NEGOTIATING TECHNOLOGY CONTRACTS

97TH ANNUAL COUNTY JUDGES & COMMISSIONERS ASSOCIATION OF TEXAS CONFERENCE

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GALVESTON, TEXAS

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OVERVIEW:

- Front-End Thinking

- The Basics

- Important Technology Issues

- Potential Litigation Issues

- The Wrap-Up

FRONT-END THINKING

● Know the parties, the law, and the deal.

● Watch out for the potential litigation issues.

● Don't be afraid to negotiate -- but understand the realities of the negotiation.

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THE BASICS – PART 1 (Initial Questions)

- What practical transactional goals exist considering the proposed term, pricing, maintenance, warranty, and deliverables?

- Do the parties have contract authority to complete the transaction?

- Will the contract be illegal?

- What documents should be attached to the contract?

- What enactment procedure must be followed for contract validity?

- What litigation risks can be identified?

- How badly do you want or need the deal?

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THE BASICS – PART 2 (County Contract Authority)

● **Substantive law:** TEX. CONST. art. V, § 18, TEX. LOC. GOV'T CODE Ch. 81 (broad contract powers for county); *In re Prudential Ins. Co. of America*, 148 S.W.3d 124, 129 Tex. 2004) (parties have broad right to contract, so long as law or public policy is not violated); *City of Denton v. Municipal Admin. Serv., Inc.*, 59 S.W.3d 764, 769 (Tex. App. – Fort Worth 2001, no pet.) (contract made in violation of statute is illegal).

● **Procedural law:** TEX. GOV'T CODE Ch. 551 (Texas Open Meetings Act/TOMA for enactment); TEX. LOC. GOV'T CODE Ch. 262, Subch. C (County Purchasing Act for bidding, procurement, and discretionary exemptions).

● **Bid Rule Exemptions** (for goods/services, including "high technology items") -- TEX. LOC. GOV'T CODE §§ 262.022-.023, 262.024, 262.030.

● **Question:** May a technology contract properly be exempted as a professional service or some other authorized bidding exemption under § 262.024 – or must it be procured through: (1) an RFP procedure under §§ 262.022(4) and 262.030 as a high technology item; or (2) typical competitive procurement procedure under § 262.023? *See* Tex. Att'y Gen. Op. No. JM-890 (1988). **5**

THE BASICS – PART 3 (Contract Illegality)

● **Unconstitutional Debt:** Means any pecuniary county contract obligation (including a multi-year or indemnity obligation), unless the debt is lawfully and reasonably contemplated by the parties, at contract formation, to be satisfied completely from: (1) the current revenues for that year; (2) a fund then within the immediate control of county; or (3) a provision made for the levy/collection of a sufficient tax to pay the interest and provide at least a 2% sinking fund for debt retirement. TEX. CONST. art. XI, §§ 5, 7.

● **Unconstitutional Grant of Funds:** Means any county contract obligation which provides public funds to a private party unless the contract: (1) determines the grant of funds serves an authorized public purpose; and (2) provides sufficient controls to ensure accomplishment of that purpose. TEX. CONST. art. XI, § 3, art. III, §§ 51, 52.

● **TOMA Violation:** A county contract that violates TOMA is voidable through civil litigation, and criminal penalties and removal from office may be pursued against the violator. TEX. GOV'T CODE §§ 551.141-.146; TEX. LOCAL GOV'T CODE §§ 87.011-.032.

● **Competitive Procurement Violation:**   A county contract that violates competitive procurement rules may be enjoined through civil litigation, and criminal penalties and removal from office may be pursued against the violator. TEX. LOCAL GOV'T CODE §§ 87.011-.032, 262.033-.034.

IMPORTANT TECHNOLOGY ISSUES – PART 1

- **TEX. LOCAL GOV'T CODE § 205.009:**

  Denial of Access Prohibited -- A person under contract or agreement with a local government or elected county officer to create, file, or store local government record data electronically or to provide services, equipment, or the means for the creation, filing, or storage, may not, under any circumstances, refuse to provide local government record data to the local government in a timely manner in a format accessible and useable by the local government.

- This statute is important at all times during contract operation, and particularly when a vendor change occurs.

- **Remember:** The local government data belongs to the government.

IMPORTANT TECHNOLOGY ISSUES – PART 2

- **Maintenance/Support Charges –** To save money, try to delay maintenance/support charges until the system is constructed to county specifications and operating successfully.

- **Non-Disclosure Agreements –** These provisions are designed to protect the vendor's trade secrets and intellectual property rights, not the government data held or used by the vendor to do the work of the contract.

- **Data Security Provisions –** These provisions are designed to protect the security of government data used by the vendor to do the work of the contract. Procedures and protections should be included to protect the government data, including without limitation: encryption and password procedure; dual control restrictions; physical protection of equipment and software; employee background checks; data breach response and notification procedures; periodic audit procedures; and compliance with applicable laws.

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IMPORTANT TECHNOLOGY ISSUES – PART 3

● **Software as a Service Escrow –** A buyer may worry about a vendor going out of business. To solve that concern, a **"software as a service escrow"** component may be sold to the buyer as protection.

● This cost component allows the software to be maintained by an escrow agent – but to be released to the buyer if the vendor goes out of business -- thus allowing the buyer to continue to operate without vendor support.

● This solution rarely works. Special hardware and software typically will be required for successful operation, and the software will be complex and not easily understood by government operators.

● A more practical and cost efficient solution is to consider **insurance requirements and financial disclosure provisions** in order to identify vendor sustainability issues in time to change vendors.

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IMPORTANT TECHNOLOGY ISSUES – PART 4

● **Combination Use Situations -- Indemnity Protection for Buyer –** Typically, the vendor will indemnify the buyer regarding intellectual property suits pertaining to the vendor's technology, but exceptions to this protection usually will be included. The indemnity exceptions may be too broad for adequate buyer protection.

● If the exception removes indemnity for a suit regarding the use of the vendor's technology "in combination with hardware or software not provided by the vendor" the exception is too broad. Most pieces of hardware or software work in combination with the products of a third-party.

● The solution is simply to narrow the indemnity exception – by allowing the vendor indemnity protection in combination use situations -- unless the combination use achieves the functionality described in the specifications provision of the buyer contract.

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IMPORTANT TECHNOLOGY ISSUES – PART 5

● **Detailed Specifications Needed –** If the vendor is customizing software for the buyer, the contract should include detailed specifications describing all features and functions of the system.

● If the vendor's standard specifications are insufficient to describe the features and functions the buyer desires – the buyer should draft additional specifications for the contract, typically with assistance of an IT specialist.

● Why is this important? It's because other important provisions in the contract (e.g., default, warranty, maintenance, and system acceptance clauses) will activate and be operable should the system not be delivered or perform in compliance with the "specifications."

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IMPORTANT TECHNOLOGY ISSUES – PART 6

Insurance Provisions – The purpose of requiring insurance for one contract party or the other is to properly allocate risk in appropriate circumstances. Technology contracts sometimes fail to include provisions for the vendor to maintain insurance for the buyer's protection. The following coverage issues should be considered as applicable to the proposed transaction:

- commercial general liability coverage;

- professional liability/error & omission coverage;

- automobile liability coverage;

- workers' compensation coverage;

- employer's liability coverage;

- cyber liability coverage;

- vendor/self-insured scenarios.

POTENTIAL LITIGATION ISSUES

Consideration should be given regarding potential litigation issues to be included in the contract, including:

● Default/remedy definitions and procedure;

● Warranty and indemnity protections;

● Procedural issues such as choice of law, venue, alternative dispute resolution (mediation and/or arbitration), and waiver of jury trial.

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THE WRAP-UP

● The practical difficulty is this: large corporate vendors are reluctant to differentiate from their standard contract forms or options -- but you should try to negotiate the deal points desired by the county.

● Be ready to ask this question: How badly do we need or want this contract? If your answer indicates a strong need/desire, then try to find reasonable compromise positions with the vendor to all of your deal points. And it certainly helps from a competitive standpoint to have another vendor available – with the first vendor knowing about the other.

● Obtain specialized IT advice for your deal point positions before the negotiation begins. This will save time during the negotiation and drafting of proposed contract provisions.

● We wish you the best of success in your work as a public servant.

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