

NEGOTIATING TECHNOLOGY CONTRACTS

VG YOUNG INSTITUTE OF COUNTY GOVERNMENT:
63RD ANNUAL SCHOOL FOR COUNTY COMMISSIONERS COURTS

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BRYAN, TEXAS

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OVERVIEW:

- Front-End Thinking
- The Basics
- Important Technology Issues
- Potential Litigation Issues
- The Wrap-Up

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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 goals exist concerning the proposed contract term, pricing, maintenance, warranty, and deliverables?
- Does contract authority exist?
- Will the contract be illegal?
- What documents should be attached to the contract?
- What enactment procedures must be followed for contract validity?
- What are the litigation risks?
- How badly do you need or want 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 exist for counties); *In re Prudential Ins. Co. of America*, 148 S.W.3d 124, 129 (Tex. 2004) (parties' have a 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 -- for compliance regarding contract approval/enactment); TEX. LOC. GOV'T CODE Ch. 262, Subch. C (County Purchasing Act -- for compliance regarding bidding, competitive procurement, and exemptions).

• **REMEMBER:** A "high technology item" is defined in Ch. 262 as a service, equipment, or good of a highly technical nature, including: data processing, telecommunication, and radio equipment; software; and related technical support services. A "high technology item" contract should not be exempted from competitive bidding as a "professional service" contract under § 262.024(a)(4) -- it should be competitively procured through the "Request for Proposal" procedure described in § 262.030. Tex. Atty Gen. Op. No. JM-890 (1988) at *4-5; TEX. LOC. GOV'T CODE §§ 262.022-.023, 262.024, 262.030.

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THE BASICS - PART 3 (Illegal Contract)

• **An 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 the 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, § 7.

• **An Unconstitutional Grant of Funds** means a county contract obligation which provides public funds to a private party -- unless the contract: (1) determines that the grant of funds serves an authorized public purpose; (2) provides sufficient accounting, cost, and administrative controls to ensure the accomplishment of the public purpose; and (3) ensures that a return benefit accrues to the county. TEX. CONST. art. XI, § 3, art. III, §§ 51, 52; Tex. Atty Gen. Op. No. KP-0029 (2015) at *1 quoting *Tex. Mun. League Intergov't Risk Pool v. Tex. Workers' Comp. Comm'n*, 74 S.W.3d 377, 384 (Tex. 2002).

• **REMEMBER: A Texas Open Meetings Act or Competitive Procurement Violation**, including a constitutional or statutory violation, may: (1) render the contract voidable through civil litigation pursued against the county; and (2) result in criminal penalties and removal from office proceedings pursued against the public official violator. See TEX. GOV'T CODE §§ 551.141-.146; TEX. LOC. GOV'T CODE §§ 87.011-.032, 262.033-.034.

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IMPORTANT TECHNOLOGY ISSUES – PART 1

- **TEX. LOC. 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 for system operations -- particularly when a change in vendor is contemplated or occurs.
- **REMEMBER: The county's data belongs to the county.** Use contract provisions which clearly state: (1) the format, time-frame, and payment requirement (if any) for the vendor to return the data to the county when the contract ends; and (2) the county's rights to access and back-up data at any time.

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IMPORTANT TECHNOLOGY ISSUES – PART 2

- **Maintenance/Support Charges:** Try to save money for unnecessary maintenance and support charges. Consider provisions which delay the initiation of those charges until: (1) the system is constructed to county specifications and operating successfully; or (2) perhaps even a later date given the existence and extent of warranty and other vendor obligations provisions in the contract.
- **Non-Disclosure Provisions:** These provisions typically are designed to protect the vendor's trade secrets and intellectual property rights -- not county data or information held or used by the vendor to perform the contract. Non-disclosure provisions in the county's favor may be used to protect the integrity and confidentiality of county data and information.
- **Data Security Provisions:** These provisions typically are designed to protect the security of county data used by the vendor for the work of the contract. Procedures/protections should be included to protect county data, such as: encryption and password procedure; dual control restrictions; physical protection of equipment and software; employee background checks; data breach response and notification; periodic audits; litigation discovery provisions relating to when and how the vendor may release county data during litigation; and compliance with applicable laws and privacy policies.

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IMPORTANT TECHNOLOGY ISSUES - PART 3

- **Software as a Service Escrow:** A county may be concerned about a vendor going out of business during the contract. To solve that concern, a "software as a service escrow" component may be sold to the county as protection. This allows the software to be maintained by a third-party/escrow agent to be released to the county if the vendor goes out of business -- thus allowing the county to continue to operate the system without vendor support.
- **REMEMBER:** There is a risk that this solution might not work effectively if the vendor goes out of business. Special hardware and software typically will be required for successful system operation -- and the software may be complex and not easily understood by county personnel to operate and maintain system effectiveness.
- **SOLUTION:** A practical solution is to consider **insurance requirements and financial disclosure provisions** to identify vendor sustainability issues in time for the county to consider changing vendors.

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IMPORTANT TECHNOLOGY ISSUES - PART 4

• **Combination Use Situations – Indemnity Protection for County:** Typically, the vendor will indemnify the county regarding intellectual property litigation claims pertaining to the vendor's technology – but exceptions to this indemnity obligation usually will be included to protect the vendor. Those indemnity exceptions may be too broad for adequate county protection.

• **Third-Party Combination Use Exception:** If the exception disallows indemnity for the county regarding a claim involving the use of the vendor's technology "in combination with hardware or software not provided by the vendor," this exception typically is viewed as too broad for effective county protection. That's because most hardware or software systems operate in combination with the products of a third-party.

• **REMEMBER:** The solution may be to narrow the indemnity exception -- to allow an exception to the vendor's indemnity obligation to the county for all combination use situations -- unless the combination use achieves the functionality described in the specification provisions in the contract between the vendor and the county.

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IMPORTANT TECHNOLOGY ISSUES – PART 5

• **County Requested Software Modification – Indemnity Protection for County:** The vendor will try to limit its indemnity obligation to the county by adding an exception for a third-party claim caused by any vendor modification of the software conducted at county request. This indemnity exception typically is viewed as too broad for adequate county protection.

• **Solution:** This indemnity exception should be narrowed in the county's favor. The exception should not apply when the vendor: (1) had a choice or discretion about how to write the software modification requested by the county; or (2) acted improperly to write the software modification using the third-party's software without first obtaining a license.

• **Remember:** The county should seek broad indemnity protection from the vendor for third-party claims. This software modification indemnity exception can be narrowed in the county's favor by using a contract provision which recognizes the exception only when the third-party claim is directly caused by the county's software modification request.

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IMPORTANT TECHNOLOGY ISSUES – PART 6

• **Technical Specifications Needed:** If the vendor is customizing software for the county, the contract should include detailed, technical specifications describing all features and functions of the system.

• **Technical Specifications Provided by County:** If the vendor's standard specifications are insufficient, the county should draft additional specifications for the contract – typically with the assistance of an IT specialist.

• **REMEMBER:** Clearly stated and precise technical specifications are important for the county's interests under the contract 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 technical specifications. If those specifications are not clearly stated -- or not stated at all -- the county's default, warranty, and remedy rights under the contract may be impaired.

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IMPORTANT TECHNOLOGY ISSUES – PART 7

- **Insurance Provisions** – The purpose of requiring insurance for one 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 county's protection. This failure should be avoided.
- **REMEMBER:** The following coverage issues typically should be considered for the proposed contract:
 - 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.

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POTENTIAL LITIGATION ISSUES

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

- Default/remedy definitions and procedure in the county's favor;
- Warranty and indemnity protections in the county's favor;
- Procedural issues in favor of the county -- such as choice of law, venue, alternative dispute resolution (such as mediation or arbitration), and waiver or non-waiver of the right to a jury trial.

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THE WRAP-UP

- **THE PRACTICAL DIFFICULTY:** Vendors are reluctant to modify their standard contract forms or options -- but you still should try to negotiate the deal points desired by the county.
- **ASK THIS QUESTION INTERNALLY:** How badly do you need or want this contract? If your answer indicates a strong need or 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.
- **CONSIDER USING AN IT CONSULTANT:** Consider obtaining specialized IT advice for your deal point positions before the negotiation begins. This will save time during the negotiation and drafting of the contract.
- **BEST TO YOU:** We wish you the best of success regarding the negotiation and implementation of your county's technology contracts.

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