CONTRACTING GUIDANCE

Networks must negotiate with vendors to purchase hardware (e.g., servers, computers), software (e.g., practice management, billing systems) and maintenance services. These contracts can be complex and will require time and attention. An effective contract requires time spent up front anticipating and addressing potential problem areas. Contracts should clearly and fairly represent the business and technical conditions agreed upon by both parties.

A contract serves three purposes:

- Describes the work to be performed and by whom
- Details the products to be delivered and the prices to be paid
- Provides a means of legal recourse and defines remedies

As the contract negotiating process begins, remember that the vendor's contract is only a starting point. Most vendors have standard contracts. The network should review these contracts to ensure they meet the network's business and financial objectives. Since the vendor negotiates contracts frequently, learning about the contracting process can help ensure that the network's interests are represented.

CONTRACT GUIDANCE PURPOSE

This document is meant to provide guidance for reviewing and negotiating a vendor contract for computer hardware, software, and support services. It covers topics relevant to the negotiating process including license scope, payment terms, warranties, acceptance testing, customization, and dispute resolution.

This guidance should not be taken as legal advice. Legal counsel should review and help negotiate every contract.

CONTRACT SCOPE AND TERMS

The scope and terms of the contract identify the parties to the contract, responsibilities, work to be performed, products delivered, length of the contractual relationship, etc. There should be a clause in the contract that defines when the contract will start. Some common start times are:

- On contract signing
- On delivery of the work plan
- On delivery of specified hardware and/or software
- On first productive use of the information system

SOFTWARE LICENSE

A software package, such as a practice management system, is typically not sold, since a sale involves a transfer of title. Instead, a software package is usually licensed for use. The software may be licensed on a rental basis, in which case a charge is made for each month the software is used. An alternative is to make a single payment, for which the vendor issues a fixed term license to use the package. In both cases the user has the right to use the package, and does not retain title or ownership. Some points to consider:

- Ensure that entitled software users are clearly defined (such as affiliates, consultants, etc.). For example, ensure that future network members are included as future users.
- Look for clauses that limit the license to a certain number of users, a particular location, or specific pieces of equipment. If these limitations do not fit network needs, renegotiate with the vendor.
- Identify if the license is perpetual or set for a specific term. If it is set for a specific term, negotiate future renewal pricing to obtain potential discounts.

SYSTEM DESCRIPTIONS/UPGRADES

Ensure that the contract includes an itemized list of the products or components the network is buying or licensing, and how much each component costs. In the case of a software contract, this list must include all system modules and their release numbers, all customization, modifications or system tailoring needed to fit the product to each center, product documentation and installation instructions, and anything else the network is acquiring as part of the package.

It is also important to negotiate for the vendor to provide upgrades to current and future software releases at no cost. This is imperative, since the cost of upgrading to the next release can cost as much or more than the original purchase.

PAYMENT TERMS

Payment terms are the assurance that the vendor will comply with what was agreed upon. Terms should be carefully negotiated and tied to value, deliverables, and key project milestones. Suggested payment terms are 1/3 upon each of the following:

- Signing or work plan delivery
- System delivery
- Full system integration and acceptance

It is possible that the network will end up with different payment schedules, but it is important to tie payments to milestones of significant value. Withhold a large percent of the payment until the system is fully operational, integrated, and performs according to the acceptance specifications. Consider the following:

- Identify how the software license price is structured—by facility, by number of users, by computer model type. The network may want to consider an overall, enterprise-wide price.
- Negotiate now for discounts for future purchases and renewals.
- Ensure that all the applicable elements of pricing have been clearly identified in the contract including:
  - Equipment costs
  - Software fees
  - Interface fees
  - Custom programming
  - Implementation costs
  - Conversion costs
  - Travel costs
  - Software support fees
  - Continuing support fees for interfaces
  - Education and training fees
  - New release/version pricing if not included in support fees
  - Annual increase caps, (e.g., lesser of inflation or 4 percent)

WORK PLAN

The work plan is the road map to a complete system installation. It is not always provided, however. It is good practice for the network and the vendor to jointly develop a mutually agreeable work plan. Delivery of the work plan becomes an opportunity to tie the first payment to a tangible milestone, instead of tying it to the signing of the contract.

CUSTOMIZATION

Most software products need to be customized to suit a particular environment. Develop a detailed set of specifications for the features that are to be customized to meet your business needs. It is important to get specific price quotes from the vendor by module and include them in the contract. If the module is to be customized at no charge, still include it and indicate “N/C” in the space reserved for charges.

Custom features, for which the network has paid specifically, should now become network property. Ensure that the contract states so in specific terms. If the vendor wants to retain ownership so they can sell this feature to other clients, negotiate for a lower price or for some other important concession.

DELIVERY OF HARDWARE AND/OR SOFTWARE

Negotiate for control over the initial delivery dates and tie payments to the delivery of separate components, if applicable. Ensure that there are penalties for delays and enforce them. Also, clearly identify who pays the delivery charges and insurance and who bears the risk of loss.

If the procurement is for new hardware, ensure that the vendor warrants the hardware as new. Specify terms and conditions for when there is "acceptance" of the hardware from a contractual standpoint.

SYSTEM WARRANTIES

Only purchase products from vendors who warrant their products. The warranty will usually state that the vendor is warranting the system to work as described in the system documentation and as attested by the vendor in its proposal, if one was received.

In addition, the system should also work as described in sales presentations and negotiating sessions, provided these meetings and presentations were adequately documented. These warranties should not be implied. Everything that is warranted has to be specified in the contract. Consider the following:

- Ensure that the vendor warrants that the hardware (if applicable) and software will operate in accordance with the agreed upon specifications.
- Incorporate performance standards such as response time, batch processing time, and/or backup time.
- Ensure that the warranties cover:
  - interfaces and other custom programming
  - enhancements including bug fixes and new releases
  - potential disabling codes (i.e., viruses, time clocks, back doors, etc.)
- Verify that the time period of the warranties protect the network's investment.
- Determine the network's remedies in the event of a breach of the warranty. Describe if the vendor is required to make fixes and the required timeframe. Negotiate for the ability to refuse to pay and/or obtain a return of all monies paid when warranties go unfulfilled.

- Verify that the vendor has insurance or provides a performance bond.
- Look for a limited liability statement in the contract by the vendor. It is normal and acceptable, and its purpose is to protect the vendor if the network is sued.

YEAR 2000 (Y2K) COMPLIANCE

This continues to be an essential consideration for every contract for any product that contains a microchip or for software. Ensure that the contract specifies that the vendor's product is fully Y2K compliant.

ACCEPTANCE TESTING

Once the system has been customized and installed, the vendor should provide certification that the system is ready for use and that it is capable of performing all functions. It is now important to ensure that it meets the specifications defined in the contract by conducting an acceptance test.

Acceptance tests must be designed to satisfy documented requirements. These tests should be incorporated into the contract, either directly or by reference. The vendor must agree to these tests before signing the contract, so that if these criteria are not met, the contract is considered breached. Give the vendor at least one opportunity to correct the malfunction.

The contract should also describe the time period within which tests must be performed, and timing and procedures for providing notices of deficiency and vendor corrections. Also specify any holdbacks of payment pending final acceptance. In summary:

- Be sure to include provisions in the contract that allow the network to conduct acceptance tests and detail the acceptance testing process.
- Ensure that the testing timeframe allows sufficient time to test the software (e.g., for month-end and quarter-end procedures and reports).
- If the testing discloses defects in the software, state that the vendor is responsible within a certain time frame for correcting the errors.
- Negotiate for the ability to return the software and hardware for a full refund if not accepted per the acceptance process.
- Modular acceptance testing is acceptable, but after testing all modules an entire system acceptance test must be conducted. This test ensures that the modules all work together as an integrated system. Keep in mind that when an error or malfunction affecting a module is corrected, the entire system must be tested again to ensure that the correction had no effect on another part of the system.

REQUIRED HARDWARE AND SOFTWARE CONFIGURATION

You have expectations about how the system should perform in the network environment in terms of functions and features, response time, system availability, and maintainability. The vendor will usually provide advice regarding how much computing power, storage, additional hardware, etc. will be necessary to run the system. This then becomes part of the financial analysis.

To protect the network from an understatement of the required hardware and software, require the vendor to provide all additional hardware and/or software that will be necessary to get to the specified level of system performance. This may meet with resistance; however, this is a very effective method of putting the risk on the vendor for development of the appropriate configuration. Realize that if third parties (resellers) provide the hardware or software, they will inflate the price of the products above what might be negotiated directly with the hardware or software vendor.

VENDOR SUPPORT AND MAINTENANCE

The network will need ongoing software product support from the vendor. The best software can fail. Determine the level of support required by the organization. The contract normally specifies vendor support for a period of time and the hours of availability. Ensure that support is tailored to meet network requirements. If the health centers are located on the East Coast and hours of operation are from 8:30 a.m. to 4:30 p.m., the vendor should support those hours, regardless of the vendor's business location.

For software packages, maintenance and support costs are usually a percentage of the software price. It is likely that this percentage will be based on the list price of the product and not on the discounted price. This is fair as long as it is expressed up front and as long as the maintenance cost does not inflate as the list price inflates. The average price for maintenance and support is 12 - 15% of the list price. Some vendors may charge as much as 20%, with the list price increasing every year. Negotiate caps on how high these costs can rise for the duration of the contract.

For hardware, maintenance and support costs are usually fixed, however, these prices are often negotiable.

TRAINING AND DOCUMENTATION

Expect the vendor to provide sufficient training and documentation so the system can be used in the network environment. Because of its expense, the network may want to keep responsibility for ongoing training. A "train-the-trainer" approach is a cost effective

alternative to vendor-provided training. Train the trainer is when the vendor trains network staff members who can then train network users on the product.

Documentation is the vendor's responsibility. Contracts usually provide for a set number of copies, normally one, of documentation. Since making copies of the documentation is expensive, ask the vendor via the contract to provide enough copies to cover the needs of both information systems and user departments. Even if the documentation is delivered on CD-ROM, request sufficient copies to cover all the network's needs.

RESPONSIBILITIES

The success of the project depends on both parties fully executing their responsibilities. This section of the contract provides an opportunity for the vendor and the organization to clearly identify their full expectations of the other party not listed elsewhere. Do not make assumptions regarding responsibilities; instead, clearly state them in the contract.

PROBLEM RESOLUTION AND ESCALATION PROCEDURES

It is important to clearly define problem resolution and escalation procedures. Vendors usually have problem resolution and escalation procedures in their standard contract. Read and understand them. If the vendor's standard procedures do not meet the network's requirements, negotiate special procedures.

Either way, include a clear definition of these procedures in the contract. Remember that it is likely that the vendor's standard procedures will change over time, so explicitly describe the minimally acceptable procedures in the contract for protection.

DISPUTE RESOLUTION

You will want to have the laws of the state in which you do business, not the vendor's state, to be the governing laws of this contract. Also ensure that dispute resolution and litigation occurs in your state. This will make recourse easier and less cumbersome should anything go wrong. This is often unacceptable to the vendor, but is worth pursuing, particularly if all products and services are to be delivered in the customer's home state.

Determine if the network wants to use alternate dispute mechanisms (such as arbitration) in lieu of the court system in order to obtain a quicker resolution and to reduce legal expenses. Consult legal counsel regarding the advisability of and alternatives for arbitration.

Finally, if disputes are to be litigated, ensure that the contract specifies who will pay attorney's fees.

REGULATORY CHANGES

Health care is a tightly regulated business, both at the federal and state levels. The vendor must be willing to make software changes to meet all federal, state, and local mandates, in terms of functionality and within the required time frames at no additional cost.

State and federal requirements on patient data are constantly changing. If the vendor is charging each time they must make these changes, there will be significant unplanned expenses. Thus it is the vendor's responsibility to comply with the appropriate regulations at no cost to the network.

SOURCE CODE

There is a risk when buying software that the vendor will not survive the life of the contract. That event could leave the organization with a system that is not only unsupported but that cannot be changed or fixed in case of a system malfunction. Thus, the network should have a copy of the system source code to protect it from this risk.

Vendors will often be reluctant to provide their clients with a copy of the source code. Since the network also requires protection from the possibility of a vendor business failure, a workable solution is to place the source code in escrow. If the network chooses this approach, however, ensure that the source code is updated as the software is updated and that all changes are audited and notarized. Also request to be notified in writing each time the vendor updates the copy of the source code in escrow.

CONFIDENTIALITY

During the course of the engagement, especially during implementation, it is likely that vendor personnel will see confidential and proprietary business information. Protect the network and the patients from this possibility. Both parties should execute agreements not to disclose confidential information about the other. These agreements should extend at least to the end of the contract, and possibly beyond the completion of the contract.

Confidentiality can be applied on a blanket basis without constraint, provided that once this information reaches the public domain, it shall no longer be covered by the agreement. If certain data, such as patient data, are known to be critically confidential, specifically mention these in addition to the blanket confidentiality clause.

OUT-OF-POCKET EXPENSES

Out-of-pocket expenses will be a major variable cost. Out-of-pocket expenses are the project costs that the vendor will pass on for travel, hotel, meals, and per diem. Carefully plan all required vendor staff visits and limit unnecessary ones as they will inflate costs.

CANCELLATION PROCEDURES

There are a number of reasons why the contract may not be able to be fully executed. Identify these reasons in advance and provide the provisions for contract cancellation. These reasons could include:

- The vendor's failure to deliver and install the product on time
- The product's failure to accommodate custom features or required interfaces
- The vendor's business failure

Regardless of the cause, include the option to cancel for sufficient and specified reasons. Equally, if the vendor fails to perform after the system is live, the network will want the ability to terminate the contract early.

The contract should also contain a clear definition of what constitutes satisfactory completion of the contract by both parties.

LIABILITIES AND PENALTY CLAUSES

Limit network liability in the event of a breach of contract. Network liability should never exceed the amount to be paid had the contract been satisfactorily completed. Recent rulings against vendors have led to new protections for buyers; however, the best source for advice on liability and penalty clauses is legal counsel.

CONTRACT ASSIGNMENT

In general, do not permit the vendor to assign the contract to another vendor. If the vendor were to assign the contract, the contractual responsibilities would still remain with the original vendor, but the performance of the contract could be done by another entity, and the quality of performance might suffer. Thus, obtain the right to block the reassignment of the contract to any other entity without prior knowledge and approval.

VENDOR FINANCIAL STATEMENTS

Demand evidence of vendor financial performance. Financial statements give a good indication of the financial structure and viability of the organization. Include a statement in the contract that a quarterly financial statement will be provided. This should be straightforward if the vendor organization is public, however if the organization is private the matter may be subject to negotiation.

In any event, it is advisable to append a copy of the current financial statement to the contract coupled with the vendor's representation of its authenticity. If the vendor then

becomes financially unstable, there may be an opportunity to hold back money on the basis that the vendor misrepresented their financial condition.

PRICE

Having negotiated all the previous terms and conditions, it is now time to negotiate price. Evaluate the fair price across the total cost of ownership (at least 5 years). The relationship of the total cost to potential value should be used to finalize a price. Use the Financing Plan to ensure that all potential costs are captured.