



**Limitation on Liability in Iowa IT Contracting
Report to Iowa Department of Administrative Services
Submitted by SPPG**

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Table of Contents

Overview.....	3
Findings and Policy Implications in Brief.....	4
<i>Assessment Findings Highlights</i>	4
<i>Policy Implications of the Findings</i>	5
<i>Other Related Issues</i>	6
The Issue and Context	6
Limitation on Liability in Other States	7
<i>California</i>	8
<i>Minnesota</i>	9
<i>Missouri</i>	10
<i>North Dakota</i>	10
<i>Tennessee</i>	11
Risk Assessment	13
State Procurement Process	16
Contract Terms and Conditions	18
Options for Iowa in Addressing Limitations on Liability	19
<i>Multipliers</i>	21
<i>Damages with Unlimited Liability</i>	21
<i>Other Considerations in Contracting</i>	22
<i>Contract Specifications on Statement and Scope of Work</i>	22
<i>Risk Assessment by the State</i>	22
<i>RFP Process Considerations</i>	23
Related Issues for Consideration by the State	24
<i>Consistency Across the Enterprise</i>	24
<i>Agency Readiness to Undertake Projects</i>	25
Final Comments	25

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Overview

The debate on whether and how to structure contracts to allow limitations on vendor liability for information technology (IT) goods and services is not new in Iowa or states across the nation. Iowa's discussion has continued for several years, with a recent resolve on the part of IT vendors and Iowa Department of Administrative Services (DAS) to work in tandem to achieve agreement on reasonable contracting terms, including consideration of changes and/or clarification of limitation on liability policy. With the 2007 General Assembly's passage of language requiring DAS and Iowa Department of Management to adopt rules that spell out the limitation on liability criteria, DAS has proceeded, with engagement of the vendors, to begin to develop specifics of the policy.

In an effort to ensure a clear understanding of the state and industry practices and impacts of Iowa's current policy, DAS retained State Public Policy Group (SPPG), a Des Moines-based private consulting company, to conduct a short-term study of the fundamental issues surrounding limitation on liability. This report summarizes the findings of that assessment, conducted during February and early March 2008.

The scope of the assessment was finite, focusing on issues around limitation on liability and state procurement of IT goods and services. This is an important distinction, since the limitation on liability issue may be greater in the IT sector than in other sectors and since the assessment did not delve deeply into several other issues related to IT procurement and contracting processes in Iowa.

SPPG conducted numerous conversations with representatives of IT vendors that have current contracts, have contracted with Iowa in the past, and who have not contracted with Iowa for many years if at all. Vendors represented companies offering the gamut of IT services. Those contacted for this effort typically included individuals who "cover Iowa" and corporate counsel who either work in contracting or in the risk assessment phase.

The study also included discussions with individuals with special expertise who were recommended by the vendors. Contacts were also made with procurement officials in several other states in efforts to gain insights into potential solutions in the area of limitation on liability for IT procurements. Finally, DAS provided valuable background information and context to support the study as well.

This report provides DAS with synthesized information from all of these sources. No specific vendor or source of comment is identified, and anecdotal information, while plentiful, will not be included in this report.

Though the report focuses on needs and shortcomings from the perspective of those participating in this study, the overall attitude of those contributing was very positive, supportive, and appreciative of the effort. Every contact and conversation undertaken to complete this study was completed in the spirit of mutual respect for the position of the industry and the state and of seeking reasonable policy decisions. The IT industry is eager for the state of Iowa to come to a decision on limitation on liability as a significant step toward enhanced solutions and options for IT systems in state government.

Findings and Policy Implications in Brief

Many of the findings will not surprise the DAS reader. The study served to ascertain the level to which a given factor is an issue and provide a level of “reality check” to the state. The key findings are included in this section as a brief overview, as well as the implications for Iowa’s limitation on liability policy. It is important to note that vendors provide different types of services, which translated into nuances related to the overarching issues and potential solutions. Nonetheless, certain issues emerged repeatedly from all vendors, regardless of the specific services they offer. Detailed discussion of the following highlights and other related issues is included later in the report.

Assessment Findings Highlights

- Vendors believe Iowa’s unlimited liability provisions cost their businesses money and cost them business. They willingly participated in the conversations because it is in their best business interests to do so.
- Unlimited liability in Iowa contracts is, first and foremost, a balance sheet issue for vendors. Putting a company worth billions of dollars on the liability line for a contract worth a small fraction of that amount is not an acceptable business practice within their corporate policy. The requirements of the Sarbanes-Oxley Act heighten and call specific attention to that fact.
- Vendors and others explained their rationale that larger IT firms can likely present better or more creative solutions, often at lower costs. None provided hard data to confirm that assertion. However, anecdotal examples were credible as they indicated how companies balance the factors of an ideal versus a minimally-compliant solution with cost factors and overlay those with the anticipated risk factors.
- Many believe that unlimited liability provisions that are unacceptable to large IT firms reduce competition for providing the state with options for their IT solutions. Again, vendors provided no hard data that harm is caused to the state by unlimited liability provisions. There was additional discussion about how small companies are affected by unlimited liability, and whether the unlimited liability policy provides a more level playing field. Vendors believe that companies that submit proposals despite the unlimited liability

provision may often be smaller firms who may lack the level of expertise, may have fewer resources to devote to the project, or who may need the business enough to overlook that provision. They feel the smaller firms may, as a result, propose lesser solutions.

- Iowa is viewed as difficult to work with in RFP and contracting processes, particularly in comparisons with other states. It was noted that Iowa is one of the only, if not the only, state that will exclude a proposal if vendors take exception to any of the terms. The refusal by the state to negotiate is also a barrier. These factors are included in a firm's risk assessment during its early phases of determining whether to submit a proposal.
- Risk assessment processes are fundamental for vendors in their decisions on pursuing a project. Their corporate decisions are made as a result of these analyses, with the local company contact often in no position to influence the outcome. Among the factors that influence the potential vendors' risk analysis is that the state does not conduct a state risk assessment associated with the project or include that information in the RFP for vendors so vendors can more appropriately integrate those considerations and related costs into their proposals.

Policy Implications of the Findings

- For vendors to receive internal approval to submit a proposal in Iowa, the state would need to establish a specific policy that limits vendor liability in ways similar to the private sector.
- Risk assessment is a critical element for both the state and the vendor. Policy solutions must include clarifications of level of risk for both parties, which will lead to more realistic liability limits.
- The procurement process - including development of the desired outcome, the RFP phase, and the contracting phase - plays a significant role in a vendor's risk assessment process. Improvements to this process will also allow vendors to more easily accept higher limits on liability than are found in their private sector contracts.
- As Iowa sets its policy regarding procurement for IT goods and services, Iowa decision makers must reach clarity on its priorities for the outcome: maximum competition, balanced competition between large and small companies or Iowa-based companies, best solution, lowest price, greatest value, lowest risk, high security, and a host of other considerations. Establishing these priorities, or principles guiding the state, will help guide development of Iowa's limitation on liability policy that best serves state government, Iowa taxpayers, and the IT vendor sector.

Other Related Issues

Other issues related to unlimited liability were brought forward in the discussions. While this report is focused on the scope of study set forth by DAS, these related issues also have significant impact for vendors and may require additional attention by the state to fully address optimizing opportunities for vendors to participate in Iowa's procurement process.

- There is currently inconsistency in procurement policy and rules across all state agencies, not only DAS-issued procurements. Other branches of government are also inconsistent with executive branch procurement through DAS.
- Many services and sectors have been covered by the state's unlimited liability provisions. Consideration will need to be given regarding whether the IT sector should be the only beneficiary of revised rules.
- The state currently does not offer IT and other vendors clear indications of the risks to the state associated with proposals it issues, so vendors cannot accurately determine their costs associated with the state's risk.
- There is a significant need for increased flexibility within the state's procurement and contracting processes, terms, and conditions.

The Issue and Context

There is no question that Iowa's unlimited liability requirements are causing large IT vendors to decline to participate in Iowa's state government contracting opportunities. Further, the issue is inextricably linked to other elements of state procurement. Specifically, the state's lack of clarity in identifying and stating risk to the state, the non-transparency of the state's RFP process, and the state's inflexibility in contract negotiations compound the negative balance when a company conducts its risk assessment process to determine whether to submit a proposal in Iowa. Simply stated, it is near-universal among vendors that the Iowa procurement processes make it too difficult for vendors to ascertain the state risks involved in a project, and unlimited liability provisions make it impossible from a business perspective for corporate leaders to allow the company to undertake a project with such significant uncertainties.

That vendors do not see the issue of unlimited liability as a discrete issue implies that a solution bringing about best results may need to address the integrated issues identified in this report.

Vendors believe that conducting business with the public sector should mirror the terms and conditions they negotiate when doing business in the private sector. However, vendors do recognize the importance of accountability to the public, the public trust, and the special circumstances (such as HIPAA or critical services systems) that may enter the scope of certain

public contracts. Some indicate that doing business with Iowa government costs them more than their work in other states and the private sector because of the constraints found in the procurement process and contract terms and conditions. They make the case that limiting liability would, in fact, reduce their costs and allow that reduction to be reflected in lower project budgets.

A significant consideration for vendors is the “one-sided” process and terms and conditions of the contracts in Iowa. Seemingly, all the cards are in the state’s hand, and the lack of limitation on liability is ultimately the card that drives the vendors away from the state. In addition, there is a perception of unfairness because DAS operates under one set of guidelines while other state agencies, elected offices, and branches of government “do not comply” with any consistent rules. There clearly is a lack of understanding that elected offices and other branches of government are not under the authority of the DAS procurement rules.

However, there is a conviction that executive branch agencies should “operate under the same rules.” A number of anecdotes supported the negative experiences of vendors and adverse impact on their business opportunities. Other anecdotes were included in the vendor letters provided to SPPG by DAS which were a part of comments on the draft rules disseminated several months ago.

Vendors do agree, however, that IT procurement is substantially different from other large procurement efforts in the state, such as building construction or transportation projects. Those non-IT procurement processes and terms and conditions in the contracts are typically much more clearly specified and performance and delivery lacks “grey areas” where subjective judgment may become a factor.

Limitation on Liability in Other States

This study sought information from selected states regarding their limitation on liability provisions as well as other considerations faced in their state. In addition, the study sought information from the vendors regarding their perception of how Iowa compares with other states. The national association and several independent subject matter experts were also contacted for their comment.

The magnitude of the issue around unlimited liability is difficult to quantify. Those who track this issue noted that approximately once every two years there is some situation in a state across the nation that could be considered extreme. Experts and industry representatives point out that the state pays higher costs for all IT contracts as vendors include its costs of mitigating unlimited liability in their pricing. Further, managing contract requirements and

performance throughout a project is a better strategy to mitigate a project's failure than contractual unlimited liability provisions.

Vendors, without hesitation, stated that Iowa is among the most difficult, if not the most difficult, state with which to do business. Unlimited liability provisions eliminate many from considering responding to an Iowa RFP. These are decisions made by the risk assessment division of the corporation, many times despite the Iowa-based company representative advocating for the chance to submit despite the liability levels.

In addition, other states engage vendors constructively before a RFP is issued, do a better job of specifying risk to the state, and specify limits on liability. All of these components allow vendors to clearly understand the scope and risks of a process, encourage innovation, and help vendors control costs by limiting liability. More detail will be provided in later sections of this report.

States generously shared information regarding their limitation on liability and how they have constructed their procurement processes. States consulted in this study were California, Minnesota, Missouri, North Dakota, and Tennessee.

California

In vendors' discussions about commercially-reasonable terms and conditions, a number mentioned the approach taken by California. To learn more about how California's IT procurement process works, conversations were conducted with Michael Barth, Deputy Director of California Department of General Services (DGS); Dawn Ford, a procurement officer in California DGS; and Robert Metzger, attorney with Pillsbury Winthrop Shaw Pittman LLP in Los Angeles and who represented industry interests in developing the California language.

The 2X multiplier is one of the key elements cited in vendor discussions of potential limits on vendor liability, with California noted as an example and leader in negotiating standard terms. Both the state officials and the industry attorney contacted in this study noted that the 2X factor was proposed by the California executive branch and was one of the negotiated items. The intent of the 2X multiplier was to provide for covering costs to procure a replacement and implement the project with the replacement, though there was no formal analysis or formula used to arrive at the 2X factor.

Metzger noted the importance of California's negotiations about what would be included in the 2X factor. Negotiations covered what would be included, and what types of claims would remain subject to unlimited liability. The industry argued to calculate the multiplier using the actual price of a contract line item deliverable rather than the price of the total contract.

The terms also contain a provision that allows, in some situations, liability being limited to the amount of the current separate segment of work in an incremental or phased project.

Current thinking in California includes a shift to reduce the limit on liability if there is not a large risk and to disaggregate deliverables when calculating liability. Recent developments indicate there may be further discussions which would adjust some of the terms and some of the procurement process steps. One reason for further adjustments would be to attract better and more innovative solutions of greater value.

Barth believes that the 2X factor is not a benefit to the state in lawsuits. He suggested a better tool to apply would be code language prohibiting punitive damages in suits against the state. He also believes a performance bond coupled with progress payments would be a good approach.

Barth also questioned the wisdom of using a bidding process where lowest price wins to contract. He suggested a value bidding process that considers price, experience, and history of success.

Metzger emphasized that exposing vendors to unlimited liability does not work or save money for the state. The unlimited liability provision increases the likelihood of no or only one bidder on a project and fosters a more contentious approach to performance.

In the California standard language, the theory was that the state would take on a 1X level of responsibility, which was a negotiated item. In more innovative procurements it allows the state to default and be responsible for its actions. For example, if the state does not provide the data to the vendor for a migration contract, the vendor cannot perform. This allows the vendor to terminate the contract for state nonperformance.

According to the DGS officials, the application of different contract terms for IT vendors has been difficult for the state, and other vendors outside of the IT sector do not like contracting under terms of unlimited liability while IT vendors have their liability limited.

Minnesota

Due to time constraints, extensive discussions with Minnesota procurement officers were not feasible. However, it would be valuable for the state of Iowa to explore Minnesota's model for issues involving IT contracts and liability, since vendor feedback indicated that Minnesota employs a flexible system that is amenable to vendors. In brief conversations with Minnesota procurement officers, state procurement staff members indicated that Minnesota uses a unique approach to IT service contracts. They described the state's intent behind this

approach as hoping to allow flexibility with liability language that is more palatable for businesses that promotes competition and participation while still providing the state with adequate protection. For further conversations with Minnesota staff who are experts in IT contract liability, Iowa procurement staff and stakeholders should contact Betsy Hayes at 651-201-2407.

Missouri

Through conversations with Missouri procurement officers, staff indicated that Missouri has different liability provisions, depending on the contract service category. The state does not have one provision stipulating a specific limitation of liability except with regard to bidding software. The state of Missouri only accepts limitations on liability when contracts involve software. This provision was implemented as the result of, as the state describes, difficulty with vendors. Software vendors expressed objections to the language of the general liability provision, which states that the state of Missouri will not be responsible for any liability incurred by the contractor. Missouri officials have not kept records of any vendors who have declined to submit proposals because of any limitation of liability issue, but procurement officers suspect that some vendors opted against engaging in IT contracts with Missouri for reasons of unlimited liability.

The provision for software contract liability now states that the contractor shall be responsible for any and all personal injury or property damage as a result of contractor negligence. However, the contractor is not liable for any injury or damage as a result of state negligence, third party claims against the state for losses or damages, loss of or damage to the state's records or data, or economic consequential or incidental damages, even if the contractor is informed of their possibility. When a vendor submits a limitation provision in its RFP response, generally the state will allow that type of stipulation, as long as the vendor does not limit its liability relative to bodily injury, property damage, or copyright infringement. In the instance that the state of Missouri recovers damages for a default on the contractor's part or other liability, the contractor is liable only for payments referred to in intellectual property and patent and copyright terms; bodily injury and property damage, and software license fees paid.

The state of Missouri does not conduct a formal risk assessment for contracts. The responsibility of the risk assessment is left to the vendor and its standards for evaluating possible threats to the state and vendor.

North Dakota

During the 2005 North Dakota legislative session, Senate Bill 2250 was signed into law and is currently in effect. (Section 32 12.2 15 of the North Dakota Century Code) The Act carves out

a small exception to the general rule that an agency may not contractually indemnify a vendor or third party.

The Act states that if a contract involves the purchase or lease of software, communication, or electronic equipment, and if the director of the Office of Management and Budget and the Attorney General determine it is in the best interest of the state, an agency may agree to limit the liability of a vendor. This determination must be in writing.

In addition, if an agency entered into a contract prior to the effective date of the Act and the contract required the agency to limit the liability of the contracting party, the person who signed that contract will be deemed to be acting within the scope of employment, provided the contract is approved or ratified by the Attorney General and the director of the Office of Management and Budget.

A committee has been formed to review requests for both prospective and retrospective approval. The state has made it clear that requesting approval from this committee should be a last resort. The state's perspective is that it is generally in the best interest of the state to remove the indemnity language. By law, the committee may only approve requests to indemnify a vendor if it is in the best interests of the state. The position of the state is that this is rarely the case. Other than those contracts approved under the process outlined in N.D.C.C. § 32-12.2-15, the state's Risk Management Fund will not cover claims against the state that arise by an indemnity or limitation on liability provision included in a state contract.

The Risk Management Division of the Office of Management and Budget has written sample indemnity and limitation on liability language for use in each contract with the state: <http://www.nd.gov/risk/publications/manual.html>.

Tennessee

Tennessee passed a limitation on liability in its Legislature in 2004. According to Tennessee procurement officers, the issue continued to arise, especially with regard to IT companies. As companies became more sophisticated, they continued to press the issue with the state. The IT companies went to the Legislature and worked out a compromise between the vendors and stakeholders. As was the case in Iowa, the Tennessee Attorney General's office objected to the limitation on liability clause at the beginning of the process and deemed it an unconstitutional provision for the state to undertake.

Within the act that amended Tennessee law to allow a limitation of liability, the bill outlines the following reasons for the change:

- It is in the best interest of public to attract maximum number of qualified vendors when the alternatives would be higher prices or lack of goods or services.
- Companies may be reluctant to bid on state contracts due to unlimited liability.
- The state has suffered from a lack of qualified vendors because of objections to potential unlimited liability.
- Companies who do bid in unlimited liability situations may increase prices of their proposals to cover this situation.

Currently, Tennessee law allows for limitation on liability clauses for IT and telecommunications contracts. Limitation on liability contracts are not allowed for other state contracts unless there is only one bidder or sole source. If there is only one bidder, the vendor can go through the process of approving the limitation of liability through the Commissioner of Finance and Administration. The state is forbidden from accepting any limitation on liability for an amount less than two times the value of the contract without special permission. The rules require special permission from the Commissioner of Finance and Administration for agencies to grant limitations on liability if the limitation is less than two times the value of the contract. In the agency's request for adoption of a limitation on liability clause, the request must include the text of the limitation of liability; risks of liability to the state and the impact on the state by allowing a limitation; conditions in the market which justify a limitation of liability; anticipated impact on the state's procurement if the limitation is not allowed; and identification of agency staff who are familiar with the request.

The state of Tennessee requires that a request for limitation of liability must be made at the appropriate time in procurement process to ensure fairness of procurement or interests of the state in competitive procurements. During the RFP process, an agency can request a limitation of liability after receiving written comments from potential vendors. In this case, the request for a limitation of liability and decision should be made prior to amending the RFP. State agencies can request a limitation of liability at any stage of procurement when the process has failed to provide a qualified vendor.

Tennessee procurement staff stated that both parties agreeing to a limitation of liability of two times the amount of the contract has been relatively successful. Most IT and telecommunications companies agree to this multiplier.

Risk assessments are the responsibility of the state of Tennessee through its state agencies. The state may collaborate with the vendor for assistance in assessing risk to the state. Contract values are established by the maximum liability of the state; if there is not a maximum liability in the contract, the Commissioner determines the value of the contract.

Risk Assessment

Assessing and analyzing risk serves as the decision making process for vendors in determining whether they submit a proposal to the state. If the decision is affirmative, the process continues in determining the type of solution the firm proposes.

A key component of the risk assessment for a vendor is the state's risk. That level of risk plays an important role in deciding if a proposal meets the business' criteria and the elements of a solution that may be proposed. If the state does not clearly identify its risk areas and quantify their impact, a vendor is at an impasse as to how to respond to unknown factors. Unless the state provides this information, a vendor is essentially forced to submit a proposal based on guesswork as to the risk points. This theme recurred time and again in the discussions with vendors.

Added to the lack of information on the state's risk, unlimited liability provisions exponentially increase the uncertainty factor for vendors. Many vendors, if not most, simply decline to accept the risk that comes with contracts with the state of Iowa that reflect both unlimited liability and minimal information on the state's view of the risks associated with a specific project. Again, it is a business decision driven by a balance of factors that create an untenable position of risk for a company.

The unlimited liability provisions and the lack of specific information included in a RFP impact the state - Iowa or any state - in the following ways:

- Vendors are less able to construct and propose a solution that best addresses the problem while mitigating the risks to the state.
- The state will receive proposals based on incomplete information, i.e., the state's areas of risk for the project.
- Proposals received will have cost proposals that are inflated by vendors' costs to cover any possible risks vendors can imagine. Vendors must include these costs in order to justify the unknown risks they would be accepting.
- Competition has been reduced in recent years by unlimited liability provisions in Iowa RFP and contract language. All the firms contacted indicated they have a clear policy that they will not seek work in Iowa where unlimited liability is included in the contract, they look at RFPs on a case-by-case basis and typically recommend against submitting a proposal, or their current contracts with agencies are not DAS procurements or were negotiated prior to or in a different set of circumstances from the period where unlimited liability was required. Some vendors have contracts with other Iowa offices of elected officials or branches of government that did not apply the unlimited liability provisions.

Several vendors cited specific RFPs they declined to pursue because of one or both factors - the unlimited liability provisions and lack of information about the state's risk areas. Unlimited liability, the issue of lack of state's risk information aside, is reducing the number of large IT firms competing on any given RFP to provide Iowa's technology solutions.

- Logic might lead to a conclusion that the withdrawal of many of the large "household name" IT vendors from the Iowa competition results in a reduction in quality of the solutions available to the state. While hard data are not available, the vendors participating in this study make a compelling case. They explain that their capacity, experience, resources, economies of scale, and innovation allow them to bring high quality solutions to states at a reasonable price. Smaller firms who submit proposals in Iowa despite the unlimited liability provisions and lack of information on state risk often do so with less capacity, experience, resources, economies of scale, and innovation. Whether that produces a product of less quality is not determined. That these smaller firms would compete in Iowa is also seen by some as an indication of the bidding firms' policy lacking a rigorous risk assessment process which may result in less-than-ideal and less innovative solutions.
- A related issue is whether smaller firms would be put at a competitive disadvantage if the largest firms were allowed to craft liability provisions and contractual terms and conditions favoring their position. Vendors participating in this study indicated there are many ways for states to address the "level playing field" questions, many of which the state already has in place in its procurement process. Examples of these provisions include the Targeted Small Business program and proposal evaluation criteria calling for selection of an Iowa firm in the case of a tie in scoring.

It is critical to understand the vendors' risk assessment process. While some are more sophisticated than others, all companies undertake a formal process of identifying and assessing risk to their own company. Several points along the path of this process are decision points regarding whether to proceed with developing a proposal. These processes are applied in evaluating both public and private sector business opportunities. It is important to stress that this is a business transaction, and the decisions are made based on the economics of the project in the end.

Ultimately, the risk assessment is instrumental in determining whether a potential project is a good business investment for the company. A number of factors figure into the overall commercial reasonableness of a contract. Limitation on liability is just one of those factors. Typical steps in a vendor's risk assessment process include the following, generally conducted in a step by step process that begins with the RFP and ends with contract negotiations.

Companies have various structures and internal divisions staffed to provide the expertise to produce reliable analysis based on the inputs.

- Initial review of the RFP. Key elements for vendors in this early review are whether the RFP contains unlimited liability provisions. If it does contain unlimited liability provisions, for many vendors, the RFP does not move beyond this point. A second key element in this review is whether the vendor's representative had discussion with the agency before the RFP was issued so the vendor has a clear understanding of the problem and what is expected. A significant number of vendors will not pursue submitting a proposal unless they have been part of pre-release conversations with the agency. Talking to agencies prior to release of the RFP is seen as a risk mitigation step by the vendor. In the initial review phase, some vendors consider the input of local representatives; other firms make their decisions solely on the analysis model they have in place.
- Scope of work, including the services and technology elements required. Vendors assess the alignment of their company's services with the scope to determine how simple or difficult it will be to adapt or develop a solution. This also includes assessment of how specific and clear the requirements are stated.
- Vendor experience in required technology elements.
- Client experience in the required technology element. This is one way to estimate risk to the state and to the vendor. Clients have varying levels of experience in working on technology projects.
- Assessment of client's motivation, decision making record, understanding of realistic expectations, and willingness to make change.
- Client project management and governance, including designating a strong project manager and taking a partnership approach to the project.
- Client ability to complete its assigned tasks and deliver required elements to the vendor on time. If the vendor sees indications that the state cannot or will not be able to support project implementation as needed in a timely manner, it increases the risk to the vendor considerably.
- Client contract terms that add more cost. Some states require vendors to layer risk mitigation tools on top of each other. For example, the contract terms may call for practices that mitigate risk during implementation of the project and also require a high amount of insurance. Both increase cost to the vendor and duplicate mitigation impact.
- Vendor human resources requirements and staff availability and capacity to complete the project on time and within budget.
- Allocation of resources.

- Cost of resources required, including human resources.
- Cost factors in cash flow.
- Cost factors of risk. This includes insurance or other mitigation strategies as well as anticipating crisis or extreme situations and their cost to settle.
- Legal approval, including risk and contract terms.

Vendors emphasize the value to the end product of states undertaking a risk assessment process similar to the private sector for every IT RFP issued. This would enable vendors to respond with more accuracy and tailor their proposals to the stated situation in the procuring agency. However, vendors were not able to identify any state with a workable and comprehensive risk assessment process on which Iowa could model a state risk assessment process. Certainly, by internally assessing risk, a state agency could better mitigate its risk through its RFP specifications, clear and specific contract provisions, project management, and active participation as a partner in the implementation. Vendors believe these steps would effectively eliminate the state's perceived need for unlimited liability provisions in state contracts.

State Procurement Process

While unlimited liability provisions in Iowa contracts are the only decision point for some vendors in their business dealings with the state, most vendors point to Iowa's procurement process in the discussion of how difficult it is to do business with the state. The key issues vendors see with the procurement process include:

- Lack of openness and pre-release planning and input regarding framing the IT problem.
- Lack of specificity in statements of work.
- Lack of specific information about the state's analysis of risk areas.
- Lack of flexibility in RFP and draft contract language. The immovable position of the state on limitation on liability is one of the prime examples of inflexibility.

Vendors are hopeful that the state will address some of the procurement process and contracting issues as they are dealing with the limitation on liability issue. Improvements in the procurement process will help with the question of level of liability of the vendor and will make it more likely that vendors can make a business case for submitting a proposal in Iowa.

Some vendors noted that the state may believe the state will receive more creative solutions from vendors if they issue a RFP that is vague and leaves much to the creative side of the vendor in proposals. On the contrary, this vague statement of work language is constraining to

vendors, leaves them guessing, and results in higher-cost proposals to cover the costs of uncertainty, risk, and time required to re-tool if they “guessed wrong” about what the agency really wanted.

In descriptions of how vendors work with other states in the procurement process, and with their private sector clients as well, it was evident that those states undertake a collaborative approach to identifying the problem and establishing potential broad solutions. In contrast, they experience procurement in Iowa as more of a contentious process, with the state holding all the information until it is released in a written RFP, with vendors left to figure out what the state agency really means by the words on paper.

Elements of other states’ procurement processes were noted as helpful to vendors in their understanding of the state’s need, understanding the state’s risk, in submitting a quality solution, and mitigating risk for their company and the state. They include:

- When an agency is considering issuing a RFP for a solution, the state conducts informal discussions with vendors during the stage when the agency is framing the scope and determining the type of solution.
- When the RFP is issued, discussions continue so that vendors are able to return to the state to clarify state intent or need while vendors are developing their proposed solutions. This goes beyond a bidders conference to include an acceptable process to get additional information as the questions arise. Because the time frame for procurement in these large projects is so long, vendors find that agencies sometimes change their thinking as the process continues, and they need to have that information as well.
- Content of the RFP includes greater specificity in the statement of work, risk analysis, deliverables, agency capability, and degree of active involvement of the agency in the project implementation. This type of information enables vendors to propose solutions that fit the agency’s capacity and achieve the best balance in meeting the requirements of the project.
- Incorporating improvements to the RFP, taking into consideration what is learned from potential vendors during the process, and re-issuing an amended RFP is seen by vendors as a good way to improve upon the array of solutions received by the states through improved clarity of the problem and related needs.
- Prescriptive RFPs and seeking rock-bottom pricing from vendors constrains vendors from proposing preferred, innovative, and leading edge solutions that may be a greater value to the state in the longer term.

It is evident to vendors that the agency processes in procurement are fundamental to the issue of limitation on liability in Iowa IT contracts. In essence, the procurement process and the RFP itself are mitigation tools that significantly reduce the risks to both the state and the vendor.

Contract Terms and Conditions

The state has its interests and those of the people of Iowa that it is bound to protect through its contract terms and conditions. Vendors strongly state that inflexible and one-sided contract terms and conditions are not the best way to protect those interests. The IT sector is united in its voice that discussions, negotiations, flexibility, and contracts that specifically allocate responsibility to all participating parties provide greater protection of the interests of the state and its citizens than refusal to budge from unlimited liability and other rigid contract terms and conditions.

Some vendors view Iowa's terms and conditions as outdated by as much as a decade in some areas. Terms and conditions that create a negative business case for vendors include:

- Unlimited liability. As noted earlier, this is the first decision point for many vendors that keep vendors from offering creative and innovative solutions to complex IT needs.
- Layering of risk mitigation measures. Contracts may include language on the state's acceptance of the vendor's work as a trigger for payment, requirements of high amounts of insurance with the state listed as an additional insured, and other terms that essentially provide redundant and duplicative risk mitigation.
- Contract termination language. The standard state contract language often provides less protection for the vendor in the cases where the state terminates a contract for the state's loss of funding or for other reasons.
- Contract language allocating liability. Liability that is shared encourages the level of technology, innovation, and delivery time of the products.

Vendors reiterate that the state of Iowa needs to be willing to negotiate if it includes options for negotiations in the RFP language and contract language. Vendors have experienced instances of submitting a proposal, yet when the time came for negotiating limits on liability or other contract terms, the state, in reality, was not willing to negotiate. If the state does not intend to negotiate, language indicating state willingness should not be in the RFP. Again, this is a business issue for companies expending resources based on good faith that a solution can be negotiated.

According to the vendors included in this study, the state of Iowa is risk-averse in its approach to its processes to develop IT solutions, its contract terms and conditions, and in its policies

which constrain vendors from proposing what vendors would consider the best solution. The fear of “something terrible” happening in the course of an IT project can be mitigated in far better ways than constraining vendors from giving their best ideas and best value in their proposals and their work. Certainly, including unlimited liability provisions in contracts is perhaps the most effective risk-averse practice to keep IT vendors from participating in Iowa’s market.

Vendors who continue to work in Iowa undertake risk mitigation strategies within their companies. Each of these strategies either adds cost for the IT solution offered, reduces the innovation and complexity of the solution, or both. Some of the strategies and their impacts include:

- Purchasing insurance. Insurance is costly, and those costs must be passed on to the customer, even though there is frequently no justification for the amount of insurance required.
- Purchasing a bond. Similar to the insurance approach to risk mitigation, the cost of the bond must be reflected in the cost of services to the state.
- Limiting liability through vendors working in a partnership, with the primary contractor being a smaller company. The liability, then, is limited to the value of the smaller firm, protecting the multi-billion dollar larger firm from risk.
- Proposing only “tried and true” solutions in response to Iowa RFPs. Vendors reduce their risk by using solutions they developed or have tested to perfection in other applications in other states. This, of course, limits the innovation and creativity for Iowa agencies that might want leading-edge technology solutions or have a state-specific problem.
- Providing “staff augmentation” services. Instead of the vendor being responsible for coming into the agency to implement a project, the vendor simply provides staff with the appropriate expertise to work directly for the agency on a contracted basis for a finite time. This is one of the easiest ways for a company to mitigate its risk - by not taking on the responsibility in the first place.

The state could avoid many of these negative impacts and achieve a broader array of solutions through limiting liability, addressing other terms and conditions of contracts, and enhancing its procurement process to provide additional information to potential vendors.

Options for Iowa in Addressing Limitations on Liability

Vendors welcome the efforts to establish reasonable limits on liability in Iowa IT contracts procured through DAS. Their views may be summed up as “Any limit is better than no limit” so they at least know the boundaries. Even so, IT firms will continue to operate according to

commercially-reasonable terms, and limitation on liability must still fall within those parameters to allow them to participate in Iowa's technology solutions.

Commercially-reasonable contract terms for IT vendors are those that have been established and negotiated in the private sector and under which vendors typically operate, and include:

- Liability for direct damages is limited to the value of a line item in the contract or of the total value of the contract.
- Liability for direct damages is limited to the extent of vendor responsibility.
- Exclusions on the limit of liability for direct damages should be eliminated; exclusions render limits meaningless.
- Unlimited liability for personal injury.
- No liability for consequential or third-party damages.
- No cap for either side on intellectual property.
- No cap for either side on confidentiality.
- Include negotiated warranty of product/service terms.
- Include negotiated specific details of the scope.

Vendors vary on their expectation for terms and conditions in the public sector. Most believe public sector terms should be the same as in the private sector, enabling vendors to bring the same level of innovation, creativity, complexity, and value of solutions to benefit the state and its taxpayers.

The reality of IT vendors' work with public sector is the state's expectation that vendors accept a greater liability, liability for considerations not included in private sector contracting, that the state not accept consequences for its failure to fulfill its obligations under the statement of work, and that the state remain immune to suit by the vendor or any third party. In Iowa, unlimited liability has been added to this list. Given this situation, the upcoming discussion about criteria for limiting vendor liability in Iowa needs to consider the listed private sector commercially-reasonable terms and also include elements of the tradition of IT contracts with the public sector.

Options for consideration in Iowa need to reflect an understanding of balance of cost, risk, and quality of the product. Within each of those elements are numerous other factors that must also be balanced to yield an overall optimal set of parameters under which the state's interests are well served and vendors are able to compete effectively.

Multipliers

A common approach to limiting liability is to apply a multiplier to the value of the contract. While this sounds straightforward, it is not so clear when applied on a day-to-day basis. Additional considerations related to use of a multiplier include the following:

- The number to which the multiplier should be applied.
 - In contracts with adequate levels of specificity, the number can be related to a line item or delivered element of work within a larger contract.
 - Or, the number can be the total value of the contract.
 - Where contracts are renewed or additional phases added to the original contract, the number serving as the basis for the multiplier should be the value of the current phase of the contract, rather than the cumulative amount of the contract since its inception. In other words, the past work that has been accepted by the state is finished; liability should only be considered relative to the new work.
- The size of the multiplier.
 - Vendors use 1x as their standard in private and in public contracts.
 - The farther from 1x the multiplier becomes, the more difficult for a vendor to make a business case for pursuing the project with the state.
 - 2x is seen as “tolerable” by some vendors. The findings of the company’s risk assessment would provide other inputs from which a decision would be made.
 - In cases of highly sensitive systems and data where higher risk is present, some vendors would consider a slightly higher multiplier. However, they believe other mitigation measures - risk assessment, specific contract details and measures, performance measures, and strong project management and oversight - better address those risks. The approach should be one of prevention, rather than legal action if there was a negative incident.
- The type of damages for which the vendor is liable.
 - Vendors agree they may be held liable for direct damages.
 - Indirect, third-party, or consequential should not be the vendors’ liability unless so stated in the negotiated terms of the contract.

Damages with Unlimited Liability

Vendors also acknowledge there are some types of damages for which liability will not be limited in contracts with the state. Those areas may include the following, which would be subject to negotiation:

- Death or bodily injury.

- Intellectual property.
- Confidentiality.

Other Considerations in Contracting

There are other Federal and state laws and regulations that must be considered in developing and negotiating contracts. The state, of course, needs to be aware of those and work within any additional constraints while seeking to make the process and resulting contracts fair and enabling for vendors.

Contract Specifications on Statement and Scope of Work

Vendors strongly suggest that detailed and specific expectations spelled out in the negotiated contract are the best safeguard against performance failure or “something terrible” happening in a project. Iowa contracts are often not specific enough in these areas. Among the minimum specifics that should be included are:

- Individual deliverables detailed.
- Time frame stated.
- Objective criteria for acceptance of the deliverable by the state.
- Project management responsibilities for the state and for the vendor.
- Criteria to trigger change orders.
- Reporting and oversight procedures.
- Level of involvement of the state agency in project implementation.

Risk Assessment by the State

Vendors clearly indicated their concern that the state is unable to accurately articulate its risk when undertaking an IT project. The impact of vendors not knowing the state’s risk areas is additional uncertainty for vendors, which leads to proposed solutions that risk being less than fully effective or less than complete.

Iowa’s procurement leadership has indicated that state agencies undertake minimal, if any, risk assessment steps as part of crafting the scope of a needed IT solution. As the state considers this element of identifying and controlling risk, it will need to look internally regarding the priority of incorporating these processes.

The current uncertainty caused by the absence of a state risk assessment translates directly into higher costs for the state as vendors “cover” uncertainty in additional and more costly mitigation steps.

Options for the state to address this issue - and indirectly address the issues related to limitation on liability - are to undertake an internal risk assessment process as part of developing the scope of the RFP. Just like the private sector, the risk assessment will position the state to be more efficient in its subsequent steps to address the technology problem using a contracted vendor. The findings of the risk assessment would be included in the RFP, enabling vendors to have a clear picture of the state's situation and expectations. The array of solutions, quality of proposals, creativity and innovation of proposed solutions, and value to Iowa and its taxpayers would be the benefits.

RFP Process Considerations

In addition to implementing specific criteria for limiting vendor liability in state IT contracts, adjustments to the RFP process would have significant mitigation impacts on state and vendor exposure to risk. In general, vendors suggest that a more flexible process that included ongoing communication would result in a stronger array of proposed solutions that would bring greater value to the state. This approach to the procurement process in IT solutions would set IT apart from other types of procurement processes for goods and services in the state.

Mirroring the vendors' perspectives stated in an earlier section of this report, titled State Procurement Process, vendors suggest the following be included to improved their proposed IT solutions and mitigate the risks to the state and the vendors:

- DAS and the contracting agencies should engage vendors in informal discussions that would help agencies frame their IT problem and understand the risks to the state.
- The RFP issued may be a draft and include the stated problem and risks to the state. The statement of work would be more developed and specific, rather than vague language that does not provide specific guidance to vendors. Terms and conditions of the resulting contract included in the RFP would include specific limits on liability for the statement of work and the risks identified.
- The RFP would include additional information about agency capacity, staff capacity, and the level of active involvement of the state and key personnel in implementing any proposed solution. This element is important to a vendor's risk assessment and is often one of the elements lacking in a RFP.
- A bidders conference would not be the only opportunity for vendors to continue to clarify the needs and expectations of the state as the state continues to adapt its development of the concept and problem.

- A revised/amended RFP would be issued from which vendors would design their proposed solutions. The revised RFP would include the final specifications on limitation on liability and other key terms and conditions of any resulting contract.

Of course, measures would need to remain in place to ensure equity among all IT vendors, large and small, in access to participating in each stage of the procurement process. The state would also need to consider how any challenges or appeals would be handled under a changed and more communicative procurement process. Those responsibilities would remain with the state.

Related Issues for Consideration by the State

This report has focused on the issue of limitation on liability for IT vendors competing in the DAS procurement process. With that understanding, the content has offered insight into liability, contracting, and the procurement process as inextricably-linked factors in addressing limitation on liability. However, other issues were consistently mentioned in the discussions with the participants in this assessment. In the spirit of providing a complete picture of the broader issues, this section of the report includes several related issues for the consideration of the state as it seeks practical solutions to the concerns of the IT vendor community.

Consistency Across the Enterprise

Many vendors indicate a problem of near-equal magnitude as unlimited liability in their efforts to work in Iowa. This is the issue of inconsistency in Iowa's procurement, contracting processes, and contract terms and conditions. Vendors expect consistency for their own company's benefit as well as in consideration of potential "different rules for different companies" perception that occurs when a state agency uses processes and rules different from DAS or vice versa.

It makes sense to IT vendors that working with the state in Iowa should mean that everyone uses the same processes and rules. This current piecemeal system was created as a result of allowing state agencies to conduct their procurement independent of DAS. Vendors urge some consideration of making procurement processes the same across all agencies, whether that involves rules changes or legislation. Limitation on liability, procurement processes, and uniform parameters for contract terms and conditions are the minimum areas where consistency should be sought.

An additional consideration relative to consistency is that of the application of limitation on liability provisions to contracts in other sectors. Issues of consistency and fairness may be created where there are none now if there are special rules regarding liability applied for a single sector.

Agency Readiness to Undertake Projects

Success in implementation of IT projects is largely dependent on the state agency, its existing IT capacity, and its staff preparation. A significant risk factor, and frustration in implementation for some vendors, is that state agencies are not able to perform to the level required to support the vendor's required scope of work.

Elements of this concern include lack of staff, lack of staff with the right expertise, low priority for attention to the project, failure to deliver needed support and state deliverables (such as data) to the vendor in a timely manner, low level of support by agency leadership, and inadequate project management by the state staff.

On the surface, one might think these are problems of the agency and vendors should not be concerned. However, these agency-focused concerns are real factors that impact the vendor in the risk assessment phase. If the agency's capacity is an unknown, that is a negative element in the decision to proceed to the proposal development phase. The many elements of state agency readiness to undertake a project, and manage the change it brings, are more acute in the project implementation phase.

Vendors suggest that RFPs include a level of detail that shows that the agency has addressed the elements required for a vendor-agency partnership to be successful in implementation. Though this is most likely outside the purview of any DAS remedies to limitation on liability and its related issues, it was frequently cited as a risk and/or problem for many vendors.

Final Comments

A number of vendors and experts consulted in this study indicated movement toward recognizing the California model as an acceptable public sector standard for limitation on liability. While they did not necessarily fully embrace the California model, they agreed it represents progress.

For Iowa, consideration of this model may be a starting point for the state. Even so, the complexity of the limitation on liability issue for Iowa spans issues from attitude to working technology. There is no simplistic answer or wholesale transfer of another state's solution to Iowa.

The IT vendors and experts whose voices are represented in this report are supportive of the effort and will remain actively engaged with the state in the next steps. As the state moves forward, it is important to keep in mind several critical points:

- Vendors must continue to operate from a business position and seek commercially-reasonable terms and conditions.
- Risk assessment is equally important for the state and the vendor. Lack of information about the state's risks mean the risk for the vendor, along with the cost of a solution, goes up.
- Unlimited liability is negatively impacting the innovation, creativity, complexity, value, and quality of solutions offered to the state.
- Flexibility and a view of the relationship as a partnership between the state and the vendor are fundamental to successful contracts and IT solutions.
- Steps to improve Iowa's IT solutions involve inextricably-related issues of limitation on liability, procurement processes, and contracting terms and conditions.

As a reflection on the many comments offered and a synthesis of vendor concerns into potential solutions, consideration of a structure that includes the following parameters may be viable for further discussion.

1. Limitation on liability might have a floor and ceiling for liability, with the state responsible for stating the liability in the RFP along with the rationale justifying that limit.
2. The floor would be a multiplier of 1X and apply to typical, simpler IT projects. The ceiling would be 3X and apply only to projects with the highest risk and most sensitive data involved. Most projects would fall in the 1X to 2X range.
3. The multiplier would apply to direct damages. The base would be the total amount of the contract or the current phase or extension of the contract. In large contracts, the base could be negotiated and related to key deliverables.
4. Unless negotiated and specified in the contract, indirect, third-party, or consequential damages should not be the vendors' liability.
5. Unlimited liability would remain for death or bodily injury, intellectual property, and confidentiality suits.
6. The specific multiplier and rationale described in item 1 above would be determined by the state after a hybrid of a state agency internal risk assessment and informal information gathering and discussions available to all vendors. These elements may not be finalized until a later version of the RFP is issued.
7. The RFP process would be approached in a more open manner to foster innovation, value, and the broadest array of solutions.

8. Contracts would include a number of negotiated elements and would be required to include additional specifics that serve to mitigate risk and enhance performance to the equal advantage of the state and the vendor.

The synthesized solution outlined here shifts the elements discussed by vendors together into a configuration that allows a new discussion to begin. This solution was not developed by any of the vendors, but hypothetical components of it were posed as part of individual discussions.

In tandem with the above steps for consideration by DAS to address the issues, additional issues should be considered broadly by the state, addressed, and applied to all state agencies. These additional issues extend beyond the purview of the Department of Administrative Services but should be addressed by the appropriate governing authority.

1. Establish a procurement process that applies to all state agencies, regardless of whether they conduct their procurement through DAS.
2. Implement risk mitigation measures for IT projects to include, at minimum, an initial information gathering process with vendors to help the agency better understand their problem and identify state risk points.
3. Develop more specific and consistent terms and conditions for all state contracts that serve as risk mitigation elements. Some of these may be standard language; others will need to be project-specific and/or negotiable.
4. Apply limited liability and the other procurement and contract practices to all vendors, regardless of sector, to ensure fairness and competition across all procurements.

As this study concludes, the vendor community is poised to continue the discussion with the state. The state will be successful in addressing its IT contract and liability issues through seeking a reasonable balance of risk, cost, and quality of the product.