



Practical Tips for Negotiating Today’s Complex IT Services Contracts

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Software as a Service (SaaS): The New Way Public Entities Purchase Software

Instead of purchasing software that must be installed, maintained, updated and serviced on their own in-house IT equipment, public entities are now licensing software on a monthly, quarterly, or annual subscription basis from a software vendor who centrally hosts it in the 21st century cloud. Known as Software as a Service (SaaS), it is also sometimes referred to as “on-demand software.”

SaaS vendors typically manage a public entity’s applications, data, runtime, middleware, servers, storage, network and operating systems. The tremendous costs, headaches and problems of owning software are shifted from the public entity to the vendor and factored into the subscription fee. While the SaaS model provides great daily operational relief to public entities, it introduces a new set of issues that must be proactively addressed with SaaS vendors. Below

is a checklist of the most critical contractual issues along with practical tips for favorably negotiating them into a SaaS agreement.

DATA BREACH AND DATA SECURITY: LIABILITY, INDEMNITY, AND NEGLIGENCE

Responsibility for security and privacy related compliance cannot be outsourced to a software service provider. The SaaS agreement should describe the vendor’s security practices, such as an explanation of the technical, organizational and administrative controls and safeguards used by the vendor for hosting and processing customer data when delivering the software service. The subscriber should ensure that security standards are reflected in contractual clauses and monitor performance of service providers to the security standards.

Issue	Factors to Consider	Negotiating Tip
Liability	SaaS vendors generally will not accept consequential damages liability, which is defined as foreseeable financial damages arising from a data breach, because such damages are likely to greatly exceed the amount the customer paid and the vendor received.	Persuade the SaaS vendor to accept liability for direct damages from a data breach up to an agreed upon limit based on overall value of the contract or a multiple thereof, e.g., 1.5x or 2x the amount the vendor is expected to be paid over an agreed upon time period.
Indemnity	Focus on third party claims because risks may be different depending on the SaaS contract or service. Focus on the allegation, not who is at fault, i.e., “caused by” v. “related to” or “arising out of.”	Persuade the vendor to narrow the indemnity.
Negligence	SaaS vendors should accept some consequential damages liability when the data breach results from the vendor’s own gross negligence or intentional misconduct.	Persuade the SaaS vendor to include a clause addressing the vendor’s liability for its own causal omissions or commissions. Also, cyber-liability insurance is available to protect against those risks which a party is unable to contractually allocate to the other side.

UPTIME COMMITMENT

The SaaS application should be available and usable to the same degree it would be if installed in an on-premises computing environment.

Issue	Negotiating Tip
<p>The SaaS vendor should agree to make the application available and accessible at least 99.5% of the time 24x7x365.</p> <p>Excludes routine maintenance outages (only during non-peak usage hours) and events outside the vendor’s control, such as Internet outages and equipment failures not within the vendor’s environment.</p>	<ul style="list-style-type: none"> • Obligate the vendor to provide fee credits if it fails to meet the availability commitment. • Include a “three strikes” termination clause, e.g., if the vendor fails to meet the availability commitment on three separate occasions during a two month period, it would constitute a material breach. • Customer is entitled to terminate and receive at least a prorated refund of unused fees paid in advance.

APPLICATION PERFORMANCE WARRANTY

The agreement should state that the SaaS application will perform “in all material respects” (or “substantially”) in accordance with its applicable specifications or documentation, which could be without limitation as to time such as when the customer is paying on an annual subscription basis.

Note: Vendors may limit the warranty to some period of time after either the commencement of the agreement or after discovery of the defect. 90 days is typical and considered reasonable.

Issue	Negotiating Tip
<p>The remedy for a vendor’s breach of the performance requirement can be limited, e.g., termination of the agreement if the application’s performance does not meet the warranty and the vendor cannot correct it.</p> <p>Obtain the right to a refund given the hardship and expense associated with researching, selecting and switching to an alternate vendor.</p>	<ul style="list-style-type: none"> • Negotiate refunds: <ol style="list-style-type: none"> (1) At least the entire service period’s fees. (2) A prorated refund of the unused portion of the subscription license fee for the remainder of the term or service period. (3) A refund for a portion of the fees paid prior to termination. • Expand the vendor’s overall maximum liability to the total amount paid over the contract period, which is common in traditional installed software license agreements.



NEED ASSISTANCE WITH YOUR IT PROCUREMENT CONTRACTS

This checklist is designed to help public entities avoid potential pitfalls in today’s cloud-based IT equipment and services procurement contracts. Meyers Nave Principal Richard Pio

Roda prepared this checklist and is available to provide advice and counsel for drafting, reviewing, negotiating and/or managing IT equipment and services contracts.

Please contact Rich at rpioroda@meyersnave.com or 510.808.2000. This checklist does not constitute legal advice.

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