Chapter 25
IT Contract Formation

Chapter highlights

Purpose: This chapter provides discussion of how to create an effective and well- prepared IT contract document.

Key points:

- The formation of an effective contract starts while drafting the solicitation.
- All IT contracts should promote excellence in supplier performance.
- Due to the nature of technology procurement, and the many risks associated with these public investments, there are many specific contractual provisions that must be included in a technology contract which agencies do not normally use for non- technology purchases.
- The lead procurement professional assigned to a technology contract is accountable for ensuring the inclusion of relevant federal and *Code of Virginia* contract provisions and any VITA-required IT specific contractual terms.

Table of Contents

25.0 Introduction

Every acquisition of IT goods and services needs an appropriate contract. Every acquisition requires written technical, legal, administrative and financial agreements between the parties. Contract formation requires mutual consent to agreeable terms by both parties, generally manifested by an offer and acceptance. This chapter provides VPPA and VITA requirements and includes guidelines to cover the components of a successful IT contract.

The formation of an effective starts with the drafting of the solicitation. All terms and conditions that the agency intends to include in the contract should be incorporated into a proposed contract that is included in the solicitation. If the agency attempts to insert substantive contract provisions after proposals are received or during negotiations, suppliers may need to revise pricing or other proposal elements. Agencies should always provide the desired resulting contract in the solicitation package

25.1 Statutory provisions relating to contract formation

Article 2 of the VPPA (Virginia Code §2.2-4303 et seq.) sets forth rules and requirements of contract formation with the Commonwealth generally. Agency personnel conducting an IT procurement should familiarize themselves with all provisions of Article 2 prior to preparing a contract.

In certain instances, public bodies are prohibited from contracting withsuppliers if:

- The supplier, or any affiliate of the supplier, fails or refuses to collect and remit sales tax or fails or refuses to remit any tax due to the Department of Taxation. (Virginia Code §2.2-4321.1)
- The supplier, including its affiliates and all subcontractors, is excluded on the federal government's System for Award Management (SAM) at SAM.gov | Home.

- The supplier is providing any hardware, software, or services that have been prohibited by the U.S. Department of Homeland Security for use on federal systems. (Virginia Code§ 2.2-5514).

25.2 The Offer

An offer is an expression of willingness to contract with the intention that the offer shall become binding on the party making the offer (the supplier) as soon as it is accepted by the party receiving the offer (the agency). An offer gives the agency the ability to form a contract by an appropriate acceptance.

An offer is not valid until received by the agency. If the offer has a stated time within which the acceptance must be made, any attempted acceptance after the expiration of that time will not be successful. Instead, the agency will be considered to have made a counter-offer that the original supplier can accept or reject. Generally, the time for accepting an offer begins to run from the time it is received by the agency. If there was a delay in delivery of the offer and the agency is aware of the delay, the usual inference is that the time runs from the date on which the agency would have received the offer under reasonable circumstances. If no specific time is stated within which the agency must accept, it is assumed that the supplier intended to keep the offer open for a reasonable period of time, to be determined based on the nature of the proposed contract, prior dealings, trade usage and other circumstances of which the agency knows or should know.

Most Commonwealth solicitations require that an offer (bid or proposal) be valid for 90 to 120 days after the bid or proposal due date. This timeframe should accommodate the expected time for the agency to conduct evaluations, prepare the contractual document, as well as any pre-award phases including steering committee, OAG review, VITA Security Assessment, VITA high risk contract review and/or CIO or Secretary of Administration in unique situations and approval and receipt of any pending budget.

25.2.1 Revocation of an offer

An offer is generally revocable by the supplier at any time prior to acceptance. An offer may be revoked by any words that communicate to the agency that the supplier no longer intends to be bound by the offer. An offer is also revoked by any action by the supplier that is inconsistent with the intent to be bound once the agency learns of such inconsistent action. A revocation is effective upon receipt by the agency.

25.2.2 Termination of an offer

An agency cannot accept an offer under these circumstances:

- The death or insanity of the supplier, even without notice to the agency of such occurrence.
- The agency's rejection of the offer, which cannot be reinstated by the agency's subsequent attempted acceptance.
- The agency's counter-offer, which implies a rejection of the original offer.
- Revocation of the offer by the supplier.
- Expiration of the offer.

25.2.3 Rejection of an offer

A rejection of an offer is effective upon receipt by the supplier.

25.3 Acceptance of an offer

A contract is formed when acceptance of the offer is sent.

25.3.1 Acceptance by silence

Silence may not constitute an acceptance except where, based on prior dealings between the parties, it is reasonable that the agency should notify the supplier if it does not intend to accept. Also, where the supplier has given the agency reason to understand that agency's acceptance may be manifested by silence or inaction, and the agency remains silent, that is tantamount to acceptance of supplier's offer.

25.3.2 Notice of acceptance

The supplier is entitled to notice of the acceptance. Thus, even if the agency effectively accepts an offer and a contract is formed, failure by the agency to notify the supplier of the acceptance within a reasonable time may preclude the supplier from enforcing the contract.

25.3.3 Notice of acceptance by performance

When an offer invites acceptance by performance, the supplier is not required to provide notice to accept the offer, unless the supplier so specifies. Agencies should not communicate or agree to acceptance by performance but should always have a written contract document or purchase order which memorializes the terms of the transaction. In transactions for the sale of goods, where commencement of performance may be used to communicate acceptance, if the supplier is not notified of acceptance within a reasonable time, it may treat the offer as having lapsed prior to acceptance. However, if an agency has reason to know that the supplier does not have means of learning that performance has begun, the supplier's contractual duty will be discharged unless:

- The agency exercises reasonable diligence to notify the supplier of acceptance;
- The supplier learns of the performance within a reasonable time; or
- The offer indicates that notification of the acceptance is not necessary.

25.3.4 Notice of acceptance by return promise

Where the agency accepts by promise, the agency must exercise reasonable diligence to notify the supplier of the acceptance or ensure that the supplier receives the acceptance. All public body transactions are required to be memorialized by a written contract or purchase order.

25.3.5 When acceptance becomes effective

An acceptance becomes effective when:

- Absent the offer specifying when the acceptance is effective, acceptance is effective when sent, if sent by reasonable means.
- If an acceptance is sent by means that are not appropriate or reasonable under the circumstances or if it is improperly dispatched, the acceptance will be effective upon receipt.
- In the case of option contracts, an acceptance is not effective until received by the supplier.

25.3.6 Terms of acceptance

An acceptance is sufficient even if it contains additional or different terms from those offered that result from mutually accepted and agreed negotiations by both parties.

25.3.7 Acceptance of terms on packaging and in shrinkwrap and clickwrap

Standard terms presented on or within product packaging present special problems with respect to contract formation. When a shrinkwrap package containing a software program contains a printed warning stating that unwrapping the package constitutes consent to the terms of the license therein, those licenses terms may or may not be binding depending on the jurisdiction interpreting such licenses. Under the Uniform Computer Information Transactions Act UCITA, which has been partially enacted in Virginia, such software license terms are binding on the licensee. Where software is downloaded from the internet, with the licensee being required to click on the "I agree" button indicating agreement to the licensor's terms, such conduct is deemed to be a binding acceptance of the licensor's offer.

25.4 Forming an IT contract

25.4.1 The contract document

An IT contract can be a simple purchase order (PO) and include only eVA PO terms, be based on an invitation for bid (IFB) that has a nominal set of terms and conditions which are non- negotiable, or can be a negotiated agreement based on a complex request for proposal (RFP) process.

VITA has a master library of standard definitions, standard contract clauses and specific terms and conditions that are appropriate for various different IT procurement types:

- Services

- COTS Software and Maintenance
- Hardware and Maintenance
- Solution
- Cloud Services
- Telecommunications
- License Agreement Addendum for EULA

These terms can be selected for the appropriate procurement type(s) by SCM sourcing consultants through VITA's contract management system during solicitation/contract development.

For other agencies, "major" IT procurements require the use of the requirements found in the VITA "Minimum Requirements Matrix for use with VITA IT Templates" on the SCM webpage: Procurement Forms | Virginia IT Agency

For Software as a Service (Saas) or cloud-based contracts, a mandatory set of cloud terms must be included in the contract. These may be obtained by contacting: scminfo@vita.virginia.gov.

25.4.2 General guidelines for a successful IT contract

The key to success in forming any IT contract is setting and meeting the agency's business needs and project's expectations. This can be accomplished by the designation of a joint steering committee to manage the contract's success; identifying individuals for both parties who will have responsibility for the project; continual dialog and open discussion of problems; keeping the contract up-to-date with an effective change-control process; and requiring the supplier to provide early and frequent progress reports in order to minimize the potential for surprises.

According to IT contract experts, most IT contract troubles result from one of the following scenarios:

- Supplier makes unrealistic commitments (e.g., performance guarantees, unachievable schedules, fixed price contracts without the required analysis) or supplier underestimates labor time, costs, risks.
- There is no firm contractual baseline (e.g., unclear requirements, terms and conditions and statements of work) in the contract.
- The supplier does not manage the agency relationship *(i.e.,* the working relationship must be continually enhanced, and problems must not be hidden).
- The contract does not contain a procedure and process for managing change *(i.e.,* no formal change management process).

The following industry best-practice considerations should be used when forming an IT contract:

- A successful IT contract will include all technical and administrative expectations and commitments from both parties. The contract should include procedures for quality reviews, testing, measurement of progress, performance capture and reporting, defect management, change request processing, upgrades and problem escalation. The agency should consider its needs with respect to supplier reliability, performance, functionality, compatibility, lifespan, security compliance, support and cost.
- In order to reduce the likelihood of failure, the contract should be as specific as possible. Contract failure can be avoided by making sure both sides agree upon a common, written set of definitions, specifications, and timetables with regards to the services or systems being procured. As questions and issues arise, both sides can refer to and, if necessary, revise the document.
- The supplier looks to define its contractual obligations while the agency seeks to solve business issues. To deal with this difference in perspectives, the contract should include conflict and change provisions.
- The agency should monitor all IT contracts carefully, especially contracts for IT services. In most IT contracts, there is a service or support element involved, and suppliers should be held to their performance/response time contractual guarantees and promised service levels beyond the initial implementation period. If the supplier is not providing adequate service or not meeting agreed upon service levels, if the product is not operating as promised, or if the agency usage is not as high as anticipated, the agency may receive a partial refund or request a credit or higher discount.

- There is an advantage in agreeing to a detailed service level agreement (SLA) that confirms what exactly supplier responsibilities are under the contract. A good SLA will reflect common sense project discussions and seek a balance of interests and incentives.
- Pricing should adapt to certain contract changes, for example, changes in services, optional services and revised or unmet SLA. Another adaptive price modality would include subscription-based services as in Software as a Service procurements where pay-as-you-go pricing (or scalable pricing) should be included in the pricing so that agencies only pay for the actual number of users of the service. If contract prices are fixed over a period, then price increases, and sometimes decreases, may need consideration. Agencies should seek to limit increases to the rate of inflation and can even include a cap; i.e., +/-3% of the CPI.
- Both parties should contractually agree to specific expectations, promises, and contingencies. For example, system specifications should include not just the required functionality, but should also spell out any performance requirements or constraints, compatibility requirements, anticipated lifespan, and acceptable levels of defects.
- Both parties should clearly and unambiguously define key terms, conditions, and activities such as the meaning of "beta testing" or the standards for determining whether the agency has accepted the system. In the IT world, accepting a system can occur at many different times, such as when it has passed a series of agreed- upon tests ("acceptance testing") and has been in operation for a certain period of time with no serious defects. If all parties are not willing to define acceptance, that's a strong warning sign that a dispute may emerge. However, the exercise of creating an SLA may flush out potential problem areas well in advance of any signing, payment, or delivery.
- All time references should be specific dates. Avoid the use of "reasonable time" or "promptly" and be specific in each party's requirements under the contract (i.e., "within three days after (some point in time; i.e., contract award date)."
- If formulas are used within the agreement, make sure that they work.
- Do not use vague references such as "prepared to our satisfaction," "in a timely manner," would reasonably be expected to." It is difficult to determine when a supplier "has performed in a timely manner."
- Avoid using words like "materiality" and "solely" unless definitions are included.
- Carefully select use of the words "shall" (mandatory) and "may" (permissive).
- If the contract is defined as "high risk" pursuant to Virginia Code§ 2.2-4303.01, the contract must contain distinct and measurable performance metrics and clear enforcement provisions, including penalties and incentives, to be used in the event that contract performance metrics or other provisions are not met.

Finally, VITA recommends that all contract documents go up and down the chain of command in both parties' organizations as needed to make sure all relevant personnel understand what is promised and what is expected and that the final contract includes all. Additionally, VITA's Project Management and Oversight Division provides standard Commonwealth project-related templates and tools, including a Technology Management Glossary, for IT-based terminology to drive consistency throughout the Commonwealth. (Visit: https://www.vita.virginia.gov/it-governance/project-management/).

25.5 *Code of Virginia* contractual requirements

The *Code of Virginia* requires that certain language and requirements be included in every public body contract. In addition, there is other contract language that is required to be included in public body contracts through either policy or by an Executive Order of the Governor. Current statutory provisions dictated by the *Code of Virginia* are updated annually on July 1st or as legislation or policy may otherwise require. Current versions may be located at the following VITA SCM website location: https://www.vita.virginia.gov/procurement/contracts/mandatory-contract-terms/, at "Core Contractual Terms."

25.6 Federal contractual requirements

There are certain federally mandated clauses which are to be included in all agency IT contracts if there is a possibility that federal funds may be used to procure any product or service from the contract. The assigned agency procurement professional should ensure that all federal flow-down terms are included in any procurement using federal funds. The clauses are as follows:

25.6.1 Civil Rights Clause

The following certification is required to be in the solicitation for which the contract award is made: "The bidder, with his signature on this proposal, HEREBY AGREES THAT he will comply with the title VI of the Civil Rights Act of 1964 (P.L. 88-352) and all requirements imposed by or pursuant to that title, to the end that, in accordance with title VI of that Act and the Regulation, no person in the United States shall, on the ground of race, color, national origin or sex, be excluded from participation in, be denied the benefits of, or be otherwise subjected to discrimination under any program or activity for which the bidder receives Federal financial assistance and HEREBY GIVES ASSURANCE THAT he will immediately take any measures necessary to effectuate this agreement."

25.6.2 Anti-Kickback Clause

Read section 52.203-7 of Subpart 52.2 of the *Federal Acquisition Regulation.* This certification is also required to be in the solicitation for which the contract award is made: "The offeror, by signing its offer, hereby certifies to the best of its knowledge and belief that no Federal appropriated funds have been paid or will be paid to any person for influencing or attempting to influence an officer or employee of any agency, a Member of Congress, an officer or employee of Congress, or an employee of a Member of Congress on its behalf in connection with the awarding of this contract."

25.6.3 Clean Air Act

"Supplier hereby agrees to adhere to the provisions which require compliance with all applicable standards, orders or requirements issued under the Clean Air Act."

25.6.4 Energy Policy and Conservation Act compliance

Read Subpart 23.2 of the *Federal Acquisition Regulation.*

25.6.5 Anti-Lobbying Act

For more information read the Lobbying Disclosure Act of 1995. Supplies are required to sign the VITA Lobbying Certificate prior to contract award. This signed form is then retained in the procurement file. The current version of this form may be downloaded from this VITA SCM website, under the Forms section: https://www.vita.virginia.gov/procurement/policies--procedures/procurement-forms/.

Additionally, the following provision must be included in VITA-issued contracts: "Supplier's signed certification of compliance with 31U.S.C. § 1352 (entitled "Limitation on use of appropriated funds to influence certain Federal Contracting and financial transactions") or by the regulations issued from time to time thereunder is incorporated as Exhibit XX to this Contract."

25.6.6 Debarment Act compliance

Read Subpart 52.209-6 of the *Federal Acquisition Regulation.* VITA recommends:

- Language be included in the "Termination for Breach or Default" provision of the contract: "If Supplier is found by a court of competent jurisdiction to be in violation of or to have violated 31 USC 1352 or if Supplier becomes a party excluded from Federal Procurement and Nonprocurement Programs, VITA may immediately terminate this Contract, in whole or in part, for breach, and VITA shall provide written notice to Supplier of such termination. Supplier shall provide prompt written notice to VITA if Supplier is charged with violation of 31 USC 1352 or if federal debarment proceedings are instituted against Supplier.
- This language be included in the "Ordering" provision of the contract: "Notwithstanding the foregoing, Supplier shall not accept any order from an Authorized User if such order is to be funded, in whole or in part, by federal funds and if, at the time the order is placed, Supplier is not eligible to be the recipient of federal funds as may be noted on any of the Lists of Parties Excluded from Federal Procurement and Nonprocurement Programs.

25.6.7 Federal Employment Eligibility Verification (E-Verify) Program

Pursuant to Virginia Code§ 2.2-4308.2,all IT contracts and contract modifications for services, staff augmentation contractor services or statement of work resources must include the following language: "If Supplier has an average of 50 or more employees for the previous 12 months of the date of this contract, supplier affirms that it is registers and participates in the E-Verify program."

25.6.8 Mandatory Internal Revenue Service Publication 1075 (required for federal tax information (FTI) data only)
In any agency contracts that will or may include the entry, handling, processing, storage, movement, sharing of, or access to Federal Tax Information (FTI) by a supplier or any subcontractor of supplier in any manner, IRS Publication 1075 shall apply to that contract. The required IRS language, Mandatory IRS Publication 1075 - Exhibit 7, Safeguarding Contract Language, is attached as an exhibit to any applicable contract. A copy of this exhibit is located at: https://www.vita.virginia.gov/procurement/contracts/mandatory-contract-terms/.

Suppliers must acknowledge that they will comply with all applicable requirements of these terms and IRS Publication 1075 in its entirety. Non-compliance with the terms and IRS Publication 1075 may be determined, solely by the agency, as a material breach of the contract.

25.6.9 Compliance with applicable federal information security and privacy laws
Virginia Code§ 2.2-2009 requires that any contract for information technology entered into by the Commonwealth's executive, legislative, and judicial branches and independent agencies require compliance with applicable federal laws and regulations pertaining to information security and privacy.

25.6.10 Procurements funded with federal funds
When an agency conducts a procurement that is wholly or partially funded with federal funds, it is necessary to understand the federal funding source's contractual requirements and expectations for the agency and/or for flow down to the supplier. Appendix 25.6.10 provides a table that offers high-level questions that you may need to consider when forming your solicitation and contract.

25.7 VITA contractual requirements

VITA requires that all statutory requirements be included in any IT contract whether issued by VITA or when delegated to an agency for issuance (refer to Chapter 1 of this manual for more information). VITA's website, https://www.vita.virginia.gov/procurement/contracts/mandatory-contract-terms/ provides the statutorily-mandated terms. These are updated annually to incorporate statutory changes. IT contracts should include the active link to these rather than full text as suppliers must comply with then-current versions, as updated, during contract performance.

25.7.1 Requirements for SCM strategic sourcing professionals
VITA-required contract provisions are included in VITA's contract management system. If questions arise about which provisions are best-suited for a particular procurement, please contact scminfo@vita.virginia.gov. General guidelines on which provisions should be used for different types of IT procurements can be found in Appendix 25.7.1 to this manual.

25.7.2 Requirements for major and delegated agency procurements
Pursuant to Virginia Code §2.2-2012(B), CIO approval is needed by any agency seeking to procure IT goods and services. Agencies desiring CIO approval to issue an IT contract (or solicitation) must include the minimum elements shown in the "Minimum Requirements Matrix for Major and High-Risk IT Procurements" available at the SCM webpage at the following URL: https://www.vita.virginia.gov/procurement/policies--procedures/procurement-forms/.

Agencies conducting a "high-risk" procurement, as defined in Virginia Code§ 2.2-4303.01, must submit both the solicitation and the resulting to contract to VITA and the agency's OAG representative for review of the terms and conditions. Reviews will be conducted within 30 business days and will include an evaluation of the extent to which the contract complies with applicable state law, as well as an evaluation of the appropriateness of the contract's terms and conditions. The review will also ensure the inclusion of distinct and measurable performance metrics, as well as penalties and incentives, to be used in the event that the contract's performance metrics are not met.

Agencies are required to contact VITA's Supply Chain Management division (SCM) at: scminfo@vita.virginia.gov during the contract planning stage prior to awarding a high-risk contract. SCM will assist the agency in preparing and evaluating the contract and identifying and preparing the required performance metrics and enforcement provisions.

VITA recommends that all solicitations and contracts submitted to VITA or the CIO for review and approval, or that are delegated to agency without need for VITA or CIO approval include the following qualities to improve the turnaround time for the agency:

- Be free of typographical, spelling and formatting errors.
- Be free of duplications and conflicting language/terms.
- Include all mandatory provisions required by the *Code of Virginia* and any Federal flow- down requirements.
- Include all document exhibits that comprise the whole contract.
- Be already reviewed by the agency's OAG representative, if necessary.
- Be submitted electronically in Microsoft Word format to the agency's then-current designated PMD representative.
- All solicitations and contracts that are submitted to VITA for review must include an agency-completed version of the matrix in Appendix A, as a document separate from the contract to facilitate VITA review.

Additionally, all final contracts requiring CIO approval must have undergone review by the agency's OAG representative prior to submission to VITA. Agencies may obtain assistance in developing a technology contract by emailing a request to: scminfo@vita.virginia.gov

25.7.3 Requirements for promoting supplier performance

All IT contracts should promote excellence in supplier performance. Measuring a supplier's performance as part of the contract, combined with the agency's management of the supplier's performance will provide greater value for the Commonwealth and taxpayers.

In order to emphasize excellence in supplier contract performance, VITA recommends that all IT contracts include the following:

- Agency and project performance expectations and objectives.
- Procedures for systematically gathering and using ongoing performance data on supplier's performance during the term of the contract.
- An issue resolution and/or escalation process with defined time frames.
- Built-in incentives/remedies attached to supplier performance.
- Distinct and measurable performance metrics
- Clear enforcement provisions, including penalties and incentives, to be used in the event that contract performance metrics or other contractual provisions are not met.

During contract negotiations, work with the supplier on establishing partnering programs and measurable goals for reducing administrative burdens on both parties while ensuring supplier performance and value. Include negotiated goals into the contract. Always make agency satisfaction with the supplier's performance an on-going measurement during the term of the contract.

The type of performance data needed will be determined by the type of procurement. For instance, a contract for maintenance support will require a service level agreement with monthly reporting on supplier's service performance in order to tie remedies to payment via a percentage discount. A solution and implementation driven procurement should include sequential milestones or deliverable submissions and gear remedies to on-time delivery and/or acceptance criteria. For a contract with a Value-Added Reseller (VAR) or for an off the shelf IT commodity procurement, availability and delivery may be performance drivers. Please refer to Chapter 21 of this manual, Performance-Based Contracting and Service Level Agreements, for a more in-depth discussion and valuable guidance.

If the agency's procurement is a "high-risk contract" as defined in§ 2.2-4303.01, then the solicitation and resulting contract must include distinct and measurable supplier performance metrics and clear enforcement provisions, including clearly outlines penalties and incentives, to be sued in the event that contract performance measures are not met. Please see Appendix 25.7.3 for suggested language to be included in your high-risk contract.

Agencies should consider the following questions and integrate them into the contract from what was included in the solicitation and negotiated, if applicable, with the supplier:

- What does the project need (product specifications, service turnaround, etc.) to satisfy the end user(s)? "What would the successful project look like?"
- How quickly must the supplier correct each failure? What are the agency's remedies if supplier does not correct the failure within the specified time?
- What measurement and enforcement tools and processes will be implemented to ensure that performance can be measured and enforced?
- What financial or other incentives or remedies are needed by the agency?
- Does the agency have the ability to get out of the contract without penalty if the supplier is not meeting its service level obligations?
- How important is it to the agency for the supplier to provide "transition services" while an agency is trying to procure a new supplier?

25.7.4 VITA security and cloud contractual requirements

Virginia Code § 2.2-2009 mandates that the CIO is responsible for the development of policies, standards, and guidelines for assessing security risks, determining the appropriate security measures and performing security audits of government electronic information. Such policies, standards, and guidelines shall apply to the Commonwealth's executive, legislative, and judicial branches and independent agencies.

Agencies are required to comply with all security policies, standards and guidelines (PSGs) applicable to their procurement. For more information on security PSGs, see: https://www.vita.virginia.gov/it-governance/itrm-policies-standards/

For any procurements of third-party (supplier- hosted) cloud services (i.e., Software as a Service), there is a distinct process for obtaining VITA approval to conduct the procurement. Your agency's Information Security Officer or AITR can assist you in understanding this process and in obtaining the required documentation to include in your solicitation or contract. There are specially required Cloud Services terms and conditions that must be included in your solicitation and contract, and a questionnaire that must be included in the solicitation for bidders to complete and submit with their proposals. You may also contact: enterpriseservices@vita.virginia.gov.

25.8 VITA recommendations for a successful IT contract

Below are discussions and guidance on typical IT contract elements. While some of these are common elements in all contract documents, this discussion is focused on a technology perspective.

25.8.1 IT special insurance coverages

In IT contracts Errors and Omissions (E/O) Insurance should always be required for Suppliers, except for simple computer-off-the-shelf (COTS) software products. This insurance covers a Supplier's performance errors and intentional or accidental omissions in their performance obligated by the contract's technical/functional requirements. The coverage amount is based on the complexity of your procurement. Typical language to include in a contract is: "Supplier shall carry Errors and Omissions insurance coverage in the amount of $5,000,000 per occurrence."

For cloud service procurements, it is recommended to require the contractor to also provide coverage for Cyber Security Liability Insurance to assist in data loss or security breach, which can result in losses valued in excess of millions of dollars. Typical language to include in a contract is: "Supplier shall carry Cyber Security Liability insurance coverage in the amount of $5,000,000 per occurrence." This coverage amount can be increased based on your risk factor and project complexity and data/security sensitivity. The minimum coverage amount required by VITA Security remains at $5,000,000. Any reduction must be approved by VITA Security and/or the CIO.

25.8.2 IT Scalability

Scalability (the ability to expand an application or use of hardware) is often a significant issue in complex IT transactions. Agencies should watch for data interoperability issues. If scalability may be a possible issue in an agency, IT contract, the agency should be sure to obtain a warranty regarding scalability of applications and data interoperability. Scalability in software as a service contracts serves a "pay as you go" fee structure so you don't pay for more than you need.

25.8.3 Material breach provision in IT contracts

Most contracts allow a party to terminate the contract for the other party's "material breach." It is often difficult to determine whether a particular set of facts amounts to "material breach." Agencies should identify key scenarios which would constitute "material breach" and include those in the IT contract. If repeated small breaches could also constitute a "material breach", the IT contract should include that language.

Commonwealth agency contracts usually provide that the supplier should not have a right to terminate for breach for any reason, particularly for a mission critical application or solution. If the supplier has the right to terminate the contract, the impact to the agency, project or Commonwealth as a whole, could be paramount, because our common goal is uninterrupted business on behalf of the citizens. If there is a material breach, outside of payment disputes, the agency and the supplier should work to cure the breach and, if necessary, escalate the issue. Your OAG can offer additional guidance for your particular agency and project.

25.8.4 Source code escrow

If there is a potential need to obtain source code for an application if the supplier is unable to support it (bankruptcy, cessation of support of the product, etc.), the contract should provide for a source code escrow. Source code escrow provisions should identify the escrow agent, when must supplier make escrow deposits (initial and on-going), the triggers under which the escrow agent will release the source code to the agency (insolvency, failure to support, sunset of the application, breach by supplier, etc.) and any and all payment terms. Source code escrow must contain all documentation and runtime files necessary for compilation. Testing of the deposited source code (including later release versions) is strongly recommended. The supplier will have its own agent and escrow agreement form.

Agencies should carefully review any such agreement before incorporating it into the contract or signing it. Ideally, an escrow agreement should be negotiated prior to contract execution so the agency can uphold its best interests on behalf of the Commonwealth.

Visit SCM's website at this URL: https://www.vita.virginia.gov/procurement/policies--procedures/procurement-tools/ and select "Guidance on Source Code Escrow" from the menu for additional information and language related to escrow.

25.8.5 Key **IT** supplier personnel

The IT contract should identify the supplier's key personnel and also include under what circumstances supplier would be able to replace such key personnel. In addition, if the agency would like background and security checks on supplier's personnel, as well as the right to interview or demand replacement of such personnel, those provisions should be specifically included in the agreement. This provision is of special value in a large and/or complex IT project.

25.8.6 Force majeure in IT contracts

A force majeure ("a greater force") event excuses a party's failure to perform when failure results from some circumstance beyond a party's reasonable control (be careful of "labor and supply shortages" being included in the definition of force majeure in the agreement, since these often are based on business circumstances over which the supplier actually does have some control). The force majeure language defines when each party's obligation to perform is deemed to be "suspended." Agencies should include a clause that gives them the right to terminate the contract if force majeure continues for a certain period of time- typically 30 days, though a shorter period would be appropriate for a mission-critical system.

25.8.7 Disaster recovery provision in IT contracts

IT contracts where the supplier has network or operational responsibilities or processes or stores Commonwealth data should include a disaster recovery plan (back-ups, hot-site, cold site) and detail supplier's responsibility to provide full or partial restoration, to participate in disaster simulation exercises and the frequency of such responsibilities, to securely hold copies of all data for quick and easy access. The contract should also provide a timeframe for returning the agency to normal service levels following the disaster. Hosting and software as a service contracts must insist that all disaster recovery facilities are in the continental U.S.

25.8.8 Termination of IT services

Agencies should strive to obtain a contractual commitment from the supplier that the supplier will not suspend services except in the most limited circumstances. It is important to include "transition assistance" language within the IT contract. For instance, if the contract is not renewed or terminated or if work on a project is terminated for any reason, the supplier is responsible to provide reasonable transition assistance to allow for the expired or terminated portion of the services to continue without interruption or adverse effect and to facilitate the orderly transfer of such services to the agency. Recommended transition contract language is available in Appendix 25.8.8.

25.8.9 Maintenance needs in IT contracts

The contract should clearly state the manner of maintenance/support to be provided and identify who to contact for service and/or repair. The contract should also include severity levels, an agreed upon acceptable response time for the supplier, the level of maintenance/support to be provided, as well as the billing structure for such services. The contract should also include a notification/escalation process for the resolution of errors, deficiencies or defects, including the method of notification to the supplier, acceptable response time and the agency's recourse if the supplier's action does not correct the problem or is not acceptable to the agency.

25.8.10 IT documentation and training needs

The IT contract should describe responsibilities of both parties regarding the provision of user manuals, technical support manuals, application documentation, training materials and other training needs. The IT contract should include the due dates of all such materials, format and level of detail of the materials to be provided under the contract. All training needs should be specifically described in contract including the nature and extent of training to be provided by the supplier as well as the location, timeframe and cost of training.

25.8.11 Liquidation costs and completion failure remedies in IT contracts

If the supplier's failure to deliver on time will adversely affect an agency's capacity to perform its business function, a liquidated damages clause should be included in the contract. This clause will establish the method for computing the reimbursement to an agency for costs incurred due to the failed delivery of the IT product or service. This may be linked to service level requirements or acceptance testing failure. Liquidated damages must be based on a realistic estimate of the expense incurred by the Commonwealth.

25.8.12 Assignment of IT contracts

Agencies will want broad rights to assign the contract (or license) in their IT contracts. This allows them to transfer technology resources to other agencies or even to outside contractors who are providing them with services. Suppliers often want to prohibit such assignments to encourage sales or to prevent technology from falling into the hands of competitors. IT contracts should allow agencies to assign agreements to other agencies and to those contractors providing them with services, provided that the contractor may only use the technology to provide services to the agency, not to its other customers. It is best to have this right without requiring the advance agreement of the supplier. Most assignments should provide that the Commonwealth or agency has the right to assign the contract or license upon giving notice to the supplier. Although it can create extra work for managing suppliers, it is not uncommon to have a contract provision requiring a customer to notify a supplier of an assignment, even if the supplier's consent is not required.

25.8.13 IT performance bonds

Although performance bonds (a surety bond issued by an insurance company to guarantee satisfactory completion of a project by a supplier) are usually used in construction or transportation contracts, the *Code of Virginia* (§ 2.2-4339) provides that a public body may require a performance bond for contracts for goods or services if provided in the IFB or RFP. For example, a supplier may cause a performance bond to be issued in favor of the agency for whom the supplier is developing and implementing a major IT solution. If the supplier fails to develop and implement the solution according to the contract's requirements and specifications, most often due to the bankruptcy of the supplier, the agency is guaranteed compensation for any monetary loss up to the amount of the performance bond. Performance bonds are contracts guaranteeing that specific obligations will be fulfilled by the supplier. The obligation may involve meeting a contractual commitment, paying a debt or performing certain duties. Under the terms of a bond, one party becomes answerable to a third party for the acts or non-performance of a second party.

Performance bonds are required in a number of business transactions as a means of reducing or transferring business risk. Agencies may require a performance bond for the purpose of reducing public responsibility for the acts of others, and the courts require bonds to secure the various responsibilities of litigants, including the ability to pay damages.

In IT contracts, a performance bond may be in addition to the E/O insurance requirement, but never in place of it, as E/O insurance is a professional liability insurance that covers just what the term implies, but not remuneration for a supplier bankruptcy situation.

25.8.14 The IT statement of work

A strong statement of work (SOW) should define precisely, clearly and completely all the obligations of the parties with respect to the IT effort to be performed. The SOW details what the supplier agrees to do, what the agency agrees to do, the instructions to the supplier and the technical, functional and performance and reporting requirements and specifications of the contract. All SOWs must be in writing and agreed to before any work begins. The SOW should be an exhibit to the contract. The SOW should be sufficiently detailed so that a person who is unfamiliar with the contract will be able to clearly see everything that is included and what is not. Please refer to manual Chapter 21, Performance-based Contracting, SOWs and SLAs and Chapter 12, SOWs for IT Procurements for more in-depth discussion and details on creating effective and complete SOWs. A SOW template, as well as a Change Order template, are available at the following link: https://www.vita.virginia.gov/procurement/policies--procedures/procurement-tools/

25.8.15 IT confidentiality agreements

Parties to IT contracts frequently enter into confidentiality agreements before the contract is signed. Any consultant or supplier who has access to sensitive agency data must agree to treat that data as confidential, whether it is personally identifiable employee or agency data, agency lists, marketing plans, nonpublic financial information or trade secrets. In many cases, an agency may need to disclose some of this information to an IT supplier before the contract is signed. Confidentiality protection requires more than a well written agreement.

When an agency needs to protect certain information, employees need to be educated not to make unnecessary disclosures. Where the confidentiality agreement calls for marking or otherwise identifying information as confidential, employees must be sure to so identify the information. It is important to keep complete and accurate records of who has access to the information and how it is transmitted and used.

Key elements of confidentiality obligations to include in contracts are clauses that:

- **Identify confidential information:** The contract should provide a definition of what constitutes "confidential information." If the agency desires that the confidentiality agreement be more restrictive, it can require that each item that is disclosed be specifically identified as being "confidential" in order to be within the scope of the agreement. Here is one example of such a clause: It may make sense for an agency to include as confidential information "all oral and written information that an objective observer would consider confidential taking into account the surrounding circumstances."

- Detail the extent of the nondisclosure obligation: The core of any confidentiality agreement is the clause that obligates the receiving party to treat the received information as confidential. This clause can be drafted in any number of ways. Such an obligation is usually mutual, meaning that both the agency and the supplier are obligated to maintain the confidentiality of the other's confidentiality agreement. The clause should include both a nondisclosure and nonuse obligation. It should also specify a level of care that the recipient uses with respect to its own confidential information, and restricts the recipient from reverse engineering the disclosing company's proprietary information or creating derivative works. A variation might include an absolute obligation not to disclose, rather than an obligation to exercise a defined level of care to avoid disclosure. Depending on the importance of the information being protected, an agency may consider including a detailed security requirements addendum. Another way of limiting the use of the information would be to say that the recipient may "use the information only for the purpose for which it was disclosed, or otherwise solely for the benefit of the Discloser."

- List exceptions to confidentiality: Certain information is typically exempted from the coverage of a confidentiality agreement. This usually includes information that was already known by the recipient on a non-confidential basis, was independently developed by the recipient, or is information that was publicly available or becomes publicly available through no fault of the recipient Other exceptions to confidentiality coverage might include information obtained from a third party without obligation of confidentiality, or information disclosed by the discloser without obligation of confidentiality.
    - A supplier might also want a confidentiality exception for "residual information." The supplier's programmers will inevitably learn skills through the work they perform for the agency, and it would be impossible to prevent them from using these skills. The supplier will not want to be liable for breach of contract as a result of the supplier's use of such residual information. It is also not a bad idea as a general rule from the agency's point of view, because the agency potentially receives the benefit of residual information that the supplier received from other agencies.
- Disclosures required by law: A party that is bound by a confidentiality agreement may find itself subject to a court order or a subpoena to disclose information that such party is contractually obligated not to disclose. Many confidentiality agreements specifically deal with this situation by requiring notice to the discloser and an opportunity to object or seek a protective order.
    - Agency procurements are subject to the Freedom of Information Act (FOIA), with exceptions in the VPPA. The confidentiality language should specifically address an agency's obligation to comply with FOIA and what information the supplier may exempt from FOIA disclosure and the steps necessary to exempt the information. The requirements of the Virginia Freedom of Information Act are more fully discussed in Chapter 10 of this manual.
- Duration of confidentiality obligation: Many recipients of confidential information from suppliers seek to limit the length of their obligation not to disclose such information. One way to do this is to limit the term of the confidentiality obligation. Some agreements, for example, require the recipient of confidential information to regard the information as confidential for a period of one, two or three years. On the other hand, it may be very important to the discloser to preserve the confidentiality of the disclosed information indefinitely. This is an issue that the parties should consider based on the specific facts and needs of the parties. VITA normally includes confidentiality obligations in its Survival provision.
- Return of confidential materials: The discloser of confidential information will want to include a clause requiring the recipient to return the confidential information to the discloser upon request. When the confidentiality clause is part of a larger agreement, the agreement should provide that the confidential information will be returned to the discloser upon the expiration or termination of the agreement. The agreement should always provide that it will be governed by the laws of the Commonwealth of Virginia

In addition to the clauses described above, a confidentiality agreement might contain other provisions specific to the agency's need and situation.

25.8.16 IT warranties

A warranty is a promise or guarantee made in the contract that certain conditions or obligations will be met by the person making the warranty. The IT contract should require the supplier to warrant that, as applicable to the procurement, all equipment, software, systems installed, and services meet the contractual requirements. Suppliers generally prefer to disclaim all implied warranties of merchantability and fitness for purpose in favor of specific repair or replace warranties that give little or no recourse to agencies. In order to protect the agency, the contract should either reinstate the implied warranties or avoid the supplier's implied warranty disclaimers by devising a format that exchanges supplier disclaimers for specific express warranties. All express and implied warranties should be clearly stated in the contract.

The contract should include a stated warranty period that begins after acceptance of the product and prior to the commencement of paid-for maintenance/support. During the warranty period the supplier is required to fix problems and provide some level of support at no additional cost to the agency. Warranty periods vary in length. They are frequently twelve months, although they may be as short as three months. Each VITA contract template

includes warranty language adapted for the particular procurement type. After the warranty period expires, agencies commonly receive ongoing service through a maintenance agreement.

Most agencies will want far more extensive warranties than merely a warranty that the product will conform to all agreed-upon requirements, and they will want warranties that last beyond the "warranty period". This is true especially in contracts in which the supplier prominently states that it makes no warranties other than those expressly set forth in the agreement. An agency that purchases a product or licenses software should also obtain a warranty from the supplier or licensor that the technology will not infringe on the rights of any third party. In addition to warranties that the product and all fixes and enhancements will conform to agreed-upon requirements and will not infringe the rights of any third party, an agency might require *express warranties* from the supplier that ensure:

- The product and all enhancements and new versions will contain no known defects.
- Supplier has the right to enter into the agreement and to perform its obligations under the agreement.
- The agreement is its legal, valid and binding obligation.
- Neither supplier nor its employees have been or are the subject, directly or indirectly, of any governmental order, investigation or action of any kind, including without limitation any order or action to revoke or deny any export privileges, and supplier will notify agency immediately in the event supplier or any of its employees become subject to any such order, investigation or action.
- Supplier's software, services or products shall not infringe on any third party's intellectual property rights, including, but not limited to patent, trademark, copyright or trade secret.
- Supplier is under no obligation or restriction, nor will it assume any such obligation or restriction, which would in any way interfere or be inconsistent with, or present a conflict of interest concerning, the services which are the subject of the agreement.
- Supplier's performance will not breach or conflict with any prior obligation of supplier to any other party, including any obligation to keep confidential any information acquired by supplier before the date of the agreement.
- Unless approved in advance by agency, no information supplier discloses to agency in providing the services that are the subject matter of the agreement will be confidential to supplier or any third party.
- The supplier, if a licensor, has the right to grant a license to the software free and clear of any liens and encumbrances.
- The supplier is not currently the subject of any litigation or pending claim that would materially affect the supplier's ability to perform.
- The fess and hourly rates set forth in Exhibit/Schedule are the best rates supplier offers to any of its customers.
- The software and all enhancements and new versions will contain no known computer virus or other "contaminants," including any codes or instructions that may be used to access, modify, delete, damage or disable agency's computer system, which shall include, but not be limited to, security or expiration codes.
- Licensor expressly waives and disclaims any right or remedy it may have at law or in equity to unilaterally de-install, disable or repossess the Software should Licensee fail to perform any of its obligations under this Agreement.
- In no event shall Licensor have the right to purposefully or accidentally electronically repossess the Software using "self-help" devices. For purposes of this Agreement, "repossess" shall include, but not be limited to, electronic lock-outs or booby traps.

When the supplier incorporates third party software into the software it is licensing or selling, the agency may want to include that the supplier must obtain comparable warranties from such third parties and shall assign such warranties to the agency. The supplier should also commit to cooperate with the agency in the enforcement of any such warranties. While the warranty regarding the conformity of the software to the agreed-upon requirements may have a fixed term, for example, of twelve months, the agency may want the warranty against infringement to last indefinitely.

IT contracts may define levels of product errors and deal with each level in a different manner. For example, the contract might define a "fatal error" as one that results in the inability of a system to perform a vital business function of the agency (as further defined in the agreement). The contract might provide, for example, that if the agency discovers a fatal error within six months, then the supplier will handle the error in the same manner as it would handle infringement. In other words, the supplier would modify or replace the product, offer some workaround, or terminate the license and pay the agency the depreciated book value of the software. The agreement might provide that the licensor or supplier will use its best efforts to fix any error other than a fatal error.

25.8.17 IT hold harmless clauses

This language addresses the issue of who pays when there is a claim for damages arising out of the work performed or a product provided under an IT contract. A hold harmless clause is an indemnity clause and is to be included in all IT contracts. Under an indemnity clause, the supplier agrees to indemnify, defend and hold harmless the agency, its officials and employees from and against any and all claims, proceedings, judgments, losses, damages, injuries, penalties and liabilities of, by or with third parties. Additional information about indemnification is provided in subsection 25.8.18 below.

25.8.18 IT indemnification contractual language

An agency that licenses or acquires technology from an IT supplier should include a provision in its IT contract for the supplier to indemnify the agency for claims from third parties arising out of the failure of any warranties, the supplier's breach of the agreement, or the infringement on the party of the third party's intellectual property rights by any product or services provided by the supplier.

VITA's standard contract indemnification provisions are attached to this manual in Appendix 25.8.18. Before including the VITA language, or any other indemnification language the agency wishes to use, its contract, the agency should engage their OAG representative for assistance.

25.8.19 Liability limitations in IT contracts – General

In the private sector, most IT contracts contain language which limits the liability of the supplier to some multiple of the value of all payments made under the contract. As agencies rely heavily on their IT suppliers to assist in providing essential government services to citizens, limiting a supplier's liability may not be as appropriate. When preparing the IT contract, the agency should evaluate the true risk involved should the supplier fail to perform or deliver. Agencies should take care to limit risk in its IT procurements through good contract scoping, specifications, good statements of work and supplier and contract management.

- Liability for direct and indirect damages: Hold suppliers responsible for *direct* damages arising out of an IT contract. Do not hold suppliers responsible for third party claims arising out of *indirect* damages, with certain exceptions, including infringement of a third party's intellectual property or willful misconduct by the Supplier. Unless responsibility is specifically allocated to the supplier in the contract, the agency should not hold supplier responsible for indirect damages, including special or consequential damages. Example: Supplier should not be liable for lost data, unless the contract specifically provides for supplier responsibility for lost data in the contract.

- Amount of liability limitations: Supplier liability should be limited according to the IT contract risk. If a contract contains a liability limitation that is a multiple of the total amount of the contract, then the agency and the supplier should specifically address in the contract how the "amount of the contract" is calculated. This is especially important where the contract has an extension clause or unique funding mechanism. Even if a limitation of the supplier's liability is included, the contract should exclude unlimited liability for infringement of a third party's copyrights or patents from that cap. A limitation of the supplier's liability also should not cap the amount of supplier's liability for property damage, death, or bodily injury suffered either by the agency and its employees, or that might be brought as a claim by a third party. An agency may negotiate no limit for breach of security, confidentiality, infringement or data privacy provisions of the contract.

25.8.20 Liability contractual language for major IT projects

Pursuant to § 2.2-2012.1 of the *Code of Virginia*, in all contracts for a "major information technology project" (as that term is defined in § 2.2.2006), the terms and conditions relating to a supplier's indemnification obligations and

liability must be reasonable and cannot exceed twice the aggregate value of the contract. Section 2.2-2012.1 further provides that in instances of "(i) the intentional or willful misconduct, fraud, or recklessness of a supplier or any employee of a supplier or (ii) claims for bodily injury, including death, and damage to real property or tangible personal property resulting from the negligence of a supplier or any employee of a supplier" a supplier's liability is unlimited.

An exception to the liability limitations exists in contracts that pose an "exceptional risk" to the Commonwealth. In these instances, the CIO is required to conduct a risk assessment prior to the issuance of a Request for Proposal. The risk assessment must include consideration of the nature, processing, and use of sensitive or personally identifiable information. If the risk assessment concludes that the project presents an exceptional risk to the Commonwealth and the limitation of liability amount provided for in the paragraph above is not reasonably adequate to protect the interest of the Commonwealth, the CIO may recommend and request approval by the Secretary of Administration to increase the limitation of liability amount. The Secretary of Administration must approve any recommended maximum alternative limitation of liability amount before it may be included in any Request for Proposal issued for the project.

25.8.21 IT pricing

While the obligations of the IT supplier to the agency may be complex, the primary obligation of the agency is simple. The agency pays the supplier for its IT services or products. IT agreements commonly list the amount of fees and the manner of payment in a schedule (exhibit) to the contract. The contract might state that the amounts set forth in the schedule will be effective for the base term after the contract is signed. If the agency agrees to any increases, they should be capped at a low fixed percentage or at a percentage based on published inflation indices, such as the Consumer Price Index. The agency should require adequate notice of any price increase so that the agency can replace the supplier if it finds the price to be too high.

The nature of the IT procurement, and what the agency is obtaining, may significantly impact how and when payment obligations are due. System development contracts are traditionally for large complex projects and commonly call for progress payments. An agency can manage the risk of these projects by paying in increments based on project milestones or holding back a portion of the fee until the software/system is deemed by the agency to be acceptable. In order to work within these constraints, IT suppliers are increasingly breaking projects into smaller chunks, covering shorter periods of time. Agencies may want to evaluate whether it would be more beneficial to pay a greater amount for the supplier's services in implementing the software, rather than for the software license itself.

Software license agreements may call for one-time payments or recurring payments, depending on whether the software license is viewed as a subscription or "paid-up." Applications service/hosting and software-as-a-service are normally subscription based. Fees depend on use and may be charged monthly or annually. Maintenance fees are recurring regardless of whether the underlying license is paid-up one time or is an ongoing subscription and may include additional hourly charges. The maintenance price should be based on the actual price paid for the software after all discounts and negotiations, rather than the list price, which usually will be significantly higher.