not included here, consideration of private greed is not included here, nor is any measure of public injury. It is just about the money between the parties, much of which is already spent by the State.

Accordingly, the Court makes its determination fairly and diligently.<sup>1</sup> The good faith of the parties cannot reasonably be questioned, especially the hard-working employees of the State and IBM. But the competence of the parties in this project is sometimes open to question.<sup>2</sup> The short ill-fated life of this super-sized contract will remain an enigma.

Overall, the Court finds, as a matter of fact, that the State failed to meet its burden to show that International Business Machines Corporation (“IBM”) committed a material breach of the contract. Certainly the State showed that IBM did not perform well in some respects, especially when trying to get subcontractor ACS Human Services (“ACS”) to answer phones - notwithstanding evidence of ACS lobbying against IBM in violation of its own subcontract. But

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<sup>1</sup> See Exhibit A for a logistical summary of the case pursuant to Trial Rule 58(B).

<sup>2</sup> For example, certain constitutional rights of applicants are now found to have been violated during the contract. See Perdue v. Gargano, et.al. (2012), Ind., 964 N.E.2d 865.

the record is too laden with too much evidence of political factors, the overwhelming difficulty of attempting such a project, and the State's own inconsistent performance to not allow a conclusion that unsatisfactory results were not caused as much by the State as IBM. Considering the contract as a whole, IBM's performance does not show breach going to the heart of the contract, and the State did not prove otherwise.

On the other hand, the Court finds as a matter of law that most of IBM's claimed damages at trial (so-called "deferred fees") are unreasonable and cannot be collected. The net amount of money due to IBM upon termination of the contract is \$52,081,416. Specifically, \$40,000,000 was already awarded prior to trial upon summary judgment, so damages awarded at trial total an additional \$12,081,416, mostly for equipment that the State has retained.

It must be noted that counsel for both parties showed remarkable and uncommon ability. All lawyers are warmly congratulated, with a measure of gratitude, for working at such a high level of professionalism, showing exceptional civility, and strong intellectual acumen.

## **Findings of Fact<sup>3</sup>**

### **The Contract**

#### **Indiana's Welfare System**

1. Indiana's welfare system was, in the words of Governor Daniels, "broken." (Ex. 621, 11/29/06 Tr. at 2:04.) Among other things, it was "plagued by high error rates, fraud, wasted dollars, poor conditions for its employees, and very poor service to its clients." (*Id.* at 2:10-14.) The State's welfare-to-work record was the worst in the country. (Exs. 568, 2325,

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<sup>3</sup> Citations to trial testimony are taken from the uncertified transcript and are unofficial.

1644.004.)<sup>4</sup> Governor Daniels described the old system as “America’s worst welfare system” (Ex. 612, News Release (Nov. 29, 2006)),<sup>5</sup> and FSSA Secretary Mitch Roob described the system as “horribly broken” (Ex. 2306)<sup>6</sup> and an “unmitigated disaster” (Ex. 1679).<sup>7</sup> The State concluded that “[t]he status quo is simply not acceptable.” (Ex. 55 at 5.)

### **The Idea and Intent of the “Modernized” System**

2. In late 2004, shortly after Governor Daniels’s election, senior State officials, including the Governor, Secretary Roob of the FSSA, and former Indianapolis Mayor Stephen Goldsmith, began developing the concept of a welfare eligibility overhaul based on a “remote eligibility” model similar to that previously undertaken in Texas.<sup>8</sup> Under this model, Indiana citizens would apply for benefits “via web and call center” without the need for a face-to-face meeting with a case worker, and eligibility determinations would be done on a centralized, statewide basis rather than in the local county welfare offices. (Ex. 53, Roob email; Tr. 5885:10-21 (Roob).) The impetus for this change came from the “top of the administrative hierarchy: the governor and cabinet secretary were the two key advocates of modernization. They laid out their vision and priorities at the start, then proceeded methodically, resisting accommodations that

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<sup>4</sup> See, e.g., Ex. 1894, Main, email to Roob (Nov. 21, 2006) (“First in child deaths, last in welfare-to-work.”); Ex. 250, Roob letter at FSSA1\_04642780 (Dec. 19, 2008) (“Four years ago, FSSA was an agency in crisis. We were first in child deaths, last in welfare-to-work.”); Tr. 3454:11-20 (J. Dunn); Tr. 3896:8-11 (Boggs).

<sup>5</sup> See also Ex. 568, Mills, email to Southworth (July 28, 2009) (Governor Daniels: “complete disaster by every definition”); Ex. 2325, Governor Op-Ed. (Jan. 2, 2007) (Governor Daniels: old system was “totally indefensible”); Ex. 1644.004, 11/22/2006 Tr. at 10:20 (Daniels: old system “indefensible”).

<sup>6</sup> Ex. 2306, DeAgostino, Downsizing proposal won’t serve Indiana, caseworkers say, South Bend Tribune (July 27, 2005).

<sup>7</sup> Ex. 1679, Kusmer, Welfare contract may cost state \$1 billion, Indianapolis Star (Nov. 18, 2005). See also Ex. 55 at 15-19 (finding “inconsistent application of rules, regulations and policy,” “burdensome caseloads,” “high case error rates,” “poor participation in programs designed to promote self-sufficiency,” “inappropriate delays,” “dissatisfied clients,” and a system “conducive to fraud”); Ex. 189, Roob, Indiana Crying for Reform of Assistance Eligibility Process, South Bend Tribune (Nov. 9, 2005) (the system “does not work for those trying to use the system; it does not work for employees trying to administer the system; and it does not work for Indiana taxpayers who must help fund the tens, maybe even hundreds of millions, of dollars lost each year because of antiquated and inefficient processes”); State Proposed Findings ¶ 2 (“Prior to 2006, the Public Assistance Eligibility determination process for DFR programs was ‘cumbersome, slow, inconvenient, and highly prone to errors.’”); *id.* ¶ 3 (“RFI 6-C and RFP 6-58 detailed the dire condition of the State’s current system....”).

<sup>8</sup> Tr. 5885:15-5886:1 (Roob) (Steve Goldsmith brought this concept to Roob’s attention); Tr. 7043:3-9 (Main); Ex. 53, Roob, email to Roob (Mar. 21, 2005); Tr. 4506:6-14 (Molina) (the Indiana plan was “similar” to Texas).

might have compromised their goals.” (Ex. 1957 at 112.)<sup>9</sup> The State began what Governor Daniels would later describe as a “very, very lengthy and careful [two-year] process” of study and design to further develop the system concept. (Ex. 621, 11/29/2006 Tr. at 10, 14.) Former FSSA Secretary “Roob and his project manager, Zach Main, visited county offices across the state. Their report to Governor Daniels decried ‘terrible customer service’ in the offices they visited. ‘Indiana’s neediest citizens, the ones who have the least access to transportation, have to drag along children or leave a job in order to jump through a bunch of hoops to access the system.’ Analysts found that citizens in need of the FSSA’s help were forced to make more than two million unnecessary trips a year.” (Ex. 188, Goldsmith, What’s Left for Government to Do?, The American, Jan./Feb. 2008, at 2-3.)

3. As described in a report entitled *Eligibility Modernization: The Need for Change*, “FSSA began to explore ways to improve the eligibility application for public assistance and welfare programs” in 2005, and “developed the general traits necessary to modernize and improve the application system.” (Ex. 55 at 11.)<sup>10</sup> One of the State’s requirements for the new system was that it “reduce the number of mandatory visits to local offices” by “giving clients more avenues to interact with the agency” such as “the Internet, an automated and interactive phone system, and local organizations in the community.” (*Id.* at 5.)<sup>11</sup> This would not only free

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<sup>9</sup> See also Ex. 1957, Goldsmith & Burke, Moving from Core Functions to Core Values: Lessons from State Eligibility Modernizations, in *Unlocking the Power of Networks* at 112 (2009).

<sup>10</sup> See also Ex. 55 at 25 (“The agency has developed guidelines that address many of the problems in today’s eligibility system; these guidelines form the foundation for an Indiana solution that is acceptable to clients and taxpayers.”); Ex. 609, Robertson, email to Goode (June 9, 2006) (same).

<sup>11</sup> See also Ex. 609, Robertson, email to Goode (June 9, 2006) (“We will move from a case based system to a process and task based system. This specialization will enable us to completely reengineer our current model to take advantage of the inherent efficiencies of task specific labor.”); Ex. 192, Indiana FSSA Eligibility Modernization Project, Implementation APD at FSSA1\_073211201 (Nov. 14, 2006) (“FSSA conducted an extensive analysis, including a study of the best practices and lessons learned from states already embarking on modernization efforts” to develop “a framework to guide the modernization initiative.”); Ex. 2138, Office of the Governor, Indiana State Government’s Performance Report at 27-28 (Aug. 19, 2005) (“FSSA has developed a new service model for public assistance eligibility determinations. The first step to this transformation, writing and awarding an RFP to a vendor to manage the transition to the new model, is complete.”).

FSSA clients from the requirement of face-to-face eligibility processing, but also save the State money. As Secretary Roob put it, “It’s better for them and cheaper for us if they don’t come into the office.” (Ex. 90112 at 2.)

### **The Procurement Process and the IBM Coalition**

4. In October 2005, FSSA issued a Request for Information (“RFI”) seeking vendors to assist with the Project, noting that “FSSA is now engaged in a program to redesign the state’s process and systems for determination of client eligibility for public assistance,” the system “should enable Indiana citizens to enroll with a minimum of personal visits,” and the “desired outcome” was a “[d]ecrease [in] volume going through local offices.” (Ex. 194 at 5, 14-15.)<sup>12</sup>

5. The RFI sought assistance in implementing a modernized system in which “clients [could] apply in person, through the Internet, over the phone, by fax or mail.” (*Id.* at 6.) The RFI emphasized the goal of increasing the self-sufficiency of applicants for social services. (*Id.* at 13.)

6. IBM and a group of 12 coalition companies, designated the “Hoosier Coalition for Self Sufficiency,” submitted a response to the RFI on January 3, 2006. (Ex. 223.) The largest portion of the work among the Coalition members, and the largest portion of the compensation, went to ACS, which employed the personnel assisting in the processing of eligibility applications (many of whom were former State employees).

7. Following the State’s Request for Proposal and Request for Best and Final Offer, other participating bidders dropped out, leaving the IBM Coalition as the only potential contract

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<sup>12</sup>See also Ex. 194 at 18-19 (“While maintaining some local presence is required, FSSA anticipates that the new solution may move most eligibility work to more efficient and effective venues. These could include: Service and mail centers Web Service Interactive Voice Response and Call Centers.”); Tr. 5924:11-18 (Maxwell) (agreeing that the “statements in the RFI [are] consistent with [his] understanding of what the State wanted when [he] came onto the project in terms of moving away from face-to-face meetings and a caseworker model and moving towards more self-sufficiency and moving people off of welfare”).

partner. (Tr. 2835:8-14 (Goode).) Having concluded that the State could not undertake a meaningful modernization of the eligibility system without independent vendor assistance (Ex. 530), on May 11, 2006, the State announced its intention to award the eligibility modernization contract to the IBM Coalition. (Ex. 1902 at 4.)

### **The Interagency Review Committee**

8. Before the MSA was signed, however, Governor Daniels ordered an additional step in the procurement process, appointing an Interagency Review Committee chaired by the Governor's Chief of Staff, Earl Goode, and consisting of the heads of six State agencies.<sup>13</sup> That committee worked for seven months, making further modifications and eventually approving the overall concept and design of the system.<sup>14</sup> The committee's approach "preserve[d] some facets of the original vendor responses ... [but] [was] primarily the product of significant Review Committee revisions, based on (a) what it learned from its study of other states' experiences with similar modernization efforts and (b) its analysis of the potential risks involved with modernization in general." (Ex. 199 at 1.) On December 27, 2006, the Governor issued a press release stating that "he had accepted the review team's recommendation to proceed with the modernization solution as revised and designed by that team ... ," observing that: "No decision we've made is more clearly in the public interest." (Ex. 1676.)

9. The committee's recommendations, which the Governor adopted and which were incorporated into the final contract, specifically identified the move away from face-to-face meetings and the old caseworker-based system as among the State's key requirements. "Rather than be assigned to a single caseworker, clients would be able to contact and work with a variety of people in multiple settings." (Ex. 199 at 14.) In addition to being more efficient and saving

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<sup>13</sup> Ex. 236, Governor, letter to Warrick at 2 (May 26, 2006) (stating that this review was an "extra step to the normal procurement decision process").

<sup>14</sup> Ex. 1676, Press release, Governor Signs Contract to Modernize State Eligibility System (Dec. 27, 2006).

clients multiple trips to county offices, the committee found that “[t]he proposed eligibility system would lessen fraud and abuse by limiting the opportunities a client has to collude with a caseworker because caseworkers would no longer control cases from opening to close.” (*Id.* at 17.)

10. The committee underscored the same goals that the State had previously identified in the RFI, including improving work participation, reducing fraud, achieving cost savings, and using technology to provide electronic access and a paperless system. According to the committee, Governor Daniels “directed the Review Committee to consider modernization in the context of achieving the following objectives: Meeting the goals of improved welfare reform efforts and improving public assistance policies and procedures; Satisfying the State’s request that State employees who go to work for the selected vendor receive the same or better base salary and comparable benefits; Being in the best interests of Indiana’s taxpayers; and Providing short-term and long-term economic benefits to the State.” (Ex. 199, cover letter at 2.) In particular, the committee noted that “Indiana’s policy initiative aims to promote the development of policies and procedures that underscore the importance of work, accuracy, and caseload integrity across all areas of public assistance” and that the Governor had “specifically asked the Review Committee to assess whether the path to modernization would help welfare recipients become economically self-sufficient.” (*Id.*, report at 3.) The committee found that “the recommended solution satisfies each of the above objectives” because, among other things, it would “[I]mprove delivery of and access to FSSA benefit services by modernizing access through telephone and web-based access points,” reduce fraud by removing caseworker control, and allow the State to achieve its primary goal of “self-sufficiency.” (Ex. 199, cover letter at 1-2, report at 14, 16; *see also* Ex. 1249, Daniels, memo to Roob (May 22, 2006) (the “overarching

policy vision” of modernization was “to assist and support welfare recipients towards social and economic self-sufficiency”).)

11. While “the Review Committee identified several areas of potentially significant risk in successfully implementing the recommended solution” (Ex. 199, cover letter at 3), it concluded that “the status quo is not acceptable” (*id.* report at 25). Accordingly, the committee found that “[t]his recommended public-private agreement will best support FSSA and DFR administratively,” noting that “[e]ssential governmental functions and governmental oversight and control will be retained by the State.” (*Id.* at 29.)

#### **The Master Services Agreement (“MSA” i.e. the Contract)**

12. On December 27, 2006, the parties executed the contract. During the months-long process of negotiating and drafting the agreement, the State was represented by outside counsel as well as the Attorney General’s office, which reviewed the contract as it was being drafted and approved it “for form and legality.” Governor Daniels signed for the State. (Ex. 1649, MSA Signature Page.)

13. The resulting contract was a 10-year, \$1.3 billion public-private agreement that sought to “transform and modernize the process by which information needed or related to making eligibility determinations is collected, organized, and managed.” (Ex. 1911 at IBM-IN04475510, IBM-IN04475826.) The MSA contains more than 160 pages plus extensive attachments, including 10 exhibits, 24 schedules, and 10 appendices, encompassing all aspects of the parties’ working relationship.

#### **Contract Goals and Design Requirements**

14. The MSA incorporates the various goals that the State outlined during the procurement process. Section 1.1(1) identifies the following “Policy Objectives”:

The overarching policy objectives of the Modernization Project and this Agreement are (i) to provide efficient, accurate and timely eligibility determinations for individuals and families who qualify for public assistance, (ii) to improve the availability, quality and reliability of the services being provided to Clients by expanding access to such services, decreasing inconvenience and improving response times, among other improvements, (iii) to assist and support Clients through programs that foster personal responsibility, independence and social and economic self-sufficiency, (iv) to assure compliance with all relevant Laws, (v) to assure the protection and integrity of Personal Information gathered in connection with eligibility determination, and (vi) to foster the development of policies and procedures that underscore the importance of accuracy in eligibility determinations, caseload integrity across all areas of public assistance and work and work-related experience for Clients in the Programs. (MSA § 1.1(1).)

15. The MSA's Schedule 3, "Vendor Services Environment," identifies three primary outcomes the State sought to achieve through the Project: self-sufficiency, programmatic savings, and administrative savings. (MSA Schedule 3, at 2.) "The Vendor solution will use enabling activities, technology and governance activities to enhance the client experience, facilitate self-sufficiency, and enable administrative and programmatic savings." (*Id.*)

16. The Schedule 3 "self-sufficiency" goal is also underscored in Section 1.1, where it twice states that among the State's "overarching policy objectives" are "to assist and support Clients through programs that foster personal responsibility, independence and social and economic self-sufficiency" and "to foster the development of policies and procedures that ... underscore ... work and work-related experience for Clients in the Programs." (MSA § 1.1(1).) Accordingly, the MSA contains a series of provisions laying out a program to improve work participation. (MSA § 3.4.10, Schedule 1, at 6, 8, 15, 21, 35-36, Schedule 3, at 5, 16.)

17. The Schedule 3 "programmatic savings" goal includes efforts to reduce fraud. Schedule 3 emphasizes this as a goal of Modernization, directing that, among other things, there be "mitigation activities that better identify instances of Client fraud." (MSA, Schedule 3, at 2.) Similarly, Section 1.1 identifies "the development of policies and procedures that underscore the importance of ... caseload integrity across all areas of public assistance" as well as the provision

of benefits only “to individuals and families who qualify for public assistance” as important objectives for the program. (*Id.* § 1.1(1).)

18. Schedule 3 also underscores the “administrative savings” the State sought from the program. This reiterates Section 1.1’s objective of providing “efficient” eligibility determinations. (*Id.* § 1.1(1).) In order to advance the goal of efficiency, the MSA also contemplates the creation of a paperless system in which record files could be accessed and stored electronically, to make them “readily available to any authorized user.” (*See id.* Schedule 3, at 10.)

19. Schedule 3 also correlates the Section 1.1 objectives about “improv[ing] the availability” of services through the implementation of new technologies. (*Id.* § 1.1(1).) Accordingly, it emphasizes the use of “enabling technologies” such as phone and internet avenues to access the modernized system. *See* MSA Schedule 3, at 4, 6-7, Schedule 1 LS1 (“the Vendor model assumes electronic applications”), LS5, LH1, LH6, LH117; Ex. 2908, Steady State Procedures Manual Vol. I, at 4.

### **The Memorandum of Understanding (MOU)**

20. Finally, the MOU executed with the MSA (between IBM, Indiana Economic Development Corporation, Purdue University, and Indiana University) underscores the importance of the economic development activities that were “part consideration” for the MSA. (Ex. 1709 at 3.) As Governor Daniels observed the day he announced the agreement, these economic development benefits were of “enormous importance to the Indiana economy” and his announcement would have been “just as big” if the Project involved those efforts alone. (Ex. 1644.005 at 2:05-3:15.)

### Parties' Responsibilities Under the MSA

21. The MSA set forth each party's responsibilities for various functions related to the performance of the Services in a detailed "Statement of Work." (MSA Schedule 1.) Under the terms of the MSA, the IBM Coalition would first assist the State in processing social services applications under the State's existing procedures in all of Indiana's 92 counties (the "As-Is" system). (MSA § 3.1.3; MSA Schedule 4.) The modernized system would then be rolled out in phases on a region-by-region basis according to a "preliminary," "initial Transition Timeline." (MSA § 3.2.1(2).)<sup>15</sup>

22. The MSA contemplated that on completion of this transition period -- when the modernized system had rolled out to all counties -- the Project would reach "Steady State," defined in the MSA as "the fully implemented Vendor Service Environment." (MSA § 3.2.1(1), Appendix I, at 22.)

23. The MSA provides that the State would retain operational control throughout the Modernization Project.<sup>16</sup> Appendix V to the MSA contains a Governance Plan that provides for a State team with responsibilities that included "general authority and responsibility for operational, technical, financial, and general management and oversight of the Services provided under the Agreement." (MSA App. V, § 3.7.2.)<sup>17</sup>

24. The State also retained all policy-making authority over the Project. Section 3.1.1(6) states that "[t]he State shall make, and shall retain final authority with respect to, any

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<sup>15</sup> See also Ex. 513, Main, email to staff at IBM-IN00898231 (June 13, 2008) (FSSA viewed the transition schedule as "written in pencil"); Ex. 4, Critics Call for Daniels, lawmakers to Investigate Privatization (Mar. 11, 2008) ("Our timetables are written in pencil.").

<sup>16</sup> Tr. 7282:18-7283:1 (Adams) (agreeing that "operational governance was, in fact, in modernization directed by the State staff"); Tr. 7280:12-21 (Adams) (agreeing that under the modernized solution, "the State was going to retain both responsibility and control over the entire process").

<sup>17</sup> See also Ex. 316, FSSA, Legislative Questions & Answers Provided at 10 (Jan. 10, 2007) ("The State's oversight will be expanded from what i[t] has historically been able to accomplish," while "the State's accountability for the programs [would] remain the same as prior to modernization.").

policy changes with respect to the Services.” (MSA § 3.1.1(6).)<sup>18</sup> In addition, the State was required to approve all of the detailed procedures under which the modernized system would operate, which were contained in the Steady State Procedures Manual and incorporated into the MSA as Appendix VI-B. (*Id.* § 3.6.3(3), (5)-(7); *see also id.* § 3.6.3(7) (providing that the services would be performed “in accordance with the most recent State-approved version of the Steady State Procedures Manual”).) Exercising this authority, the State signed off on each aspect of the implementation of the design of the modernized system,<sup>19</sup> and provided detailed requirements (along with ACS and the other subcontractors) for its implementation.<sup>20</sup>

25. Finally, the State had a direct operational role in the Modernization Project that extended to “certain tasks on every application.” (Tr. 2173:9-14 (Harris).) The State retained sole authority to make, and sole responsibility for, all eligibility determinations: “The State shall have and shall retain final responsibility for eligibility determinations under each of the Programs ...” (MSA § 3.1.1(1).) In addition, the State had responsibility for critical aspects in collecting information, processing applications, and other steps leading up to the final eligibility determinations. In some counties, the local offices were run entirely by State workers. (*See* MSA § 3.1.1(2).) In others, Services were provided by State and Coalition workers. (MSA § 3.1.1(3).) Regardless of the location, however, the State Retained Activities, for which the State was responsible under the MSA, included a range of functions, including performing client interviews for all programs, answering client questions, processing applications, running the medical review teams that made determinations of disability in Medicaid disability cases,

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<sup>18</sup> Tr. 4559:12-24 (Molina) (agreeing that “the State of Indiana retained all policymaking authority on the modernization project,” which was reasonable because that’s “not an expectation for the contractor” to do that).

<sup>19</sup> *See, e.g.*, Exs. 2942, 3064A, 3065B, 3081, 3082, 3085.

<sup>20</sup> *See* Tr. 3196:17-3197:10 (Shaver) (“[A]s users of the system, ACS, Arbor, and the State needed to provide IBM the requirements for how to build that system ... that we would need in order for us to operate a service delivery system.”).

approving all training, and conducting the hearings and appeals process. (See MSA Schedule 1.)<sup>21</sup>

26. In addition, State workers in every local office oversaw the work of the Coalition.<sup>22</sup> Under Modernization, the State retained “a significant number of employees who ... continue[d] to be solely in charge of making final eligibility determinations and [were] involved in overseeing the services provided by the IBM Coalition.” (Ex. 56, Interagency Committee Report at FSSA1\_04856252 (Nov. 22, 2006).) This included DFR employees in “every county office.” (*Id.* at FSSA1\_04856259.)

### **MSA Performance Standards and Liquidated Damages**

27. The parties viewed modernization as a considerable challenge. FSSA Division of Family Resources (DFR) Director James Robertson observed in a meeting with potential vendors: “No one has done this successfully, as far as we know.” (Ex. 2307 at 2.) Before the MSA was signed, there already had been well-known problems with similar modernization efforts in Texas and Florida. The problems in Texas were so severe that in early 2006 -- months before the MSA was signed -- the rollout of the project was stopped because applications were not being processed.<sup>23</sup> As the State’s lead consultant on the Modernization Project, James Maxwell, acknowledged, modernization required implementing a “brand new workflow and document management system,” while “*changing the ingrained habits of literally hundreds of thousands of employees and constituents.*” (Ex. 190A at IBM-IN00255540.) (emphasis supplied)

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<sup>21</sup> See, e.g., Ex. 2627, FNS guidance document at 1 (Jan. 22, 2010) (discussing federal requirement that State workers participate in food stamp interviews); Tr. 4078:24-4079:2 (Elwell) (MRT is “a hundred percent owned and operated by the State of Indiana”); Tr. 2173:23-2174:3 (Harris) (agreeing that “the State retained authority over the medical review team”); Tr. 4563:15-24 (Molina) (agreeing that “the State was responsible for the medical review team”); Tr. 2174:12-14, 2174:18-22 (Harris) (acknowledging that “the State retained authority over the hearings and appeals process”); Tr. 4563:19-21 (Molina) (agreeing that “the State was responsible for hearings and appeals”).

<sup>22</sup> Tr. 7287:3-10 (Adams) (“The work the ACS employees perform is overseen by FSSA managers.”).

<sup>23</sup> See Tr. 4510:19-4511:6 (Molina).

28. The programs falling within the Project were complex.<sup>24</sup> The processing and approval of applications for benefits for these programs involved highly individualized determinations based on the unique facts and circumstances of each individual applicant.<sup>25</sup> There were more than a million applications for benefits under these programs each year, each involving unique facts and circumstances, and each requiring individualized determinations.<sup>26</sup>

29. As a result of these challenges, the State's integral role in the project design, and the State's retention of key operational control, IBM's contractual obligations for performance outcomes on the Modernization Project were pragmatic. While MSA § 1.1 outlined several "overarching policy objectives of the Modernization Project," MSA § 1.4(5) provided that these Policy Objectives did not impose any contractual obligations on IBM: "[I]n no event shall the Policy Objectives change or expand Vendor's obligations hereunder unless expressly agreed to by the Parties pursuant to a Change." (MSA § 1.4(5).) Section 6.4 of the MSA similarly disclaims any warranties of "uninterrupted or error-free operation." (MSA § 6.4.) Finally, the Modernization Project was rolled out in stages pursuant to a timetable the MSA describes as "preliminary" (MSA § 3.2.1(2)), which could be, and in fact was, altered by the parties (*see* Ex. 1500.069, Change Order 69), and which State officials repeatedly stated was "written in pencil" (Ex. 513, Main, email to staff at IBM-IN00898231 (June 13, 2008)).<sup>27</sup>

30. The MSA does, however, contain certain specific exceptions to the general disclaimer of any obligation for performance outcomes. The agreement contains detailed performance standards set forth in Schedule 10 that fall into four categories:

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<sup>24</sup> Tr. 1935:25-1936:1, 1979:7-22, 2030:8-15 (Harris) (benefits programs are extremely complex, complicated, and difficult).

<sup>25</sup> Tr. 1937:19-1938:5 (Harris) (the unique circumstances of individual cases can generate "a million rules" for benefits determinations).

<sup>26</sup> Tr. 6974:13-17 (Marais) (over one million applications processed each year and 1.6 million in fiscal year 2009).

<sup>27</sup> *See also* Ex. 4, Petrone, email enclosing Critics Call for Daniels, Lawmakers to Investigate Privatization (Mar. 11, 2008) ("Our timetables are written in pencil.").

- (1) Critical Transition Milestones, which were largely logistical steps over the life of the Project regarding employee transition and software usage;
- (2) Transition Key Performance Indicators, which were performance measurements in the non-IBM, or “As-Is,” counties during the transition period;
- (3) Key Performance Indicators, which were performance measurements for the modernized system in force originally only during Steady State (*i.e.*, after rollout was complete in all counties); and
- (4) Service Level Metrics, which related primarily to service level measurements also in force only during Steady State.

All of these standards included liquidated damages provisions that the State had the option to enforce if the IBM Coalition failed to meet the standards, ranging from \$150,000 to \$350,000 for the Critical Transition Milestones and far smaller sums (\$500 to \$5,000) for the KPIs, TKPIs and SLMs. (MSA Schedule 10.) The amounts of liquidated damages applicable to the KPIs were nominal considering the scope of the MSA (1/25/12 Order (Breach) at 4), and were described by FSSA officials as “miniscule.” (Ex. 562.)

KPI	Performance Standard Metric	Liquidated Damage
Food Stamp Case Actions	. . . 99% of the Food Stamp Cases in any month must be [fully processed and transferred to the State] no later than 3 business days prior to the established Federal and State time guidelines.	\$5,000 per month in which this KPI is not met. Beginning September 1, 2008. (CO-64, 06-30-08)
Medicaid Case Actions	. . . 99% of the Medicaid Case Actions in any month must be [fully processed and transferred to the State] no later than 3 business days prior to the established Federal and State time guidelines.	\$5,000 per month in which this KPI is not met. Beginning September 1, 2008. (CO-64, 06-30-08)
Medicaid Disability Applications	99% of all Medicaid Disability applications with all available supporting documentation must be [fully processed and transferred to] Office of Medicaid Policy and Planning	\$5,000 per month if this KPI is not met. Beginning September 1, 2008. (CO-64, 06-30-08)

KPI	Performance Standard Metric	Liquidated Damage
	(OMPP) State's Medical Review Team (MRT) within 30 days of Application Date (excluding client or provider delay days as defined in 42 CFR 435.911(c) (1) and (2)).	
TANF Case Actions	. . . 99% of the TANF Case Actions must be [fully processed and transferred to the State] no later than 3 business days prior to the established Federal and State time guidelines.	\$5,000 per month if this KPI is not met. Beginning September 1, 2008. (CO-64, 06-30-08)

Key Performance Indicator (KPI)	Performance Standard Metric	Liquidated Damage
Call Response Time Call Center	Call Response Time is the time between the completion of the Voice Response Unit ("VRU") messages and the time at which a live agent answers the call, The Performance Standard shall be a mean of 120 seconds or less each month.	\$5,000 per month in which this KPI is not met. Beginning September 1, 2008 (CO-64, 06-30-08).
Hold Time Call Center	Hold Time is the total amount of hold time for all calls to the Call Center in which an agent places a caller on hold . . . The Performance Standard shall be a mean of three minutes or less each month.	\$5,000 per month in which this KPI is not met. Beginning September 1, 2008 (CO-64, 06-30-08).
Abandonment Rate Call Center	Abandonment Rate is the total number of calls abandoned after completion of any VRU messages, minus any call abandoned within the first fifteen seconds following completion of any VRU messages, . . . .	\$5,000 per month in which this KPI is not met. Beginning September 1, 2008 (CO-64, 06-30-08).
Workflow Management System Availability	99.5% Availability during processing hours, Monday-Friday.	\$5,000 per month in which this KPI is not met.
Eligibility Web Site Availability	99.5% Availability twenty-four hours per day, seven days per week, except for scheduled maintenance windows.	\$5,000 per month in which this KPI is not met.

(Schedule 10 to the MSA at §4.2.2.)

31. Consistent with the parties' expectation that there would inevitably be issues with performance during the transition, many of these performance standards were not applicable until Steady State. The Service Level Metrics, for example, were never applicable during the term of the agreement. Certain KPIs were accelerated to begin September 1, 2008 by an amendment to the MSA (Ex. 1500.064, Change Order 64), but many significant metrics remained inapplicable until Steady State. (*See* MSA Schedule 10.)

32. The MSA also required IBM to manage the subcontractors. [*See, e.g.*, Ex. 5104, MSA §3.8.2(7)(ii) (noting that satisfactory performance of the MSA will be measured in part by "Vendor's satisfactory oversight and management of the Subcontractors"); *id.* §14.1 ("Vendor shall be permitted to utilize the services of Subcontractors to perform portions of the Services, provided that (i) Vendor shall continue to have full responsibility and liability for the performance thereof in compliance with the terms of this Agreement . . ."); *id.* §14.7 ("Vendor remains fully responsible for obligations, services, and functions performed by its Subcontractors to the same extent as if such obligations, services, and functions were performed by Vendor directly, and for purposes of this Agreement, such work will be deemed work performed by Vendor."); *id.* §9.1.1]

### Termination Provisions

33. Finally, under Article 16 of the MSA, the State retained the right to terminate the agreement for its own convenience or for cause. (MSA §§ 16.3.1, 16.3.2.) The MSA provides that **in order to terminate for cause, there must be a breach or series of breaches that is "material considering th[e] Agreement as a whole."** (MSA § 16.3.1(1)(A)-(C).) Under the MSA's termination for convenience provision, the State could step into IBM's shoes and serve

as the prime contractor “whenever, for any reason, the State determines that such termination is in its best interest.” (MSA § 16.3.2.)

34. The MSA includes a range of payment provisions that may be applicable in the event of termination. Under Section 14.8.1(3), for example, the State had the option to assume IBM’s subcontracts, but if it elected to exercise that option, the MSA provided that “the State shall pay” **IBM subcontractor assignment fees that were specified in the agreement.** (MSA § 14.8.1(3).) Similarly, MSA § 16.6.1(4) gave the State the option to purchase the computer and other **Dedicated Equipment that IBM supplied** for the Modernization Project. However, in the event it elected to exercise that option, the MSA provided that title would pass to the State only upon “receipt of payment for such Equipment.” (MSA § 16.6.1(4).) The MSA also provided for the **payment of Deferred Fees** upon termination. (MSA §§ 16.6.6(1), (3).) These Deferred Fees, which were claimed unamortized costs and other sums that IBM had purportedly already expended or earned and whose payment was spread over the life of the contract, were listed in MSA Schedule 24 in specific dollar amounts based on the date of termination. (MSA, Schedule 24.) In addition, Section 16.6.6 included certain “**Early Termination Close Out Payments**” that were potentially applicable upon termination, which included among other things, reimbursement for hardware and software costs, costs associated with lease termination, certain salary and labor costs, and costs for leasehold improvements. (MSA §§ 16.6.6(3)-(4).) Finally, the State was entitled to request that IBM provide “**Disengagement Services**” during the transition, but again, in the event it elected to receive such services, it was obligated to “pay Vendor’s charges for completing the Disengagement Plan and providing the Disengagement Services.” (MSA § 16.6.6(2).)

## Operation and Performance of the Contract

### **Rollout of the Project**

35. Beginning in March 2007, the parties implemented a “Phase 1” effort to inform the public as well as recruiting and transferring about 1,500 State employees to IBM subcontractors. (Tr. Ex. 429, State of Indiana’s 4th Quarterly Report to Congress December 2008, p. 2.) “Phase 2” took place over a seven-month period from October 2007 through May of 2008 as the parties rolled out the modernized system in three stages to 59 of Indiana’s 92 counties. (Exs. 57, 165, 511.)

36. On October 25, 2007, the State approved the rollout of the Modernization Project to a 12-county pilot area of north-central Indiana, representing approximately ten percent of the State’s social services caseload. (Exs. 57, 511.) During this pilot phase, the State’s Modernization Project team evaluated the IBM Coalition’s performance, including the readiness of the Project’s Service Centers, document processing center, general infrastructure, and application processing. The team, including Secretary Roob, regularly met with the IBM team during the Pilot Phase and throughout the Modernization Project. (Tr. 5890:3-5891:1 (Roob).)

37. The parties saw implementation issues immediately. Tr. Ex. 5709 (showing poor call center statistics and IBM’s Peggy Anthony saying “obviously ACS is understaffed in my opinion”); Tr. Ex. 7302 (Carey Stoker of ACS identifying “multiple applications not in queues” and “duplicate scans—appears they are scanning over and over again” as problems); Tr. Ex. 5710 (draft Corrective Action Plan for Service Center Pilot Operations, noting that “if the current trend continues unabated, the backlog will overwhelm the capacity of the solution.”); Tr. Ex. 5712 (noting various issues that needed to be improved before exiting pilot, including hitting 85% on case action timeliness, p. 4); Tr. Ex. 8021 (June 2007 email from Mitch Roob to Brian

Whitfield noting persistent problems, including “WFMS [was] down for 48 hours, thousands of lost hours of work, tens of thousands of calls unanswered, honestly perhaps the worst performance I have ever seen in a call center.”

38. But as of March 10, 2008, the State concluded that the IBM Coalition had successfully completed the Pilot Phase. (Ex. 1014.) On March 20, 2008, after the State completed a detailed “Go/No Go” analysis, the IBM Coalition received the State’s “Go” and began providing Modernized Services in Region 2A (27 counties in southern and central Indiana). (Ex. 164 at IBM-IN01282621-22.)

39. After two months of operating these counties under the Modernized system, again under the State’s operational supervision, the State gave its approval to the rollout of the Modernization Project in Region 2B on May 5, 2008 (an additional 20 counties divided between southwest and northeast Indiana). (Ex. 165 at FSSA1\_05135453-54.)

### **Difficulties and Modifications**

#### ***“Healthy Indiana Plan” Applications Surge***

40. In 2007, the State-supported Healthy Indiana Plan (“HIP”) provided health insurance to uninsured Indiana residents below a certain income level. HIP significantly increased the scope and cost of the Modernization Project by adding design, development, implementation, continuing services, and reporting requirements. (Ex. 1500.023, Change Order 23 (Sept. 27, 2007).)

41. When the State amended the MSA to include this new program, it planned for a few thousand HIP applications per month. (MSA Schedule 8A, § 2.2.3(c).) However, HIP application volume regularly exceeded the State’s predictions. (Ex. 994 at 3; Ex. 2655.006 at 22;

Tr. 2192:12-23 (Harris).) As FSSA observed, “Since HIP was a brand new program in December 2007, we had no model available to forecast the amount of incoming applications. Our initial guess was 10,000 applications per month. In the first month of program, the State received over 20,000 applications for the program. We have been attempting to make up that ground for the rest of calendar year 2008.” (Ex. 744, Brooke, email to Rubio (Dec. 3, 2008).)<sup>28</sup> The State described this as a significant challenge for the modernized system.<sup>29</sup>

### *The Economic Recession and Surge of Applications*

42. In December 2007, two months after rollout of the pilot region, the State and country began to feel the effects of what has been termed the “Great Recession”.<sup>30</sup> Almost immediately, FSSA found that benefit “applications [were] up 21% and the number of processed applications [was] up 41% year against year.”<sup>31</sup> In September of the following year, with the collapse of some significant Wall Street banking institutions, the country was facing “the most severe crisis since the Great Depression.”<sup>32</sup>

43. The economic downturn hit Indiana with particular force, with unemployment rising to “10.6% -- higher than the national average.”<sup>33</sup> In December 2007, just as the Modernization Project rolled out, Indiana’s unemployment rate stood at 4.5%. (Ex. 1560 at 2 (Dec. 2007).) By November 2009, it stood at over 9%, more than doubling since the MSA was

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<sup>28</sup> See also Ex. 747, Petrone, email to Elwell (Oct. 24, 2008) (“We are seeing a LARGE spike in HIP application volume.”); Ex. 490, Elwell, email to Casanova (Dec. 31, 2009) (noting “HIP’s tremendous impact on modernization”); Tr. 2192:12-23 (Harris) (acknowledging that “the State exceeded its prediction for HIP volume”).

<sup>29</sup> Ex. 846, Project Update: Medicaid Corrective Action Plan at 3 (July 15, 2009); Tr. 4356:3-15 (Casanova).

<sup>30</sup> Ex. 2326, National Bureau of Economic Research, Determination of the December 2007 Peak in Economic Activity (Dec. 2008) (declaring that recession began in December 2007).

<sup>31</sup> Ex. 1655, Main, email to Roob at IBM-IN00369196 (Dec. 17, 2007).

<sup>32</sup> Ex. 2333, Nichols & Chen, Lehman Brothers, Harvard Business School Case Study at 1 (Sept. 6, 2011).

<sup>33</sup> Ex. 846, Project Update: Medicaid Corrective Action Plan at 3 (July 15, 2009).

signed. (Ex. 1560 at 1.) As FSSA observed in June 2009, the State was “in the middle of an economic crisis.”<sup>34</sup>

44. This economic crisis, in turn, led to an increase in government benefit applications. FSSA reported to the Legislature in December 2009 that, “[w]ith the economic downturn, FSSA program enrollment has increased by nearly 31% since 2005.”<sup>35</sup> This was a significant increase compared to historical levels. (Ex. 1802.010, Marais Report at Exhibit 1.)<sup>36</sup>

45. In response to the economic downturn, Congress passed stimulus legislation -- the American Recovery and Reinvestment Act (ARRA) -- in February 2009. Among other things, ARRA increased the amount of benefits provided to food stamp recipients, requiring changes to hundreds of thousands of food stamp cases in Indiana -- a “huge increase in workload” that “caused delays in processing other work.” (Ex. 1074, Casanova, letter to Johnson at 9 (Sept. 29, 2009).)<sup>37</sup>

#### *2008 Floods and Disasters Re-Direct State Services*

46. Compounding the challenges presented by the economic downturn and the Project’s expansion to include HIP, Indiana was hit by a series of natural disasters during 2008, which displaced thousands of Hoosiers from their homes and caused nearly \$2 billion in economic damage.<sup>38</sup> As described by the State, “[t]he 2008 disasters in Indiana have been among the worst in our state’s history.”<sup>39</sup> Eighty-two of Indiana’s 92 counties were declared

<sup>34</sup> Ex. 2194, Machak & Evans, Indiana’s food banks expecting onslaught, Indianapolis Star (June 29, 2009).

<sup>35</sup> Ex. 884, FSSA Budget Committee Presentation at 2 (Dec. 15, 2009).

<sup>36</sup> See also Ex. 1695, Murphy, letter to Governor Daniels at FSSA\_08404217 (Mar. 23, 2010) (“Indiana has seen an unprecedented increase in the number of Medicaid benefit recipients.”).

<sup>37</sup> See also Ex. 302, FSSA Opp. to Plaintiffs’ Motion for Contempt, *Thornton v. Murphy*, at 12 (May 13, 2009) (“The processing of benefits applications was ... unexpectedly impacted in March 2009 following the allotment of additional funds for nutrition assistance programs under the American Recovery and Reinvestment Act.”).

<sup>38</sup> Ex. 1961, State of Indiana, Action Plan for CDBG Supplemental Disaster Recovery Funds at 4 (Feb. 13, 2009).

<sup>39</sup> *Id.* (the disasters caused “over \$1.9 billion in damage to public infrastructure, housing and farmland”). See also Tr. 5897:19-5898:18 (Roob) (it was an “understatement” to say storms had “battered Indiana with heavy rains, strong winds and tornadoes causing widespread flooding, power outages and significant property damages”); Ex.

Presidential Disaster Areas during 2008.<sup>40</sup> In Secretary Roob's words, at one point "central Indiana was the largest lake in the country." (Tr. 5898:16-18.)

47. Secretary Roob and other State witnesses acknowledged that these natural disasters had a "significant impact on both the DFR ... as well as the Coalition." (Tr. 5898:24-5899:18.)<sup>41</sup> The State directed the reassignment of approximately one third of the State and IBM Coalition workforce "from every available post," "modernized or as-is," to assist with the processing of tens of thousands of emergency food stamp applications and thousands of FEMA Individual Assistance applications ("305 state employees and 318 Coalition staff"). (Ex. 2372, Wells, letter to Johnson at 3 (July 17, 2008).)<sup>42</sup> As Secretary Roob characterized the situation, it was "[a]ll hands on deck." (Tr. 5898:24-5899:18.)<sup>43</sup>

48. In an update to federal regulators, FSSA explained that the "diversion of resources for disaster relief won high praise from community groups and those individuals affected." (Ex. 247, IAPDU at 11 (Aug. 1, 2008).) The FSSA attributed its prompt disaster

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208, Main interview at 11 (Oct. 28, 2008) ("This has been a state that has been racked by some of the worst disasters we have ever had in the history of the state of Indiana"); Ex. 2372, Wells, letter to Johnson (July 17, 2008) ("This most recent disaster is projected to be the worst in the State's history when all of the damage is finally assessed.").

<sup>40</sup> Ex. 1961, Indiana Action Plan for CDBG Supplemental Disaster Funds at 3 (Feb. 13, 2009); Exs. 1661, 1662, Executive Orders.

<sup>41</sup> See also Tr. 2187:15-25 (Harris) ("there have been multiple officials of the Indiana State government that have ... stated that the increase in volume due to the economic downturn or the floods led to problems on the modernization project" in various public forums); Tr. 5078:13-21 (Zimmerman) ("the agency's position prior to the initiation of this case was that these natural disasters had had a huge impact on the processing of eligibility benefits in Indiana"); Tr. 4355:4-16 (Casanova) (disasters were "a huge issue for the State of Indiana"); Tr. 4555:21-23 (Molina) ("any model would have problems if there's a big increase in volume"); Ex. 2371, Main, email to Wells (Dec. 16, 2008) ("The timeliness issue is DEFINITELY [caps in original] flood related. We had a very high percentage of staff devoted exclusively to disaster food stamps during that time period."); Ex. 202, Main, email to State and Coalition staff at IBM-IN01099357 (June 13, 2008) ("Given our immediate and extended focus on mobilizing and helping those victims in one of the worst Indiana disasters in decades, and our dedication to constant improvement, we will not roll the next region until further notice. The volume we continue to experience in the regions rolled out so far, and the additional volume impact associated with those affected by the floods, means now is the time to focus on those in desperate need, and review how we are doing as a whole.").

<sup>42</sup> See also Ex. 1961, State of Indiana, Action Plan for CDBG Supplemental Disaster Recovery Funds at 6 (Feb. 13, 2009); Ex. 247, FSSA, IAPDU at 1 (Aug. 1, 2008) ("The rollouts of Regions 3 and 4 have been postponed because of the extensive flooding in Indiana during June-July, 2008 and the diversion of State and Vendor resources to respond to the needs of flood victims.").

<sup>43</sup> See also Tr. 4765:5-13 (Marshall) (discussing diversion of ACS staff in the Modernized Grant region to assist with disaster relief).

relief assistance to the IBM Coalition's efforts: "The ability to mobilize multiple state agencies and provide computers and phones for Hoosiers to apply for state and federal assistance was made possible by the infrastructure already in place as a result of eligibility modernization." (Ex. 1704, Main, Agencies Pull Together to Provide Disaster Relief, V-Can Connector, Vol. 2 (Aug. 1, 2008).)

49. As a result of the shift of personnel and technology resources away from the Modernization Project and to disaster relief efforts, the State and the IBM Coalition mutually agreed to delay the planned rollout of the Modernization Project to the remaining regions. On September 29, 2008, the parties memorialized this agreement in an amendment to the MSA (Change Order 69), which noted that the continued rollout was "delayed by mutual decision," in part "to accommodate disaster relief efforts." (Ex. 1500.069, Change Order 69 (Sept. 29, 2008).)

### **The State Assesses IBM's Performance During the Contract**

*Q: . . . I just want to talk about IBM's contract metric. It was red in December of '08, right?*

*A: . . . from my recollection, it was always red.*

*Q: But it doesn't make the high priority issues risk here in December of '08, did it, ma'am?*

*A: It's not on our list.*

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*Q: . . . project . . . as of April '09 was still, in your words as the oversight organization for this, progressing according to plan. That's what you say here, right?*

*A: Yes.*

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*Q: And, however, this was still a project in transition, true?*

*A: True.*

*Kathleen McCain, State's chief performance officer*

50. Throughout the Modernization Project, the State conducted and published a series of assessments regarding the performance of the Modernization Project, and IBM's role in the Project. For example:

- (a) In May 2008, Secretary Roob reported to the General Assembly that "we are serving more people statewide and in a timelier manner than we ever have before." (Ex. 34 at IBM-IN00704852 (May 29, 2008).)
- (b) In August 2008, FSSA reported to federal authorities that the Modernization Project "has already made substantial progress toward its goals and objectives." (Ex. 247, IAPDU at 1.)
- (c) In October 2008, DFR Director Zach Main gave IBM primarily 9s and 10s in IBM's annual customer satisfaction survey, noting that the people at IBM "work themselves to death." "They're certainly meeting my expectations now and exceeding." (Ex. 208 at 4.)
- (d) In December 2008, the State worked with IBM to create a case study that was posted on IBM's website for the benefit of other States interested in modernizing their welfare eligibility systems, in which the Director of DFR was quoted as stating, "We're very happy with how things have worked out,' ... 'We've accomplished our basic mission, to open up new channels and increase our accuracy." (Ex. 515 at 4.)
- (e) On December 30, 2008, FSSA Secretary Mitch Roob circulated an email to the Coalition stating: "Great numbers on my last Monday. Please keep them up for Secretary Murphy." (Ex. 957, Roob, email to Anthony.)
- (f) In a December 2008 interview, Governor Daniels stated that the new system was "far better than what preceded it," noting that critics wanted to "go back to a system where you had to beg for an appointment face to face," which was "atrocious." (Ex. 630, 12/19/08 Tr. at 3, 5.)
- (g) On January 17, 2009, Lawren Mills, the Governor's Senior Policy Director, reported to Governor Daniels, stating: "[W]e are meeting and for the last several months have been meeting the standards the feds set for us." (Ex. 545, Mills, email to Daniels.)
- (h) On June 14, 2009: "FSSA spokesman Marcus Barlow said on average, the agency is processing applications for Medicaid, food stamps and Temporary Assistance for Needy Families benefits just as quickly as it has before. Considering the consistency has come at a time the agency has seen a boost in applications due to the sagging economy, Barlow said it shows the modernization efforts have brought positive results." (Ex. 137, Bradner, Welfare Audit Bills Renewed By Frustrated Lawmakers, Evansville Courier & Press, June 14, 2009.)

(i) In July 2009, Governor Daniels's spokesperson told reporters that "'of course' [Governor] Daniels is confident of the privatized system's ultimate success." (Ex. 90, Will Higgins, \$1B Privatization Deal at Risk, Indianapolis Star, July 8, 2009, at 1A.)

(j) On August 17, 2009, DFR Director Cathy Boggs wrote to a constituent: "The benefits of this new system are clear: improved customer service, reduced welfare caseloads as recipients are transferred into self sufficiency, nearly \$500 million in administrative savings realized and millions more saved in avoiding future federal penalties, reduction in errors and waste, and the 1,000 new IBM jobs and advanced computer hardware for Indiana research universities.... We at FSSA are excited about our new project and feel that the modernization of our Food Stamp, Medicaid and TANF systems will help our Hoosier clients in many ways." (Ex. 2971.012, Boggs, letter to Bolton.)

(k) In trial testimony, by deposition, former DFR Director Main acknowledged that he was "happy with IBM's performance" as of the time he left FSSA. (Tr. 7045:19-21.)

51. These assessments were the result of significant review and scrutiny. In addition to oversight by State officials, the State spent more than \$13 million to employ a team of 14 full-time subject matter experts from First Data Corporation who were charged with "[e]nsuring that IBM adheres to the Master Services Agreement," performing what was described as an Operational Verification and Validation ("OV&V") function in conjunction with State officials. (Ex. 1025 at 8; *see also* Exs. 1055, 1056, 1058.) Throughout the Project, the State's contract monitors rated the Project as "yellow", which meant that, while there were high priority issues that remained open, "the project [was] progressing according to plan." (Ex. 922, OV&V Monthly Status Report at FSSA1\_05226664 (Dec. 2008).)<sup>44</sup>

52. The State expanded the scope of IBM's work eleven times over the course of the Project, adding \$178 million to the contract price. These expansions of the Modernization

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<sup>44</sup> *See also* Tr. 1813:21-1814:6 (McCain) (agreeing that as of April 2009, the Project was "progressing according to plan").

Project are reflected in contractual amendments implemented by Change Orders 23, 33, 53, 60, 64, 67, 68, 90, 93, 119, and 133.<sup>45</sup>

53. These positive assessments did not mean that the Project, which was still in transition and was facing significant external challenges, was without its problems. The IBM Coalition engaged in ongoing efforts to address problems as they arose and employed processes to continuously improve performance, including the following:

54. On November 6, 2008, the IBM Coalition met with FSSA Secretary Roob and Director Main to propose seventeen systemic changes that were designed to alleviate certain “pain points” affecting the system as a result of the significant external challenges it faced. (Ex. 65, IBM presentation (Nov. 6, 2008).) Secretary Roob approved many of the IBM Coalition’s proposed reforms, and the Coalition began work to implement a number of the new proposals. (Tr. 6144:4-6145:25 (Carpenter).)

55. Shortly after Secretary Roob approved the IBM Coalition’s proposed reforms, Governor Daniels appointed Secretary Roob to be Indiana’s Secretary of Commerce and CEO of the State’s Economic Development Corporation. (Ex. 250, Roob letter (Dec. 19, 2008).) In January 2009, Secretary Roob was replaced as Secretary of FSSA by Anne Murphy, Secretary Roob’s Chief of Staff.

56. On March 13, 2009, Secretary Murphy sent the IBM Coalition a letter drafted by the State’s outside counsel requesting a Corrective Action Plan (“CAP”). (Ex. 75, Murphy, letter

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<sup>45</sup> Ex. 1500.023, CR 23, “Healthy Indiana Plan”, signed 9/27/07 for \$129,000,000; Ex. 1500.064, CR 64, “Enhanced At Risk Client and Agency Outreach & Support”, signed 6/30/08 for \$35,142,872; Ex. 1500.067, CR 67, “Enhanced Staffing and Outreach Services Through June 2008”, signed 6/30/08 for \$4,557,125; Ex. 1500.033, CR 33, “Clarify Telecommunications Usage”, signed 12/10/08 for \$2,904,902; Ex. 1500.060, CR 60, “Warm Transfer of Phone Calls-Version 2”, signed 6/30/08 for \$2,443,400; Ex. 1500.093, CR 93, “Disaster Assistance for September and October 2008”, signed 12/16/08 for \$1,230,000; Ex. 1500.068, CR 68, “June 2008 Disaster Assistance”, signed 8/1/08 for \$940,000; Ex. 1500.053, CR 53, “HIP Third Party Liability”, signed 4/14/08 for \$285,184; Ex. 1500.090, CR 90, “SASE Pilot for Redeterminations”, signed 12/16/08 for \$90,000; Ex. 1500.119, CR 119, “Medicare Long Term Care Eligibility Changes”, signed 10/5/09 for \$487,448; Ex. 1500.133, CR 133, “Application Changes Due to FNS State Agency Operations Review (SAOR) Findings”, signed 10/5/09 for \$46,340.

to IBM (Mar. 13, 2009).<sup>46</sup> The State's letter identified 36 "issues" that it wished the Coalition to address. (*Id.*) Many of these issues were already being addressed by the plans approved by former Secretary Roob. (Exs. 65, 1929.)

57. On March 31, 2009, the IBM Coalition responded to the State's letter. (Ex. 78, Anthony, letter to Murphy (Mar. 31, 2009).) The Coalition letter denied that a formal Corrective Action Plan was required under the MSA, but expressed willingness nonetheless to work with the State to address the issues in its March 31 letter. (*Id.* at 2.) The Coalition letter further observed that 21 of the 36 issues in the State's request did not relate to any contractual measure or performance standard contained in the MSA, and six more related to performance standards that were not yet in effect (because they applied only in Steady State). (*Id.* at 1.)<sup>47</sup>

58. At the same time, IBM undertook at its own expense an extensive analysis of the end-to-end process, including not only the work of IBM and the Coalition, but also State policies and practices. This "End-to-End Assessment" contained many recommendations for improvement, ultimately concluding that any problems on the Project were "eminently fixable" and that the concept of modernization was sound. (Ex. 5430 at 3.)

59. On July 2, 2009, the parties agreed on a plan (the "Corrective Action Plan") to address the issues that had been raised by the State's March 13, 2009 letter and the End-to-End Assessment. (Ex. 79.) The Corrective Action Plan included 22 short-term "Quick Wins" targeted to address the specific issues raised by the State, and 31 long-term initiatives that were focused on improving the performance of the program over the long-term. (Ex. 5409 at 6417, 6430, 6484.)

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<sup>46</sup> Tr. 4980:6-11 (Murphy).

<sup>47</sup> See also Tr. 3937:14-17 (Boggs) (agreeing that "there were items listed out as CAP items that are not items that are contained in the Master Services Agreement").

60. By mid-October 2009, the Coalition had made “substantial progress” on the CAP. (Tr. 4015:25-4016:4 (Boggs).) The State represented in the *Thornton* litigation that, as of September 10, 2009, there had been “an incredible amount of progress” and “substantial progress in a very short period of time.” (Ex. 304, 9/10/09 Tr., *Thornton v. Roob*, at 70.) Governor Daniels was quoted as saying: ““They’ve [the contractors] gone into their pockets (and have taken) a whole lot of corrective actions,’ ... ‘The backlogs are coming way down. Complaints are dropping.”” (Ex. 1105, Boggs, email to English, enclosing Daniels Credited for Nudge on Welfare System, Ind. Courier & Press (June 29, 2009).) Secretary Murphy stated on September 25, 2009, only a few weeks before the announcement of termination, that “a team of vendors led by IBM Corp. has already made improvements in technology and added more staff under a corrective action plan submitted in July.” (Ex. 111, Murphy, email to Barlow (Sept. 25, 2009).)<sup>48</sup>

61. Of the 22 targeted issues in the CAP, only four remained in red as of October 2009 -- all four being the responsibility of IBM’s primary subcontractor, ACS. (Ex. 726 at IBM-IN00127957-59.)<sup>49</sup> According to State witnesses, ACS failed to make any serious effort with respect to its portion of the CAP responsibilities, and was instead lobbying the State, directly and through its lobbyist, to replace IBM as the general contractor on the Project.<sup>50</sup> As the State’s witness Kelley Hanley explained, the reason those four remaining items had not improved more before termination is that ACS’s Richard Rhoad, who was placed in charge of ACS’s CAP

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<sup>48</sup> See also Ex. 102, Holcomb, email to Mills (Dec. 17, 2009) (containing remarks of Governor Daniels in response to data regarding timeliness and errors: “These are good #s...actually, I have been underselling our case.”); Tr. 2214:2-12 (Harris) (agreeing that there was “an increase in timeliness” before termination announcement); Tr. 939:9-18 (Adams) (Medicaid D timeliness made “incredible progress” between May and September 2009); Ex. 1644.014 at 2:8-19, 3:11-4:1, 5:5-6:7 (Governor Daniels) (“[W]e’re not there yet, but by every measure -- and you’re welcome to the data. We’re seeing steady improvement.”); Ex. 2739, Welfare privatization criticized by advocates, *The Star Press* (Oct. 9, 2008) (Governor Daniels: “But we already have a better system, and it’s going to be a whole lot better when we get done.”).

<sup>49</sup> See Tr. 6398:17-6399:5 (Hanley) (“ACS would have been a primary person” responsible for implementing the various CAP items around timeliness); Tr. 6401:24-6402:9 (Hanley) (procedure variance was “an ACS issue”).

<sup>50</sup> See Ex. 721; Ex. 1238; Tr. 7054:24-7055:15 (Boggs) (Joe Loftus “use[d] his political contacts with the administration to help his clients, ACS and Arbor, with respect to “Modernization” and “Anne Murphy relied on Joe Loftus as a source of information in her dealings with IBM”).



eligibility case management, “moving the eligibility determinations ... [to] the local office,” where clients would “experience face to face interactions with FSSA staff handling their cases.” (Ex. 2085 at FSSA1\_08400564.) The State noted that “[t]he largest difference between the Hybrid System and the modernized system will be an increased focus on face-to-face contact.” (Ex. 97, FSSA News Release at 2 (Dec. 14, 2009).) As Anne Murphy acknowledged, “the hybrid system was intended ... to address the criticisms ... in the press back in '07 and in the lawsuit in La Porte County, and in the legislation, by increasing the focus on face-to-face contact in the county offices.” (Tr. 4939:14-21.)

64. The opposition to the remote eligibility focus of Modernization was the result of two factors. First, there was a segment of the population who simply were not as able to deal with the electronic channels of access and who needed face-to-face assistance from a caseworker in order to properly submit their applications. Second, in the old system caseworkers frequently “bent the rules” to provide applicants benefits for which they may be legally ineligible -- an aspect of the old system that the State wanted to eliminate. As Lawren Mills, the chief policy advisor to Governor Daniels, observed at the time: “[W]e are following the rules for the first time in the state’s history. We allowed this system to function 92 different ways in each county. Caseworkers got to know clients and often ‘bent the rules’ out of the goodness of their hearts. It’s hard not to want to do that, but we have to follow the federal rules, or we face massive penalties. We are finally following the letter of the law, and it is quite a culture change for constituents and providers alike.”<sup>51</sup>

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<sup>51</sup> Ex. 542, Mills, email to Coats (May 21, 2008). *See also* Ex. 208 at IBM-IN00264279 (“[T]here has been a learning curve for clients where we’ve had some of them who are used to not having to turn in all of the documents they need to turn in, in order to be eligible. Typically, their caseworker would fudge the details or go out of their way not to have them, when they have to do a redetermination, get kicked off of food stamps for Medicaid. We now have a blind system that says ‘did you turn in what you had to turn in?’ and if you didn’t turn it in, we don’t cut corners for you, we don’t break the law to make sure that you can stay on benefits.”); Ex. 3, N. Petrone email (May 23, 2008) (describing Modernization as “a system that works and fulfills the requirements of the law,” even if the

65. Instead of approaching IBM to discuss a new eligibility workplan, the State asked two longtime State welfare officials, Richard Adams and Roger Zimmerman, to look at what was not working and come up with different task routing. With a few FSSA officials watching during lunch, Adams and Zimmerman worked out the Plan B Hybrid system on a restaurant napkin. (Tr. 5025-29) However, as Zimmerman testified, the State relied upon the IBM modernization experience to get the design done. Designing the new Plan B “required going through modernization to get there.” (Tr. 5030:21.)

66. When he announced that the State had decided to move to the Hybrid system, Governor Daniels made it clear that the decision had nothing to do with the performance of IBM or anyone else in the Coalition: “[t]he issue has nothing to do with the vendors.... So it is the concept of the system and it has nothing to do with who is operating it.” (Ex. 636 at 2.)<sup>52</sup> In other words, the Governor sought to change one of the key requirements that the State had developed, that he had previously approved, and which was specified in the MSA -- the move away from face-to-face meetings and greater reliance on multiple points of access to the system.<sup>53</sup>

67. Beginning September 8, 2009, the State actively pursued IBM in the hope that it would implement the Hybrid plan. In September 2009, Governor Daniels told IBM that, “[t]he State has [a] new plan drafted and he has approved it” and that “[i]f IBM wishes to continue, they need to start working on it immediately.”<sup>54</sup> On September 11, 2009, the Governor’s Senior Policy Director, Lawren Mills, informed him that the State team had “presented our proposed

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agency had to “take the heat for those results”); Ex. 247, IAPDU at 23 (Aug. 1, 2008) (“The New Solution represents a dramatic change for clients who were accustomed to having a caseworker in a local office.”).

<sup>52</sup> See also Ex. 109, Murphy email (Sept. 4, 2009) (“It was a process problem. We just went to technology too fast and will be implementing more face to face to solve the problem.”).

<sup>53</sup> Ex. 1644.018, 10/15/09 Tr. at 2-5.

<sup>54</sup> Ex. 2213, Murphy, email to Boggs (Sept. 4, 2009).

plan to the coalition. They were very receptive to it.... IBM has asked us to sign a direct change request for this alteration in course,” but they have “to their credit, shown a willingness to start moving w/out this in place,” and that “we have their commitment to implement the plan.” (Ex. 572, Mills, email to Governor at FSSA1\_08753713-14 (Sept. 11, 2009).)

68. Secretary Murphy reported to the Governor’s staff that “IBM told us today that they would absolutely implement the Plan B,” noting that “[a]ny potential price increases need to be resolved before we move forward.” (Ex. 633, Murphy, email to Goode (Sept. 11, 2009).) This was only six days before the Governor publicly announced that the issues with Modernization had “nothing to do with the vendors.” (Ex. 636 at FSSA1\_07407676.)

69. On September 28, 2009, Secretary Murphy reported to the Governor’s advisor Betsy Burdick that IBM was “meeting with the subs” to “get the subs ‘under contract’ for this Plan B work.” (Ex. 1892, Murphy, email to Burdick (Sept. 28, 2009).) On the day the State presented its Plan B proposal to IBM and other Coalition members, the Governor’s chief policy advisor, Lawren Mills, wrote to IBM’s Steve Zaudtke and others in attendance, thanking them for their “blood, sweat, and tears” during Modernization. (Ex. 845.) The State’s desire to have IBM implement the Hybrid system right up until termination is further confirmed by numerous other contemporaneous documents and the testimony of the State’s witnesses.<sup>55</sup>

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<sup>55</sup> See, e.g., Tr. 4946:4-9 (Murphy), 4952:14-4953:3 (Murphy) (acknowledging she was “discussing with IBM whether they would, to use your word, implement Plan B” before the termination and that even “after [she] asked IBM to implement the system and ... couldn’t come to terms with them, [she] still wanted IBM to be involved in the hybrid system” and contacted them to be the tech vendor); Tr. 4953:15-4954:1 (Murphy) (admitting that “as late as October 2009, even after IBM had concluded that they could not, and you had concluded that you could not come to financial terms on them implementing the hybrid, you still wanted IBM to remain as the tech vendor”); Tr. 7053:23-7054:3 (Boggs), 3981:6-15 (Boggs) (acknowledging that “right up until the termination, the State was willing to enter into an agreement with IBM to continue to run the eligibility modernization project ... on some kind of altered model”); Tr. 1023:4-15 (Adams) (acknowledging that he had “hopes until the last day that things were going to work out” and that he “want[ed] modernization to keep going”); Tr. 2724:15-23 (Weaver) (agreeing that the State “would have preferred” to have “IBM to help the State ... in coming up with this hybrid approach” and move back to the caseworker model); Tr. 4602:21-4603:7 (Molina) (acknowledging that the record reflected that “the State asked IBM to implement what turned out to be the hybrid system” and “the State and IBM ended up not working together on the hybrid because the State asked IBM to do it at no additional cost, and IBM could not agree to that”).

70. Only when the State's budget crisis prevented the parties from reaching an agreement on financial terms did the State decide that it would "cut[] out the middle man" (Ex. 216) and terminate the IBM contract. When Secretary Murphy came into office at the beginning of 2009, she was facing a significant budget challenge.<sup>56</sup> In a March 20, 2009 email she noted: "The Senate has stripped us bare. Even OMB is shocked and that takes a lot. It scares me because no matter how hard we try to hold the line with IBM, they are going to refuse to do some things without change orders." (Ex. 77 at PRIV-FSSA-00008523.) In a May 2009 email, Secretary Murphy noted that the State had no money to pay for the extension of Change Order 64 beyond its expiration in June 2009, even though the State "needed CR 64 like [it] needed oxygen" (Tr. 4889:12-13 (Murphy)), and that, as a result, she might have to "unravel the contract." (Ex. 1949.)

71. In September 2009, when IBM concluded that it could not implement the Hybrid system without an increase in the contract price, Secretary Murphy wrote to her colleagues that IBM would "not commit to moving forward at no cost. Even if they eventually agree to no cost for Vande region, then they want more money! We don't have money now and we won't have money for the remainder of sfy '10. What a mess." (Ex. 135, Murphy, email to Adams (Sept. 27, 2009).)

72. Even after the parties failed to come to terms on an IBM-led rollout of Hybrid, the State urged IBM to continue on the Project as the technology vendor. (Tr. 4946:4-9, 4952:14-4953:3 (Murphy).)<sup>57</sup> As the State's witness Mr. Elwell, who was responsible for the

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<sup>56</sup> Tr. 4888:10-12 (Murphy).

<sup>57</sup> See also Tr. 4953:15-4954:1 (Murphy) (agreeing that "as late as October 2009, even after IBM had concluded that they could not, and you had concluded that you could not come to financial terms on them implementing the hybrid, you still wanted IBM to remain as the tech vendor").

Disengagement Plan, noted in contemporaneous correspondence, it was his “fantasy” that IBM remain on the Project. (Ex. 469, Elwell, email to Gargano (Nov. 19, 2009).

### **The State Terminates the Contract**

*The issue has nothing to do with the vendors, it has to do with the structure of the system and the way it tries to do its business . . . It is the concept of the system and it has nothing to do with who is operating it.*  
Governor Daniels

73. On October 15, 2009, Secretary Murphy sent a letter to IBM stating that the State was terminating the MSA for cause. (Ex. 1555.) Although the State had actively pursued IBM’s continued involvement in the Project until budget constraints had ended the parties’ discussions, the State nonetheless invoked the termination-for-cause provision of the MSA as the basis for the termination, citing two alleged failures as a basis for that termination, “quality and timeliness.” (*Id.* at 1.)

74. The same day as the State’s termination letter, Governor Daniels held a press conference to announce that the State was terminating IBM’s involvement in the Modernization Project, and “assum[ing] the role of integrator or prime contractor going forward.” (Ex. 52, 10/15/09 Tr. at 2:10-11.) The Governor commended IBM for its work, citing a number of benefits that the IBM Coalition had conferred on the State, including eliminating the fraud that was “rampant in Indiana’s welfare system,” creating a universally praised “paperless system,” improving the welfare-to-work rate “dramatically,” and saving the State tens of millions of dollars as compared with the old welfare eligibility system. (*Id.* at 3:14-4:2, 5:8-13, 6:2-11, 15:4-7.)

75. The Governor observed that, “They [IBM] did try hard. If resources would have fixed the problem, we wouldn’t we wouldn’t be making this announcement.... [I]t wasn’t

resources. It wasn't effort. It was a flawed concept that simply did not work out in practice." (Ex. 52, 10/15/09 Tr. at 4-5.) The Governor was not alone in his assessment. The State's Director of Project Management Nicole Geller described IBM's Project Executive as "beyond dedicated." (Tr. 7039:17-19 (Geller).) And DFR Director Zach Main stated that "[t]hey [IBM] work themselves to death...." (Ex. 208 at 4; *see also* Ex. 845 (Mills) cited above, referring to the "blood, sweat, and tears you've put into this project up to this point.")

76. The State then proceeded to implement the Hybrid system using IBM's equipment (payment for which IBM seeks in this action), IBM's subcontractors (for which the State would later refuse the compensation specified in the contract), and IBM's know-how. The State was helped in financing the move to the new and more expensive "Hybrid" system by the savings from the termination of the IBM contract,<sup>58</sup> as well as the \$83 million in Deferred Fees and subcontractor assignment fees owed under the contract, which the State refused to pay IBM. As Secretary Murphy acknowledged, "The State basically cut out the middleman and dealt directly with ACS rather than having to pay IBM." (Tr. 4936:23-4937:7.)

77. After the State announced the termination on October 15, 2009, IBM worked with the State under an agreed "Disengagement Plan." Specifically excluded from IBM's scope of work were (a) activities associated with changes in the delivery model (*e.g.*, Hybrid/"Plan B"); (b) enhancements to the system (aside from "minor enhancements"); and (c) "any other activities that had been performed, or were identified to be performed, prior to December 14, 2009." (Ex. 472 at 31.) The MSA was terminated, and IBM's responsibilities under the MSA ended, on December 14, 2009.

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<sup>58</sup> Tr. 3905:7-10, 3982:25-3983:2, 7054:18-23 (Boggs) (State was facing "significant budget constraints," "didn't have additional money to pay IBM," and by terminating IBM, was able to "take money it had been paying to IBM and then use it to pay the subcontractors additional amounts to be able to, you know, run various aspects of the system"); Tr. 7058:13-20 (Ornellas) (agreeing that "it looks as though" "the millions of dollars that [the State] didn't have to pay to IBM because it terminated the contract" "went to other vendors" as well as other costs).

## Conclusions of Law

### The State Fails to Show Material Breach

78. The State must prove a breach that is “material considering this Agreement as a whole.” (MSA § 16.3.1(1)(A)-(C).)

79. Whether a breach is material is generally a question of fact to be decided by the trier of fact. Goff v. Graham (1974), Ind. App., 306 N.E.2d 758, 765. In determining whether a breach is material, the following five factors are to be considered:

- (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
- (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
- (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
- (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
- (e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

Frazier v. Mellowitz (2004), Ind.App., 804 N.E.2d 796, 803 [adopting the Restatement (Second) of Contracts § 241 (1981)]. *See also* Ream v. Yankee Park Homeowner's Ass'n (2009), Ind. App., 915 N.E.2d 536; Collins v. McKinney (2007), Ind.App., 871 N.E.2d 363, 375.

80. Material breach is one that goes “to the heart of the contract.” Steve Silveus Ins., Inc. v. Goshert (2007), Ind.App., 873 N.E.2d 165, 175.

81. Where a party substantially performs, there is no material breach: “Substantial performance is the antithesis of material breach.” 15 Williston on Contracts § 44:55 (4th ed.).

82. When construing a contract, unambiguous contractual language is conclusive upon the parties and the courts. If an instrument's language is unambiguous, the parties' intent is

determined from the four corners of the instrument. If, however, a contract is ambiguous or uncertain, its meaning is determined by extrinsic evidence and its construction is a matter for the fact-finder. *Id.* When interpreting a written contract, the court should attempt to determine the parties' intent at the time the contract was made, which is ascertained by the language used to express their rights and duties. *Id.* The contract is to be read as a whole when trying to determine the parties' intent. *Id.* The court will make every attempt to construe the contractual language such that no words, phrases, or terms are rendered ineffective or meaningless. *Id.* at 216. The court must accept an interpretation of the contract that harmonizes its provisions as opposed to one that causes its provisions to conflict. City of Indianapolis v. Kahlo (2010). Ind.App., 938 N.E.2d 734, 744 [citing Niezer v. Todd Realty, Inc. (2009), Ind.App., 913 N.E.2d 211, 215]

83. The intention of the parties to a contract is a factual matter to be determined from all the circumstances. Ochoa v. Ford (1994). Ind.App., 641 N.E.2d 1042, 1044.

84. The Court accordingly interprets the MSA according to its plain language. Courts cannot “make contracts for parties, nor can they, under the guise of interpretation, supply provisions actually lacking, or impose obligations not actually assumed.” *Int'l Shoe Co. v. Lacy*, 53 N.E.2d 636, 639 (Ind. App. 1944). The parties agree that the MSA is unambiguous<sup>59</sup> and that “evidence of prior or contemporaneous written or oral statements and negotiations cannot operate to either add to or contradict the written contract.” *Hinkel v. Sataria Distrib. & Packaging, Inc.*, 920 N.E.2d 766, 769 (Ind. Ct. App. 2010). Nonetheless, parol evidence may be considered “if it is not being offered to vary the terms of the written contract,” but rather “to show the nature of the consideration supporting a contract” or “to apply the terms of a contract to

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<sup>59</sup> See Tr. 7404:24-7405:1 (State's closing) (“[N]o one has suggested there's ambiguity, and we don't think there is.”); *id.* at 7488:18-24 (State's closing) (agreeing that “there's no ambiguity about the contract anywhere”); *id.* at 7489:18-19 (State's closing) (“The contract is unambiguous. We've never contended otherwise.”).

its subject matter and to shed light upon the circumstances under which the parties entered into the written contract.” *Krieg v. Hieber*, 802 N.E.2d 938, 944 (Ind. Ct. App. 2004).

85. Overall, the Court finds two factors from Restatement (Second) of Contracts § 241 most determinative of material breach here, that is, “the extent to which the injured party will be deprived of the benefit which he reasonably expected,” and “the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances.” So, what, if anything, did the State get from IBM? And, if IBM did fail to perform, do the circumstances show a possibility it could correct those problems?

#### **The State’s Benefits Preclude Material Breach**

86. “*Modernization*” Is The Foundation of “*Hybrid*”. Despite some sloppy metrics from trying to manage ACS, IBM assisted the State in processing millions of public benefit applications during the nearly three years it worked on the Modernization Project. In May 2008, Secretary Roob reported to the General Assembly that “we are serving more people statewide and in a timelier manner than we ever have before.” (Ex. 34 at IBM-IN00704852 (May 29, 2008).) The subsequent FSSA administration reiterated this point in August 2009: “Since this effort began, we have *processed more applications in a more timely manner* every single month.” (Ex. 2971.014, Boggs letter to Waits (Aug. 25, 2009) (emphasis added).)<sup>60</sup> The analysis performed by IBM’s statistical expert Laurentius Marais, corroborates such evidence. (Ex. 1802.010, Marais Report at Exhibit 4.) But more importantly, the evidence shows that the State

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<sup>60</sup> See also Ex. 33, Carpenter, New System Called Not Needy-Friendly, Indystar.com (May 21, 2008) (“We inherited a system that was broken,’ he [Mitch Roob] declares, ‘and we’re now serving more people, faster, with less chance for fraud” thanks to high-tech privatization.”); Ex. 2404, Kelly, Welfare Shift Debuts Under Fire, Ft. Wayne J. Gazette (May 22, 2008) (“‘What we can say is statewide we are processing more applications faster than we ever had,’ Main said.”); Ex. 1644.014, 12/19/08 Tr. at 2:8-19, 3:11-4:1, 5:5-6:7 (Governor Daniels) (“[M]ore people, not fewer, are getting benefits, and they’re getting them quicker than they did before.”).

was able to achieve what it now characterizes as a successful “Hybrid” system only by going through Modernization with the IBM contract. As found above, DFR Deputy Director Roger Zimmerman, architect of the Hybrid system, testified that designing Hybrid “required going through modernization to get there.” (Tr. 5030:21.) The Court finds this fact to have great weight regarding whether there is a material breach or not. Modernization is the foundation on which the State Hybrid system now stands. For better or worse, and through much transition difficulty, the contract, including IBM’s efforts, conferred the overall aggregate benefit sought by the State: a new welfare system that works better.

87. *Welfare-to-Work.* As found above, improvement in Indiana’s worst-in-the-nation welfare-to-work record was one of the State’s goals for modernization. The MSA required that the Coalition establish and conduct a detailed program for improvement in welfare to work. (MSA § 3.4.10, Schedule 1, at 6, 8, 15, 21, 35-36, Schedule 3, at 5, 16.) By the time of termination, the Modernization Project had “dramatically” improved work participation rates, as the Governor reported at his October 15, 2009 press conference announcing the termination of the contract and the State’s move to the Hybrid system. (Ex. 52, 10/15/09 Tr. at 15.) As the Governor later explained in a report to federal regulators, this included “dramatic” improvement between June and October during the period of the Corrective Action Plan. (Ex. 878, attachment at 5-6.)<sup>61</sup> Indiana went from a worst-in-the-nation welfare-to-work record to meeting the federal work participation targets in 2008 and 2009 (which it had failed to do in 2007 before rollout of Modernization). State officials agreed this was a significant success.<sup>62</sup>

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<sup>61</sup> See also *id.* (“During the Quick Win [CAP] period, July 1, 2009 to September 30, 2009, ... [s]pecial emphasis was placed on the two largest Modernized counties, Allen and Vanderburgh,” with Allen achieving a 58% increase and Vanderburgh a 45% increase in work participation rate.).

<sup>62</sup> Ex. 1081; Tr. 3463:11-17 (J. Dunn), 3482:14-22 (J. Dunn) (“I know they were touting this as successful.”), 3510:21-3511:3 (J. Dunn) (agreeing that the standard that had to be satisfied to have “great success” in moving families off of welfare was 11.3% and the State satisfied it for 2009); Tr. 2118:7-17, 2118:23-2119:2 (Harris) (noting that targets met in 2008 and 2009, that a number of states did not meet the targets, that the State

88. *Fraud Reduction.* An October 20, 2009 presentation intended for the State Budget Committee, notes that “[t]he reduction of fraud was one of the major goals and major successes of modernization.” (Ex. 349, Murphy Budget Committee Talking Points at 4 (Oct. 20, 2009).) The MSA established a series of Coalition procedures designed to halt fraud, including “mitigation activities that better identify instances of Client fraud.” (MSA, Schedule 3, at 2; *see also* Ex. 2813, Steady State Procedures Manual, Vol. 2, at 25-28.) Governor Daniels stated at his October 15, 2009 press conference that those procedures were successful: “The fraud that was rampant in Indiana’s welfare system has apparently stopped.” The Governor observed that “the official reports say over \$100 million was stolen in the last year before we began to try to make this change.” (Ex. 52, 10/15/09 Tr. at 3:14-20.)<sup>63</sup> During IBM’s tenure, that figure was reduced to zero, another benefit of modernization.<sup>64</sup>

89. *Administrative Cost Savings.* In addition to achieving programmatic savings, Modernization resulted in significant administrative savings, compared with the State’s only viable alternative<sup>65</sup> -- modernizing the eligibility system internally. This was another of the primary outcomes illustrated in the MSA. (*See* MSA Schedule 3, at 2.) Governor Daniels

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acknowledged “there had been an improvement in work participation based on the IBM Coalition’s work,” and that this was “a benefit for any state”); Tr. 4021:24-4022:14 (Boggs) (the Coalition’s IMPACT program had been “such a success” that the State planned to “roll it out to the rest of the state”); Ex. 1022, Daniels submission to ACF at 2, 5-6 (Oct. 26, 2009) (stating that the program “quickly placed participants in countable work activities,” that “the projected federal work participation rate improved dramatically (up 58%) as a result of these aggressive and sustainable efforts,” and that “based upon the Coalition partner for TANF/IMPACT services success in the Modernized parts of the state, FSSA requested that they cover parts of the state that had yet to be converted to Modernization”); Ex. 246, at 7 (Sept. 3, 2008) (in Grant region there was a “99% reduction of individuals awaiting services” and an “18% increase in work participation rate”); Tr. 3901:15-3902:5 (Boggs) (at termination, “it was the official position of the State that the welfare-to-work rate was better in modernized counties than in as-is counties” and “because of the success of the modernized approach in dealing with Welfare-to-Work,” the State decided to “apply that approach not only to the modernized regions, but also throughout the State”); Tr. 6455:16-23 (Mills) (the “Welfare-to-Work numbers in the modernized region are really amazing”); Tr. 4541:16-19 (Molina) (avoiding the work participation penalty was “beneficial”).

<sup>63</sup> *See also* Tr. 3894:4-12 (Boggs) (not aware of “any instances of fraud” that occurred during modernization).

<sup>64</sup> Tr. 2120:22-24 (Harris) (agreeing this was a “benefit of modernization”); Tr. 3894:4-12 (Boggs).

<sup>65</sup> Ex. 236, Governor Daniels letter to Warrick at 2 (May 26, 2006) (“It is simply beyond argument that the FSSA welfare system has failed recipients and taxpayers alike, and must be changed.”).

concluded on the day of termination, “we are saving -- we projected initially maybe 50 million a year over the first 10 years. Now it looks more like 40.” (Ex. 52, 10/15/09 Tr. at 6:5-7.)<sup>66</sup>

90. *Modern Electronic Access to the Eligibility System.* Also illustrated in the MSA is the goal of providing Indiana citizens with modern electronic access to the eligibility system. By the time of termination, the Coalition had created that access, which State officials represented was benefiting hundreds of thousands of FSSA clients, and continues to do so under the Hybrid system. As described in a report by federal regulators on Modernization, the system’s electronic access was “an important customer service component of the Indiana [M]odernization [P]roject that can greatly enhance access to program benefits.” (Ex. 2572 at 16.) Federal regulators reported that in just the three months of January 4, 2010 through April 2, 2010, “clients have filed a total of 49,662 applications online.” (*Id.*)<sup>67</sup> The State described this modernization legacy as the “primary benefit[]” of the State’s current Hybrid system. (Tr. 4437:4-4438:5 (Shields).)<sup>68</sup>

91. *The Electronic Paperless System.* The record shows that the State benefited from the “paperless” system that was created under the MSA. Governor Daniels noted the day he announced the Hybrid program that “everyone who has looked at the system prefers a paperless

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<sup>66</sup> See also Tr. 2119:22-24, 2120:8-13 (Harris) (agreeing that “cost savings were a benefit to the State of Indiana from modernization”); Tr. 4539:15-24 (Molina).

<sup>67</sup> See also Ex. 2818, Lyons email at IBM-IN00100011 (Oct. 9, 2009) (noting that 60% of applications were being submitted online); Ex. 1037, OV&V Second Quarterly Report at 8 (July 14, 2008) (“The number of applicants filing online applications has increased significantly from the pilot region.”).

<sup>68</sup> See also Tr. 4437:4-4438:5 (Shields) (“I think the clients of Indiana will gain the most in the accessibility of our new programs. They do not have to wait on one caseworker to return their call. They can call the 800 number and any one person will assist them. If they want to apply for benefits or access benefits online or via the phone, they can do that.”); Tr. 5143:9-15 (Zimmerman) (“the State cited the benefits from the modernization solution as being the primary benefits of hybrid as well”); Ex. 1872, Boggs, email to Gallien at FSSA1\_08298324 (Aug. 10, 2009) (“We believe the advantage of the different methods to apply addresses transportation issues, and is a cost saved by the client.”); *id.* (“You don’t have to make so many trips to the office, which saves my clients money since they have to buy tokens to ride the bus down.”); Tr. 7046:16-7047:3 (Main) (agreeing that it “was a more efficient process for them [clients],” and that “the modernized system achieved significant savings for clients in terms of time and effort ... as well as cost in obtaining welfare benefits as a result of ... reduced trips to the local offices”); Tr. 5921:17-23 (Maxwell) (agreeing that “all these access points that were developed ... such as internet and telephone and things like that” represented “another major benefit of the project”).

system to the boxes of files and the chaos that ... existed before.” (Ex. 52, 10/15/09 Tr. at 3:21-4:2.) DFR Director Boggs characterized this as a “huge advancement.” (Tr. 3960:9-13.)<sup>69</sup>

92. *Technology and Infrastructure -- WFMS.* State officials described IBM’s Work Flow Management System (WFMS) as a benefit of Modernization, which the State carried over into Hybrid. For example, in describing the Hybrid system, the State represented to federal regulators that “[t]he same technologies that have been utilized will continue to be used (e.g., Curam for Workflow Management System ...).” (Ex. 16090 at 11.) As DFR Deputy Director Roger Zimmerman acknowledged, while the State has renamed the system FACTS, the system is “WFMS re-branded with a different name.” (Tr. 5147:13-21.)<sup>70</sup> Similarly, in testimony before the court in the *Thornton* litigation in April 2010 (months after termination), the State’s representative Rich Adams replied when asked “what is the best from the modern,” “[t]hat is using the WFMS system, document imaging. Those are really the two main aspects -- oh, along with the integrated voice response phone system.” (Ex. 90062, 4/8/10 Tr. at 40:3-7.)<sup>71</sup>

93. *The Healthy Indiana Plan.* State officials have described the Healthy Indiana Plan, which was part of Modernization, as an unqualified success. Secretary Murphy called HIP “an unmitigated success from the start” (Ex. 3004), and current FSSA Secretary Michael Gargano confirmed that HIP “has been a nationally recognized success since it began” (Ex.

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<sup>69</sup> See also Tr. 2120:25-2121:4 (Harris) (“the paperless system was a benefit” in the counties that had rolled out).

<sup>70</sup> See also Tr. 667:21-23 (Adams) (“[T]his is called now FACTS, it was called WFMS, a similar process to the modern system as existed.”); Tr. 5194:21-5195:1 (Jolly) (“It’s [WFMS] -- it’s become renamed, but I believe the Curam product is still, that IBM originally installed, is in use. We just don’t call it WFMS anymore, we call it FACTS, but it’s the same, same platform.”).

<sup>71</sup> See also Ex. 1705, Zimmerman, email to Boggs re Vanderburgh Staffing Model (Nov. 10, 2009) (electronic files are a “big time saver for workers”); Ex. 830, Weaver, memo to Ross at 29-30 (Oct. 31, 2008) (when asked whether there would be any benefits to replacing WFMS, the State’s Chief Information Officer reported: “There are none. WFMS has recently modernized business processes and enhanced a legacy system.”); Tr. 4683:25-4684:9 (Herman) (“the technology is wonderful”).

3003).<sup>72</sup> According to Secretary Roob, the success of HIP was attributable to Modernization: “It is solely due to modernization that we were able to implement in a record of seven months and provide coverage for thousands of previously uninsured Hoosiers.” (Ex. 34, Roob, letter to members of the General Assembly at IBM-IN00704853 (May 29, 2008).) HIP was implemented statewide in just eight months, effective January 1, 2008. (Ex. 73 at 12.) The State described the Healthy Indiana Plan as “proof that privatization is working.” (Ex. 1698, Scott, Opponents Speak Out About FSSA System, Journal and Courier, at 6C (Oct. 15, 2008).)<sup>73</sup>

94. *Disaster Assistance.* The State acknowledged the valuable contribution that IBM and the Coalition members made in responding to the natural disasters in 2008. Former Secretary Roob testified that IBM’s response “was terrific” (Tr. 5899:21-5900:1), and former DFR Director Main indicated that the State “could not be happier with IBM’s ability to jump in with both feet and do whatever was necessary to help us manage those disasters.... [T]hey have been just better partners than we ever could have asked for” (Ex. 208, Main interview at 11 (Oct. 28, 2008)). FSSA recognized that its successful response to the natural disasters would not have been possible without Modernization: “[W]ithout our new modernized system, we would never have been able to do all the outreach we did.” (Ex. 41, Auld, email to Montgomery (Oct. 17, 2008).)<sup>74</sup>

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<sup>72</sup> See also Ex. 541, Mills, email to Jankowski (May 20, 2008) (“HIP is TOTALLY modernized. All the counties send their applications and supporting info to Marion, and it’s going FINE. The ONLY complaints I have ever gotten on HIP have nothing to do w/the IBM deal.”); Tr. 7044:4-6 (Main) (agreeing that he never concluded that “the Healthy Indiana Plan wasn’t a success”); Tr. 2192:12-2193:2 (Harris) (agreeing that “people really liked the Healthy Indiana Plan and the benefits that it provided to the citizens of Indiana”); Tr. 7043:10-7044:6 (Main) (the rollout of HIP was a success).

<sup>73</sup> See also Ex. 556, Mills, email to Governor at 3 (Aug. 20, 2008) (“All (no matter where someone is in the state) HIP applications are going through the modernized system, and we’re having great success there.”); Ex. 34, Roob, letter to General Assembly at IBM-IN00704853 (May 29, 2008) (“It is clear that individuals can use the modernized system with success; the Healthy Indiana Plan (HIP) is a good example. HIP was implemented in January of this year in the modernized solution. Since that time, we have received over 47,000 applications, *all* of which are processed by the new system.”).

<sup>74</sup> See also Ex. 1704, Main, Agencies Pull Together to Provide Disaster Relief, V-Can Connector, Vol. 2, at FSSA1\_05208291 (Aug. 1, 2008) (“The ability to mobilize multiple state agencies and provide computers and

95. *Economic Development.* At his 2006 press conference announcing the MSA, Governor Daniels described the economic development Memorandum of Understanding as having “enormous importance to the Indiana economy” and opined that his announcement that day would have been “just as big if the project involved those efforts alone.” (Ex. 1644.005 at 2:05-3:15.) “A thousand new jobs coming to Indiana in the information technology business. In addition, cutting edge, super-computing capability for our universities ... housed at I.U.” (*Id.* at 3:15-18.) Three years later, in his October 15, 2009 announcement of the decision to terminate the MSA, Governor Daniels observed that “it’s also important to remember that as part of this contract, IBM brought a thousand new separate private-sector jobs to Indiana at Daleville and Anderson. And those people are at work today ... in productive employment because of this contract.” (Ex. 52, 10/15/09 Tr. at 5:7-13.) Unrebutted trial testimony by IBM’s Mr. Whitfield establishes that IBM satisfied all of its obligations under the Memorandum of Understanding. (Tr. 5651:7-17.)

96. All in all, the State was not deprived of benefits it reasonably expected from the contract, although some benefits were not received as smoothly as the parties would have expected.

#### **IBM’s Improvement Precludes Finding Material Breach Within Short Timeframe**

97. After only 19 months of a 10-year contract (including only 12 months with applicable performance measurements), determining IBM’s performance in the field is premature and problematic – particularly considering all circumstances.

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phones for Hoosiers to apply for state and federal assistance was made possible by the infrastructure already in place as a result of eligibility modernization.”); Ex. 303, 5/27/09 Tr., *Thornton v. Roob*, at 90-92 (Adams) (“IBM provided all the technology, the satellite links. We had a computer setup. It was a beautiful thing.... We were starting to recover from that in August and then September-October, terrible floods again.... So, we lost about three months in 2008, 200 folks involved. Then the recession started, caseloads going up. Food stamp applications increased about 12 percent. Somebody alluded to MAD applications going up. You name the type of application, it went up.”); Tr. 5913:3-11 (Roob) (Modernization “allowed us to respond to devastating floods in June and September [of 2008]. We were able to help over 80,000 families by providing disaster food stamps [to] those affected by the disasters.”).

98. The record demonstrates that KPI metrics for timeliness were consistently missing the mark. But the parties' total working environment was fairly unsettled until about the summer of 2009, as it turns out, due to economic uncertainty, natural disaster, and the parties' common administrative difficulties. The political environment also interfered with the working environment since ACS (the largest and highest-paid contractor) was interfering with the MSA by directly lobbying the Governor, and the State was unable or unwilling to redirect the revenue necessary to adequately fund Modernization with IBM.

99. The record also demonstrates, as found above, that the measured performance of IBM was steadily improving during 2009, especially in the months leading up to the October 2009 termination. Therefore, anything that could be interpreted as an IBM failure not only had a likelihood of being cured, but was apparently in the process of being cured at the time of termination.

**Considering The MSA As A Whole, IBM's Performance  
Does Not Show Breach Going To The Heart Of The Contract**

100. Looking at the whole contract and IBM's whole performance, at least substantial performance is clearly shown as a matter of fact. The State's case extrapolates from a number of general examples of frustrated welfare applicants and State workers, and even attempts to estimate from data that as many as 80,000 or more applications (out of 1 million) were processed late during the 12 measured months of IBM's management. Taken as true, these examples still have to be balanced against the whole contract and IBM's whole performance showing benefits to the State and adhering to MSA policy objectives. Accordingly, the heart of the contract remained intact, although sometimes beating irregularly.

## The State's Arguments Are Unavailing

### *Schedule 10 Metrics*

101. The State's main argument and focus is Schedule 10 timeliness metrics. The MSA and Schedule 10 shows the timeliness metric was of the same importance as the 19 of 24 KPIs that the Coalition consistently met, including performance reporting, system availability, document scanning, document indexing, constituent care response time, and Help Center availability. (See Ex. 1083, SLM-KPI Summary Chart; MSA Schedule 10.)<sup>75</sup>

102. The State claims that the Coalition (in this case the primary subcontractor, ACS) consistently missed the KPIs for Call Center abandonment rate, timely processing of applications and redeterminations, and the SLMs for adherence to proper processing procedures ("procedure variance"). The status of the various Schedule 10 metrics for the most relevant period is set out in IBM Demonstratives 4027-4028. (See also Ex. 1083; IBM Demos. 4025, 4026.) The Court notes that IBM was consistently meeting the majority of the KPIs when the State announced the termination in October 2009. (Ex. 1083, SLM-KPI Summary Chart.) IBM's record with respect to the objective Performance Standards incorporated into the MSA precludes any finding of material breach.

103. The State contends that IBM was in breach for failure to meet the "SLM" metrics but the only performance metrics in Schedule 10 related to accuracy are the SLMs that never went into effect. In addition, improved accuracy in processing is one of the MSA's "Policy Objectives" under Section 1.1 that the parties agreed would not create an IBM contract obligation absent a change order. Therefore IBM cannot be found in breach for failing to meet these metrics.

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<sup>75</sup> See Tr. 7488:25-7489:10 (State's closing) (acknowledging that "there's nothing the contract that says any of them [the MSA policy objectives] are more important than the other").

104. The KPIs were not originally intended to apply during the transition period. (See MSA Schedule 10, §§ 3.1, 4.1.) As the State’s Director of Project Management Nicole Geller acknowledged, even though some of the KPIs were accelerated under Change Order 64, “[n]obody was looking to the KPIs or the other performance metrics in the MSA as a measure of performance during transition because both the State and the Coalition understood that the project was still in a transition phase, and so applying measures that were intended for use during steady state would not be appropriate while a project was in transition.” (Tr. 7031:18-7032:1.) Likewise, Anne Murphy acknowledged that “the KPIs and SLMs were not originally intended to be metrics applicable in transition,” but rather were “steady state methods.” (Tr. 4897:20-4898:3.)<sup>76</sup>

105. The KPIs, including timeliness, were associated with identical liquidated damages, in an amount that the State described as “miniscule” (Ex. 562),<sup>77</sup> a reasonable indicator of the weight the parties gave to these measures in the agreement. As the State’s expert Mr. Harris acknowledged during his testimony, in his 30-plus years of experience he could not identify “any project that has smaller amounts of liquidated damages associated with KPIs than the Indiana modernization project.” (Tr. 2229:9-15 (Harris).) The MSA provides that the specified liquidated damages constitute “reasonable estimates of the State’s projected financial loss and damage resulting from Vendor’s *breach*....” (MSA § 15.2.5(3) (emphasis added).) Liquidated damages were paid in lieu of performance and provided IBM with an alternative means of performance that was satisfied by payment (which payment is undisputed). That was also the contemporaneous understanding of the State’s OV&V contract compliance organization

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<sup>76</sup> See also Tr. 2228:13-18 (Harris) (“the KPIs ... were originally intended as performance metrics for a fully rolled out modernization project”); Tr. 2226:25-2227:3 (Harris) (“during the transition period there were originally no performance metrics in effect for the modernized portions of the project”).

<sup>77</sup> See also, e.g., Tr. 4903:17-4904:4 (Murphy); Tr. 7052:18-21 (Boggs) (describing amounts as “nominal”).

and lead outside consultant. As First Data's Sanjay Vaze testified, "if timeliness was not met in a given month but IBM paid the liquidated damage, then as far as [First Data was] concerned, that was technically not a contractual breach." (Tr. 3315:9-18.) Similarly, as the State's lead consultant James Maxwell acknowledged, "IBM could perform under the contract by paying the contractual penalty if it was out of ... spec on any of the performance measures." (Tr. 5928:18-5929:1.) The Court finds based on the complete record in this case, including the testimony of the witnesses, that the Coalition's failures to meet certain Schedule 10 metrics did not constitute a breach of the MSA, in light of IBM's payment of liquidated damages.

106. The State further claims material breach related to application backlog, food stamp error rates, federal (*i.e.*, overall) timeliness, the number of appeals from adverse decisions, the reversal rate of appeals, and employer turnover or staffing levels. However, none of these issues were the subject of any performance standards under Schedule 10 of the MSA.<sup>78</sup> The parties agreed to four specific measures of Call Center performance, three of which were green at the time of termination. (Ex. 1083, SLM-KPI Summary Chart.) Nevertheless, the State now argues that the four agreed-to measures are "misleading" and "do not tell the full story of how bad IBM's Call Center performance was." (State Post-Trial Br. at 92-94.) However, the more general provisions in the contract (such as the MSA's "Policy Objectives") do not create IBM contractual obligations (MSA § 1.4(5)), and in MSA § 6.4 the parties expressly disclaimed any warranty of "uninterrupted or error-free operation." "The existence of express terms in a valid contract precludes the substitution of and the implication in law of terms regarding the subject matter covered by the express terms of the contract." *Keystone Carbon Co. v. Black*, 599 N.E.2d 213, 216 (Ind. Ct. App. 1992). "This principle is especially true in Indiana because our courts

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<sup>78</sup> See, e.g., Tr. 2234:20-2235:25 (Harris); Tr. 4537:19-4538:16 (Molina).

will zealously defend the freedom to contract.” *Peoples Bank & Trust Co. v. Price*, 714 N.E.2d 712, 717 (Ind. Ct. App. 1999).

*State’s Claim of “Dissatisfaction”*

107. Beyond Schedule 10, the State points to record evidence, including confirming documents and testimony by IBM witnesses, that the State was “dissatisfied” with aspects of the Modernization Project (as was IBM), and claims IBM was in breach under § 3.8.2(7). However, this provision does not say that the State’s dissatisfaction will support a claim of breach (much less a claim of material breach), but rather that the State’s level of satisfaction is one of eight enumerated ways in which IBM’s performance will be judged. As found above, the problems with the Modernization Project that can be attributed to IBM under the contract are not material when compared to the MSA as a whole and the bargained-for benefits that the State received.

108. The State most frequently cites an email from IBM’s Mike Daniels to Brian Whitfield following a February 2009 call from Governor Daniels, in which Mike Daniels describes the situation as an “abomination.” (Ex. 7410.) Having reviewed the email and the related documents surrounding it, and having heard the testimony concerning this document from both the author, Mr. Daniels, and the recipient, Mr. Whitfield, which the Court finds credible, it is clear that Mr. Daniels was not referring to the Modernization Project itself as an “abomination,” but rather the fact that he had received a call from Governor Daniels complaining about the Project without sufficient warning from Mr. Whitfield. (Tr. 6506:24-6507:11 (Mike Daniels); *see generally* Tr. 6505:4-6, 6507:9-11, 6506:7-9 (Mike Daniels).) Actually, the Daniels email came just two months after the State had cooperated with IBM in the development of the case study of modernization posted in December 2008 on IBM’s website, in which the State noted that “[w]e’re very happy with how things have worked out.’ ... ‘We’ve accomplished

our basic mission, to open up new channels and increase our accuracy.” (Ex. 515 at 4.) Just three months after this email, the State represented to the court in *Thornton* that the IBM contract was the “only way” that FSSA would be able to meet its “obligations to all the citizens of the state.” (Ex. 303, 5/27/09 Tr., *Thornton v. Roob*, at 18:9-13.)<sup>79</sup>

#### *Technology and WFMS System*

109. The State also claims “technological dysfunction,” such as unavailability of WFMS or the eligibility website. The record does not support that technology failures during the MSA, alone or in combination with other problems, support any material breach. The Schedule 10 metrics relating to technology were consistently met during 2009. (Ex. 1083.)<sup>80</sup> Moreover, as noted above, the record contains positive assessments by State officials regarding IBM’s technology, including IBM’s WFMS, which the State continues to use to this day. In fact, the State actively pursued IBM to continue its work as the technology vendor even after the parties were unable to come to terms for IBM to remain as the general contractor. (Tr. 4946:4-9, 4952:14-4953:3 (Murphy); Ex. 469, Elwell, email to Gargano (Nov. 19, 2009).)

#### *Six Sigma Quality Control*

110. The State claims that IBM did not implement a particular management control method. However, the record fails to show an adequate explanation of the method or how it specifically related to the MSA or IBM’s performance.

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<sup>79</sup> Both parties showed unbridled energy to zealously parse individual words and emails, some out of context, many in which the Court found little weight or relevance.

<sup>80</sup> See also Tr. 6401:2-14 (Hanley) (“During the CAP period, IBM was able to demonstrate, based on statistics, that they were within the acceptable range of downtime for WFMS.”); Ex. 13181 (“The State reviewed WFMS performance metrics for the CAP period as part of the Root Cause Analysis process and approved the report to be used. Application availability appears to be improved and has remained stable.”).

*Breach of Client Confidentiality*

111. The State cites the *possibility* of unauthorized individuals obtaining access to personal information remaining on public computers, which is noted in the December 2008 OV&V report as a “Risk” -- that is, “[a]n uncertain event or condition that, if it occurs, has a ... negative effect.” (Ex. 1503.019, Dec. 2008 OV&V Report at 13; Ex. 1034, OV&V Operations Plan at 12.) The State did not include this issue two months later in its list of 36 items to be addressed in the CAP. (Ex. 75.) Nor does it appear anywhere in the 362-page final CAP document mutually agreed to between the State and IBM on July 2, 2009. (Ex. 5408.) Finally, the State produced no evidence at trial of any instance in which anyone who was not authorized was known to have accessed such information. Under those circumstances, the Court cannot find that this issue was material, alone or in combination with the State’s other alleged problems.

*Americans with Disabilities Act*

112. In its post-trial filings, the State raised for the first time the suggestion that the Modernization Project may not have been compliant in some respect with the ADA. This issue was not raised at any point during the trial, and the Court cannot determine based on the documentary fragments that the State cites that the Project was out of compliance with the ADA, or if it was, that this could be considered a material matter.

*Failure to Manage Subcontractors*

113. Although the record reflects significant disagreements among some of the Coalition members from time to time during the Project, the Court cannot conclude that these disagreements were the result of a failure by IBM to effectively manage the Project, as opposed to the pressures that any group of companies would have experienced given the complexity and difficulty of the Modernization Project. The Court notes in this respect that when the State was

negotiating with IBM to implement the Hybrid system, the State urged that the Coalition should remain intact with IBM as the prime contractor. (Ex. 845, Mills, email to Murphy (Sept. 8, 2009); Ex. 1892, Murphy, email to Burdick (Sept. 28, 2009).)

114. The State's main argument centers on the failure of ACS to timely answer the phone and process applications. As found above, these failures do not bring either party any pride, but do not constitute a material breach, particularly with the payment of liquidated damages.

115. Most notably the evidence shows that actions of ACS's lobbyist contributed to an atmosphere of distrust among Coalition members. On January 3, 2007, less than two weeks after the MSA was signed, Joe Loftus wrote Secretary Roob: "I expect to get a lecture later today from IBM reminding me that they are the Prime. They just do not get it." (Ex. 244, Loftus, email to Roob (Jan. 3, 2007).)<sup>81</sup> A series of similar communications between Loftus, ACS executives, and State officials followed over the course of the Project.<sup>82</sup>

116. By engaging in such discussions, ACS presumably violated its contract with IBM and the State was in violation of the terms of the MSA, which provided that IBM was the "sole

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<sup>81</sup> See also Tr. 4927:4-9 (Murphy).

<sup>82</sup> See, e.g., Ex. 58, Murphy, email to Roob (Jan. 27, 2008) (discussing Loftus meeting with Governor Daniels regarding "ACS having to pick up the cost of the recent increase in work from IBM"); Tr. 4931:4-10 (Murphy) (Loftus told her that he had "got himself a meeting with the governor," whom Loftus knew); Ex. 245 (Loftus, email to Roob: "IBM really does not understand how to deliver social services."); Ex. 596, Burdick, email to Novotny (Dec. 18, 2008) (stating that ACS's Skip Stitt "who the Governor knows would like to spend some time talking with the governor about [the] Welfare Modernization project," that this was "a request for a candid and private discussion" and that Governor Daniels "suggest[ed] he meet with you [Burdick] and Lawren first and give you the long version and later meet with him for the short version"); Ex. 564, Murphy, email to Mills (April 2, 2009) ("Loftus told me yesterday that his clients only got about 12M of the 40M change order."); Ex. 1900, Murphy, email to Loftus: "I met with Joe and Tom from ACS last week. You have done a nice job representing them and I will let them know."); Ex. 638, Murphy, email to Mills (May 28, 2009) ("I did speak with their [IBM's] sub, Arbor (Paul Dunn), today ... Joe Loftus represents Arbor and was at the meeting."); Ex. 639, Murphy, email to Goode (May 29, 2009) ("Just talked to Joe Loftus .... ACS also believes the IBM CR 64 mark-up was around 50%."); Ex. 1944, Kasper, email to Murphy (in response to a news article regarding problems on the Modernization Project: "This had to make Loftus happy..."); Ex. 2213, Murphy, email to Boggs (Sept. 4, 2009) ("Of course I am irritated that Mike Daniels complained about my talking with the subs and requested that it stop, but the below message says that moving forward, it may be important for the State to talk to the subs directly.").

point of contact with regard to contractual matters.” (MSA § 14.6.2.)<sup>83</sup> ACS officials testified that they were aware that such contacts were contractually prohibited,<sup>84</sup> and the Governor’s Chief of Staff Earl Goode “told folks in the governor’s office that they shouldn’t be talking to the IBM subs.” (Tr. 6420:11-21 (Goode).) Nonetheless, such communications continued throughout the life of the Project.

117. The Court is unable to find that the IBM breached the contract by failing to adequately manage ACS at the same time ACS and the State were talking behind IBM’s back.<sup>85</sup>

*The State’s Publicity Claim*

118. The State’s publicity claim is contrary to the MSA’s plain language. The MSA’s publicity provision exempts communications “related to a Proceeding” like this one “to enforce the first Party’s rights under this Agreement”:

Notwithstanding any other limitation in this Section 21.12, nothing shall prohibit either Party from identifying the other Party in any pleading or other document related to a Proceeding to enforce the first Party’s rights under this Agreement. (MSA § 21.12(7).)

119. A “Proceeding” is defined as “any judicial, administrative or arbitral action, litigation, suit, mediation, or formal adversarial proceeding of any kind ...” (MSA App. I, at 17.) The unauthorized disclosures the State alleges violate this provision were made on or after October 15, 2009 (the date of the termination announcement) and “relate to” this proceeding or the mediation, exempting them from the scope of § 21.12 under that provision’s plain language. The State also offers no explanation for how it could make repeated public statements about the

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<sup>83</sup> See also Ex. 1204, ACS Contract Art. 3.1.2(2), at 10 (Dec. 14, 2006) (“IBM will be the sole point of contact for ACS regarding any and all matters relating to the Modernization Project and the Services.”).

<sup>84</sup> Tr. 3263:20-3264:1 (Shaver) (agreeing that she was “personally aware that any contact with the State either needed to be through IBM or authorized by IBM”).

<sup>85</sup> The record shows the State’s evidence of IBM breach largely relies upon ACS performance which accordingly belies State’s claims.

Project without violating this provision (under its interpretation) when the obligations thereunder are reciprocal and would apply equally to the State. (MSA § 21.12(6).)

*The State's Abuse of Process Claim*

120. The State's abuse of process claim fails because statements in court filings are protected by an absolute privilege. *Hartman v. Keri*, 883 N.E.2d 774, 777 (Ind. 2008) ("Indiana law has long recognized an absolute privilege that protects all relevant statements made in the course of a judicial proceeding, regardless of the truth or motive behind the statements.").

121. In addition, the State has not identified any statements by IBM that it alleges support this claim. In any event, the Court finds that IBM's statements in this litigation have all been relevant to the proceeding and that there is nothing in those statements that would serve as a basis for an abuse of process claim.

*The State's Indemnification Claim*

122. The State brought a claim for indemnification for the \$1,210,511 food stamp penalty it was assessed in June 2010. That claim is barred by the MSA's plain language, which states that the State may only seek reimbursement for federal penalties incurred "during Steady State" (MSA § 15.2.6) -- a stage of the Modernization Project that was never reached. In addition, the State has not demonstrated that it has actually suffered any out-of-pocket loss as a result of federal penalties. To the contrary, the evidence showed that it reinvested 50% of the amount of the penalty in its own programs, and the State did not introduce evidence at trial indicating that it ever actually paid any money to the federal government. (Ex. 417, SNAP Reinvestment Plan (2010).) Rather, the State received a bonus from the federal government for improved performance, amounting to more than \$1.6 million. (Ex. 13138, FNS Letter to Governor Daniels (June 16, 2011).)

## **IBM Is Entitled to Some Damages For Termination of the MSA**

### **Subcontractor Assignment Fees Reiterated**

123. MSA § 14.8.1(3) clearly states that “the State shall pay” the subcontractor assignment fees if it accepts assignment of the subcontracts (which the State did here), regardless of whether there was a termination for cause. As the Court previously ruled during summary judgment, IBM is entitled to Forty Million Dollars (\$40,000,000.00) for such fees.

### **Dedicated Equipment**

124. IBM is entitled to \$9,510,795, the unchallenged appraised value of the Dedicated Equipment the State retained after terminating the MSA, regardless of whether IBM materially breached the MSA. “[T]he parties agree that the Equipment at issue was transferred to the State pursuant to the MSA.” 1/25/12 Order (Replevin) at 2. “It is further undisputed that the State did not pay IBM’s invoice for the Equipment.” *Id.* The State investigated any discrepancies in the list of Equipment at issue until resolved,<sup>86</sup> and did not offer any expert opinion challenging the appraisal by IBM’s expert, Ron Savill, who found that the fair market value of the Equipment is \$9,510,795. (Tr. 6986:14-21; Ex. 2934.001, Appraisal (Jan. 18, 2012).) The Court finds Mr. Savill’s analysis to be sound and credible.

125. The State agreed that it only had a right to use the Equipment during the Term of the MSA (MSA § 3.4.7), and that if it wanted to keep the Equipment, it would have to be “purchased by the Successor [here, the State]” (MSA § 16.6.1(4)). The State agreed that it would not receive a bill of sale transferring title for the Equipment until “receipt of payment for such Equipment.” (*Id.*) The State breached the MSA by keeping the Equipment and refusing to pay the bill.

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<sup>86</sup> Tr. 1709:9-12 (Cline); Ex. 2705, Cline, email to Gargano at FSSA1\_08775892 (Jan. 26, 2010).

126. The State argues that the Dedicated Equipment should be considered an “equipment cost” that falls within the Early Termination Close Out Payments, which it maintains are only payable in the event of termination for convenience. Again, the State’s position is contradicted by the MSA. The MSA provides that if the State wants to keep the Equipment, it must pay for the Equipment “to the extent included within the Early Termination Close Out Payments *or otherwise purchased by the Successor*” and that IBM is only required to issue a bill of sale transferring title “upon receipt of payment for such Equipment.” (MSA § 16.6.1(4) (emphasis added).) Thus, even if IBM were not entitled to payment for the Equipment as an ETCOP, Section 16.6.1(4) dictates that the State “otherwise purchase” the Equipment if it wanted to keep it.

127. Consistent with these provisions, the evidence shows that even after the State sent a “for cause” notice of termination, the State recognized that IBM owned the Equipment and that the State was required to pay for it. Thus, after notifying IBM that the State wanted the Equipment, the State’s Doug Elwell acknowledged that he expected an invoice from IBM. (Tr. 4065:8-11 (Elwell).) IBM invoiced the State and provided “supporting documentation” for the invoice. (Tr. 4070:5-4071:7 (Elwell); Ex. 481, Elwell, email to Howe at FSSA1\_00447947 (Dec. 14, 2009).) And the State budgeted to pay IBM \$9.5 million “for acquiring all hardware.” (Tr. 4071:23-4073:6 (Elwell); Ex. 464, Elwell, email to Ornellas at 7 (Jan. 11, 2010).) Nonetheless, it never paid the invoice or returned the Equipment. (Tr. 6174:23-6175:2 (Carpenter).) IBM is entitled to the fair market value of the Equipment (\$9,510,795) under the MSA’s plain language.

#### **Early Termination Close Out Payments**

128. IBM is entitled to \$2,570,621 in “Early Termination Close Out Payments” due under MSA § 16.6.6. These include actual costs IBM incurred as a result of the State’s

premature termination. The State's only defense to payment of these costs is that they are not due in the event of termination for cause. The State did not introduce any credible evidence suggesting that IBM did not incur these costs or challenging the amount of these costs. The Early Termination Close Out Payments owed by the State are as follows: (1) \$2,305,964.37 in prepared software costs owed under MSA § 16.6.6(3);<sup>87</sup> (2) \$31,143.58 in lease termination payments owed under MSA § 16.6.6(3)(C) to end the lease on IBM's Indianapolis office space;<sup>88</sup> (3) \$61,284 in improvement costs IBM incurred in improving its Indianapolis offices owed under MSA § 16.6.6(3)(D);<sup>89</sup> and (4) \$101,763 in salary and labor costs for IBM employees and \$71,466 for Crowe employees idled as a result of the termination, which are owed under MSA § 16.6.6(4)(B) because the State gave less than 75 days notice.<sup>90</sup>

#### **Prejudgment Interest**

129. IBM is entitled to prejudgment interest under I.C. § 24-4.6-1-103. The applicable statutory rate for prejudgment interest is 8%. I.C. §§ 24-4.6-1-102 & 24-4.6-1-103. IBM shall submit a separate petition for calculated prejudgment interest within thirty (30) days.

#### **IBM Is Not Entitled To Damages for Deferred Fees or Mandatory Changes**

##### **No Showing That Deferred Fees, as Liquidated Damages, Are Reasonable And Proportionate**

130. The term 'liquidated damages' refers to a specific sum of money that has been expressly stipulated in the provisions of a contract as the only amount of damages to be recovered by one party for a breach of the agreement by the other. *Time Warner Entertainment*

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<sup>87</sup> Tr. 6294:9-6295:9 (Zaudtke) (IBM purchased software licenses and software maintenance plans that ran for a period beyond the December 2009 services termination date); Exs. 1788, 1715.005, 2711-2715.

<sup>88</sup> Tr. 6295:12-23 (Zaudtke); Ex. 1796 at 1.

<sup>89</sup> Tr. 6295:25-6296:13 (Zaudtke); Exs. 1790, 2716, 2717.

<sup>90</sup> Tr. 6296:14-6297:7 (Zaudtke); Ex. 2706 at IBM-IN01109815; Tr. 6297:8-21 (Zaudtke); Exs. 2706, 1715.005.

*Co., L.P. v. Whiteman*, 802 N.E.2d 886, 893 (Ind. 2004) (citing *Merrillville Conservancy Dist. v. Atlas Excavating, Inc.*, 764 N.E.2d 718, 724 (Ind. Ct. App. 2002)).<sup>91</sup> In Indiana, liquidated damages provisions are appropriately used where: (1) the calculation of actual damages would be difficult or impossible; and (2) the amount stipulated in the provision is not unreasonable. *A.V. Consultants, Inc. v. Barnes*, 978 F.2d 996, 1001 (7<sup>th</sup> Cir. 1992) (quoting *Raymundo v. Hammond Clinic Ass'n*, 449 N.E.2d 276 (Ind. 1983); *Beiser v. Kerr*, 20 N.E.2d 666, 669 (Ind. 1939); see also *Rogers v. Lockard*, 767 N.E.2d 982, 990 (Ind. Ct. App. 2002) (citing *Gershin v. Demming*, 685 N.E.2d 1125, 1127 (Ind. Ct. App. 1997); 22 AM.JUR.2D *Damages* §683 (1988)) (explaining that liquidation clauses “have value and are generally enforceable” where “the calculation of actual damages would be uncertain, difficult, or impossible.”).

131. Indiana law permits liquidated damages *only* when the proscribed sum “fairly” compensates for the breach. *Olcott Int’l & Co., Inc. v. Micro Data Base Sys., Inc.*, 793 N.E.2d 1063, 1077 (Ind. Ct. App. 2003), *trans. denied*. If the provision is “grossly disproportionate” to the loss from breach, the liquidated damages will be treated as an unenforceable penalty. *Id.*

132. In distinguishing whether a stipulation provides for liquidated damages or an unenforceable penalty, the court looks to “the facts, the intention of the parties and the reasonableness of the stipulation under the circumstances of the case.” *Olcott International & Co. v. Micro Data Base Systems, Inc.*, 793 N.E.2d 1063, 1077 (Ind. Ct. App. 2003) (quoting *Gershin*, at 1128).<sup>92</sup> Furthermore, in *Rogers*, the court held that the issue is not resolved through the use of terms such as “damages”, “liquidated damages” or “penalty”; rather, each provision must be considered in the light of the contract as a whole in determining the meaning the parties intended to give a provision. *Rogers*, *supra*. at 991.

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<sup>91</sup> Citing *George B. Swift Co. v. Dolle*, 80 N.E. 678, 681 (Ind. Ct. App. 1907).

<sup>92</sup> Citing *Nylen v. Park Doral Apartments*, 535 N.E.2d 178, 184 (Ind. Ct. App. 1989).

133. In *Art County Squire, L.L.C. v. Inland Mortgage Corp.*, supra., the court explained that liquidated damages provisions are looked on most favorably when both parties have made a good faith effort to estimate actual damages in arriving at the stipulated amount. Id. at 891. There, a mortgage lender sought recovery of a balloon payment, which included unexplained late payment fees, following a default on the loan. Id. at 888. The court, in finding that the fees constituted an unenforceable penalty, reasoned that it relied heavily on the application of the “reasonableness standard.” Id. at 892. Similarly, in *A.V. Consultants*, supra., the 7<sup>th</sup> Circuit held that “damages are unreasonable when they are ‘grossly disproportionate to the loss which may result from the breach’ or ‘unconscionably in excess of the loss sought to be averted.’” *A.V. Consultants*, supra. at 1001 (quoting *Raymundo*, supra. at 283) (emphasis added); *see also Skendzel v. Marshall* (1973), Ind., 301 N.E.2d 641, 644-5.

134. The Deferred Fees claimed by IBM are liquidated damages. Therefore, it is IBM’s burden to show “some proportionality between the loss and the sum established as liquidated damages.” *Wildwood Industr., Inc. v. Genuine Machine Design, Inc.*, 587 F. Supp. 2d 1035, 1048 (N.D. Ind. 2008) (quoting *Harbours Condominium Ass’n, Inc. v. Hudson*, 852 N.E.2d 985, 993 (Ind. Ct. App. 2006)).

135. “The distinction between a penalty provision and a liquidated damages provision is that a penalty is imposed to secure performance of the contract, and liquidated damages are to be paid in lieu of performance.” *Rogers*, supra. at 991; *see also Gershin*, supra. at 1128, n.3 (defining a “penalty” as “the sum a party agrees to pay in the event of a contract breach, but which is fixed, not as a pre-estimate of probable actual damages, but as a punishment, the threat of which is designed to prevent the breach” (quoting *Black’s Law Dictionary* 1133 (6th ed. 1990)).

136. The Deferred Fees provision attempted only to prevent a future breach, not to fix damages if a breach occurred. *See, e.g., Rogers v. Lockard, supra.* at 991 (“a penalty is imposed to secure performance of the contract”); *Gershin v. Demming, supra.* at 1128, n.3; *Zalewski v. Simpson*, 435 N.E.2d 74, 77-78 (Ind. Ct. App. 1982); *Art Country Squire, L.L.C. v. Inland Mortg. Corp.*, 745 N.E.2d 885, 891 (Ind. Ct. App. 2001); *A.V. Consultants, Inc. v. Barnes, supra.*; *Hahn v. Drees, Perugini & Co.*, 581 N.E.2d 457, 463 (Ind. Ct. App. 1991).

137. In addition, a liquidated damages clause devolves into an impermissible penalty if it would allow the plaintiff to “receive[d] its expected profit plus the value of its services.” *A.V. Consultants, supra.* at 1001; *Hahn*, 581 N.E.2d at 463 (“our decision in this respect is fully supportable upon the ground that the treble damages exacted by the covenants bear no reasonable relationship to the amount of damages incurred by Drees in the event of breach. The treble damages clause clearly would impose a penalty, and is thus unenforceable.”). Here, IBM’s Deferred Fees include a profit component twice what IBM expended to achieve under the MSA as a whole. As IBM’s pricer, Clare Sugrowe, testified:

Q: Now, regarding -- Mr. Charfoos asked you what the gross profit percentage on the entire contract would be. Do you recall that?

A: Yes.

Q: And you said it was 15 percent?

A: Right.

Q: Do you recall that when you were pricing out the transition component of deferred fees, that you included a 30 percent gross profit component?

A: Yes.

[Tr. 5871:9-18.] Courts resolve doubtful cases in favor of classification as a penalty. *See, e.g., Lake River Corp. v. Carborundum*, 769 F.2d 1284, 1290 (7th Cir. 1985) (liquidated damages clause was a penalty; Illinois law).

138. Furthermore, if a single sum is specified as damages for any and all breaches regardless of their relative gravity, the provision is not a reasonable attempt to estimate actual damages and thus is a penalty.

139. Neither the MSA nor Schedule 24 provides guidance on the calculation of Deferred Fees, nor are the amounts even pro-rated by month. Accordingly, the Deferred Fees, as a liquidated damages provision, are an unenforceable penalty.

140. IBM fails to show sufficient evidence that the Deferred Fees are reasonable and proportionate.<sup>93</sup>

141. IBM's internal documents show, and its executives admit, that even with the State's termination IBM was profitable on Indiana modernization. For instance, internal IBM financial documents show that on a cash basis IBM received gross profit of over \$25 million on the Modernization Project. [Tr. Ex. 7070, p. 5.]<sup>94</sup> IBM executives on this matter admit that IBM was profitable. [Tr. 3695-3696, 3608-3609, 3697, 3582-3583 (admitting that IBM was profitable on the Indiana Modernization Project).] This profitability was positive for the IBM executives involved. [Tr. 3697.] Indeed, IBM's Modernization Project overall was bid with a forecast of 15%-17% gross profit, but profits came in above budget at 18.4% on an accrual basis. [Tr. 3608-3609, 3697.]

142. Moreover, the penalty nature of Deferred Fees is demonstrated by looking at what would have occurred if the State had terminated on day one of the contract, or week one, or

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<sup>93</sup> IBM's financial expert, Louis Dudney, claimed that the Deferred Fees corresponded to amounts on IBM's balance sheet. [Tr. 7092:23-7093:2.] However, Mr. Dudney's analysis was tied to the labels placed on balance sheet items and he did not perform any independent analysis to confirm that the amounts IBM's balance sheet corresponded to actual transition costs. [Tr. 7191:24-7192:19 ("I didn't do an analysis separate and apart from reviewing IBM's application of its accounting practices.")]. IBM's accounting practices allow for the deferral of transition costs "If these 'set-up' costs can be specifically identified and are non-recurring, they may be deferred to match against future revenues." [Tr. Ex. 1800.001, Dudney Rep., p. 17]. Testimony at trial indicates that the amounts IBM placed on its balance sheet does not meet this standard. For example, IBM deferred over \$11 million in expenses paid to RCR to its balance sheet [Tr. Ex. 9209, p. 7] even though RCR project manager Matthew Rager testified RCR was performing the same services during transition as it would at steady state. [Tr. 2514:6-2517:8 ("all the roles would be the same")]. IBM presented no direct evidence or testimony regarding how these continuous and recurring changes qualify as "transition" expenses under its accounting rules or correspond to amounts included within Deferred Fees.

<sup>94</sup> IBM recognized even higher profits on an accrual basis. Indeed, IBM financial reporting showed that through June 2009 IBM had priced out the Modernization Project at a gross profit of \$39.9 million, but realized profits above that of \$48.5 million on an accrual basis. [Tr. 3695-3696.]

month one, or quarter one. Per Schedule 24 of the MSA, if the State had terminated the day after executing the MSA, by IBM's position the State would have owed IBM \$44,667,554, even though IBM at such a stage obviously would not have rendered any performance, and even if the termination were for cause. [Tr. 1624.] As the Seventh Circuit explained in *Lake River*, however, in determining as a matter of law that a liquidated damages clause was an unenforceable penalty, looking to "day one" hypothetical breaches sheds light on the penalty aspect of damages clauses like this one:

Suppose to begin with that the breach occurs the day after Lake River buys its new bagging system for \$89,000 and before Carborundum ships any Ferro Carbo. Carborundum would owe Lake River \$533,000. Since Lake River would have incurred at that point a total cost of only \$89,000, its net gain from the breach would be \$444,000. This is more than four times the profit of \$107,000 (20 percent of the contract price of \$533,000) that Lake River expected to make from the contract if it had been performed: a huge windfall.

769 F.2d at 1290.

143. For all these reasons, the Deferred Fees are a penalty, unreasonable, lack a proportionate foundation, and accordingly unenforceable.

#### **IBM Failed To Show Sufficient Evidence of Mandatory Change Fees**

144. IBM claims four mandatory "law change" change orders allow fees for extra work under the MSA. But the record only shows evidence for Change Orders 119 and 133, and is insufficient for both. [See Zaudtke Tr. 6299:1-6302:24.]

145. The "law changes" in these change orders both pre-dated the MSA and should have been incorporated by IBM initially into the project.

146. CR 119 related to changes required by the Deficient Reduction Act of 2005. [Tr. Ex. 1005; Tr. 4332:21-4334:2.] CR 133 related to changes required by FNS to comply with provisions in 7 CFR 273.2. [Tr. Ex. 1500.133.] The last time 7 CFR 273.2 was amended prior to CR 133 was in 2003.

147. IBM failed to show why it is entitled to payment from the State for making changes to comply with laws passed prior to the enactment of the MSA for which IBM's processes and procedures should have already been in compliance.

### **Judgment**

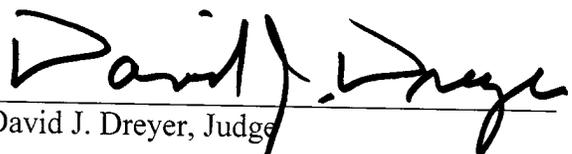
148. Trial judgment entered for IBM and against the State on IBM's Complaint in the amount of Twelve Million Eighty One Thousand Four Hundred Sixteen Dollars and No Cents (\$12,081,416). Previous summary judgment is reiterated in the amount of Forty Million Dollars and No Cents (\$40,000,000). Final judgment amount totals Fifty Two Million Eighty One Thousand Four Hundred Sixteen Dollars and No Cents (\$52,081,416), plus prejudgment interest and costs.

149. Judgment entered for IBM and against the State on the State's Complaint, and the State takes nothing.

150. Accordingly, State's Motion for Involuntary Dismissal of IBM's Breach of Contract claim is denied.

**IT IS SO ORDERED.**

Dated this 18<sup>th</sup> day of July 2012.

  
David J. Dreyer, Judge

STATE OF INDIANA )  
 )ss:  
COUNTY OF MARION )

MARION SUPERIOR COURT  
CIVIL DIVISION 10  
CAUSE NO. 49D10-1005-PL-021451

STATE OF INDIANA, )  
acting on behalf of the )  
Indiana Family & Social Services )  
Administration, )  
 )  
Plaintiff )  
 )  
v. )  
 )  
INTERNATIONAL BUSINESS )  
MACHINES CORPORATION, )  
 )  
 )  
Defendant. )

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INTERNATIONAL BUSINESS )  
MACHINES CORPORATION, )  
 )  
Plaintiff, )  
 )  
v. )  
 )  
STATE OF INDIANA, )  
acting on behalf of the )  
Indiana Family & Social Services )  
Administration, )  
 )  
 )  
Defendant. )

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**EXHIBIT A**  
**TO COURT'S ENTRY OF JUDGMENT**  
**PURSUANT TO TRIAL RULE 58(B)**

1. The case was tried to the Court without a jury.
  - a. State of Indiana sued and alleged breach of a services contract to manage the State's welfare system, as well as designing and implementing technological items. The State sought over \$170 million.

- b. IBM sued and alleged breach of contract, seeking specified fees and expenses allegedly due upon termination. IBM sought almost \$100 million.
  - c. The two lawsuits were consolidated into one trial and both claims were resolved accordingly.
2. Appearances by counsel:

**FOR THE STATE OF INDIANA:**

Mr. John R. Maley  
Mr. Peter J. Rusthoven  
Mr. J. Curtis Greene  
Mr. Patrick W. Price  
Mr. Damon R. Leichty  
Ms. Meredith Thornburgh White  
Mr. Kyle W. LeClere  
BARNES & THORNBURG LLP  
11 South Meridian Street  
Indianapolis, IN 46204

Mr. Adam J. Krupp  
INDIANA DIVISION OF FAMILY RESOURCES  
402 West Washington Street  
Room W-392  
Indianapolis, IN 46204

**FOR INTERNATIONAL BUSINESS MACHINES CORPORATION:**

Mr. Steven D. McCormick  
Mr. Jonathan C. Bunge  
Mr. Douglas G. Smith  
Mr. Aaron D. Charfoos  
Mr. Daniel Lombard  
Ms. Lauren K. Schwartz  
Ms. Erin Wagner  
Mr. Chris Catizone  
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Mr. Andrew W. Hull  
Mr. Daniel K. Burke  
Mr. Jason L. Fulk

HOOVER HULL LLP  
111 Monument Circle  
Suite 4400  
P.O. Box 44989  
Indianapolis, IN 46244-0989

3. Jurisdiction for the matter is established under applicable Indiana law, Trial Rule 75(A), and Article 21.3 of the parties' contract.
4. Before trial, the case involved substantive rulings regarding executive privilege of State officials' communications, exemption of Governor Daniels's testimony, and twelve (12) motions for summary judgment. Accordingly, the court performed in camera review of over 150,000 pages. In addition, rulings on numerous objections in designated depositions were necessary for over 40 witnesses.
5. During trial, the Court sat for six (6) weeks, heard 92 witnesses (making notations upon the unofficial transcript in "real time"), and received 7,500 exhibits.
6. After trial, the Court read the unofficial transcript, reviewed the exhibits, and read about 400 pages of the parties' submissions with citation to the record. In addition, the Court conducted its own research to make its final determination.
7. The Court received special permission from the Indiana Supreme Court to manage the case and pleadings under an electronic filing system operated by LexisNexis.

## GLOSSARY OF COMMON TERMS AND ACRONYMS

**“2A” a/k/a “Region 2A”** -- After the Pilot was complete and approved by both the State and the IBM

Coalition, the next step was deployment to region “2A,” the second phase of the modernization rollout commencing on March 24, 2008 and consisting of 27 Counties in the Clark and Vigo Regions.<sup>1</sup>

**“2B” a/k/a “Region 2B”** -- After operating the modernized solutions in the 37 counties the State and

IBM Coalition approved the expansion of modernized operation into region “2B,” the third phase of

the modernization rollout commencing on May 19, 2008 and consisting of 20 Counties in the Allen

and Vanderburgh Regions.<sup>2</sup>

**“ADA”** -- Americans with Disabilities Act

**“AFSCME”** -- Union of the American Federation of State and County Municipal Employees

**“AG”** -- Assistance Group

**“AHIC”** -- American Health Information Community

**“APD”** -- Advance Planning Document (FNS Submission)

**“APDU”** -- Advance Planning Document Update (FNS submission)

**“ARRA”** -- American Recovery and Reinvestment Act

**“As-Is counties”** -- Counties which have not been modernized

**“Business case”** -- A nontechnical enumeration of the rationales driving a project, including the background of the project, options considered for the project, and the expected business benefits, costs

and risks.

**“Business requirement”** -- A high-level description of what a software system must provide, capturing the intended behavior of the system and the services, tasks or functions the system is required to perform.

**“BAFA” or “BOFA”** -- Best and Final Offer; Best or Final Offer

**“CAP”** -- Corrective Action Plan

**“CMS”** -- Centers for Medicare & Medicaid Services; Federal Agency under HHS that administers

Medicare and Medicaid

**“DFR”** -- Division of Family Resources; division of the Family and Social Services Administration

responsible for administering SNAP, TANF, Medicaid, HHW, and HIP

**“DDM”** -- Deputy District Manager (in FSSA)

**“DSNAP”** -- Disaster Supplemental Nutritional Assistance Program

**“EA”** -- Eligibility Associate; position responsible for processing applications and application requests

**“ES”** -- Eligibility Specialist

**“FDGS”** -- First Data Government Solutions (or just First Data); group responsible for providing monitoring and evaluation services to the FSSA

<sup>1</sup> Ex. 164.

<sup>2</sup> Ex. 165.

**“FNS”** -- Federal Food and Nutritional Services; Federal Agency of the USDA responsible for administering federal nutritional assistance programs

**“FS”** -- Food Stamps

**“FSSA”** -- Indiana Family and Social Services Administration

**“GBS”** -- Global Business Services; the professional services arm of IBM which includes management

consulting, systems integration, and application management services; one of two major divisions

within IBM Global Services

**“Governance”** -- The management framework for the Modernization Project, as outlined in the “Governance Plan” (Appendix V to the MSA). The Governance Plan sets out several standing committees by which the State and the IBM Coalition reviewed the project and resolved issues. Schedule 7 of the MSA lists the required reports that were regularly reviewed as part of the governance

process.<sup>3</sup>

**“GTS”** -- Global Technology Services; a major division within IBM Global Services responsible for

infrastructure services including outsourcing and integrated technology services

**“HCSS”** -- Hoosier Coalition for Self Sufficiency; the IBM led Coalition of subcontractors responsible

for modernization

**“HHW”** -- Hoosier Healthwise (related to Medicaid Program)

**“HIP”** -- Healthy Indiana Plan; “a program enacted into Indiana Law . . . to provide personal health

accounts and health insurance for the uninsured and low income residents of Indiana.”<sup>4</sup>

**“IAPD”** -- Implementation Advance Planning Document (FNS submission)

**“ICES”** -- Indiana Client Eligibility System; “an automated eligibility Software system used by FSSA

in the determination of eligibility for public assistance programs.”<sup>5</sup>

**“IEDC”** -- Indiana Economic Development Corporation; an instrumentality of the State to promote

economic development within the State

**“IMPACT”** -- Indiana Manpower and Comprehensive Training

**“KPI”** -- Key Performance Indicator; “[P]erformance metrics, and associated penalties, designed to

provide incentive to Vendor to focus on other key metrics related to the Service components that are

important to the State and its Clients.”<sup>6</sup>

**“LD”** -- Liquidated Damage

**“Lean Six Sigma”** -- A combination of Six Sigma and Lean management strategies which focuses on

elimination of waste and defects in products and services.<sup>7</sup>

**“MAD”** -- Medical Disability

**“MA-DAG”** -- Medical Disability Assistance Group

**“MED”** -- Medicaid for Employees with Disabilities

<sup>3</sup> See MSA, Appendix V.

<sup>4</sup> MSA, Appendix I at 11.

<sup>5</sup>MSA, Appendix I at 12.

<sup>6</sup>MSA, Schedule 10, § 1.2.

<sup>7</sup>See MSA Article 3.7 and Appendix VII.

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**“MMIS”** -- Indiana’s Medical Management Information System

**“MOU”** -- Memorandum of Understanding; agreement by and among IBM, Indiana University, Purdue University and the Indiana Economic Development Corporation signed December 27, 2006

**“MR”** -- Maintenance Release. After the initial development process was completed and the Pilot

rolled out in October 2007, IBM continued to update the modernization systems by issuing Maintenance Releases on a predefined periodic basis. The IBM application team worked with State

and Coalition subject matter experts to jointly assess enhancements requests and then develop collections of items that would be completed in any particular maintenance release.

**“MRT”** -- Medical Review Team; team who determines an applicant's eligibility for Medicaid based

on a disability in Indiana

**“MSA”** -- Master Services Agreement

**“Netfor ticket”** -- The IBM Coalition operated a help desk as part of the modernization project. Anyone with the State or Coalition could call the help desk with any kind of problem. The staff manning the help desk used a software system called “Netfor”. Each reported problem would be entered into the Netfor system through a “ticket”. Each ticket would identify the who, what , where

and when information related to the problem.<sup>8</sup>

**“NOR”** -- Notice of Redetermination

**“OMB”** -- Office of Management and Budget

**“OMPP”** -- Office of Medical Policy and Planning

**“OV&V”** -- Operational Verification and Validation (First Data)

**“Pilot” a/k/a “Region 1”** -- The initial rollout period of modernization commencing on October 29,

2007. It consisting of 12 Counties and involved approximately 10% of the Indiana population. The

Pilot allowed the State and the IBM Coalition to learn and make adjustments based on real-world experience before the State approved additional deployments in other regions. The State and the IBM

Coalition ran the pilot from 10/29/2007 through 3/21/2008.<sup>9</sup>

**“Plan B”** -- A revised system designed to incorporate the technological advances of the modernization

plan with an increased emphasis on face-to-face interaction between applicants and staff. For example,

the Plan B eliminated the centralized call center and service centers and directed applicants to local

offices for their interviews. Plan B retained the software systems developed by IBM as part of modernization with changes necessary to implement the new focus.<sup>10</sup>

**“PMO”** -- Project Management Office

**“PMP”** -- Project Management Professional

“**RFI**” -- Request for Information 6-C

“**RFP**” -- Request for Proposal 6-58

“**RMP**” -- Risk Management Plan

“**RPM**” -- Rational Portfolio Manger

<sup>8</sup> *E.g.*, Ex. 1503.012 at 4.

<sup>9</sup> Ex. 57.

<sup>10</sup> Ex. 1903.

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“**S&L SO**” -- State & Local Government Strategic Outsourcing, a division within IBM Global Services

“**SC**” -- Service Center; “locations which are operated by Vendor or its Subcontractors to provide the

Services which do not include personal interfaces with Clients . . .”<sup>11</sup>

“**SCD**” -- Service Commencement Date

“**SCHIP**” -- State Children Health insurance Program

“**SEC**” -- State Eligibility Consultant

“**SEM**” -- State Eligibility Manager

“**Six Sigma**” -- Management strategy which emphasizes elimination of variation and defects in products and services. As used by the IBM quality assurance team, Six Sigma sought to improve the

quality of process outputs by identifying and removing the causes of defects and minimizing variability

in the processes used to complete the welfare eligibility transactions. It utilized a set of quality management methods, including statistical methods, and used a special group of people within the

organization who are experts in these methods. See also **Lean Six Sigma**.

“**SLA**” -- Service Level Adjustment; SLA is a metric type measuring the following following: Medicaid Long Term Care Procedure Variance Rate, Other Medicaid Procedure Variance Rate, TANF

Procedure Variance Rate, Food Stamp Procedure Variance Rate and All Family Work Participation

Rate.<sup>12</sup>

“**SME**” -- Subject Matter Expert. In software development, an SME is a person who is knowledgeable

about the domain (*e.g.*, social services eligibility) being represented in the system. The SME tells the

software developers what needs to be done by the computer system, and how the SME intends to use

it.

“**SNAP**” -- Supplemental Nutritional Assistance Program (new name of Food Stamp Program as of

10/08)

“**SOF**” -- State Operated Facility

“**SSPM**” -- Steady State Procedural Manual

“**TANF**” -- Temporary Assistance for Needy Families; federal program which provides temporary

cash assistance to indigent families with children.

**“TKPI”** -- Transition Key Performance Indicator; six metrics, measured only during Transition and only in the As-Is environment: TANF Timeliness and change in volume, Food Stamps Timeliness and

change in volume, and Medicaid Timeliness and change in volume.<sup>13</sup> (MSA, Sched. 10, § 2)

**“UAT”** -- User Acceptance Testing; in general, a process “conducted by end-users to determinate that

the software performs as intended in the environment that it is required to perform in.”<sup>14</sup> In Indiana,

UAT was designed to “identif[y] the general approach that will be employed to validate that the Pilot

performs as expected in the intended environment in which it will be expected to operate . . . .”<sup>15</sup>

<sup>11</sup> MSA, Appendix I at 19.

<sup>12</sup> MSA, Article 4.1(2) and Schedule 10, § 3.

<sup>13</sup> MSA, Schedule 10, § 2.

<sup>14</sup> Ex. 2943A at 6 of 35.

<sup>15</sup> *Id.*

5

**“Use case”** -- A Use Case defines in narrative form the interactions between external actors and the

software system under consideration, *e.g.*, a description of call center operations and procedure. A Use

Case describes the sequence of interactions between actors and the system necessary to deliver a service. A complete set of use cases specifies all the different ways to use the components of a system

and the system as a whole. Generally, Use Cases are written in an easy-to-understand narrative using

the vocabulary of the project (such as the delivery of public benefits). This makes the Use Cases easy

to follow and encourages users involvement in defining the requirements.

**“WFMS”** -- Work-Flow Management System; computer system that integrates with ICES

**“WIC”** -- Woman, Infants and Children (a special SNAP program)