



September 2009

How to Be Smart in Technology Procurement Transactions

Tom Dougherty
dougherty@fhhlaw.com
703-812-0409

If you're the person in your organization responsible for buying sophisticated software-controlled products – for example, corporate phone systems, advanced medical devices, supply chain management systems or call center technology – you routinely face a host of complex considerations. In most such cases (which I refer to as “technology procurement transactions”), the products are not purchased off the shelf; rather, they tend to be built from the bottom up from separate software, firmware and equipment that is integrated and programmed to address the buyer's peculiar needs.

But no matter what unique customization features any particular acquisition entails, it is important to recognize that certain issues and concerns tend to apply to virtually all of these transactions.

When you negotiate the acquisition of virtually *any* sophisticated software-controlled product or system, you should keep in mind the following issues which tend to be common across a vast range of such deals:

Scope Creep The buyer has to do more or buy more or different support systems than the buyer expected in order to install and operate the vendor's equipment and software.

System Warranties The vendor warrants the performance of individual system components but *not* the performance of the system as a whole. For example, imagine the server is performing in accordance with its specifications and the software is performing in accordance with its specifications but the system does not work. Warranties as to the performance of just the server and the software, alone, do nothing to help you in this circumstance. This problem also arises in maintenance agreements.

Incomplete Performance Warranties The vendor warranties do not warrant all features and functions desired by the buyer.

Software Warranties and Remedies Vendors often resist warranting their rights to license the software to the buyer. What if a third party alleges that the vendor's software infringes the third party's copyright or a court enjoins further use of the software?

Does It Work? The vendor does not propose to acceptance test the completed system before turning it over to the buyer. The only thing that is worse than not having an agreement as to how the system is to perform is to go live with the system without testing it to see if it functions as contemplated. And do not rely on warranties and maintenance agreements in lieu of acceptance testing. If I am not convincing you of the importance of acceptance testing, read about what happened to Qwest when it activated a supply chain management system that did not work:

<http://www.computerweekly.com/Articles/2002/08/02/188824/supply-chain-failure-dents-ici-profits.htm>.

Software Updates, Patches and New Releases The vendor does not agree to provide software updates and patches for free, or to make new (and backwardly compatible) software releases available to the buyer at a pre-agreed price.

Long Term Software Maintenance The vendor does not agree to maintain software beyond any one-year rolling warranty term.

Availability of Spares and Peripheral Units The vendor does not agree to continue to make spares and peripheral units (like CPE) available for a set number of years at stabilized or benchmarked prices.

Long-Term Dependability of the Small Vendor Often buyers contract to use an important piece of software or equipment provided exclusively by a small vendor. Well, what if that vendor goes out of business? In this circumstance, the buyer may want to consider procuring rights of access to the software source code through a two-party or three-party escrow, a trust agreement or a source code license.

Ownership of Custom Software If any of the software is made to the buyer's order in whole or in part, who will own that part that is made to order – the vendor, the buyer or both?

These are just a sampling of some of the more important considerations underlying the process of entering into a technology procurement transaction. How can you be sure that none of these common considerations is overlooked in the acquisition process?

Generally, buyers have an easier time addressing these issues if the issues are specifically identified in the buyer's request for proposal (RFP). Typically, the procurement process

starts with an RFP which: (1) provides prospective vendors with knowledge of the buyer's requirements; (2) better enables prospective vendors to suggest alternatives that may better suit the buyer's needs; and (3) allows the buyer to better understand its needs and requirements for the procurement. An RFP process may seem like an unnecessary step, but a well-developed RFP can avoid misunderstandings and allow the buyer to negotiate key points early when the vendor is motivated to give concessions in order to win the project. Moreover, the process of preparing the RFP, while seemingly tedious, is a very valuable exercise in discovering the features, functions and capabilities you want. The process of preparing the RFP better assures that you have considered and will view the procurement with a top-down approach, which is essential to a successful procurement.

Buyers who choose not to use an RFP setting forth their proposed material terms and conditions often find that the vendor expects the buyer to use the vendor's documentation. In this event, the buyer can expect the vendor to provide a stack of brochures, tables and charts describing the discrete pieces of software, firmware and equipment and their individual performance characteristics, along with one or more proposed standard-form agreements for the purchase and maintenance of the product. The vendor normally urges the use of its own standardized documents, often claiming that using those standard agreements will speed the process of concluding the transaction and reduce transactional costs.

From the buyer's perspective, relying on the vendor's standardized documentation is almost always a mistake. Agreements prepared by the vendor will tend almost without fail to include issues of importance to the vendor (and treat those issues, not surprisingly, in a vendor-friendly manner), while omitting legitimate concerns of the purchaser. This is not to say that the vendor is necessarily trying to put one over on the buyer. Rather, it's an inherent limitation of vendor-supplied contracts, since the vendor knows itself and knows little about the buyer. In addition, it is in the vendor's interest to warrant the individual items of software, hardware and firmware, and not the performance of the system as a whole; in short, the vendor would prefer to take a bottom-up approach that avoids system integration issues and their costs. For this reason, vendor documentation will tend to sell and warrant individual items of software, firmware and equipment, avoiding system warranties.

By contrast, when specific contractual terms and conditions are required by the buyer in an RFP, the vendor expects the buyer to demand a custom contract. And even if the vendor responds to the RFP with standard, vendor-created contract forms, the RFP can provide the buyer with a convenient checklist against which to analyze those forms. In that way the buyer can more easily determine when the vendor's form contract does not cover all terms and conditions that the buyer regards as material (or does not cover them

in an even-handed manner). In any event, buyers should not be shy about asking for custom documentation addressing the buyer's concerns.

Some readers may now be wondering how they can address these issues and follow these suggested processes, yet stay within budget and the timeframe for the project. The answer is that competent counsel familiar with technology procurement transactions should be able to work with the buyer to focus on what is critical to the buyer. That counsel can also manage the process in a manner and at a cost consistent with the size of the project and the importance of the procurement to the organization.

[Ed. note: The author has written extensively on practical and legal issues confronting telecom industry players, most recently in the September issue of "Units", the National Apartment Association's trade magazine: "Raise the Roof - Tips on Renting Roof Top Tower Access."]