Contractually Speaking . . .

Planning and Negotiating Successful IT Contracts

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Disclaimer:

THIS PRESENTATION IS TO ASSIST IN A GENERAL UNDERSTANDING OF THE LEGAL ISSUES SURROUNDING CLOUD COMPUTING. IT IS NOT INTENDED, NOR SHOULD IT BE REGARDED, AS LEGAL ADVICE. COMPANIES, ENTITIES OR INDIVIDUALS NEEDING CONTRACT SERVICES OR INDIVIDUALS WITH PARTICULAR QUESTIONS SHOULD SEEK THE ADVICE OF INDIVIDUAL COUNSEL

Summary of Topics:

- **Commonly used terms & trends**
- **Thinking Outside the Box and Not Always Reinventing the Wheel**
- **Common Contract Approaches of Vendors**
- **Drafting issues**
- **Tools – technology, checklists, & precedent files**
- **Streamlining negotiations**

Objectives:

- **Learning some inappropriate contract terms**
- **Recognizing trends in IT Procurement**
- **Identify, understand and avoid common mistakes**
- **Identify and use beneficial contracting tools**
- **Learn contracting techniques to avoid risk and loss**

Know your environment:

Early 1990s = mild recession = CONCESSIONS

- Late 1990s (1999!) =

FEW CONCESSIONS

- Early 2000s = recession =

BIG CONCESSIONS

- Today = swinging back to the early 1990s

Know your environment (2):

State Procurement:

- Consolidated Procurement Code
- Purchasing Level Authority
- "Compendium" clauses
- Statewide Contracts; Reverse Bids; Vendor Lists; Cooperative Purchasing
- And more . . .

Local Government

- Local Procurement Ordinance
- Council/Administrator/CIO authority
- Local Government "Boilerplate"
- Cooperative Purchasing

Before you begin:

Planning Analysis . . .

- **<u>Before soliciting and negotiating, understand</u>:**
- **• What is you business goal?**
- **• How critical is the app ?**
- **• How much will it cost?**
- **• How quickly do you need it?**

Contract Terms

"Limitation of Liability"

- **Maximum amount of direct damages available to each party**
- **No consequential (indirect) damages – Tip: delete provisions, or at least make it mutual**
  - **Common exceptions:**
    - **Indemnification**
    - **Breach of confidentiality provisions**
    - **Bodily injury**
    - **HIPAA, Other Privacy and Consumer Protection Laws**

TREND – Repudiation of vendor for including in procurement

- **Limits on government's liability?**

In effect, this is getting to an ***allocation of risk***

Contract Terms (2)

"Levels of Effort"

- **Reasonable efforts**
- **Diligent efforts**
- **Good faith efforts**
- **Commercially reasonable efforts**
- **Best efforts**
- **Best commercially reasonable efforts?**

Trend: Tier one efforts

Contract Terms (3)

"Material Breach"

- **Typical contract allows a party to terminate for**
- **the other's "material breach"**
- What constitutes "material?"
- **What facts amount to a material breach vs. a minor or "technical" breach**

TIP:

- **Identify key scenarios and provide in contract that such**
- **constitute material breach (e.g. interruption in service for a period of time.**
- Provide that **repeated small breaches** will constitute

Contract Terms (4)

Payment Terms and Fees

- **Timing of payments**
  - **Date based; performance based**
  - **Increases in fees over time**
    - **Fixed rate**
    - **Consumer Price Index (CPI)**

    Trend: Employment Cost Index (ECI)
- **Holdbacks and true-ups**

TIPS: (1) **Travel and out-of-pocket expenses cap**

(2) Require Vendor to provide a complete price schedule of everything being licensed/purchased, etc. – if not on list, you don't pay for it

Contract Terms (5)

"Related Services"

When Scope of Work isn't enough…

TIP: language as follows:

> ***"The Parties have attempted to delineate in this Agreement, and in its Attachments, schedules and exhibits, the specific tasks, activities, and Services that shall be performed by Vendor hereunder. Nevertheless, and notwithstanding anything to the contrary herein, the Parties acknowledge and agree that no such delineation may possibly be entirely exhaustive or complete and that all such delineations shall be interpreted as illustrations of the general types and natures of services that are to be provided by Vendor, rather than as complete and exhaustive lists of such Services. Accordingly, Vendor shall in all events perform as reasonable to fulfill both the content and the intent of this Agreement, the Attachments (or any subsequent or additional statements of work mutually agreed upon by the Parties in writing), and all other schedules and exhibits hereto."***

Contract Terms (6)

<u>Source Code Escrow</u>

Escrow Agreement

- **Who is the escrow agent?**

  Trend: Use of smaller escrow companies and cloud providers

- **Verification of deposit**
- **Notification of deposits in escrow account**

TIP: **Require vendor make initial and ongoing escrow deposits , not just upon acceptance.**

- **Release triggers: insolvency, failure to support/market, sunset, breach**
- **Licensee's rights on release and upon full payment**

Contract Terms (7)

- **Personnel**
- **Identify the vendor's key personnel**
- **Limits on vendor's ability to replace**

  Trend: Background and security checks

  Trend: Pre-qualification – if so, how?

  TIP: **Right to interview, but watch common law employment issues**
- **Right to replace**

Contract Terms (8)

Force Majeure

A force majeure event excuses a party's failure to perform when failure results from some circumstance beyond a party's reasonable control

TIP: Be careful of "labor and supply shortages"

- **Party's obligation to perform is deemed to be "suspended"**
- ***Trend: Include clause that provides termination right if force majeure continues for a certain period of time***

TIP***: Longer force majeure clauses to detail interaction with disaster recovery obligations***

Contract Terms (9)

- **Disaster Recovery**

  Include a **Disaster recovery plan (back-ups, hot-site, coldsite)**
- **Full or partial restores – how frequently?**
- **Timeframe for returning to service levels**
- **Interaction with force majeure clause**

Contract Terms (10)

- Service Termination
- Customer and Vendor position not symmetrical when faced with nonperformance
- Customer should strive to obtain commitment that:
- • Vendor will not suspend services except in the most limited circumstances
- A “no suspension of services” clause may not prevent all ills
- • A vendor bleeding money may still walk away from contract, notwithstanding clause
- • Courts are loathe to enforce personal services contracts. More likely to award
- damages, subject to contract’s liability cap
- Negotiate an exception to the typical limit of liability clause for damages
- caused by a vendor’s suspension of services

Contract Terms (LAST ONE)

Other Clauses to Consider:

- **Assignment**
- **Applicable law**
- **Insurance requirements**
- **Non-solicitation / non-competition**
- **Order of precedence**

Trend: State Customer's objectives in entering agreement

Trend: Detailed description of functionality / services

Drafting Considerations (1)

Precision and Time References

Precision:

• Draft contracts to precisely reflect the agreements and intentions of the parties

Time References:

- • Specific dates
- • Date based

TIP: Avoid “Promptly,” “with reasonable speed,” etc.

Drafting Considerations (2)

- **Use of Formulas and Materiality**

Use of Formulas:

- • Make sure they work!
- • Written algebraically

Materiality:

- • What does it mean?
- • Subjective concept

Drafting Considerations (3)

- **Structure Issues**
- **Consideration clause**
- **Whereas clauses vs. background**
- **Headings**
- **Definitions**

Drafting Considerations (4)

Tracking changes

- • **Corruption**
- • **Complicated**
- • **User-friendliness**
- • **Control**

DeltaView

- • **Control of document**
- • **Corruption**

Vendor Strategies

- Limit Scope
- Limit Liability
- Limit Warranty

Tools:

Checklists

- **Update checklists and precedent files frequently**
- **to:**
- **• Keep current with technology trends/conferences**
- **• Reflect industry standards and industry trends**

Other purchasing vehicles (Cooperative Purchasing)

Other procurement contracts for languages

FAR Procedures/Guidelines and Best Practices

www.NASPO.org (Nat'l Association of State Procurement Officials)

Procurement and Contract Attorney Consultation ;)

Streamlining

- Prepare
  - Research Business Need Solutions
  - Define Requirements and Deliverables
  - Collect All Information and Engage All Internal Stakeholders
  - Devise Negotiation Strategy
  - Determine Team

RFP

- Description of operations
- Form of contract
- Negotiations procedures and schedule
- Point of contact
- Process
- Presentations
- Evaluation
- Best and Final Process (BAFO)

The Goal

TIP: A <u>balanced agreement</u> is often what results in a successful, long-term relationship!

- **The Goal:**
  - **Maximize competition and leverage**
  - **End with two (or more) complete contracts**
- **Results can be dramatic and surprising:**
  - **Allows vendor comparison on equal basis**
  - **Encourages competition between and among vendors**
  - **Highly efficient if managed effectively**

Case Study in IT Procurement

Procurement Case Study

- Four primary processes involved in any procurement:
  - Planning;
  - Purchasing;
  - Contract formation; and
  - Contract Administration.

Planning

Consider available Procurement Vehicles.

Here is where you need to "cogitate beyond the quadrilateral parallelogram. . ."

Cooperative Purchasing (“Piggybacking”)

- S.C. Code Ann § 11-35-4810.
- E-Government Act of 2002 (44 U.S.C. § 101)
- 1122 Programs for security and anti-drug purchases
- Federal Programs for Higher Ed and Health Purchases
- GSA Schedule 70 Programs for IT Purchases
- Joint Development and post-development sharing
- Interagency Agreements

Planning

Step 1: Identification of Need

Planning

Step 2 - Timing

2) When do you need the good/service?

Planning

Step 3 - How to Meet the Need

Planning

Step 4 - Other State Agencies

4. Examples of items provided by other State agencies:

Service/Good	Agency
Graphic design, printing, photocopying, microfilm, microfiche, fleet services (vehicles), training	State Printing
Legal services	AG's Office
Collections	State Treasurer, etc.
Any information technology, Communication devices & services, computers	ITMO
Furniture, signs, etc.	Dept. of Corrections

Planning

Step 5 - Other State Agreements

Planning

Step 6 – Determine Products/Vendors and Prior Contracts/SOW Development

Planning

Step 7 - Authority

Do you have authority for the procurement?

Planning

Step 7 – Authority (Cont. . .)

Are funds available? - continued

Have all the proper authorities approved the procurement?

Planning

Step 8 - Cost Estimate

8) How much will the good/service cost?

Planning

Step 8 - Cost Estimate (Cont . . .)

- Are the prices set by law or regulation? (Ex. utilities)
- Is there an established catalog and/or market price?

- Remember – The objective is to obtain goods/services at a “fair and reasonable” price.

Planning

Step 9 - Team Members

9. **Forming Your Team**
   - Identify necessary staff and designate a project manager early in the process.
   - The procurement may include both internal and external staff from the following:
     - Program (Provide technical requirements, serve as Subject Matter Experts (SME), first level for monitoring performance)
     - Purchasing (Prepare SOW, prepare and conduct solicitation, draft/issue PO, review contracts for compliance with purchasing requirements)
     - Legal SOW, T&C, etc. review.
     - Budget

Planning

Step 9 - Team Members (Cont . . .)

9. Forming Your Team – continued

- HR (Personal services review, provide guidance for outsourcing versus in-house needs, verify independent contractor status)

TIP: Always consider Common Law Employment issues.

- Contract (Prepare and negotiate final contracts, second level of monitoring performance)
- Other Central Approvers (State Controller, Risk Management, State Engineer or Attorney General's Office, etc.).

20 Factor Common Law Employment Test:

- 1. Must comply with employer's instructions about how to do the work (when, where, how).
- 2. May receive training from or at the direction of the employer.
- 3. Has a continuing working relationship with the employer.
- 4. Provides services that are integrated into the business.
- 5. Provides services that must be rendered personally.
- 6. Hires, supervises, and pays employees for the employer.
- 7. Must follow set hours of work.
- 8. Works full-time for an employer.
- 9. Does the work on the employer's premises.
- 10. Must do the work in a sequence set by the employer.
- 11. Must submit regular reports to the employer.
- 12. Receives payments of regular amounts at set intervals.
- 13. Receives payments for business and/or travel expenses.
- 14. Relies on the employer to furnish tools and materials.
- 15. Works for one employer at a time.
- 16. Lacks a major investment in facilities used to perform the service.
- 17. Cannot make a profit or suffer a loss from performing the services.
- 18. Does not offer the services to the general public.
- 19. May quit work at any time without incurring liability.
- 20. Can be discharged by the employer.

Planning

Step 10 - Identify & Manage Risks

10. Risk? What Risk?

- Part of the planning process includes the identification and mitigation of risks from the procurement of the goods/services.
- Risk assessment is a **living** process that requires a continual reassessment of risks until the contract is fully performed and final payment is made.
- Make an initial determination about the level, type, and amount of management, oversight, and resources required to plan and implement the project from solicitation to contract close.

TIP: Include your legal department here.

Planning

Step 11 - Scope of Work & Specifications

11. Drafting / Outlining

- Start with the SOW/Specifications
  - Deliverables;
  - Personnel requirements;
  - Testing and acceptance criteria;
  - Payment amount and requirements; and
  - Time frames and deadlines.

Purchasing

Been there, done that today!

Terms and Conditions Review

These are excerpts from an actual signed contract I prepared for a vendor to develop a local government POS system . . . .

I. Vendor will perform the following functions:
    - System Analysis
    - Functional Specification Input and Approval
    - System Design
    - Program Construction
    - Documentation of the analysis and design
    - System Implementation
        - End-User Documentation
        - End-User Training

Terms and Conditions Review

Limitations of Scope and Exclusions:

- Specifically excluded from the services provided under this Agreement is the following:
- All software, services, maintenance, licenses, training, support and professional services not specifically indicated in Section I above.
- [PRODUCT] Software, Licenses, Maintenance and Support
- Computer hardware, peripherals, networks, printers, cashiering drawers, credit card machines, modems, and all other equipment needed to operate the software
- Costs, sales and use taxes, usury and other fees, insurance and bonds, escrow fees, travel and lodging for Vendor employees and agents, mileage, per diem and all other out-of-pocket expenses except those directly incurred by Vendor employees and agents in the completion of the services described above
- Software Assurances and maintenance for all software and hardware
- Change orders, add-ons, additions and supplemental services and support of all types not specifically indicated in Section I above.
- All source code, proprietary or ownership interest of any type in the software provided to comply with this Agreement.

Terms and Conditions Review

Price: The price for analysis, design, construction, testing, implementation completion of acceptance shall be Two Hundred Thousand ($200,000.00) Dollars, due upon the following payment schedule:

- $30,810.00 of the contract price shall be due upon delivery of the System Design Specifications.
- $97,170.00 of the contract price shall be due on successful completion of the System installation. This payment if contingent upon satisfaction of Acceptance Criteria.
- $47,795.00 of the purchase price shall be due thirty days after the System is "Ready for production".
- $24,225.00 of the contract price shall be due thirty days after the Agency credit card system is "ready for production".

Terms and Conditions Review

All payments received more than thirty (30) days past the due date shall be subject to a five (5%) percent late fee. Additionally, the moneys past due shall be subject to a twelve (12%) percent finance charge per annum. Should Vendor retain the services of an attorney for collection of any amounts owing under this Agreement, Agency agrees to be liable for and attorneys fees and costs accruing in any collection activities or actions. Nothing contained herein shall be construed to limit available remedies to collect the amounts owed from Agency.

Terms and Conditions Review

- IV. Software Ownership:
- All the parties to this Agreement understand and acknowledge that the software provided hereunder remains the property of Vendor. Vendor is merely granting a non-exclusive, non-transferrable site license to Agency only. No title to or ownership of any such software product is hereby transferred to Agency. Nothing herein shall limit Vendor from reproducing, altering, marketing, selling, registering, or exercising its ownership interest over the software in any manner whatsoever. Should any party to this Agreement come into possession of Vendor's source code, either directly or indirectly by reverse engineering, industrial espionage, etc., the respective party agrees to notify Vendor of its possession and shall destroy, erase or eliminate the source code in its entirety. Agency shall not copy for reproduce any software product in whole or in part, except to make back-up copies for Agency's own use. Agency shall not make such software or any portion thereof available to any person or entity, other than Agency's employees or agents in connection with Agency's use of such software. Agency shall employ reasonable measures in accordance with industry standards in order to protect the proprietary interest of the lawful owners of such software.

Terms and Conditions Review

VI. Restrictions on Hiring Employees:

- For a period of one (1) year from the date of this agreement, the Parties shall not, without the prior written consent of the current Employer/Parties, hire or contract for services with any other Party's employees. The restrictions contained in this paragraph shall also be applicable to the former employees of any Parties' employ for a period of one (1) year after the date of such former employees cease to be employed by one of the Parties.

Terms and Conditions Review

VIII. Failure to Agree upon detailed Acceptance Criteria:

At the time of execution of the Agreement by the Parties, there has not yet been agreed upon a definition with respect to the detailed Specifications, Acceptance Criteria and Project Plan (ie: the appropriate delivery, installation, and performance of the system) or what is meant by the terms "Functional Specification" and the conditions which must be met or exceeded thereunder. Additionally, no agreement has been reached between the parties as to what services must be provided to meet the criteria listed above. It is understood and agreed that no software will be delivered and no obligation to provide software will accrue until the foregoing terms and criteria are defined. If the parties do not agree upon the Specifications, Acceptance Criteria and Project Plan or to the terms thereunder, then this Agreement may be declared null and void by either party upon written notice, in which event the parties will have any additional liability to the others hereto. Further, it is the intention of the Parties to agree upon detailed Specification, Acceptance Criteria and a Project Plan within forty-five (45) days. Once these documents are agreed upon they shall be incorporated by reference and become part of the Agreement between the parties.

Terms and Conditions Review

IX. Breach and Remedies:

If Vendor fails to satisfy the Acceptance Criteria as defined by the parties at a later date, Vendor will be notified in writing within thirty (30) days from the date of delivery of the reasons alleged that Vendor has not met the Acceptance Criteria. Vendor shall have fifteen (15) days from the date of notification to begin to cure the default or defect. Vendor shall have forty-five (45) days to correct the cure, unless the cure is beyond the scope of this time frame due to reasons beyond the control of Vendor. If more than forty-five (45) days are required, Vendor shall subsequently diligently pursue a cure for the default or defect. However, Vendor shall not be held responsible for failures or delays in performance for acts, omissions or circumstances beyond the control of Vendor or its staff. Additionally, if the cure of the defect or default is delayed because of the acts, omissions or any other Parties' failure to comply with the terms of this Agreement, Vendor shall not be held in default. Vendor shall have the right to require Agency to reimburse Vendor at its standard hourly rates for the time spent by Vendor in analyzing all notifications of default or defect that were not the fault or resulting from Vendor's product.

Terms and Conditions Review

XI. Maintenance and Additional Goods and Services:

All support and services provided shall be billed and paid upon a time and material basis after Agency has indicated its acceptance of the product.

XIII. Interferences and Delays:

Vendor will not be responsible in the event of any delay or other interference that is not the fault of Vendor that prevents Vendor from providing the products under this contract to Agency. There shall be no reduction in the contract price if for any reason, other than due to Vendor's fault, that product is not delivered hereunder.

Terms and Conditions Review

XVII. Proprietary Information:

In the course of this Agreement, the Parties shall have access to secret or confidential information, records, data specifications, systems, methods, plans, policies, inventions, materials and other knowledge (confidential information) owned by the other party. All confidential material shall be and remain the property of the disclosing party. All Parties hereto agree that it shall not reveal any of the confidential material to anyone.

Questions?

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