# When More Produces Less: California's IT Terms and Conditions Produce Less Competition and Lower Value

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State agencies are important purchasers of information technology and services. With regularity, state agencies are replacing legacy systems to increase functionality, improve responsiveness, and enhance the overall quality of services being delivered to state users of information technology (IT). The advent of these new, highly sophisticated systems promises something of a revolution in both the process and substance by which state governments deliver services to their constituencies.

Unfortunately, analysis shows that the laws, rules, systems, and procedures employed by state governments to manage the procurement of such IT services have not always kept pace. Significant initiatives have been taken at the federal level toward acquisition reform in order to use techniques that are more representative of the commercial marketplace in federal government procurements; however, these same initiatives have not yet been taken or, at a minimum, have not been consistently applied at the state level. The result is a patchwork of inconsistent procedures and, worse, a continuing pattern of efforts on the part of some state purchasers to demand that IT providers accept terms and conditions that are grossly out of synch with the commercial world.

Although these positions have nominally been taken in state procurement to protect the public interest and to obtain best value for lowest price, in fact, it can be shown that such positions injure the public in several ways. First, in a situation where the procurement process is overly elaborate or depends heavily on specially negotiated variances from unacceptable standard-form state-government contract terms, the cost and time required for the negotiation process delay receipt of services and technology, add to vendor costs, and produce undesirable inconsistencies even within the purchasing practices of individual states. In addition, when legacy processes are used, they produce controversy in award decisions and foster adversarial relationships and contention between the customer and the winner of procurements.


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Second, considering the substance of terms and conditions that are too often imposed by state procuring authorities, they depart from commercial realities by imposing risks and costs on vendors that are unreasonable, disproportionate to any potential gain, and often outside the risk-management authority of the vendor. A procuring agency's insistence on dogmatic adherence to such terms discourages or dissuades otherwise competitive vendors from participating in procurements, thus depriving the public of the benefit of full competition. Even when competition does proceed, it is a practical reality that commercially unreasonable terms and conditions require vendors to engage in self-protection by incorporating these risks into their offering prices. The result is that the state agency and the public pay more—not more for more but more for less because often there is no performance value in pricing that reflects legal and liability risks that vendors incorporate as protection against unreasonable terms and conditions.

Our experience includes representation of a number of IT providers in government and non-government procurements throughout the United States. We have advised such firms in their procurement contracts with the U.S. government and with state governments in diverse geographic regions. Consequently, we have found significant variance among state practices. This variance leads our clients to conclude that certain states should simply be avoided because of onerous terms and conditions while other states—those that are more realistic regarding the allocation of risk between provider and purchaser—are interesting and compelling markets in which to aggressively seek opportunities by providing competitive pricing and top-of-the-line, cutting edge technology.

This article focuses on the State of California.[1] The IT budget for the State of California is second only to that of the federal government, and California is a marketplace that all IT providers consider important. Nevertheless, an increasing number of vendors find that public procurement opportunities in California present risks too great to pursue. In some cases, well known resources have reached no-bid decisions when considering a California opportunity, not from an inability to provide the functionality desired by the user agency but instead because of adverse reaction to the IT terms and conditions the State of California uses.

Sovereign purchasers at the federal or state level enjoy somewhat of a monopsony over the marketplace in which they operate. When that authority is abused or exercised imprudently, vendors may conclude that their only recourse is nonparticipation. This is not in the public

interest especially if the consequence is dilution in the number and quality of participants in competition for important public functions served by a particular procurement.

We seek to show the differences between the approach employed by the State of California and that employed by certain other states, to suggest resulting business and legal problems presented by the California approach to the IT industry, and to indicate why the public interest may be harmed and not protected by California terms and conditions. We conclude by offering some practical suggestions regarding procedures the State of California might employ and principles it might adopt to streamline its IT acquisition process, while also making it more cost-effective. Our goal is to outline a way in which IT procurements can proceed fairly, but faster, with more participants; with aggressive best value competition on price, quality and technology; and without exposing providers to potentially unknowable or catastrophic risk. No valid state or public purpose is served by an approach to procurement that produces such potentially unfathomable hazards to those who do business with the sovereign.

### Terms and Conditions of IT Contracts in California[2]

California has created a standard IT contract (the model agreement) for use in California IT procurements.[3] Many of the provisions of the model agreement are unnecessarily unfavorable to contractors, increasing the costs of IT services and products and decreasing competition. Of particular concern are those provisions on limitation on liability, warranty, indemnification, and ownership of intellectual property.

Section 3 of the model agreement's general terms and conditions purports to provide a limitation of the greater of $200,000 or the purchase price on liability for damages.[4] This limitation, however, provides essentially no protection for a vendor when the cost-of-cover exception is considered. In this clause, it is made clear that the limitation on liability does not limit the separate right of California to recover its cost of cover (that is, the cost of procuring equivalent systems or services minus the bid price of the liable vendor in the event the vendor breaches).[5] Also excepted from the limitation-on-liability clause are costs and damage awards falling in the category of patent, copyright, and trade secret protection.[6] Effectively, the limitation-on-liability clause provides few real limitations.

Section 19 of the model agreement requires that all goods and services furnished under a contract will conform to the contract's requirements.[7] On its face, this seems to be a very fair warranty. Goods and services should conform to the requirements of a contract through which a purchaser buys. However, the warranty further states that the system or services shall be free from all defects.[8] Moreover, the warranty is unlimited in time and allows no exceptions for failures caused by the state or by third parties, including state or third-party hardware or software.[9] California excepts from this warranty only those defects in design or specifications that were furnished by the state but not contractor-furnished designs or specifications even if they were ultimately approved by the state.[10] Finally, the state's broad warranty provision does not include standard disclaimers of other express or implied warranties.[11]

The indemnification provisions of the model agreement also present significant risks to IT providers that desire to assist the State of California. Section 4 of the model agreement provides that a contractor must indemnify the state from any and all claims and losses that arise from the performance of the contract except for consequential damages to any and all contractors, subcontractors, suppliers, laborers, or employees.[12] Once again, California has placed a very broad obligation upon its contractors: This obligation does not provide for many of the standard in-the-industry exceptions commonly found in similar contracts, such as the limitation of a contractor's indemnification obligation to only those damages that are proximately caused by a vendor's wrongful act or omission, inclusion of a comparative fault provision, and limitations to bodily injury, which would thereby exclude the possible liability for open-ended allegations of emotional damages. The California indemnity obligation requires a vendor to indemnify the state for all types of damages arising from performance of the contract even if the vendor has performed all of its obligations in strict conformance with contract requirements and is otherwise not at fault for any wrongful act or omission.[13] In other words, a vendor may find that it has an indemnity obligation despite the fact that it is innocent of any breach or other wrongful or negligent act or omission.

Of equal concern to vendors are the provisions regarding ownership of intellectual property. Section 5 of the model agreement (rights in data) provides that the state will take exclusive ownership of and may copyright all technical communications and records prepared by a contractor pursuant to its contract.[14] Moreover, California retains the right to use "ideas, concepts, know-how, or techniques relating to data processing" that a contractor develops during the course of the contract, whether developed by the contractor acting on its own or by acting jointly with the state.[15] California grants a contractor the right to use the ideas, concepts, and so on developed in the course of performance of the contract in any way it may deem appropriate.[16] Additionally, California claims title to all "inventions, discoveries or improvements of the computer programs" developed pursuant to the contract.[17] Once more, California grants a nonexclusive royalty-free license to the contractor and allows the contractor to sublicense additional persons on a royalty-free basis.[18]

While state contractors may accept assigning ownership of intellectual property developed during the course of performance of a state opportunity to the procuring state, contractors across the board are reluctant to enter into agreements that do not expressly and clearly carve out from such assignment provisions ownership to preexisting materials that may be included in deliverables. Contractors simply will not leave this issue to chance interpretation long after contract award. Contractors believe that such inexact ownership provisions place their valuable intellectual property at risk.

In addition to these provisions of the model agreement, in recent months, the State of California has additionally layered one protective provision upon other protective provision, causing bidders to significantly increase their bid prices. It is not uncommon in fixed-price California state procurements to find (1) deliverable-based payment schedules in which payment is withheld until deliverable acceptance, (2) withholding or holding back a percentage of the deliverable price until final acceptance of the system; (3) a requirement for a performance bond generally equal to fifty percent of the total fixed price; and (4) liquidated damage provisions. Any one or a combination of any two of these protections is sufficient to protect the state from the expenditure of taxpayer's monies for less than contractually required performance. All of these provisions together significantly increase the price that vendors offer to the State of California, causing, as stated earlier, the state to pay more for less.

Finally, there has been an increasing and very troubling reluctance by the State of California to negotiate with vendors. Most recently, there has been a reluctance to discuss even special terms and conditions drafted and included in a particular solicitation for a specific IT opportunity. We understand the state's desire to minimize contractor discussions in order to streamline the procurement process and create an equitable procurement system that does not favor any contractor. However, the problem with this approach in California stems from the fact that the model agreement and other special terms and conditions are out of step with commercial practices, leading many vendors to simply exit the California marketplace and thereby decreasing the competition available in the procurement process.

### Comparison of California's Standards with Terms and Conditions for IT Contracts in Other States

Other states, including New Hampshire, Vermont, Massachusetts, and Rhode Island, have adopted standard IT contracts and terms and conditions similar in kind to California's model agreement. New Hampshire, Vermont, Massachusetts, and Rhode Island have adopted a standard IT contract that is commonly referred to as the ITS07.[19] The ITS07 is a master agreement awarded by the Commonwealth of Massachusetts through a procurement conducted on behalf of the participating states. A contractor chosen as an eligible ITS07 vendor must agree to certain standard master terms and conditions contained in the ITS07. The contractor will subsequently accept additional standard terms and conditions issued by each of the participating states. For example, the State of New Hampshire asks all eligible ITS07 vendors to sign up to its own standard IT terms and conditions, which are commonly referred to as the P-37.[20]

Contracts like the ITS07 and the P-37 have helped to standardize the procurement process and contract terms and conditions governing state IT procurements throughout the northeastern United States. These procedures have eliminated the excessive time and effort required to negotiate engagement-specific terms and conditions, thereby effectively streamlining the procurement process. Other states, such as Ohio, though not participating in a coordinated effort by and among other states, have developed more or less standard terms and conditions that are present in most IT contracts.

Generally, regardless of whether we are dealing with model agreements such as the ITS07 and the P-37, individual state standard IT terms and conditions such as those effective in Ohio, or clauses drafted and incorporated into individual IT contracts by state agencies, we routinely find that the provisions contained in California's model agreement, taken as a whole, are more onerous. Moreover, within the last year we have seen certain states modify their standard provisions to incorporate commercial-like terms and conditions.

In recognition of its own inability to attract qualified IT providers due to the lack of a cap on direct damages, in spring 2001, New Hampshire also changed its limitation on liability to include a provision equal to twice the amount of the total contract price with a complete exclusion of liability for consequential damages.[21] The New Hampshire cap on direct damages incorporates the standard commercial carve-outs and is inapplicable to damages stemming from death, bodily injury, physical damage to real or intangible personal property, patent and copyright infringement or misappropriation, personal injury, or disclosure of confidential information.[22] The New Hampshire provision provides vendors with a commercially reasonable and acceptable limitation of liability. This provision allows vendors to understand and quantify the risk of performing engagements for New Hampshire, and the risks of such engagements do not threaten the very existence of the firm. In other words, a provider may bid a job in New Hampshire without concern that a breach action will bankrupt the firm. This concern is exactly what California vendors must face due to the uncapped nature of cover damages in the model agreement. Simply put, many vendors will walk away from an engagement rather than face uncapped liability.

New Hampshire's modifications to the ITS07 align its contracting practices more appropriately with commercial practices and therefore attract more qualified bidders. Specifically, New Hampshire has modified its standard indemnification provision to create indemnification liability for the contractor only for "losses suffered by the State, its officers and employees . . . on account of, based on or resulting from, arising out of (or which may be claimed to arise out of) ... the negligent acts or omissions of the Contractor."[23] The State of New Hampshire has recognized

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that it is simply unreasonable to ask contractors to indemnify state purchasers for losses that are related to performance of an agreement but that do not flow from the indemnifier's wrongful or negligent acts or omissions. This is a recognition of the fairness of obligations that are routinely accepted in the commercial marketplace.

As discussed earlier, during the last year the State of Ohio developed and now routinely includes a standard set of terms and conditions in its major IT procurements. Although many of these provisions are also out of step with commercially acceptable practices, the Ohio provisions, taken as a whole, are more in line with the commercial IT world in which the states must purchase their own IT products and services than is California's model agreement. In addition, Ohio has been willing to negotiate additional terms that further protect contractors. Specifically, Ohio's standard limitation on liability places a cap on liability that is equal to the total fixed price of a contract[24] whereas California's cap may increase liability to $200,000 if a contract price is less than that amount.[25] Ohio's cap incorporates an exclusion for third-party claims resulting from the fault or breach of contract of a contractor.[26] While most contractors find this exclusion less than optimal, Ohio does not eliminate all protections offered by the cap by an exclusion for cover damages as does California. Furthermore, Ohio has been willing to negotiate limitation of liability provisions, agreeing to except liability for third-party claims resulting only from the tortious actions or omissions of a contractor or a contractor's breach of contract.[27]

Moreover, Ohio's standard terms include an indemnification clause that requires a contractor to indemnify the state for all liability resulting from bodily injury to any person and damage to property resulting from the contract's performance.[28] For liability to accrue to a contractor, the standard term also requires that such damage is due to the fault of the contractor and that there was no negligence on the part of the state that contributed to the damage. The Ohio provision is similar to the New Hampshire indemnity provision, for both recognize that a contractor should only be required to indemnify for losses for which it is at fault. The Ohio provision, however, also recognizes that a contractor shall bear no responsibility for losses partially or totally caused by the state's own negligence. [29]

Another important distinction between Ohio's terms and those of California lies in the area of ownership of intellectual property rights. As commonly found in state IT contracts, including the model agreement, Ohio takes all rights, title, and interest in all intellectual property that comes into existence through the contract.[30] Unlike California, however, Ohio is willing to offer express and effective protection for contractors' preexisting materials. California's model agreement does not contain such effective protections for preexisting intellectual property assets of successful vendors. Moreover, the State of Ohio allows contractors to retain ownership of their preexisting shells, subroutines, and similar materials that they may incorporate into the product delivered under the contract.[31] This distinction alone may entice contractors who would otherwise not consider the possibility of giving up ownership rights in preexisting material to bid on Ohio contracts, thereby increasing the competition for Ohio's contract and ultimately lowering the cost to the public.

Wyoming is another state that offers terms and conditions in IT contracts that are more favorable to contractors than those of California.[32] Additionally, Wyoming has been willing to negotiate terms and provide more protection and less risk for successful contractors.

Wyoming has accepted equitable and commercially reasonable provisions that limit contractors' potential liability. As does California, Wyoming excludes liability for consequential damages and provides a mutual cap on other damages. This cap is limited to the amount paid or payable on the contract. Unlike other states, however, this cap applies regardless of the theory of liability or cause of action even if brought as a breach of contract or negligence action. Furthermore, this provision does not incorporate any exception for the cost of cover as does California's model agreement cost-of-cover exception, which guts the equity of a mutual cap on direct damages.

Wyoming has also accepted an indemnification clause that requires the contractor to indemnify the state if liability arises out of a contractor's negligence or willful misconduct. An indemnification obligation tied solely to negligence or willful misconduct is by itself a significant improvement over the broad indemnification obligation set forth in the model agreement, presenting far less risk to Wyoming contractors than the similar California clause presents to California providers. Moreover, Wyoming has been willing to accept an indemnity provision that includes comparative fault, which allows a contractor to shift responsibility for partial indemnification if any entity indemnified under the contract shares fault for the liability. Finally, Wyoming has acknowledged its contractual obligation to provide notice and cooperation and to allow contractors to control the handling, settlement, and defense of claims—a completely equitable provision that is missing from all the other states' provisions discussed earlier.

In terms of ownership rights regarding intellectual property, Wyoming has been willing to protect the preexisting work of those contractors that endeavor to assist it in its IT challenges. Wyoming has expressly allowed contractors to keep all rights to preexisting materials and even some materials developed, refined, or modified under the contract. Typically, Wyoming asks contractors to provide it with royalty-free, perpetual licenses for preexisting work, but this too has proven negotiable in Wyoming.

Finally in this review of other states' terms and conditions of IT contracts, we turn our attention to New York. New York has not agreed to limit the liability of a contractor by way of a cap on direct damages.[33] However, this term falls within the category of terms for which it agrees to negotiate.[34] New York also agrees to exclude liability for consequential, punitive, and exemplary damages.[35]

New York's standard performance warranty requires substantial compliance with the contract's functional requirements, design specifications, and performance standards.[36] This type of warranty is routinely accepted in the commercial marketplace. It is seen as reasonable and, most importantly, attainable. Additionally, a defined period of time for all express warranties is considered essential in the commercial marketplace. The State of New York has recognized this reality by incorporating a defined warranty period. These limitations are in stark contrast to California's perpetual warranty, which requires defect-free conformance to a contract's requirements.[37] New York's warranty recognizes that the goal of zero defects is wholly unrealistic in the software industry: All software has bugs. Some nonconformities materially degrade or prohibit performance; these must be corrected. Other non-conformities, however, are cosmetic in nature or cause no material functional or performance issues. Often correction of such errors is not even desired by a purchaser who simply wants a system that operates substantially in conformance with mutually accepted technical documents and deliverables. The entire concept of zero defects is ill-suited for the IT industry and, in fact, drives the more savvy bidders and potential contractors from the marketplace.

New York characteristically provides protection for the preexisting intellectual property rights of contractors. In at least one recent request for proposal, New York stated that the contractor would retain ownership of "existing products" while the state would assume ownership of "custom products."[38] Within the request for proposal, however, New York stated its willingness to negotiate these terms and conditions.[39]

## Comparison of California's Standards with IT Industry Standard Terms and Conditions

As one might expect after reviewing the variation between California's model agreement and the IT terms and conditions of certain other states, it comes as no surprise that the disparity is even greater when the model agreement is compared to industry standards.[40] Such a comparison reveals that California is far from the mainstream of commercially acceptable terms and conditions. This comparison illustrates the probability that although a particular vendor may overlook one or two problematic provisions to bid on an opportunity in New Hampshire, Ohio, Wyoming or New York, the same vendor may decline to bid on an opportunity in California when faced with an onerous warranty provision, an ineffective limitation of liability, a broad indemnification obligation not tied to any wrongdoing, ineffective protection for preexisting intellectual property, deliverables-based payment pending acceptance, performance bond requirements, payment holdback on deliverables until final payment, and liquidated damages—all under a fixed-price contract. As stated initially in this article, each and every one of these provisions (not to mention the composite picture presented by the combination of all of these provisions in the model agreement) is beyond the ordinary risk tolerance of most major IT vendors.

A study of the standard terms and conditions of major IT providers across the country reveals that each of these providers focuses on essentially the same concerns. Of paramount importance to all such vendors when bidding an opportunity is the inclusion of an effective limitation of liability. Without a cap on direct damages and a waiver of consequentials, many vendors will forgo an opportunity. To subject a firm to unlimited liability in the face of a warranted or unwarranted action for breach is foolish under most circumstances. Although California provides a limitation on liability equal to the greater of the contract price or $200,000, it eviscerates the provision by excepting out cover damages. Such an ineffective cap on direct damages is an immediate roadblock to seeking business opportunities in California.

Moreover, contractors routinely review the warranties that they are asked to provide to ensure that such provisions are realistic and bounded in time and scope. Commonly, these are limited to substantial conformance to the contract or deliverable specifications. Moreover, it is important to limit such warranties in time due to the turnover of the system to state users and the loss of control of the underlying code. Such a measured warranty provision is vastly different from California's broad, unlimited warranty requirement. A contractor who must provide such a broad, unlimited warranty will be forced to include additional costs in its bid price to cover the time and effort required to meet such an obligation.

In the same vein, IT providers must limit their exposure to overly broad indemnification obligations. Such overly broad obligations have a direct relationship to price. Consequently, in a competitive market in which vendors seek to offer the absolutely best price, contractors seeks to limit their indemnification responsibilities to damages that are proximately caused by their fault or negligence and to include a comparative fault provision in the event that an indemnified party shares responsibility for the damages. Also customary in the industry is a limitation on personal injury to bodily injury, thereby eliminating claims for trumped-up emotional damages. Finally, if asked to indemnify, vendors must be able to control the settlement or defense of a claim and obtain prompt notice and cooperation from the state.

Of paramount importance is the protection of preexisting intellectual property. Without such protection, an opportunity may be a vendor's last if ownership of valuable state-of-the-art intellectual property is lost. To inadequately protect such intellectual property is patently foolish for the vendor and patently overreaching for a state. Otherwise, a state would be essentially paying for one product and receiving all the prior underlying work for free. Moreover, such inadequate protection has a drastic effect on the functionality of the


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systems and the price offered by providers. Contractors that previously developed an underlying product that could be modified to meet a state's needs will not place at risk the ownership of such preexisting software. The state loses rich functionality while paying more for a custom system that will take longer to deliver and roll out. Again, a state pays more for less. Although California drafters may believe that preexisting intellectual property is adequately protected, we offer that such protection is unclear and ineffective in the eyes of many vendors.

### The Risks California Faces if It Does Not Change Its Standard Terms and Conditions for IT Contracts

As is evident from reviewing the variations between California's IT terms and conditions and those of certain other states as well as industry standards, California has not made itself attractive to IT contractors who otherwise might wish to compete for California procurement contracts. Although California has a large economy, a large population, and a corresponding large need for favorable government contracts,[41] its regularly applied contract terms and practices and procedures represent an indifference to the business realities of the commercial marketplace and the limitations that operate on prudent potential contractors. Should this continue without relief, California will experience a continuing erosion in the quality of competition, taxpayers will bear a corresponding increase in costs, and the state may find that those who do compete add premiums to compensate for the largely unbounded contracting risks.

Even allowing for its importance in the national marketplace, California does not operate in isolation and should listen to its vendors as an initial measure. In practical experience, too often the procurement authorities in California use iterative acquisition techniques that are available to them to refine vendors' understanding of the state's needs but not the reverse. Obligations to shareholders simply prevent IT vendors from accepting the economic hazards presented in some California procurements, and the state has to appreciate that this is not an occasional problem but has become systemic. Once it acknowledges the fact of material disparities between its terms and conditions and the trend among other states and in federal IT procurement, it becomes obvious that California will need to solicit at least feedback from its potential contractors if not lessons learned from the experience of other states.

IT contractors do not seek changes to California's terms and conditions because they hope to avoid competition; to the contrary, they accept the core importance of competition to the public procurement process. IT contractors seek competition that proceeds on a commercially reasonably basis without exposing a winner to the risk of potential loss due to confiscation or damage from the future operation of a contract term or condition that has little relevance to the actual value of the contractor's proposal or the true objectives of the state. Moreover, California is not serving a bona fide interest of the sovereign by coercing its vendors, whether by design or indifference, to negotiate one-sided agreements that inequitably favor the purchaser. The result is a distortion to the competitive process and to the system of public procurement and one that produces no public gain.

We believe that providers of IT services and products who wish to compete in California seek provisions that will establish realistic risk and allow them to offer their best solutions at very competitive prices without fear of bankrupting their firms or placing significant intellectual property at risk. California should not neglect the reasonable needs of its vendors unless it is prepared to accept less than a competitive pool of bidders on IT contracts or to tolerate a contentious and adversarial (if not frequently litigated) relationship with its contractors after awards are made.

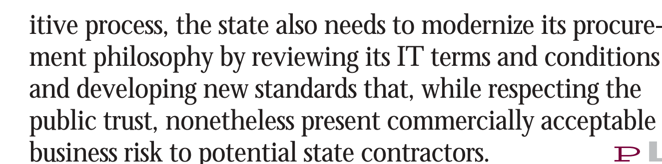
California stands to gain by acting to more closely align its IT terms and conditions with those of other states. Currently, our experience indicates that IT vendors evaluate potential government procurement contracts with a view to whether the level of risk presented is tolerable. There are circumstances and situations where IT vendors have simply chosen to decline to participate in contract procurements where the risks are too great. When vendors must choose the allocation of their proposal and performance resources (as most if not all do), they will seek contracts in states with more favorable terms rather than deal with states whose terms present risks that are perceived to be intolerable. Certainly, the interests of the citizens of California will be served by avoiding a situation where the state ranks low on the hierarchy of entities with whom contractors seek to do business.

Those who administer the procurement process in California should not be lulled into thinking that they are securing a better value for the state and its citizens by insisting on non-market terms and conditions. Even when a vendor is willing to accept the risk of participation in a particular competition, responsibilities to shareholders and other ordinary principles of risk management require that contracting risks be reflected in the pricing of proposals and, in some cases, in strategies employed during contract performance. No contractor endures by taking on potentially calamitous risk without a means to recover for the associated costs. For example, if a contractor is forced to warrant to a zero-defect standard, additional costs will be included in the best price offered to a state. Alternatively, in performance, the contractor will adopt a very stringent or even combative policy in dealing with suggestions from the state: What might in another setting be a cooperative relationship can become one beset with changes and delay claims submitted by the contractor. Thus, in this example, the ultimate best value for California and for other states is secured by bearing the cost of repair for minor defects in IT products and services rather than through an approach that essentially pays every contractor to bear that risk. Similarly, with provisions such as ineffective caps on direct damages, broad indemnification obligations, and terms that threaten loss of independently developed intellectual property, overreaching in the contract terms by the state often, if not ordinarily, produces greater cost to the purchaser than the incremental value derived.

### Recommendations for California

Our recommendations reflect both process and substance. As a matter of process, we urge California to take steps that will inform it of the problems its vendors perceive in the present model agreement and in the way in which the state handles representative IT procurements. As noted, we also urge California to review and consider the lessons learned from the experience of other states and from the federal government. A survey of potential contractors will yield detail about many of the issues addressed in this article and add to the list of important issues as well. As California undertakes such a task, it might also consider conducting a vendor forum at which there could be an open exchange among interested parties about the key issues, reflecting the perspectives of the contracting community as well as the concerns of those responsible for management of public acquisition. Findings of such a process might be prepared in draft by a joint working group and then circulated for comment. As part of this effort, another logical step is to conduct an objective comparison of California's terms and conditions with those standard terms commonly utilized by other states in their IT procurement contracts. Federal terms and commonly accepted commercial provisions could be compared as well. This will show the range of options and help point toward changes that find a better balance between competing interests. As the process evolves, a key substantive event would be the circulation of a new, proposed set of model contract terms and conditions. The state might also consider changes to the approach it takes toward negotiation of IT contracts. Initially, it could serve the interests of all concerned to conduct one or several procurements in which the new terms are evaluated and to limit the right to negotiate such terms. (At least in theory, one benefit of terms that better conform to commercial realities is that there will be less need on the part of the vendor community to insist on waivers, deviations, or specially negotiated terms.)

California gains little and risks much by continuing an isolationist policy of strict adherence to its present terms and conditions. Changes to terms and conditions, aligning California IT contracts with prevailing standards, and moderating the risk calculus facing potential vendors will encourage vendors to do business in California and will produce positive effects of greater competition. Over the past several years, California has announced ambitious plans to improve the quality and responsiveness of many of its governmental services. To do so affordably with the best technology that can be obtained through the competitive process, the state also needs to modernize its procurement philosophy by reviewing its IT terms and conditions and developing new standards that, while respecting the public trust, nonetheless present commercially acceptable business risk to potential state contractors.



### Endnotes

1. California is of particular concern because of its large size. With more than 34 million people, California contains 12% of the United States' population. Considering its $1.3 trillion gross state product, California boasts the seventh largest economy in the world. *See* www.ca.gov/state.
2. *See* General Provisions of the State of California (GSPD-401), revised January 1, 2001 [hereinafter California General Provisions] and State Model Information Technology General Terms and Conditions (published by DGS Procurement Division), revised March 27, 2000 [hereinafter California IT Terms and Conditions].
3. *See* California IT Terms and Conditions.
4. *Id.* at § 3(a).
5. *Id.*
6. *Id.* at § 3(b).
7. *See* California General Provisions at § 19(a).
8. *Id.*
9. *Id.*
10. *See id.*
11. *Id.*
12. *See* California IT Terms and Conditions at § 4.
13. *Id.*
14. *Id.* at § 5(a).
15. *Id.* at § 5(b).
16. *Id.*
17. *Id.* at § 5(c).
18. *Id.*
19. *See* Information Technology Services OSD RFR Number ITS07, Software and Services PMT (published by Commonwealth of Mass., Operational Services Division, Feb. 25, 1999, as amended, Apr. 2, 1999) [hereinafter ITS07].
20. *See* ITS07, Attachment H-3 [commonly referred to as Form P-37].
21. *Id.* at § 8.2.5.
22. *Id.*
23. *ITS07* at Exhibit C, Item 13 (emphasis in original).
24. *See* Request for Proposals, RFP No. 0A01042, Attachment 3: General Terms and Conditions, Part 4: Representations, Warranties and Liabilities, published by Ohio Dept. of Admin. Svcs., Feb. 14, 2000 [hereinafter RFP 0A01042].
25. *See* California IT Terms and Conditions at § 3(a).
26. *See* RFP No. 0A01042, Attachment 3: General Terms and Conditions, Part 4: Representations, Warranties and Liabilities.
27. *Id.*
28. *Id.*
29. *Id.*
30. *Id.* at Attachment 3: General Terms and Conditions, Part 3: Ownership and Handling of Intellectual Property and Confidential Information.
31. *Id.*
32. Information regarding Wyoming's standards terms and conditions is taken from actual contracts proposed by the State of Wyoming. Due to client confidentiality considerations, we are unable to provide citations to substantiate our statements, yet we believe our statements of standard terms to be representative of terms found in Wyoming's proposals.
33. *See* Request for Proposal 00-54 e-MPIRE (published by New York State Dept. of Taxation and Finance, May 21, 2001) [hereinafter RFP 00-54].
34. *Id.* at § 6.0 (A)–(B).

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35. *Id.* at § 6.0 (B)(6)(d).
36. *Id.* at § 6.0 (B)(4)(d).
37. *See* California General Provisions at § 19(a).
38. *See* RFP 00-54 at § 6.0 (B)(3)(b).
39. *Id.* at § 6.0 (A)–(B).
40. In determining the industry standards for comparison purposes, we consulted various client contracts and personal experience in advising clients who regularly participate in IT contracts with governmental entities.
41. *See* www.ca.gov/state.

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