

Building Better IT Procurements: Reforming Contract Terms and Conditions

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BACKGROUND

- **TechAmerica Issued White Paper in March 2009**
 - “Transforming Procurement for the 21st Century: Reforming Contract Terms and Conditions to Improve Procurement Environments and Outcomes”
 - Presents input from IT industry regarding terms and conditions (T&Cs) used in complex IT contracts awarded by state and local governments
- **TechAmerica**
 - Leading voice for US technology industry – formed in 2008 by merger of Information Technology Association of America (ITAA) and American Electronics Association (AeA)
 - Approximately 1,500 member companies from the public and commercial sectors
 - Public Sector Group – serves the needs of the systems integration industry and works to provide a voice for the IT community

AGENDA

- State/Local Governments' Growing Need for IT Solutions
- The Case for Transformation Enabled by IT
- The Trouble With Terms and Conditions
- Benefits of Commercial T&Cs
- Procurement Provisions of Greatest Concern
- Recommendations

GROWING NEED FOR IT SOLUTIONS

- IT services and supplies increasingly important to state/local governments (SLGs)
 - INPUT: SLG spending to grow to \$72 million by FY 2011
 - Eclipsing even the federal government as a buyer of IT goods and services
- Scale and complexity of IT projects are compounding
- Demographic and financial challenges complicate challenge of deploying IT solutions for SLGs
 - Increasing number of federal/state mandates
 - Rising demand for services and benefits
 - Tight budgets: demand will outpace funding
 - Client and citizen expectations are growing
- Acquisition of timely, value-adding IT solutions is critical to SLGs ... but procurement processes are ineffective and, in some cases, may deter competition or increase cost to SLGs

TRANSFORMATION THROUGH INFORMATION TECHNOLOGY

- Thoughtful SLG leaders must look to transform government through innovations in both business practices and IT solutions
- Industry participation and commitment are essential to capture best practices in an innovative, cost-efficient fashion
- Procurement processes have moved away from a balanced partnership with industry
 - Less flexibility, less communication, less trust
- Result is that true innovation – and transformation – are significantly more challenging and risky for industry
 - Less competition, less timely procurement, less innovation

TROUBLE WITH TERMS AND CONDITIONS

- Contract T&Cs present challenges, frustration, and wasted resources ... with little connection to business value or financial reward
- Allocation of risks and costs that are disproportionate to potential gain negatively affects SLGs
 - Only vendors with insufficient expertise or assets bid
 - Experienced vendors bid higher prices or elect to act as subcontractors
 - Procurement process delayed by extended negotiations
 - Vendors take robust, costly protections against excessive risk exposure
 - Disputes more likely during contract performance – no margin for changes or mistakes
- Experience shows that relationship where one party bears a disproportionate share of the risk is, in the end, not satisfactory to either party and not likely to be continued

BENEFITS OF COMMERCIAL T&Cs

- Decreasing cost to drive best value for the customer
- Attracting more, and better qualified, vendors to bid on projects
- Expediting the procurement process
- Aligning the SLG with best practices in procurement
- Improving the customer-vendor relationship

PROCUREMENT PROVISIONS OF GREATEST CONCERN

- ***Limitation of Liability***

- Mississippi v. AMS (2000): \$474-million jury verdict for state on IT contract valued at \$12 million – limitation-of-liability clause in contract unenforceable
- NASCIO (2004): contracts should not be drafted to create unlimited liability for IT vendors
- Iowa (March 2008): “no question that Iowa’s unlimited liability requirements are causing large IT vendors to decline to participate in Iowa’s state government contracting opportunities”
- Reasonable, enforceable limits on contractual liability are necessary and fair
 - Limitation of liability for direct damages
 - Disclaimer of liability for indirect, consequential, special, and punitive damages

PROCUREMENT PROVISIONS OF GREATEST CONCERN

– *Performance Bonds*

- Surety market has reduced the amounts and types of performance bonds available to vendors
 - High-value and extended-term bonds difficult to secure
 - Companies often must partially or fully collateralize bonds with letters of credit – reduced liquidity for the corporation
 - Significantly increased costs for performance bonds – e.g., 40x cost in 2002-2003
- Some SLGs demanding bonds at 100% of contract value – using bond as insurance policy against political risk, rather than a guarantee that a project will proceed despite a defaulting contractor
- Smaller companies excluded
- Large companies pass cost of bond (including collateralization) onto SLG – significant cost for marginal payoff

PROCUREMENT PROVISIONS OF GREATEST CONCERN

– *IP Ownership*

- IT vendors must be permitted to protect their IP and leverage what they learn for future engagements
- IP ownership by SLG is rarely necessary or in the public interest
 - Delivery of supplies and services does not require ownership
 - Becoming potential competitor of vendor is counter-productive and, in most cases, unrealistic
- SLGs should acquire no greater ownership and no more rights in IP than are necessary to achieve project goals
- Generally, a broad license from the vendor to the SLG is sufficient to protect the public interest

PROCUREMENT PROVISIONS OF GREATEST CONCERN

– *Indemnification*

- Indemnities for third-party claims for IP infringement, personal injury, and damage to property are not unusual
- Problem is broad indemnification clauses that cover all types of contractor action or inaction, including breach of contract

– *Most Favored Customer Pricing*

- Contractual commitment of this type is not necessary or advisable
 - Competition ensures fair and reasonable pricing
 - Lowest price is not always desirable in “best value” procurement
 - Obligations are extremely difficult (if not impossible) for IT vendors to manage
 - » Perfect knowledge of pricing on prior contracts?
 - » Monitoring prices prospectively on thousands of contracts?
 - » Identifying contracts that are “the same” or “similar”?
 - » Applicability to solutions contracts vs. commodities?
- SLGs much more likely to gain competitive pricing through a robust procurement process

PROCUREMENT PROVISIONS OF GREATEST CONCERN

– *Warranty*

- Obligations must distinguish between (i) generally available hardware and software, (ii) vendor services, and (iii) third-party hardware and software
- Scope of clause should be appropriately limited – timing, remedies
- Standards should be objective and clear (e.g., “materially complies with the specifications set forth in the contract”) rather than subjective and ambiguous (e.g., “satisfies the buyer’s needs as set forth in the RFP, the proposal, and the contract”)

– *Liquidated Damages*

- Properly constructed clauses can be legitimate tool, but overly rigid or punitive clauses are counter-productive
- Clauses that allow for multiple damage assessments to be triggered by the same event, or that fail to cap available damages, are likely to fall outside vendors’ acceptable risk profiles
- Provide performance credits in lieu of money damages?
- Provide mutuality in terms of “bonus payment” for early delivery?
- Provide ability to “earn back” damages associated with incremental milestones if subsequent milestones are met?

RECOMMENDATIONS

- TechAmerica urges state and local governments to:
 - Take steps that will inform them of vendors' concerns with existing IT agreements
 - Consider lessons learned from the experience of other governments, including federal agencies
 - Support the creation of a new, proposed set of model terms and conditions for IT procurement
- Vendors and SLGs should work together to modernize procurement approaches and develop T&Cs that, while respecting the public trust, present commercially acceptable business risk to vendors