Contractually Speaking: Drafting & Negotiating IT Contracts that Work

Matthew A. Karlyn
Attorney
Neal, Gerber & Eisenberg LLP
INTRODUCTION

- Economic cycles & contract terms
- Commonly used terms & trends
- Drafting issues
- Tools – technology, checklists, & precedent files
- Streamlining negotiations
LEARNING OBJECTIVES

1 – Understand what contract terms you need in information technology contracts

2 – Recognize recent trends in information technology transactions and understand how and why they might be helpful to you

3 – Identify and understand common drafting issues in contracts and how to avoid problems

4 – Identify and learn how to use various tools that are beneficial in the contracting process

5 – Learn some negotiating techniques that can help streamline the negotiation process (better terms, fewer dollars)
Economic Cycles & Contract Terms: Timing is Everything

- Contracting is dynamic, not static. As economy improves, vendors are less willing to make concessions.

- Example → Technology
  - Early 1990s = mild recession = CONCESSIONS
  - Late 1990s (1999!) = FEW CONCESSIONS
  - Early 2000s = recession = BIG CONCESSIONS
  - Today = swinging back to the early 1990s
An Example – Warranties

- 1990 ≈ 8
- 1999 ≈ 2
- 2001 ≈ 28
- Today ≈ 10 - 12
Before You Start: Planning Analysis

Before drafting, reviewing, and negotiating IT contracts understand:

• What is your business goal?
• How critical is the application you are licensing or the services you are purchasing?
• How much will it cost?
• How quickly do you need the application implemented or services performed?
Commonly Used Terms & Trends: Representations and Warranties

- **Representation** = a statement of fact upon which another party is expected to rely
  - Must demonstrate materiality

- **Warranty** = a party’s assurance as to a particular fact
  - “Per se” material
Commonly Used Terms & Trends: Warranties

- How long?

- What warranties do you want?
  - Quality of service, performance of software, scalability, no sunset, adequacy of documentation and training, frequency and quality of updates, sufficient title, no disabling devices, no unintentional destruction or improper alteration of data, conformity to RFP, etc...

- Trend: No open source software

- Trend: Sarbanes-Oxley / SAS 70 compliance

- Trend: Commitment to fully cooperate with other vendors

- Remedies

- Disclaimers
Commonly Used Terms & Trends: Scalability

- Scalability is often a significant issue in complex IT transactions
- Watch for data interoperability issues
- Trend: Obtain a warranty regarding scalability of applications and data interoperability
- Remedies
Commonly Used Terms & Trends: Limitation of Liability

- Maximum amount of **direct** damages available to each party
- No consequential (**indirect**) damages – make it mutual
- Common exceptions:
  - Indemnification
  - Breach of confidentiality provisions
  - Bodily injury
  - HIPAA
  - **Trend:** Repudiation of vendor
- Limits on customer’s liability?
- Allocation of risk
Commonly Used Terms & Trends: Levels of Effort

- Reasonable efforts
- Diligent efforts
- Good faith efforts
- Commercially reasonable efforts
- Best efforts
- Best commercially reasonable efforts?
- Trend: Tier one efforts
Commonly Used Terms & Trends: Material Breach

- Typical contract allows a party to terminate for the other’s “material breach”

- May be difficult to determine whether a set of facts amounts to material breach
  - Solution:
    - Identify key scenarios and provide in contract that such constitute material breach

- Repeated small breaches
Commonly Used Terms & Trends: Payment Terms and Fees

- **Timing of payments**
  - Date based; performance based

- **Increases in fees over time**
  - Fixed rate
  - Consumer Price Index (CPI)
  - *Trend: Employment Cost Index (ECI)*

- **Holdbacks and true-ups**

- **Travel and out-of-pocket expenses (cap)**

- **Trend: Lower (no) interest on late payments**

- **Trend: All fees clause**

- **Trend: Schedule of everything being licensed/purchased and all other products/services offered by the vendor – if not on list, you get it free**
Commonly Used Terms & Trends: Related Services

- **Scope of work**
- **When scope of work isn’t enough:**
- **Trend: Related services clause:**

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

- Escrow Agreement
  - Who is the escrow agent?
    - Trend: Use of smaller escrow companies
  - Verification of deposit
  - Notification of deposits in escrow account
  - When must vendor make escrow deposits (initial and on-going)?
  - Release triggers → insolvency, failure to support/market, sunset, breach
  - Licensee’s rights on release
  - Payment
Commonly Used Terms & Trends: Personnel

- Identify the vendor’s key personnel
- Limits on vendor’s ability to replace
- Trend: Background and security checks
- Trend: Pre-qualification – if so, how?
- Right to interview
- Right to replace
Commonly Used Terms & Trends: Dispute Resolution

- **Arbitration or Mediation**
  - What rules apply and what law controls?
  - How are the arbitrators or mediators chosen?
  - Where will the arbitration or mediation take place?
  - Language issues?

- **Litigation**
  - What law controls; what jurisdiction?

- **Trend: Detailed dispute resolution clause to include:**
  - Escalation procedures
  - Timeframes
  - Parties to be involved
  - Final step is on-site meeting
Commonly Used Terms & Trends: Force Majeure

- A force majeure event excuses a party’s failure to perform
  - When failure results from some circumstance beyond a party’s reasonable control (be careful of “labor and supply shortages”)
  - Party’s obligation to perform is deemed to be “suspended”

- Trend: Include clause that provides termination right if force majeure continues for a certain period of time

- Trend: Additional force majeure events (e.g., acts of terrorism)

- Trend: Longer force majeure clauses to detail interaction with disaster recovery obligations
Commonly Used Terms & Trends: Disaster Recovery

- Disaster recovery plan (back-ups, hot-site, cold-site)
- Full or partial restores – how frequently?
- Timeframe for returning to service levels
- Interaction with force majeure clause
Commonly Used Terms & Trends: Service Termination

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

- Assignment
- Applicable law
- Insurance requirements
- Non-solicitation / non-competition
- Order of precedence
- Trend: State Customer’s objectives in entering agreement
- Trend: Detailed description of functionality / services
Drafting Issues: Precision and Time References

**Precision:**
- Draft contracts to *precisely* reflect the agreements and intentions of the parties

**Time References:**
- Specific dates
- Date based
- Promptly
Drafting Issues: Use of Formulas and Materiality

- **Use of Formulas:**
  - Make sure they work!
  - Written algebraically

- **Materiality:**
  - What does it mean?
  - Subjective concept
Drafting Issues:
Words to Scrutinize Carefully

- Solely
- Estimate
- Shall vs. may
- Goal
- How certain?
  - Would
  - Could
  - Would reasonably be expected to
Drafting Issues: 
Structure Issues

- Consideration clause
- Whereas clauses vs. background
- Headings
- Definitions
Tools:

Technology

- Tracking changes
  - Corruption
  - Complicated
  - User-friendliness
  - Control

- DeltaView
  - Control of document
  - Corruption
Tools: Internal Tools

- Checklists
- Precedent files
- Update checklists and precedent files frequently to:
  - Keep current
  - Reflect industry standards and industry trends
Streamlined Negotiations: Prepare

- Prepare
  - Research, define, and collect all information
  - Devise negotiation strategy
  - Determine team
Streamlined Negotiations: RFP

- RFP
  - Description of operations
  - Form of contract
  - Negotiations procedures and schedule
  - Point of contact
  - Process
  - Presentations
  - Evaluation
Streamlined Negotiations: Conduct Negotiations

- Parallel Negotiations
- Adhere to process and schedule
- Decision makers
- Issue paper procedure
- Best and final offer (BAFO)
Streamlined Negotiations:
The Goal and the Results

- **The Goal:**
  - Maximize competition and leverage
  - End with two (or more) complete contracts

- **Results can be dramatic and surprising:**
  - Allows vendor comparison on equal basis
  - Encourages competition between and among vendors
  - Highly efficient if managed effectively

- **Remember:** A *balanced agreement is often what results in a successful, long-term relationship!*
Streamlined Negotiations: Advantages

- **For vendors:**
  - Control of the process
  - Schedule is fair and manageable
  - Faster and cheaper
  - Better outcome

- **For customers:**
  - Same as for vendors
  - Benefits of competition, leverage
  - Fallback
QUESTIONS

Matthew A. Karlyn
Information Technology Practice Group
Neal, Gerber & Eisenberg LLP
2 North LaSalle Street
Chicago, IL 60602
(312) 269-8065
mkarlyn@ngelaw.com
www.ngelaw.com