Comparative Review of State IT Procurement Practices

prepared for the

NASPO IT Procurement Work Group

by

Richard Pennington[1]

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[1] Richard Pennington is a life member of NASPO. At the time this whitepaper was prepared, Richard was Of Counsel to McKenna Long & Aldridge LLP in the Denver office. The firm is a member of TechAmerica. This paper does not reflect the views of the firm, TechAmerica, or any client. While this whitepaper content is informed by the author's 27 years of experience representing and collaborating with various government and private clients, as well as associations, only the NASPO IT Procurement Work Group participated in its development.

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In June 2010, the Information Technology ("IT") Work Group of the National Association of State Procurement Officials (NASPO) surveyed the states regarding selected practices in IT procurements. This whitepaper is a comparative review of state practices.

BACKGROUND

This whitepaper identifies and compares state practices in IT procurement regarding indemnification and limitation of liability, rights in intellectual property, warranty, use of performance bonds, and negotiation of vendor-proposed exceptions to standard terms and conditions. This background section summarizes the history of the problem, the NASPO IT Procurement Work Group's development of its survey, and the approach to this whitepaper.

History of the Problem

Since the passage of the Sarbanes-Oxley Act, states increasingly have been challenged in IT procurements by vendor requests to negotiate liability allocation, warranty, and intellectual property rights contract clauses. NASPO's flagship publication, *State and Local Government Procurement: A Practical Guide* (NASPO's "*Practical Guide*") identified emerging issues, including one related to terms and conditions. As states' procurements get more complex, "procurement officers will likely face increased opposition by vendors, particularly the largest ones, to terms and conditions that those governments may have included in their contracts for a long time."[2] Moreover, there is a recognition that suppliers may decide not to compete if they consider clauses too onerous.[3]

The Western States Contracting Alliance (WSCA) launched an initiative that focused on these issues and involved attorneys advising the WSCA states. NASPO formed an IT Procurement Work Group, and NASPO membership was briefed on liability allocation and intellectual property rights issues at the 2008 NASPO Annual Meeting. The topic was included in both the 2009 and 2010 NASPO Marketing Meetings.

In 2008, the state of Iowa commissioned its own study of limitation of liability and published a report summarizing best practices. In 2009 - 2010, the state of Oregon worked with TechAmerica[4] to complete its own review of terms and conditions.[5] In 2010, the National

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[2] National Association of State Procurement Officials, *State and Local Government Procurement: A Practical Guide*, p. 248 (NASPO: 2008).

[3] Kirk Buffington and Michael Flynn, *The Legal Aspects of Public Purchasing, 2d. Ed.*, p. 82 (NIGP: 2007).

[4] TechAmerica is an industry association comprised of over 1,200 U.S. technology companies. The author's firm, McKenna Long & Aldridge LLP, is a member of TechAmerica.

Association of State Chief Information Officers (NASCIO) completed a survey of limitation of liability policies established by its membership. The survey results revealed that many states had established policies permitting negotiation of limitation of liability clauses.[6]

Work Group Survey of IT Procurement Practices

The Iowa and NASCIO national reviews, in particular, stopped short of what the NASPO IT Procurement Work Group hoped to achieve in terms of a comprehensive review of liability allocation, warranty, and intellectual property policies in the states. Moreover, given the apparent amenability of some states to negotiate these contract provisions in procurements, the Work Group also wanted to identify procurement process approaches that could be used to reach agreement on reasonable terms.

The Work Group decided that it would be unrealistic to expect that states would agree on a standard set of terms and conditions. As one can see from the IT Procurement Work Group survey responses, state model terms and conditions are mature, internally integrated, and reflect unique state laws. As a consequence, the Work Group decided that the preferable approach was to develop a survey of state IT procurement practices and make the policies, contract terms, and solicitation provisions available to NASPO. States were asked to submit model solicitation and contract provisions in IT procurements; 25 states responded to the survey. States were asked whether proposals were rejected or vendors disqualified if they took exception to state contract clauses governing:

- Indemnification
- Limitation of liability, including caps of liability and exclusion of damages, e.g. consequential, special, indirect and incidental damages
- Intellectual property rights
- Warranties and disclaimer of implied warranties
- Terminations for convenience or unavailability of funds
- Requirements for performance bonds

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[5] Oregon's challenges are somewhat unique. Oregon's judicial decisions have essentially eliminated the tort liability caps for Oregon public entities under the Oregon Tort Claims Act. Oregon's terms and conditions, in particular, may warrant special attention because they were developed after considering comments from TechAmerica.

[6] Links to the Oregon, Iowa and NASCIO studies are published on the NASPO IT Procurement Work Group Web site.

Approach of this Whitepaper

This whitepaper is intended to compare and summarize the varying approaches found during the survey; it was prepared using the written survey responses.[7] This whitepaper identifies language that can be helpful in negotiations[8] and avoids wholesale, verbatim recitations of entire contract clauses.[9] Enough verbatim language is included so the survey responses can be searched and language located.

Individual state law requirements vary, of course, and some approaches identified in this whitepaper may not be available under the laws of all states. In responsiveness issues in particular, recent judicial decisions have illustrated varying state laws. New Jersey, for example, apparently has statutes that define responsiveness in a restrictive way that has been applied by courts to requests for proposal ("RFP"). On the other hand, in Pennsylvania, the 2010 *Language Line* case[10] construed the requirement for responsiveness to an RFP as requiring only timely submission of a signed proposal. As this whitepaper illustrates, the concept of "technical unacceptability" of proposals used by some states may be somewhere in between.

NASPO's *Practical Guide* describes competitive sealed proposals as a solicitation method that permits discussions and negotiations with vendors, as well as an opportunity for proposal revisions when in the best interest of a state.[11] This whitepaper highlights those solicitation practices that facilitate some negotiation of terms and conditions in the context of a competitive solicitation. This whitepaper also identifies contract language used by the states that could be useful, concessionary positions that may promote agreement during negotiations. Some of these practices mirror negotiated approaches used by industry in negotiations between commercial entities. In general, many state solicitations include language that permits rejection of nonresponsive offers and indemnity provisions, and because those kinds of terms are widely available, they are not covered.

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[7] While Colorado has not yet responded to the survey, the author is familiar with provisions used by the state of Colorado in recent solicitations, and some provisions are cited where appropriate. (Colorado is a Model Procurement Code state.)

[8] Especially helpful references are included in footnotes. For example, the North Dakota and South Carolina model contract terms and conditions include commentary regarding use of various provisions. The South Carolina terms and conditions include citations to federal General Accountability Office decisions relevant to issues like responsiveness and definitive responsibility criteria. It is not unusual for state courts to look to federal law and precedent for guidance in unique public procurement issues.

[9] NASPO has an expanded version of the draft whitepaper containing full text of clauses and the Colorado appendices.

[10] *Language Line Services, Inc. v. Department of General Services*, No. 1694 C.D. 2009, 2010 WL 744236 (Pa. Commw. Ct., Mar. 5, 2010).

[11] National Association of State Procurement Officials, *State and Local Government Procurement: A Practical Guide*, p. 111 (NASPO: 2008).

SUMMARY OF CONCLUSIONS

States have a range of approaches to these issues, and this whitepaper highlights the differences. This section summarizes the key conclusions that can be drawn regarding IT procurement practices identified by the survey.[12]

Indemnification

States do not indemnify the contractor. Most states use broad form indemnification provisions, and some use limiting language to exclude indemnification by the contractor to the extent the state is at fault. Provisions permitting contractor control of defense, and cooperation by the state in the defense, are common.

Limitation of Liability, Including Caps on Liability and Exclusion of Damages

More states than expected have capped liability in some solicitations. Among those states that have capped liability, liability caps of twice the contract value are more common than caps equal to the contract value or caps in excess of twice the contract value.

Of the limitation of liability clauses submitted, most cover general contract indemnity but exempt from their operation claims or liability arising out of intellectual property infringement and claims or liability arising out of bodily injury (including death) and damage to tangible property. Even in the commercial environment, these are often negotiated exceptions to limitation of liability clauses because the risk either is insurable or acknowledged to be totally within the contractor's control.

Intellectual Property Rights

Of the clauses submitted that allocate intellectual property rights, the clauses generally allocate ownership (as opposed to license rights) based on whether the state has funded development. Some states only take license rights, and those that retain ownership acknowledge the additional rights of contractors and subcontractors in commercial off-the-shelf software or intellectual property developed at private expense. Some states distinguish between rights in the "media,"(e.g. a computer software disk) and the underlying intellectual property. The state retains ownership rights in the former, license rights in the latter.

As a minimum, the states should obtain unlimited, irrevocable, worldwide, perpetual, royalty-free, non-exclusive licenses to use, modify, reproduce, perform, release, display, create derivative works from, and disclose the work product, and to transfer the intellectual property to third parties for state purposes.[13]

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[12] Especially with respect to RFP evaluation, discussion of terms, and proposal revisions, only North Dakota provided written procedures. States were asked instead to provide the contact information for persons familiar with these issues and the negotiation process used by the state.

[13] The Federal *Common Rule* and other federal agency requirements may specify minimum rights in federally funded procurements.

States include intellectual property indemnity provisions in contracts where the Uniform Commercial Code warranty of title (and against infringement) does not adequately protect the state, e.g. service contracts for software development.

Numerous states permit exclusion of consequential, indirect, incidental and special damages, a practice that appears to be consistent with industry practice.

Warranties and Disclaimer of Implied Warranties

Among states responding to the survey, most warranties extend the period within which defects may be identified, with warranty periods ranging from 90 days to 3 years, with 1 year the most common period. Although two states include a standard implied warranty disclaimer in their model terms and conditions, most states do not.

Some states include explicit provisions requiring assignment to the state of warranties extended by subcontractors.

Terminations for Convenience or Unavailability of Funds

All states who responded have contract clauses conditioning state performance on availability of funds. There may be some room to clarify funds availability conditions that are based on funds being made "available" or "allocated," administrative steps after the appropriation that may cause vendor concerns. Consider integrating milestone deliverables and progress payments with state appropriations and administrative allocation of funds processes so vendors have some practical assurance of payment for completed performance.

Requirements for Performance Bonds

For the majority of states who submitted relevant clauses or policy, no performance bond requirements are prescribed by state statute or rule.

Exceptions to Terms and Conditions and the Negotiation Process

The last section of the whitepaper summarizes the limited information available in the survey responses regarding the rejection of proposals that take exceptions, the states' processes for negotiating terms in the context of a formal solicitation, and the related issue of post-award negotiation of terms and conditions. There apparently is some negotiation during solicitation and evaluation; states' survey responses imply existence of a flexible approach to responsiveness on RFPs. But the survey responses do not fully explain how those provisions are negotiated, and the timing of those negotiations. Instead, states generally provided the Work Group with contact information to permit additional follow-up discussion.

Two states – Colorado and North Dakota, both of which have adopted versions of the Model Procurement Code – have laws and rules that:

- permit vendors to identify exceptions to terms and conditions;
- allow the state to evaluate the effect of those exceptions; and

- provide a means to discuss the issue with the vendor and invite/require proposal revisions to make the terms and conditions acceptable to the state before final evaluation and award. Those states also limit the permissible scope of post-award contract negotiation.

South Carolina likewise has sophisticated policy and training guidance that demonstrates the use of discussions and proposal revisions under some circumstances.

This paper does not discuss the challenges posed in terms of resources from using this flexibility, assuming a state's laws permit some negotiation of terms and conditions. For example, the evaluation/negotiation of these terms and conditions may require legal resources, can involve evaluation committees in tasks they are not especially qualified to perform, and often prolongs the source selection process. Yet, the existence of RFP practices that permit (but discourage) exceptions to terms and conditions, allow for discussion of the terms, permit proposal revisions, and evaluate exceptions, may be of interest to some states and are discussed in this whitepaper.

LIABILITY ALLOCATION, WARRANTY, AND BONDING PRACTICES

Most state survey responses included solicitation and contract language relevant to these issues. As has been noted, there is an abundance of state language requiring indemnification, informing vendors that proposals may be rejected if they do not follow solicitation instructions, etc. Given the widespread use of such solicitation terms, this whitepaper does not analyze all those state practices comprehensively. Instead this whitepaper identifies significant variations in practice that may be useful in achieving successful procurements or negotiated agreement.

Indemnification

There are two fundamental aspects of indemnification. On the one hand, contractors sometimes request indemnification by the state in negotiation; broad indemnification by the state is almost universally prohibited. On the other hand, contractors may object to common state clauses requiring indemnification of the state by the contractor.

Indemnification by the State

States generally do not indemnify contractors. In some cases -- real property leases, for example -- a legislature may authorize indemnification but only to the extent the liability is waived by the state under the governmental immunity act.[14]

The Commonwealth of Massachusetts includes a unique provision implying that indemnity by the Commonwealth may be permitted under some circumstances. "Any

[14] See, e.g., Colo. Rev. Stat. Ann. § 24-30-1501 (authorizes limited indemnification in real property lease where the state is a tenant and the provision is approved by the office of risk management; indemnity is limited by the Governmental Immunity Act, so the statute permits indemnification of some tort claims up to $600,000 per incident).

indemnification of the Contractor shall be subject to appropriation and applicable law."[15] The State of Oregon uses riders to commercial software maintenance agreements and software license provisions that contemplate inclusion of indemnification provisions in commercial agreements. The rider explicitly states that "Agency's obligation to indemnify is subject to the limitations of . . . the Oregon Constitution and the Oregon Tort Claims Act."

Indemnification of the State by the Contractor

Almost all states use a clause that requires the contractor to indemnify the state and provide a defense against any claims, liability, or damages arising out of contractor performance. Most state indemnification provisions are developed as a matter of policy and not prescribed statutorily.

South Dakota's response included a typical, broad form indemnification provision:

> The Consultant agrees to indemnify and hold the State of South Dakota, its officers, agents and employees, harmless from and against any and all actions, suits, damages, liability or other proceedings that may arise as the result of performing services hereunder.[16]

One issue for contractors is the extent to which this indemnity applies to third party claims that are based on state actions, in whole or in part. Minnesota's clause explicitly makes the indemnity applicable to actions where the state may be at fault, applying the indemnity to "all claims or causes of action, including all legal fees incurred by the State arising from the performance of the Contract by the Contract Vendor or its agents, employees, or subcontractors," but the indemnity "does not include liabilities caused by the State's gross negligence or intentional wrong doing of the State."

California's indemnification provision also is a fairly typical limited form indemnity. The California form explicitly adds a defense obligation and attorneys fees, and limits the contractor's indemnity to contractor "willful misconduct or negligent acts or omissions."

Some states like California explicitly include subcontractor actions within the scope of the contractor's indemnification. South Dakota's contract terms require a "flow down" of the indemnification clause so that subcontractors are contractually obligated to indemnify the state: "The Consultant will include provisions in its subcontracts requiring its subcontractors to comply with the applicable provisions of this Agreement, to indemnify the State . . ."

North Dakota has a range of indemnification provisions, use of which is based on different characterizations of risk. The state uses a "matrix that helps agencies select the

[15] Citations are omitted unless quotes are not taken from survey responses. Text in survey responses can be located using the search functions and the partial quotations.

[16] Note below that North Dakota also has an alternative form used in IT contracts that limits the indemnity to claims based on the "vicarious liability" of the state.

appropriate indemnification clause." The matrix is unique in that it has paired indemnity and insurance provisions for the various categories of risk.

Various limits on the Contractor's Indemnity Obligation

During negotiations, contractors attempt to limit the scope of their indemnity obligation. The following are typical approaches that are reflected in some states' terms and conditions.

Limiting Indemnity to Fault of the Contractor

Contractors may negotiate to limit the contractor's indemnification obligation by expressly limiting the indemnity to claims or liability to the extent caused by the contractor. Minnesota's indemnification expressly applies to claims where the state may be at fault, but "does not include liabilities caused by the State's gross negligence or intentional wrong doing of the State." New Mexico's indemnification provision, on the other hand, limits the contractor's indemnification obligation to contractor negligence, requiring indemnity for "actions, proceedings, claims, demands, costs, damages, attorneys' fees and all other liabilities and expenses of any kind from any source which may arise out of the performance of this Agreement, caused by the negligent act or failure to act of the Contractor, its officers, employees, servants, subcontractors or agents."[17]

Contractors want to exclude liability that arises from acts by the state. In New Mexico's case, "Neither party shall be responsible for liability incurred as a result of the other party's acts or omissions in connection with this Agreement." South Dakota's model indemnification provision has a more narrow exclusion that may be useful as an initial state negotiating position: "this section does not require the Consultant to be responsible for or defend against claims or damages arising **solely** from errors or omissions of the State, its officers, agents or employees." (emphasis added) Oregon's general indemnify similarly excludes claims or liabilities "attributable solely to the acts or omissions of Agency or the State of Oregon."[18] These more favorable (to the state) provisions require the contractor to indemnify unless it can prove that the state was solely responsible for the damage or liability that led to the claim. North Dakota's alternative form of indemnity used in IT contracts excludes "claims based on the State's

[17] Use caution in negotiating revisions to indemnification language that condition the indemnity using characterizations of fault using terms like "negligent." Indemnity provisions generally are strictly construed. The intended applicability of contractual indemnity to "willful" acts may be ambiguous if "negligence" is specified as the standard of fault. Moreover, some liability theories do not require a showing of negligence. Breach of warranty theories may not require a showing of negligence, and liability for inherently dangerous activities (like blasting services) may be based on "strict liability" without a showing of negligence.

[18] Oregon, however, modifies the indemnity exclusion in its riders to commercial software licenses and software maintenance agreements. The indemnification obligation does "not extend to any indemnifiable loss to the extent caused by the negligence or willful misconduct of Agency, the State of Oregon, or their agents, officials, or employees." Thus, a contractor need not show that a claim or liability is attributable solely to the acts of the state.

contributory negligence, comparative and/or contributory negligence or fault, sole negligence, or intentional misconduct."

Adding a State Defense Cooperation Obligation

Offering to include reasonable defense cooperation by the state is another way to ameliorate contractor concerns. California's model terms provide indemnification as well as defense cooperation, control and participation provisions that can be important to companies. California's provision states:

> Such defense and payment will be conditional upon the following: a) The State will notify Contractor of any such claim in writing and tender the defense thereof within a reasonable time; and b) Contractor will have sole control of the defense of any action on such claim and all negotiations for its settlement or compromise; provided that (i) when substantial principles of government or public law are involved, when litigation might create precedent affecting future State operations or liability, or when involvement of the State is otherwise mandated by law, the State may participate in such action at its own expense with respect to attorneys' fees and costs (but not liability); (ii) the State will have the right to approve or disapprove any settlement or compromise, which approval will not unreasonably be withheld or delayed; and (iii) the State will reasonably cooperate in the defense and in any related settlement negotiations.

Other states add provisions defining the defense obligation and the state's willingness to cooperate. Massachusetts permits "an opportunity to participate in the defense." South Carolina's model indemnification provisions note that the "State shall reasonably cooperate with Contractor's defense of such suit or claim." Oregon adds comprehensive language regarding "approval of the Attorney General" and a right of the state to assume its own defense.

Customary Limits on Intellectual Property Indemnification

Governments (and industry) often are successful getting companies to accept IP indemnification. In fact, many IT companies include IP indemnification as part of their boilerplate. The scope of the indemnity extends at least to patent, copyright, and trademark infringement. Whether "trade secret" misappropriation is included in a general intellectual property indemnification is a matter of state law. Like California, Oregon and New Mexico explicitly extends the indemnification to trade secrets. In the case of New Mexico, the contractor indemnifies the state "if any third party obtains a judgment against the Procuring Agency based upon Contractor's trade secret infringement relating to any product or services provided under this Agreement."

Companies commonly will accept IP infringement indemnity. But companies are concerned that some claims may arise out of unauthorized use or modification of the product, or continued use after the government has been notified to stop infringing use.

Common exclusions include state alteration of the product, unauthorized use, use of state-directed specifications, or continued use after notice of infringement. North Carolina includes the common exceptions for state alteration or continued infringing use from the intellectual property indemnification. Likewise, New York excludes from the contractor's intellectual property indemnification obligation "I) Authorized User's unauthorized modification or alteration of a Product; ii) Authorized User's use of the Product in combination with other products not furnished by Contractor; iii) Authorized User's use in other than the specified operating conditions and environment." Similarly, Ohio's indemnification clause limits indemnity, "This obligation of indemnification will not apply where the State has modified or misused the Deliverable and the claim is based on the modification or misuse." Oregon exempts "Use of the Deliverables or the System in a manner other than as contemplated" in the contract.

South Carolina adds another common exemption for those cases where the state directs use of a design specification that may be infringing. South Carolina exempts claims " to the extent (i) that the claim is caused by Contractor's compliance with specifications furnished by the State unless Contractor knew its compliance with the State's specifications would infringe an IP right, or (ii) that the claim is caused by Contractor's compliance with specifications furnished by the State if the State knowingly relied on a third party's IP right to develop the specifications provided to Contractor and failed to identify such product to Contractor."

North Dakota has a comprehensive set of terms and conditions that integrates indemnification provisions with insurance requirements. The North Dakota Risk Management Division has a role in defining acceptable liability allocation provisions. North Dakota limits the indemnity to "vicarious liability" in IT contracts, indemnify that is somewhat more restrictive than North Dakota's broad form indemnification.

Limitation of Liability

Indemnification is the obligation of one party, normally the contractor, to pay ultimate liability (and usually reasonable defense costs, including attorney fees) suffered by the other contracting party, in this case the state. Limitation of liability, on the other hand, is a contractual limitation of the liability that can be assessed against either party. Limitations of liability often include an exclusion of certain types of damages, e.g. indirect or consequential, and may also include monetary limitations on the ultimate amount of liability.

Notable Statutes and Practices Regarding Limitation of Liability Policies

Several states use limitations of liability clauses in their solicitations. Both California and Tennessee have statutory limitation of liability laws that require their inclusion in IT solicitations. Tennessee's limitation of liability law is applicable only in information technology. Both states use "2x" contract value formats, meaning that the liability is limited to twice the contract value. North Dakota grants statutory authority "for state agencies or facilities to negotiate with vendors to limit a vendor's indirect damages liability for software, communication, or electronic equipment contracts if it is determined by the Attorney General and the Director of OMB that it is in the State's best interest to do so."

California's limitation of liability clause states:

> LIMITATION OF LIABILITY: a) Contractor's liability for damages to the State for any cause whatsoever, and regardless of the form of action, whether in Contract or in tort, shall be limited to two times the Purchase Price. For purposes of this sub-section a), "Purchase Price" will mean the aggregate Contract price; except that, with respect to a Contract under which multiple purchase orders will be issued (e.g., a Master Agreement or Multiple Award Schedule contract), "Purchase Price" will mean the total price of the purchase order for the Deliverable(s) or service(s) that gave rise to the loss, such that Contractor will have a separate limitation of liability for each purchase order. (b) The foregoing limitation of liability shall not apply (i) to liability under the General Provisions, entitled "Patent, Copyright, and Trade Secret Protection" or to any other liability (including without limitation indemnification obligations) for infringement of third party intellectual property rights; (ii) to claims covered by any specific provision herein calling for liquidated damages; (iii) to claims arising under provisions herein calling for indemnification for third party claims against the State for bodily injury to persons or damage to real or tangible personal property caused by Contractor's negligence or willful misconduct. c) The State's liability for damages for any cause whatsoever, and regardless of the form of action, whether in Contract or in tort, shall be limited to the Purchase Price, as that term is defined in subsection a) above. Nothing herein shall be construed to waive or limit the State's sovereign immunity or any other immunity from suit provided by law. d) In no event will either the Contractor or the State be liable for consequential, incidental, indirect, special, or punitive damages, even if notification has been given as to the possibility of such damages, except (i) to the extent that Contractor's liability for such damages is specifically set forth in the Statement of Work or (ii) to the extent that Contractor's liability for such damages arises out of subsection b)(i), b)(ii), or b)(iv) above.

Tennessee's statutory clause also limits liability to "2x" the value of the contract, but use of the provision is limited to "bids for telecommunications and information technology goods and services." Moreover, the clause does not apply to "intentional torts, criminal acts, fraudulent conduct or acts or omissions that result in personal injuries or death," suggesting that intellectual property infringement liability is embraced by the limitation of liability provision, a departure from California's practice and other state practices discussed below.

Ohio also includes a limitation of liability in its model terms and conditions, but the limitation of liability excludes indemnification from its operation. Likewise, Virginia's limitation of liability provision limits liability "except for liability with respect to . . . any act or omission of any employee, agent, or subcontractor," the language used in the general indemnity

provision. Excluding a broad form indemnity in this manner from operation of the limitation of liability clause effectively may mean that only contract breach damages are capped, nothing else.

Exclusion of Consequential, Indirect, Special, and Indirect Damages

Contractors often ask to exclude consequential, incidental, special, and indirect damages.[19] A serious concern with this approach arises from the ambiguity about what types of damages fall within these legal categories. Often, that question is not answered until a final judicial opinion is obtained. Incidental[20] and consequential damages[21] are defined by the Uniform Commercial Code and jurisdictions may have judicially defined these categories of damages in the context of services. Regardless of the context and jurisdiction, these definitions are vague and often applied differently by different courts. Consequential and indirect damages are often defined by what they are not, "direct damages," e.g. the value of the loss of the benefit of the bargain, but are generally those damages that flow from the breach and are reasonably foreseeable. Special damages often require explicit proof requirements as defined by local law.

It is not uncommon to see a negotiated contract clause such as that used by Idaho:

> Contractor shall not be liable for incidental, indirect, special or consequential damages, or for lost profits, savings or revenues of any kind, whether or not Contractor has been advised of the possibility of such damages.

[19] Other types of damage exclusions include: punitive (CA); exclusion of damages from "lost data or records (FL); inclusion of profits explicitly in excluded damages (NY); "lost profits, lost savings, lost data" (OR); exclusion of profits and reciprocal definition of consequential damages (SC); punitive damages and "loss of profit, income or savings" (VA).

[20] Section 2-715 of the UCC defines incidental damages as "damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach."

[21] Section 2-715 of the UCC defines consequential damages as follows:

> (2) Consequential damages resulting from the seller's breach include
>
> (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and
>
> (b) injury to person or property proximately resulting from any breach of warranty.

Note that Idaho has expressly included lost profits in its clause, perhaps avoiding the issue of proper characterization of lost profits as direct versus consequential damages. Both Oregon and South Carolina make the damages exclusion reciprocal.

Common Exclusions from Limitation of Liability: IP Indemnity and Tort Liability

California's exclusions from the operation of the limitation of liability are typical when compared with other state provisions. In California's clause:

> . . . (b) The foregoing limitation of liability shall not apply (i) to liability under the General Provisions, entitled "Patent, Copyright, and Trade Secret Protection" or to any other liability (including without limitation indemnification obligations) for infringement of third party intellectual property rights; (ii) to claims covered by any specific provision herein calling for liquidated damages; (iii) to claims arising under provisions herein calling for indemnification for third party claims against the State for bodily injury to persons or damage to real or tangible personal property caused by Contractor's negligence or willful misconduct.

These exclusions commonly are accepted by contractors. Note in particular that California's exclusion would include a general indemnity -- not intellectual property infringement indemnification -- within the operation of the limitation. Contractors can insure against common tort liability, so they often do not push back on that exclusion. Also, while intellectual property infringement may not be insurable, infringement is a matter within contractor control, and they sometimes will agree to exclude infringement indemnification from limitation of liability clauses.

Other State Practices on Limitation of Liability and Exclusion of Damages

Idaho's clause does not include a contract value cap, but the clause excludes "incidental, indirect, special or consequential damages, or for lost profits, savings or revenues." This can be a reasonable opening limitation of liability concession by the state: damages exclusions are limitations of liability also, even though vendors also want to cap overall liability. Importantly, Idaho's limitation of liability clause excludes from its operation tort-type claims as described above, as well as "direct damages to the state" from contract breach.

Florida's approach differs in that it limits "the Contractor's liability under a contract or purchase order" to the greater of $100,000 or two times "the charges rendered by the Contractor under the purchase order."[22] The indemnity obligation is carved out of operation of the limitation of liability clause (like Ohio), although liability for lost data and records is explicitly within the operation of the limitation of liability clause (like Idaho).

[22] Use caution defining liability caps using amounts paid or, in this case, charges rendered by the contractor. In early phases of performance, before payments are made, this type of clause can establish an unreasonably low limitation of liability.

Maine, along with an indemnification provision, uses a "3x" value limitation of liability provision that similarly excludes from its operation liability based on intellectual property infringement (not including patents and trade secrets), bodily injury (including death), and damage to tangible property. Maine includes the limitation of liability provision in its IT services contracts that include complex system implementations.

Massachusetts ties its limitation of liability clause to its indemnification clause that requires indemnity "against any and all claims, liabilities and costs for any personal injury or property damages, patent or copyright infringement or other damages that the State may sustain which arise out of or in connection with the Contractor's performance of a Contract, including but not limited to the negligence, reckless or intentional conduct of the Contractor, its agents, officers, employees or subcontractors. The limitation of liability provision sets limits on "other damages" at two times the value or the good or service, or $100,000 which ever is higher, "In no event shall "other damages" exceed the greater of $100,000, or two times the value of the product or service (as defined in the contract scope of work) that is the subject of the claim."

Minnesota's standard RFP terms set the liability cap at contract amount or $10,000,000,[23] whichever is higher. Nevada uses 150% "of the contract maximum "not to exceed" value. "Contractor's tort liability shall not be limited." New York uses the "2x" form of limitation of liability and also includes a state right of offset for amounts "necessary to satisfy any claim for damages, costs and the like asserted against the Authorized User" unless a bond or insurance is available.

North Carolina uses a "2x" form of limitation of liability, with explicit exclusion for damages "caused by the State's failure to fulfill any State responsibilities." Moreover, the clause excludes from its operation: "receipt of court costs or attorney's fees"; claims for IP infringement liability; and personal injury or property damage caused by the vendor's 'negligence or willful or wanton" conduct.

As noted previously, North Dakota has statutory authority "to negotiate with vendors to limit a vendor's indirect damages liability for software, communication, or electronic equipment." North Dakota's Division of Risk Management plays a key role in selecting appropriate liability allocation provisions, and the liability caps may range between "1x"[24] and

[23] Note the variation in threshold limitation of liability ceilings: $100,000 to $10,000,000. Threshold amounts are advisable because potential liability can greatly exceed purchase amounts in small dollar contracts/purchase orders. Ask your advising counsel whether state governmental immunity limits can be considered in setting the threshold ceiling. In some cases -- federal constitutional tort actions brought by private citizens, for example - state governmental immunity limits may not apply. So some kinds of contract performance may warrant higher threshold liability ceilings.

[24] Caution should be exercised with "1x" contract amount, i.e. liability caps equal to the contract value. Courts in some jurisdictions may apply the cap literally even when there are milestone payments and a material breach occurs at the end of contract performance. If a "1x" cap is construed to permit breach damages plus refund or recoupment of milestone payments for services/supplies not finally accepted, then the "1x" cap would permit breach damages up to

"3x" depending on risk. The model North Dakota contract and instructions include common limitation of liability exclusions and exclude consequential damages.

Ohio's license contract contains a limitation of liability of the greater of "2x" the "total license and support fees paid under this contract" and an amount to be negotiated. The clause also excludes all damages other than direct damages, "by way of example only, indirect, incidental, exemplary[25], and consequential damages, including loss of profits." Ohio excludes from the limitation of liability clause the contractor's "obligation to indemnify the state under the indemnity and infringement provisions . . . for direct damages from the contractor's negligence or willful misconduct."

Oklahoma explicitly makes any limitation of liability clause void "[t]o the extent any limitation of liability contained herein is construed by a court of competent jurisdiction to be a limitation of liability in violation of Oklahoma law . . ." This language is unique among survey responses and may reflect an opinion by the Oklahoma Attorney General that concluded that limitation of liability clauses violate the Oklahoma constitution.

Oregon uses a limitation of liability clause that caps liability at "one times the maximum-not-to-exceed amount of the contract," and the clause excludes certain indirect and consequential damages. The Oregon limitation of liability clause excludes from its operation intellectual property indemnification and "claims for personal injury, including death, or damage to real or tangible personal property arising from the negligence, reckless conduct, or intentional acts of contractor."

South Carolina's model license terms and conditions caution against use of limitation of liability provisions but prescribe a model term (only after legal advice) for software contracts involving commercial off-the-shelf software. This clause includes exclusion of damages and caps maximum liability "arising from licensor's breach of this agreement, breach of warranty, negligence, strict liability, or other tort, or otherwise with respect to the supplies, services, or software provided under this agreement" at "an amount equal to the total contract price."

South Carolina also prescribes a separate "waiver of consequential damages" clause, likely because the state cautions against liability caps. The clause is a reciprocal waiver and defines consequential damages comprehensively to include "damages incurred by the state for loss of income, profit, financing, business and reputation, management or employee productivity" and "damages incurred by the contractor for principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit except anticipated profit arising directly from the work." The clause, which is

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contract value. However, there have been cases where the cap was applied literally, meaning the buyer could receive only a refund of progress payments up to the contract value, effectively leaving little or no breach remedy.

[25] *Exemplary* damages are also known as *punitive* damages in some jurisdictions.

also applicable to termination, does not cover "equitable or contract indemnification" in the waiver.[26]

Intellectual Property Rights

Fundamentally, there are two issues with intellectual property rights. First, the solicitation and/or contract will specify the nature of ownership rights in any intellectual property developed or used during performance. Second, to the extent the state does not own the intellectual property, the scope of the license is important.

The State's Retaining License Rights

California's provision reflects what may be the prevailing practice: generally confirming ownership rights to the contractor and reserving license rights to the state.[27] California uses an approach analogous to that used in the Federal Acquisition Regulations for allocating "government purpose rights" in intellectual property owned by the contractor, as is the case in California for "pre-existing materials" that are "developed or otherwise obtained by or for Contractor or its affiliates independently of this Contract or applicable purchase order." The clause states:

> RIGHTS IN WORK PRODUCT: a) All inventions, discoveries, intellectual property, technical communications and records originated or prepared by the Contractor pursuant to this Contract including papers, reports, charts, computer programs, and other Documentation or improvements thereto, and including Contractor's administrative communications and records relating to this Contract (collectively, the "Work Product"), shall be Contractor's exclusive property. The provisions of this sub-section a) may be revised in a Statement of Work. b) Software and other materials developed or otherwise obtained by or for Contractor or its affiliates independently of this Contract or applicable purchase order ("Pre-Existing Materials") do not constitute Work Product. If

[26] In some states, there are equitable or implied indemnity theories independent of express contract indemnities. There are cases that hold that the parties' use of an express contractual indemnity demonstrates an intent to exclude any equitable or implied indemnities. The South Carolina clause arguably preserves these equitable theories under South Carolina law.

[27] Other notable license rights practices include: NC (provisions include archival copy clause that explicitly limits state's right to decompile); NM (provides alternative ownership and licensing provisions; includes notice requirements when intellectual property is created), NV (source code license and comprehensive delineation of rights in data); ND (includes maintenance provisions, service level agreement for hosting, and hosting service transition assistance); NY (comprehensive license provisions); VA (comprehensive, separate licensing terms; third party/vendor transfer rights for government purposes; "Authorized User" provisions that cover local governments and "quasi-political" entities; special rights for "pre-existing rights" for background IP and software publishers).

> Contractor creates derivative works of Pre-Existing Materials, the elements of such derivative works created pursuant to this Contract constitute Work Product, but other elements do not. Nothing in this Section 37 will be construed to interfere with Contractor's or its affiliates' ownership of Pre-Existing Materials. The State will have Government Purpose Rights to the Work Product as Deliverable or delivered to the State hereunder. "Government Purpose Rights" are the unlimited, irrevocable, worldwide, perpetual, royalty-free, non-exclusive rights and licenses to use, modify, reproduce, perform, release, display, create derivative works from, and disclose the Work Product. "Government Purpose Rights" also include the right to release or disclose the Work Product outside the State for any State government purpose and to authorize recipients to use, modify, reproduce, perform, release, display, create derivative recipients of the Work Product may include, without limitation, State Contractors, California local governments, the U.S. federal government, and the State and local governments of other states. "Government Purpose Rights" do not include any rights to use, modify, reproduce, perform, release, display, create derivative works from, or disclose the Work Product for any commercial purpose. The ideas, concepts, know-how, or techniques relating to data processing, developed during the course of this Contract by the Contractor or jointly by the Contractor and the State may be used by either party without obligation of notice or accounting. This Contract shall not preclude the Contractor from developing materials outside this Contract that are competitive, irrespective of their similarity to materials which might be delivered to the State pursuant to this Contract.

Colorado also has used an approach that allocates ownership rights based on whether the Work is "Specifically Related" or "Generally Applicable" to contract performance. There is room for clarification, though. Intellectual property that is incorporated into the "Work Product" appears susceptible of categorization as either state-owned or state-licensed intellectual property, so some clarification at the time of proposal submission and negotiation may be advisable. Similarly, rights in third-party proprietary software may require clarification, as the terms "own" and "title" are susceptible to various meanings with respect to rights in the media and the underlying intellectual property. Nevertheless, Colorado's clause provides a practical vehicle for allocating and clarifying rights in intellectual property during the process of solicitation, evaluation, and award of contracts.

Other states have varying contractual approaches to allocating ownership rights in intellectual property. New York distinguishes between "existing products" and "custom products" in allocating ownership rights. Ohio begins with a default of state ownership in deliverables but permits license rights based on categories of deliverables that include "pre-existing materials," "custom deliverables," "commercial materials" and "commercial software." In Ohio, the state's rights regarding commercial software are analogous to federal *restricted*

rights. South Carolina draws the ownership and licensing distinction using "proprietary software" (license rights) and "customized software" (ownership rights).

Oklahoma obtains ownership rights for "solicitations that include software development," characterizing these contracts as a "work for hire." If software or supporting documentation is judicially determined not to be a "work for hire," the state's rights revert to a "non-exclusive, irrevocable license to use such portion." The clause also requires only license rights for a category of software denominated as "utilities," defined as "reusable or pre-existing intellectual property."

Florida explicitly permits use of the contractor's standard license agreement in some instances. The Florida provision requires, as a minimum, that the state be given "a non-exclusive, perpetual license to use, execute, reproduce, display, perform, adapt [with some exceptions] and distribute."

Maine[28] also distinguishes between retention of ownership and license rights, with the state retaining only license rights in "off-the-shelf software." The Maine provision contemplates the use of the vendor's license terms: "In the event that a separate license agreement accompanies the OTS software, then the terms of that separate license agreement supersede the above license granted for that OTS software." The Maine provision explicitly prohibits certain uses by the state, i.e., to "decompile or disassemble any OTS software," limits the ability to modify, and creates a right to make and maintain an "archival copy."

Nevada uses a license approach to intellectual property "which is intended to be consideration under the Contract" but retains ownership in the tangible media that "shall be the exclusive property of the State and all such materials shall be delivered into State possession by Contractor." South Dakota's clause retains state ownership in the underlying media and reserves a license in the "work," a "royalty-free, non-exclusive, and irrevocable license to reproduce, publish, and otherwise use, and to authorize others to use, the work for government purposes." Oregon's terms and conditions do not define what rights the contractor and state will have in new inventions. Oregon's contract terms state that "Contractor owns all Work Product," granting the "Agency a perpetual, non-exclusive, irrevocable, royalty-free, world-wide license, copy, display, distribute, transmit and prepare derivative works of Work Product, and to authorize others to do the same on Agency's behalf." With respect to third party intellectual property and contractor intellectual property that is pre-existing, the license rights are defined in an exhibit attached to the contract. Protection is afforded "Agency Intellectual Property, Data and Background Information."

[28] Maine has a special provision for "software as service" that specifies escrow requirements, [w]hen the software is fully owned, hosted, and operated by the Provider, and the Department uses said software remotely over the Internet." Software escrow provisions are included in the survey response or linked model contract provisions for the following states: MI, NY, OK (solicitations "with software development deliverables"), SC, NM, NV, ND, NY, VA.

Virginia's license approach[29] also distinguishes between license rights and exclusive state ownership rights in "Work Product," defined to include inventions, software, data and original works of authorship "discovered, created, or development by Supplier, or jointly by Supplier and an Authorized User(s) in the performance of the contract." The Commonwealth of Virginia and its Authorized Users[30] have license rights in other than Work Product. They have exclusive ownership rights in Work Product, but even in the case of Work Product, the clauses establish a license right in the case of "pre-existing rights." The license terms explicitly "allow access to the Software by third party vendors who are under contract with an Authorized User." The license terms provide separate coverage for software licenses by a "software publisher," and the commonwealth "will consider Supplier-provided language ONLY when Supplier is a reseller of the Software and the software publisher requires an End User License Agreement."

The State's Retaining Ownership Rights in the Intellectual Property

The preceding subsection discussed various approaches to state licensing of intellectual property. Some states like Virginia retain ownership in limited instances when the *work* is developed during performance; other states use only license rights. Delaware is an example of a state whose terms provide exclusive state ownership.

> OWNERSHIP OF INTELLECTUAL PROPERTY: All copyright and patent rights to all papers, reports, forms, materials, creations, or inventions created or developed in the performance of this contract shall become the sole property of the State of Delaware. On request, the contractor shall promptly provide an acknowledgment or assignment in a tangible form satisfactory to the State to evidence the State's sole ownership of specifically identified intellectual property created or developed in the performance of the contract.

Idaho retains ownership, "unless otherwise agreed." This approach could be used to require offerors to propose intellectual property rights, permitting evaluation and negotiation. Michigan uses the "work for hire" doctrine[31] to reserve ownership in deliverables as a default,

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[29] In general, Virginia's license and warranty provisions were very comprehensive and may be useful to states in assessing the need to include other IT contract terms and conditions.

[30] Authorized Users include "locality, municipality, school, school system, college, university, local board, local commission, or local quasi-public entity." In general, the Virginia license and contract terms and conditions accommodate use by local governments.

[31] A right of copyright arises at the time a tangible work is created. "Work for hire" is a doctrine applicable primarily to the employer-employee relationship to grant ownership rights in certain works. In general, in a true independent contractor relationship, the contractor owns the copyright. These model provisions properly do not rely on the "work for hire" doctrine as a primary means of allocating rights to copyright; they use express contract language to create rights.

excluding "preexisting licensed works identified in the SOW." The Michigan clause explicitly grants to the state the right to "hold in its own name all copyright, trademark, and patent registrations and other evidence of rights that may be available for Deliverables to patent and copyright," and the clause prohibits the contractor from using the data.

Michigan is unique in prescribing a "cross-license" provision, perhaps providing a mechanism for the state to achieve price reductions or even revenue. Michigan uses a clause in which the state grants a license to the contractor "to the extent required by the Contractor to market the Deliverables, and exercise its full rights in the Deliverables, including, without limitation, the right to make, use and sell products and services based on or incorporating such Deliverables."

Minnesota's model contract clause on intellectual property rights also states that the "State owns all rights, title, and interest in all of the intellectual property rights, including copyrights, patents, trade secrets, trademarks, and service marks in the Works and Documents created and paid for under this contract," and the "Contractor assigns all right, title, and interest it may have in the Works and the Documents to the State." The clause also requires written notice to the state when "any invention, improvement, or discovery (whether or not patentable) is made or conceived for the first time or actually or constructively reduced to practice by the Contractor, including its employees and subcontractors, in the performance of this contract."

Warranty

This subsection covers practices related to warranties. In some cases contracts contain numerous "warranties" that do not relate to the state's rights after product or service acceptance -- warranties of authority and compliance with the law are examples[32] -- and those representations are not covered here.

The most basic warranty is an extended period to determine whether the deliverable meets contract requirements, often after the time of final acceptance defined in the contract. Beyond that, warranty provisions may involve a variety of contractor performance obligations after acceptance. States in many cases use different warranties for IT hardware and IT services.

Contractors have a number of concerns with warranties, including the practical difficulty of supporting products with a variety of different warranties and financial issues related to recognition of revenue.[33] This discussion does not cover those concerns but instead focuses on the states' practices in requiring warranties.

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[32] Virginia has a "competitive pricing" warranty that covers amendment of the contract if the supplier enters into agreements with other customers "to provide Services under more favorable prices." Virginia's terms also include a warranty of "superior knowledge," that is analogous to the UCC implied warranty of fitness for particular purpose.

[33] Revenue recognition rules are driven by financial accounting standards. The rules define the point in time when a contractor can recognize contract payment as revenue to the company. For example, warranties that are routine, short-term and relatively minor are accounted for differently (with revenue generally recognized at acceptance, but adjusted based on estimates of

Warranty Granting Extended Period To Determine Contract Conformance

New Mexico may be an example of the more traditional extended warranty, "The Contractor further warrants that the software provided under this Agreement will meet the applicable specifications for [recommend 6 mo. - 2 yrs.] years after Acceptance." South Dakota calls this "product conformance," and the model contract terms give the state 12 months to determine whether the software meets specifications. South Carolina's warranty term also is one year, "Contractor warrants all items acquired shall conform to all contractor's representations, the requirements of this contract, and all published documentation."

Idaho's warranty has two periods, a 90-day warranty that media "will be free from defects in materials and workmanship under normal use for ninety (90) days from the delivery date," and a one year warranty following acceptance that "the Customized Software will perform in accordance with the specifications and acceptance criteria set forth in the Agreement."

New York uses one-year warranty and an "additional warranties" clause that establishes baseline warranties, but "[w]here Contractor, product manufacturer or service provider generally offers additional or more advantageous warranties than set forth below, Contractor shall offer or pass through any such warranties to Authorized Users." The New York warranty "warrants and represents that components or deliverables specified and furnished by or through Contractor shall individually, and where specified and furnished as a system, be substantially uninterrupted or error-free in operation and guaranteed against faulty material and workmanship for the warranty period, or for a minimum of one (1) year from the date of acceptance, whichever is longer ("Project warranty period")." The New York provisions have separate coverage for "independent software vendors."

Oregon may have some of the most comprehensive and well integrated provisions regarding inspection, acceptance, and warranties. Oregon specifies a 90-day "Acceptance Period," during with the "Agency shall use the System for the transformation and processing of System data in a live production environment." If the "System materially fails to conform to or perform" to the acceptance criteria, the contract specifies remedies. A negotiated warranty period then is specified during which time the contractor "shall at no charge to Agency, furnish such materials and Services as shall be necessary to correct any defects in the System that prevent the System from meeting the Acceptance Criteria and Warranties provided in the Contract." The period of support after the warranty period is covered by a post warranty "maintenance and support agreement" attached as an exhibit to the contract.

Warranties of Performance

North Carolina uses a 90-day warranty from the date of acceptance. North Carolina's clause states that "Vendor shall assign warranties for any Deliverable supplied by a third party."

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the amount of future warranty obligations) under Financial Accounting Standards than warranties that are more akin to acceptance, where revenue recognition may deferred until completion of the warranty term. State accountants may be able to assist with negotiations where this issue surfaces.

Further, North Carolina's warranty protects against "any surreptitious programming codes, viruses, Trojan Horses, 'back doors' or other means to facilitate or allow unauthorized access."

Florida has complex warranty provisions applicable to a procurement of network infrastructure estimated at $100 million in volume. Florida's provisions include a hardware "parts coverage and support" warranty (1 year) and a 30-day money back guarantee ("Standard intellectual property owner's warranty") for some software. Florida's provisions also create an optional "warranty upgrade" and "warranty service response" requirements.

Ohio prescribes a three-year warranty in software implementation contracts. The warranty separately covers deliverables, commercial software deliverable under the contract, and media on which the software is delivered that "will be free from defects and viruses." Ohio's general provisions also include the following warranty disclaimer, "General Exclusion of Warrantees. The Contractor makes no warranties, express or implied, other than those express warranties contained in this Contract."

Oklahoma prescribes a warranty clause for use in solicitations that includes "software development deliverables." The contractor warrants that the "products or deliverables shall individually, and where specified by Contractor to perform as a system, be substantially uninterrupted and error-free in operation and guaranteed against faulty material and workmanship for a warranty period of a minimum of ninety (90) days from the date of acceptance."

Virginia has comprehensive warranty and license terms that include in the terms of the warranties:

- the product is "upward compatible with any other Product";
- "performance standards and Mean Time Between Failure (MTBF) standards";
- defined warranty and maintenance response requirements; and
- "election of an alternative warranty level offered by Supplier."

The survey response shows negotiable periods for the various forms of hardware and services warranties, although the model IT hardware contract has a one-year "system software warranty."

Requiring Performance Bonds in IT Solicitations

The California survey response provides policy guidance and ranges of options relating to the requirements for performance bonds and letters of credit.

North Dakota makes performance bonds a matter of discretion and instructs the agencies in its model RFP to specify the amount as a dollar amount or percentage of contract price, "the amount should equal to the potential liability involved with the contemplated service contract. The amount of a performance bond or surety deposit should be equal to the cost of a replacement contract.. . . In lieu of a performance bond, the contractor may substitute a certified check or

cashiers check drawn on a federally insured bank, or other form of bid security acceptable to the State."

New Mexico requires a performance bond if the amount of the contract exceeds $1 million or, "if the contract is for custom developed software/application or Commercial Off the Shelf (COTS) software with greater than 20% modification/enhancement." The survey response does not indicate the amount of the bond required.

Nevada requires a performance bond but permits reduction of the amount at the completion of phases, "upon successful completion, as determined by the State, of each of the phases of the contract."

South Carolina's policy is to "not require a performance bond unless absolutely necessary and then get legal's advice because it drives the cost up and is not always in the best interest to the State."

Termination for Loss of Funding

Most states include provisions that permit termination for nonappropriation. Some clauses condition continued performance on the funds being "otherwise made available" or "appropriated and available" or limited by "appropriations and allotments," without any contractual definition regarding the difference between failure of appropriation and other funds availability. This may cause some concern for vendors if contractual undertakings can be terminated simply by not allocating or otherwise administratively making funds available.

Massachusetts addresses this concern by contractually limiting the ability of an agency to remove funds administratively.

> Although contract payments are 'subject to appropriation' by the legislature and "allotment" by the Governor (M.G.L. c. 29, § 27) a Department may not escape contractual obligations through immediate contract termination (especially contracts for term leases, space leases, tax exempt lease purchase (TELP) or other long term commitments) unless the appropriation or allotment under the account funding the contract, or the specific language that authorizes the funding of that contract, is eliminated and the Department has no other available funds that could be unobligated or otherwise made available to pay for these obligations.

Contractors may want to negotiate terms so that milestone payments are aligned with appropriation and allocation events so availability of funds can be confirmed before beginning certain phases of performance.

California has a unique provision that mitigates the effect of nonappropriation by requiring return of some contractor property.[34] The California provision states:

> State agrees that if paragraph a) above is invoked, deliverables shall be returned to the Contractor in substantially the same condition in which delivered to the State, subject to normal wear and tear. State further agrees to pay for packing, crating, transportation to Contractor's nearest facility and for reimbursement to the Contractor for expenses incurred for their assistance in such packing and crating

COMPETITIVE SOLICITATION PRACTICES

This section of the whitepaper summarizes the limited information in survey responses[35] that describes the states' approaches to responsiveness, and the use of discussions and negotiations to address issues with terms and conditions. This section also discusses the availability of proposal revisions and the approach to post-award negotiation of terms and conditions.

Responsiveness and Treatment of Exceptions

Vendor exceptions to terms and conditions involve two questions. First, do solicitations invite -- if at all -- exceptions to terms and conditions? The related issue is how the concept of *responsiveness* is applied in the context of competitive sealed proposals. The second question is: how can the state's evaluation and award process be used to achieve agreement on terms and conditions in a way that is fair to all offerors?

Permitting Exceptions to Model ("Boilerplate") Terms and Conditions

Maine apparently does not invite exceptions in its procurements for IT professional services: "Proposals expressing any exceptions to the State's terms and conditions will be disqualified." Connecticut refers to proposals that take exceptions as "Conditional Bids:

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[34] The ABA's Model Procurement Code goes further, providing in Section 3-503(3) as follows:

> When funds are not appropriated or otherwise made available to support continuation of performance in a subsequent fiscal period, the contract shall be cancelled and the contractor shall be reimbursed for the reasonable value of any non-recurring costs incurred but not amortized in the price of the supplies or services delivered under the contract. The cost of cancellation may be paid from any appropriations available for such purposes.

[35] North Dakota included information about solicitation procedures. North Dakota and Colorado use similar processes; both are Model Procurement Code states. While Colorado has not yet responded to the survey, recent Colorado solicitation practices were also identified in the discussion.

Conditional Bids may be rejected in whole or in part." Yet the matrix in Connecticut's survey response indicates that the state does not reject a bid or proposal as nonresponsive if the vendor takes exception to the various clauses. Thus, it was not clear how the state handles these exceptions.

South Carolina appears to take a somewhat less restrictive view of responsiveness, explicitly using "materiality" as the standard for acceptability of exceptions. The state's solicitation instructions define an "offer" as a bid or proposal and state that "Any Offer which fails to conform to the material requirements of the Solicitation may be rejected as nonresponsive. Offers which impose conditions that modify material requirements of the Solicitation may be rejected. . . . Offers which include either modifications to any of the solicitation's contractual requirements or an offeror's standard terms and conditions may be deemed non-responsive and not considered for award."

Various states' procurement codes or rules allow the state to permit offerors to revise proposals. The Model Procurement Code requires that offerors be afforded an equal opportunity to revise proposals. NASPO's *Practical Guide* refers to a flexible approach in some jurisdictions to negotiation of terms and conditions, characterizing the issue as one of risk management.[36] The following discussion highlights a few state practices that refer to proposal revisions and/or how states treat exceptions to terms and conditions so that vendors are treated fairly.

Rejection of "Unacceptable" Proposals

California publishes a separate manual for IT procurement. Notably, California permits proposals with immaterial omissions to be accepted as responsive but concludes, "Material deviations of mandatory requirements cannot be waived and the bid must be rejected. All such deviations must be thoroughly documented in the procurement file to support the rejection." Manual ¶ 3D4.4. It was unclear whether that rule applies to model contract terms and conditions as well as other solicitation requirements.

Colorado is a Model Procurement Code state that permits clarifications, discussions, and proposal revisions. The Colorado Procurement Rules categorize proposals at receipt as "capable of being acceptable" and "unacceptable." Colorado's most recent solicitations have permitted exceptions but used "warning" language to discourage exceptions:

> In responding to this RFP, Offerors agreeing to abide by the requirements of the RFP are also agreeing to abide by all terms and conditions contained herein, so Offerors should identify or seek to clarify any problems with contract language or any other document contained within this RFP packet through their written inquiries about the RFP or within their proposal. It may be possible to negotiate some of the wording in the final contract, but there are many provisions, such as all of those contained in the Special

[36] National Association of State Procurement Officials, *State and Local Government Procurement: A Practical Guide*, p. 59 (NASPO: 2008).

> Provisions pages, that cannot be changed. To avoid the possibility of their proposal being rejected or of any delay in the finalization of the resulting contract, it is highly recommended that Offerors NOT take any exception to any of the State's terms and conditions. Failure of the successful Offeror(s) to accept these obligations may result in cancellation of the award.[37]

Language in a Colorado State Purchasing Office RFP (not an IT solicitation) explicitly indicated that the exceptions would be evaluated. One RFP evaluation factor was "the extent to which Offeror agrees to Colorado's basic contract terms and required state Special Provisions without seeking exceptions."[38] The RFP stated:

> Unless the Offeror notes exceptions in its proposal, the conditions of the Model Contract will govern. It may be possible to negotiate some of the wording in the final contract; however there are many provisions, such as those contained in the State Special Provisions, which cannot be changed. Offerors are cautioned that the State believes modifications to the standard provisions, terms and conditions, and the State Special Provisions constitute increased risk to the State and increased costs. Therefore, the scope of requested exceptions is considered in the evaluation of proposals.[39]

This evaluation could be conducted in connection with the price or cost evaluation, that is, the extent to which exceptions to terms and conditions were judged to represent increased risk of liability or cost to the state. South Carolina's RFP process uses an analogous "acceptable/potentially acceptable" characterization of proposals for determining which offerors' proposals may be further clarified or proceed to the discussion phase of the evaluation.[40]

Florida establishes a process for identifying various categories of exceptions and delineates the terms and conditions that are not negotiable. The terms and conditions relating

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[37] Office of Information Technology, Request for Proposal Solicitation No. RFP-005-RM-10, Site on Wheels (Mobile Interoperable Gateway), § 1.21 (Apr. 23, 2010). Moreover, the RFP permitted only 30-days to enter into agreement after award, after which time "the State could elect to cancel the award and award the selection to the next most successful Offeror(s) if the delay was not the fault of the State." *Id.* at § 1.31.

[38] State Purchasing Office, Request for Proposal Solicitation Number: RFP-JW-10-00001, Colorado Clean Energy Finance Program, § 6.1A (Dec. 29, 2009).

[39] State Purchasing Office, Request for Proposal Solicitation Number: RFP-JW-10-00001, Colorado Clean Energy Finance Program, § 1.19 (Dec. 29, 2009).

[40] South Carolina publishes policy/training materials having exceptionally comprehensive and useful analysis of proposal acceptability, clarification, discussions, and revisions of proposals. The policy is available at http://www.mmo.sc.gov/MMO/legal/MMO-legal-policy-guide.phtm.

liability allocation provisions, however, apparently "will not be negotiated and are required language for all State of Florida Contracts."

Minnesota's model RFP terms state that "a responder shall be presumed to be in agreement with these terms and conditions unless it takes specific exception to one or more of the conditions." Offerors "are cautioned that by taking any exception they may be materially deviating from the request for proposal." A "material deviation" includes a proposal that gives the responder "a competitive advantage over other vendors" or "gives the State something significantly different from that which the State requested."

North Dakota's model RFP instructs vendors that "Any objections to the contract provisions must be set out in the offeror's proposal." The model RFP appears to modify the sealed bid standard of immateriality slightly, "The procurement officer may reject any proposal that is not responsive to all of the material and substantial terms, conditions, and performance requirements of the RFP. . . . The procurement officer may waive minor informalities that . . . do not constitute a substantial reservation against a requirement or provision."

Nevada also permits exceptions, so long as they are explicit, and evaluates those exceptions. Nevada explicitly invites alternative approaches to insurance. Nevada notifies offerors that "exceptions and assumptions will be taken into consideration as part of the evaluation process."

Negotiation Process and Proposal Revisions

Fewer states provided details about the negotiation process and use of proposal revisions. The survey had asked states to identify points-of-contact for the Work Group's/states' use in later discussions about solicitation process.

Delaware uses competitive sealed proposals and includes an abbreviated description of this process in the solicitation[41] that appears to accommodate negotiation of terms and conditions. Colorado[42] uses discussions, negotiation, and proposal revisions, including best and final offers.[43] Minnesota does as well, and reserves the right to "waive or modify any informalities, irregularities, or inconsistencies in the responses received." Minnesota also reserves the right to request and best and final offer "if the state deems it necessary."

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[41] Delaware's survey response has model evaluation factors that it includes in its RFP. In Delaware's view, its contract terms promote careful consideration by vendors before they take exceptions.

[42] Appendix A has RFP language relating to the "contours" of permissible IP and liability allocation terms and the negotiation process that was used in the 2000 Colorado/Utah cooperative e-procurement solicitation. Both are Model Procurement Code states.

[43] Proposal revisions at the conclusion of discussions and before final evaluation and award are sometimes referred to as a *best and final offer* (BAFO). See NIGP *Public Procurement Dictionary of Terms*, reprinted in NASPO's *Practical Guide*.

North Dakota included in its survey response a link to model IT solicitation terms (in a very user friendly format) that instructs agencies to "include a provision for the vendor to propose the licensing options available and to recommend the advantages of those various options" and "for the vendor to detail and describe the product warranty." Thus, North Dakota's solicitation language contemplates discussions and evaluation of those terms.

Colorado and North Dakota both use the concept of *competitive range*, a long standing federal practice. North Dakota's model RFP states, "After any discussions for clarifications and the initial evaluation of proposals received, offerors whose proposal receives the highest scores and are determined to be reasonably susceptible for award will be required to provide an on-site demonstration of the proposed solution for the evaluation committee."

North Dakota distinguishes between *clarifications* and *discussions*, a distinction long recognized in federal law.

> In order to determine if a proposal is reasonably susceptible for award, the State permits communications by the procurement officer or the proposal evaluation committee with an offeror to clarify uncertainties or eliminate confusion concerning the contents of a proposal and determine responsiveness to the RFP requirements. Clarifications may not result in a material or substantive change to the proposal. The State may adjust the initial evaluation because of a clarification under this section.

Colorado and North Dakota both inform offerors that they <u>may</u> have an opportunity to revise proposals, but the states are not obligated to permit revision. This can create an incentive for offerors to submit their best proposal. South Dakota's RFP language states:

> The State may conduct discussions or request best and final offers with offerors that have submitted proposals determined to be reasonably susceptible for award. The State is not obligated to do so, therefore, vendors should submit their best terms (cost and technical). The purpose of these discussions is to ensure full understanding of the requirements of the RFP and the offeror's proposal. Discussions will be limited to specific sections of the RFP or proposal identified by the procurement officer. Discussions, if held, will be after initial evaluation of proposals by the proposal evaluation committee. If the State requests modifications to the proposal as a result of these discussions, the offeror must put the modifications in writing. If the State requests best and final offers, the State will evaluate the best and final offer submitted by the offeror against the criteria stated in the RFP and any subsequent amendments to the RFP including the best and final offer request. If an offeror does not submit a best and final offer, the State will consider its original proposal as its best and final offer.

South Carolina has the most comprehensive policy/training guidance regarding the constraints on information exchanges between the state and offerors.[44] This guidance also incorporates precedent from state bid protest/appeal decisions, as well as federal law. The distinctions between clarifications, discussions, and other information exchanges that might be characterized as proposal revisions is particularly important in RFPs. Although there are few state cases addressing these issues, federal precedent is helpful. In general, federal precedent has permitted the award on receipt of initial proposals so long as no more than "clarifications" occurred between the government and winning offeror. If those exchanges exceeded the bounds of what was considered a "clarification," discussions were deemed to have occurred, with all offerors entitled to have deficiencies in their proposals identified. Then, offerors are entitled to an opportunity to revise proposals. In this regard, best and final offerors (BAFOs) long were considered not only an approach to obtaining more favorable technical and price proposals, BAFOs also were a risk management tool because they represented a final, equitable (though somewhat limited) opportunity for all offerors in the competitive range to revise their proposals before final evaluation.[45]

Post Award Negotiation

It may be unreasonable to assume that a state can negotiate with every offeror a contract that only needs signature at the time of award. However, some limits may need to be established so the final contract does not contain materially different terms and requirements than were in the solicitation. Florida learned this in its *GTECH* case[46] where the court stated that the agency couldn't "treat the RFP process as little more than a ranking tool to determine a preferred provider and then negotiate a contract with that provider with little or no concern for the original proposal." Colorado has used the following language:

> The State reserves the right to clarify terms and conditions not having an appreciable affect on quality, price/cost risk or delivery schedule during post-award formalization of the contract.[47]

North Dakota has a solid definition of the scope of post-award negotiations:

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[44] Available at http://www.mmo.sc.gov/MMO/legal/MMO-legal-policy-guide.phtm

[45] South Carolina's excellent policy guidance and training materials are available at http://www.mmo.sc.gov/MMO/legal/MMO-legal-policy-guide.phtm. The guidance not only provides examples of the distinctions between clarifications and discussions. It also describes common prohibitions in discussions: auctioning one offeror against another; disclosing proposal approaches to competing offerors (technical transfusion); and inequity in the effort taken to identify deficiencies in one offeror's proposal (technical leveling).

[46] *State of Florida, Department of Lottery v. GTECH Corp*., 816 So.2d 648 (Fla. Dist. Ct. App. 2001)

[47] Office of Information Technology, Request for Proposal Solicitation No. RFP-005-RM-10, Site on Wheels (Mobile Interoperable Gateway), § 1.23 (Apr. 23, 2010).

> After final evaluation, the procurement officer may negotiate with the offeror of the highest-ranked proposal. Negotiations, if held, will be within the scope of the request for proposals and limited to those items that would not have an effect on the ranking of proposals. If the highest-ranked offeror fails to provide necessary information for negotiations in a timely manner, or fails to negotiate in good faith, the State may terminate negotiations and negotiate with the offeror of the next highest-ranked proposal.
>
> * * *
>
> If the selected offeror:
>
> • fails to provide the information required to begin negotiations in a timely manner;
>
> • fails to negotiate in good faith;
>
> • indicates it cannot perform the contract within the budgeted funds available for the project; or
>
> • If the offeror and the State, after a good faith effort, cannot come to terms,
>
> the State may terminate negotiations with the offeror initially selected and commence negotiations with the next highest ranked offeror

NASPO's *Practical Guide* highlights the importance of not making a "sham out of the original competitive process, counseling to perhaps re-compete if "unavoidable post-contract changes are material."[48] The Alaska Supreme Court[49] has issued a decision that provides an excellent, concise summary of the rules governing post-award contract modifications, rules that have direct bearing on post-award negotiations. While this policy primarily addresses post-award changes to specifications that materially change the nature of the contract, the Florida *GTECH* case illustrates that post-award negotiation of terms and conditions can implicate the same policies.

[48] National Association of State Procurement Officials, *State and Local Government Procurement: A Practical Guide*, pp. 25, 32 (NASPO: 2008).

[49] *Kenai Lumber Co. v. LeResche*, 646 P.2d 215 (Alaska 1982).

Appendix A
Colorado/Utah E-Procurement RFP Provisions (2000)

5.1 Evaluation and Discussion Process

Responders should not assume that they will have an opportunity for oral presentations or revisions of proposals, so they should submit their most favorable proposals as their initial proposal. If award is not made on receipt of initial proposals, responders in the competitive range (those most responsive to the requirements) will be provided an opportunity to make an oral presentation as part of the discussions. The competitive range determination will be based on the written proposals, so responders are cautioned to insure that their proposals adequately convey the soundness of their approach and understanding of the requirements.

Oral presentations with responders in the competitive range are planned to be four hours in duration. The presentation may consist of a responder briefing or demonstration concerning its technical approach as well, and the responder should address any clarifications and deficiency items that may have been identified in advance by the States. The States plan to hold the oral presentations via videoconference, so responders should be prepared to send a representative to each location if they consider it necessary to facilitate their oral presentations or achieve resolutions better than permitted on videoconferencing equipment. Colorado has a document camera and scan converter to send computer screen display images. Both Colorado and Utah have 36" videoconferencing display screen.

If proposal revisions are permitted, at the conclusion of oral presentations and discussions, a date will be established in writing by the State for submission of best and final offers. If revisions are permitted, responders shall make any revisions they deem necessary to clarify or correct weaknesses in their proposal. Revisions shall be made by "change page" to proposals. The States do not encourage complete, substantial proposal rewrites. Responders are cautioned not to make changes to the technical approach or funding model revisions that are not clearly explained and/or justified in any proposal revision. Because "risk to the States" is an assessment criteria under this evaluation methodology, responders assume the risk that proposal revisions are adequately explained so the States understand the nature of the revisions.

5.2 Basis for Award

Award will be based on the following factors in decreasing order of importance: technical features of the proposal (including functionality, implementation plan approach, and other factors in section 4); estimated costs (including costs to suppliers) and other impact (positive or negative) on the State procurement environment; and responder experience and demonstrated capabilities.

The technical factors will be assessed based on the soundness of the responder's approach and the responder's understanding of the requirement. The experience and/or demonstrated capabilities factor will be assessed by considering the extent to which the qualifications, experience, and past performance are likely to foster successful, on-time performance. Evaluation of the cost and impact on the State procurement environment will assess the likely

costs to the State in personnel and equipment to support the approach, expected costs to or other impact on the supplier community, nature of changes to State procurement process to accommodate the funding model, and a judgment concerning the benefits gained in terms of overall competition enhancement and efficiencies in workflow processing. Assessments may include a judgment concerning the potential risk of unsuccessful or untimely performance, and the anticipated amount of State involvement necessary (beyond that reasonably necessary) to insure timely, successful performance.

The selection ultimately is a business judgment that will reflect an integrated assessment of the relative merits of proposals using the factors identified above. The States reserve the right to reject any (or all) proposals that pose, in the judgment of the States, unacceptable risks of unsuccessful or untimely performance, unacceptable State resources requirements, or significantly adverse affects on pricing or competition.

6.1.7 Other Terms and Conditions.

As indicated in section 4 of the State of Colorado Solicitation Instructions/Terms and Conditions, a bilateral contract will be executed by the parties and approved in accordance with State law. The Purchase Order terms and conditions and Special Provisions will govern this agreement. The following changes and/or additions are hereby made to the "Purchase Order Terms and Conditions"[50]:

a) Paragraph 5, Rights in Data, Documents, and Computer Software or Other Intellectual Property. The parties agree that the States own the intellectual property rights to all documentation produced and delivered pursuant to the terms of this contract. The contractor, as licensor, grants to the States, their agencies and political subdivisions, a perpetual, irrevocable, non-exclusive, royalty-free license to use the software (including data) and related software documentation required for performance under this contract. This includes the rights to:

1) Reproduce and use, and permit others to reproduce and use for the States the software/documentation pursuant to this contract,
2) Prepare derivative works necessary to perform the contract,
3) Prepare copies for archive purposes,
4) Receive upgrades and updates within 30 days of commercial release, and
5) Use the software on any government computer being used for contract purposes.

The licensor grants these rights without reservation or any additional compensation.

b) Paragraph 7, Warranties. The States will accept proposals, which disclaim the warranties of merchantability, fitness for a particular purpose, or express warranties except as they may arise out of written requirements in this request for proposal or the responder's proposal. The States will not accept disclaimers of the warranty of title and against infringement. The warranty provisions may be clarified during post award contract formalization in a manner described in

[50] The Purchase Order had a broad form indemnity provision and reserved exclusive ownership rights to the State for all works. The RFP provision was intended to define the areas of flexibility.

the proposal to align its operation with the inspection and acceptance protocol proposed and accepted by the States.

c) Paragraph 8, Inspection and Acceptance. The contract clause on inspection and acceptance may be clarified during post-award contract formalization, so long as the clauses reserve the right to termination and other remedies available at law and equity in the event that any other contractor repair obligations that are proposed by the contractor fail of their essential purpose. Any clarification to the inspection and acceptance provision must be described in the proposal.

d) Insurance. The Vendor shall be required to meet the insurance requirements specified in paragraph 4.3 of the State of Colorado Solicitation Instructions/Terms and Conditions. The States will consider bonafide self insurance programs as compliant with the insurance provisions so long as they meet applicable State requirements and, in the judgment of the State, provide comparable coverage and protection against risk to the States. Any responder proposing such coverage must provide information requested by the States it deems necessary to evaluate the self insurance program.

e) Limitation of Liability (Added).
The States will agree to commercially reasonable limitation of liability clauses that limit the contract breach remedies. The limits on such clauses are:

1. Limitations of liability must exclude from their operation claims or liability for damage to tangible property and bodily injury (including death) arising out of acts of the contractor.

2. Claims and damages arising out of intellectual property infringement actions must be excluded from any limitation of liability provision, although the States will agree to reasonable notice and litigation control provisions that further clarify the operation of the indemnification obligation.

3. Responders must identify any limitation of liability provisions that they intend to propose. The States reserve the right to make reasonable adjustments in the cost evaluation factor to account to increased risk suffered from inclusion of limitation of liability provisions.