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Welcome and Some Housekeeping Items

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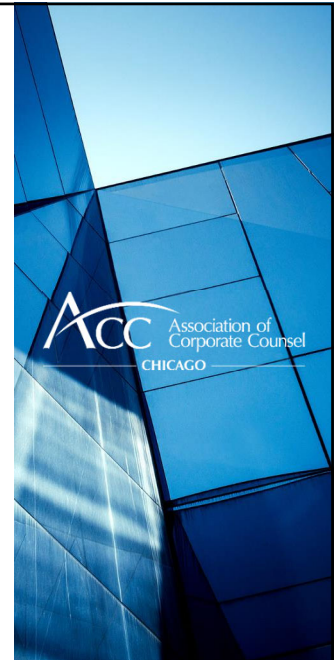
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A Reminder About the Benefits of ACC Membership...

- Free CLE, roundtables, DEI and professional development programs
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- Leadership and speaking opportunities, Chicago Lawyer subscription
- Access to ACC Global Resources, including:
 - ACC Docket Magazine & Newsstand (searchable legal news feed)
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 - E-Groups and Committees on Substantive Practice Areas

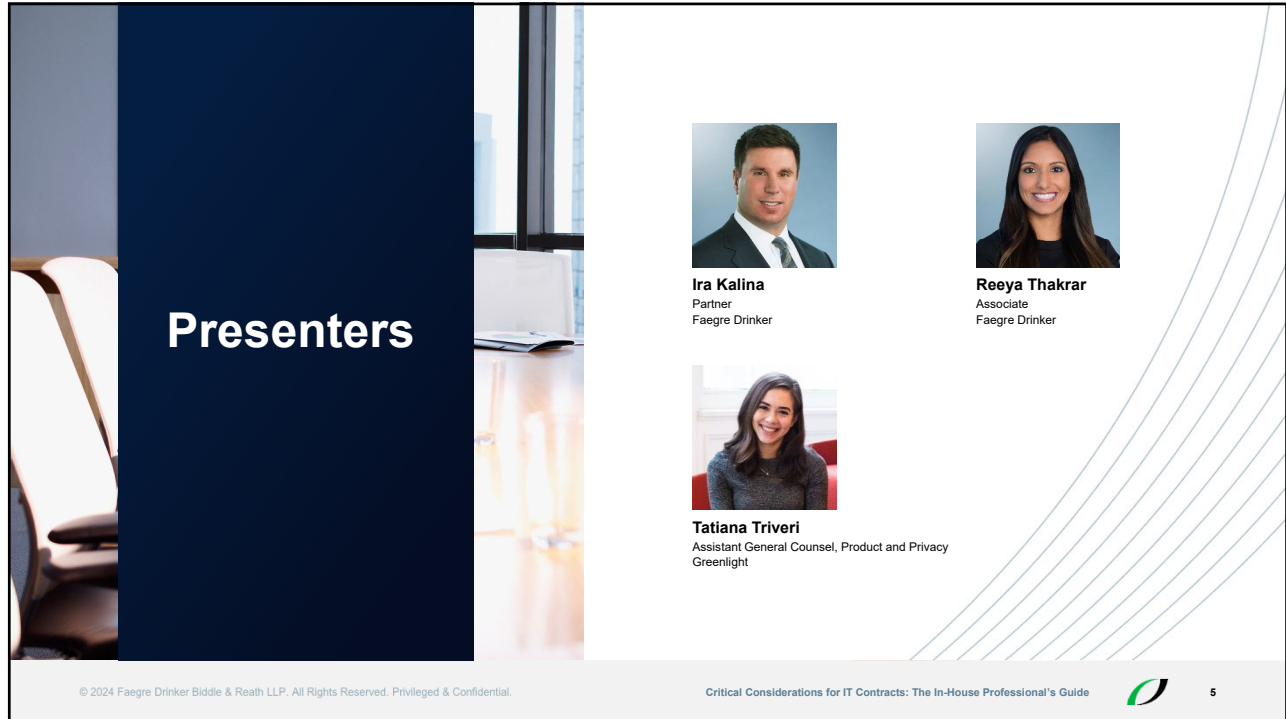


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The slide features a background of a dark, textured surface with a grid of hexagonal shapes, overlaid with white curved lines. In the top right, there are logos for ACC (Association of Corporate Counsel CHICAGO) and faegre drinker. In the top left, it says 'Presentation to Association of Corporate Counsel'. The main title is 'Critical Considerations for IT Contracts: The In-House Professional's Guide'. At the bottom left, the date 'October 29, 2024' is shown, and at the bottom center, there is a small copyright notice: '© 2024 Faegre Drinker Biddle & Reath LLP. All Rights Reserved. Privileged & Confidential.'

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Agenda

- Scope of license
- Key implementation terms
- Pricing and payment terms
- Data ownership and security
- AI specific considerations
- Service levels
- Termination and transition assistance
- Limitation of liability
- Managing the process

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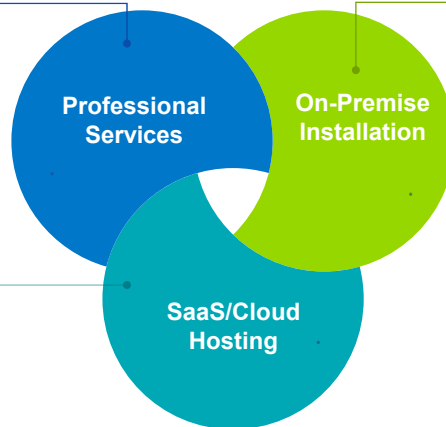
Overview

Professional Services

- Includes implementation, consulting and/or custom development
- Fixed fee/T&M
- Specifications
- Acceptance

SaaS / Cloud Hosting

- Recurring fees for access to s/w, maintenance and support
- Limited installation
- SLAs and warranties



On-Premise Installation

- One-time payment for perpetual license (or subscription-based license)
- Ongoing maintenance and support
- Installed on-site or using remote hosting services
- SLAs and warranties



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Scope of License/Use

▪ Scope of use

- Can you use the software for everything you want?
- Internal use vs. customer services
- Can you provide access to:
 - Customers
 - Service Providers
 - Hosting Providers

▪ Perpetual vs. subscription

- Support/maintenance vs. subscription
- CapEx vs. OpEx

▪ What is included

- Modules are typically identified; rarely buying a “catalog” license
- Are you getting everything you need/want?
- Which version of the software are you getting?



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Implementation Services

- **Defining scope**
 - Pre-contract SOW vs. design phase
 - Assumptions, allocations of labor and project plans
 - Acceptance criteria: documentation vs. specifications (KPIs)
- **Compatibility with existing systems**
 - Cooperation with third parties
- **Acceptance testing**
 - Beware of deemed acceptance and endless loops; consider “alarm clock” compromise
 - Acceptance vs. warranties
- **Training services**
 - Implementation vendor vs. licensor
 - Timing of contracting
 - Risk of finger pointing
 - Cooperation obligations



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Payment Terms: Software Fees

- **Balancing interests**
 - Vendor's desire: Cash flow and revenue recognition
 - Customer's financial interest: mix of cash flow vs. TCO vs. accounting
 - Customer's lawyer's interest: pay for performance
- **License fee overview**
 - Perpetual license model
 - Vendor wants fees upfront (possibly on signing)
 - Customer desire to tie to acceptance and actual/productive use
 - Subscription model
 - Fees spread (annual), but Vendor may desire to start full load prior to employee ramp-up
- **Scalability and price protection**
 - Payment terms and changes should be discussed earlier in contracting



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Payment Terms: Professional Services Fees

- **Fixed-fee projects**
 - Cost certainty
 - Vendor cushion
- **Time and materials**
 - Greater project flexibility
 - Opportunity to manage costs, avoid cushion
 - Reduced cost certainty
 - “Not to Exceed” is NOT fixed fee
- **Beware the assumptions**



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Payment Terms: Timing of Payments

- **Payment milestones**
 - Not always applicable or easily definable (other than final acceptance)
 - Typical payment schedule: 25/25/25/25
 - Beware large upfront payments
 - Make vendor justify and consider equal holdback
- **Third-party fees**
 - Frequently out of vendor's control
 - However, make sure they are identified early on
- **Fees are fungible**
 - Vendor may be willing to holdback dollars for one bucket in lieu of another



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Payment Terms: Scalability & Price Protection

- **Price protection: Annual fees or T&M rates**
 - Lock price for X years, then apply CPI escalator
- **Scalability: Growth**
 - Ability to add more volume at a set price
 - Lock price for X years, then apply CPI escalator
- **Scalability: Shrinkage**
 - Usually tied to threshold or inorganic event (i.e., divestiture)
- **Discounts/pricing for related modules**



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Data & Security: Generally

- **Where is the data?**
 - What jurisdictions will govern data (who are the data subjects...)
 - United States (state laws and regulations)
 - EU data protection concerns
- **Security standards and audits**
 - Client-specific security policies vs. vendor security policies
 - Third-party audits and standards
 - Client-driven audits and penetration testing
- **Breach notification requirements**



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What About Your Data

Data ownership vs. data mining

- Clarify company owns its data
- Understand usage data
- Usage data vs. “derived analysis”
 - If you or vendor derives ideas based on analysis of your data, who owns it and can use it?
 - If the vendor creates analysis based on aggregate data (i.e., benchmark data), you should get free access to that analysis



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Artificial Intelligence

- **Generative AI**
 - Inputs
 - Outputs
 - LLMs
- **Machine Learning**
 - Training data
 - AI models
- **Fine-tuning vs. training vs. RAG**
- **Human-in-the-Loop verification (HITL)**



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Artificial Intelligence: Key Considerations

- **All about the data**
 - Predominantly cloud/SaaS-based solutions processing customer data
 - What data will be accessed?
 - Who owns the input and output (Generative AI)?
 - How can they use data (aggregated or otherwise) for third parties or other uses?
 - Is there any training data?
- **Trained AI model**
 - Is your data used to train an AI tool? Can others use it?
 - Who owns the “learnings” or model parameters?
- **IP infringement**
 - Include traditional IP protection covering the AI service (as well as outputs) and third-party training data
 - See, lawsuits by Getty Images, NY Times, various authors



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Artificial Intelligence: Key Considerations

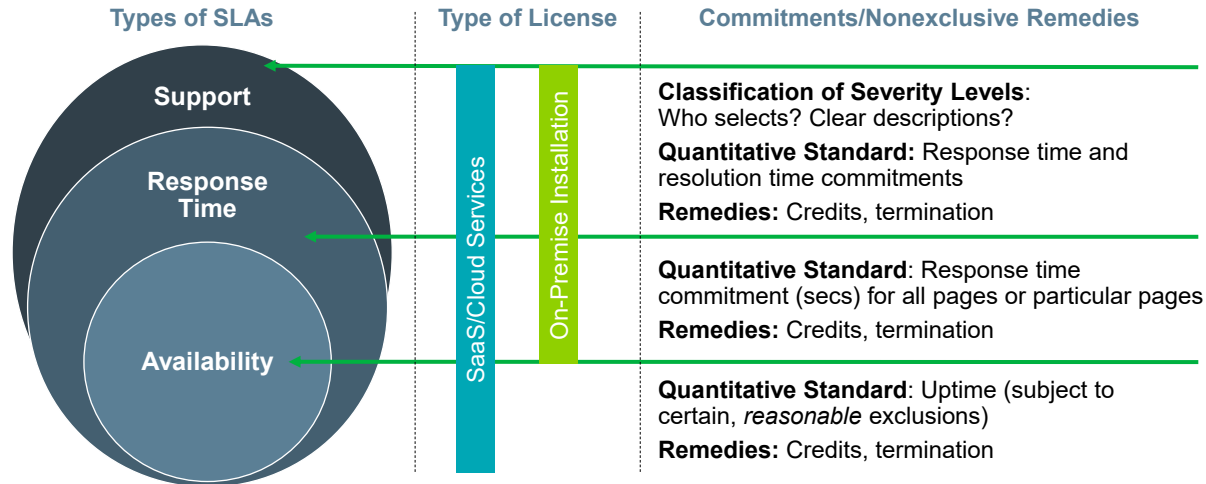
- **Performance requirements**
 - What is “performance” and how do you measure learning/improvement/outputs?
 - Chatbot guardrails
- **Regulatory compliance**
 - EU AI Act
 - Colorado AI Act
- **Risk mitigation**
 - HITL verification
 - Update diligence/intake processes
 - Use case guidelines
 - AI training and literacy



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Service-Level Agreements



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Service-Level Agreements

- **Uptime/availability commitments**
 - Monthly vs. quarterly vs. yearly
 - What are exceptions to “downtime”?
 - Service-level credits are reasonably standard here
- **Tracking and reporting**
- **Remedies**
 - What is the metric for credits?
 - Credits as exclusive remedy vs. deduction against damage cap
 - Hurdles for termination rights
 - What level of failure
 - X consecutive months or X months in any Y month period
- **Due diligence is paramount**

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Termination Rights

- **Termination for cause**
 - Typical 30-day cure period
 - “Material breach” can be difficult to prove
 - Any specific termination rights (e.g., nonacceptance, SLA/warranty failures, etc.)?
- **Termination for convenience**
 - Vendors resist revenue recognition; back-loaded costs; justification for discounts
 - Push for asymmetric rights to limit vendor’s rights
- **Termination for convenience penalties**
 - [x]% of remaining fees
 - Repayment of “commitment discounts” and/or other costs/fees



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Transition and Transition Assistance

- **Transition period**
 - Does company need to continue using software/service while finding new solution?
 - How long is reasonable/practical?
 - Consider flexible end dates with fixed/negotiated month-to-month pricing
 - No degradation in the services
- **Transition support**
 - Export data in a mutually agreed electronic format
 - Cooperate with company/replacement vendor to extract and migrate data
- **Is transition period/support needed?**



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Limitation of Liability: Baseline

▪ Standard cap and disclaimer

- In no event shall the Vendor's liability under this Agreement for any damages under any theory of law, including negligence, tort, breach of contract or otherwise, exceed _____.
- In no event will Vendor be liable under this Agreement for any indirect, special, cost to cover, incidental, consequential, punitive, or exemplary damages of any kind, including, without limitation, lost profits or lost savings, procurement of substitute goods or loss of business data, even if Vendor had been advised of the possibility of such damages.

▪ Standard negotiating issues

- Reciprocity
- Fixed-dollar amount vs. fees paid (or payable) vs. greater of
- If fees paid (or payable)
 - Life of agreement vs. 6-18 months
 - What if incident occurs in first [6-18] months
 - Aggregate under agreement vs. microcap (e.g., product/order giving rise to issue)



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Limitation of Liability: Commonly Considered Carve-Outs

The foregoing [limitation of liability/cap on damages] shall not apply to:

- Intellectual property infringement claims
- Personal injury and property damages
- Gross negligence and willful misconduct
- Failure to comply with laws
- Customer's payment obligations (if cap is reciprocal)
- Breach of confidentiality/security (see next slide)
- Indemnification obligations/third-party claims



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Limitation of Liability: Breach of Confidentiality/ Security

- **Times past (7+ years ago)**
 - Carve-out focused only on breach of confidentiality
 - Vendors accepted carve-out 90%+ without a lot of pushback
- **Current market**
 - Customers focus on confidentiality and security obligations (particularly security breach)
 - Almost all vendors will not accept straight/full carve-out
 - Separately, customers imposing detailed security audits and cyberinsurance requirements (\$3-10M per year)
- **Vendor rationale**
 - Vendors are “data agnostic” or “charging utility pricing”
 - Vendors are not your insurance company
 - Vendors say board decision to say no



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Limitation of Liability: Breach of Confidentiality/ Security

- **Cap and super cap**
 - Market has settled on a base cap, with a “super cap” for confidentiality/security
 - Super cap options:
 - 2-5x base cap
 - Fixed number (frequently linked to cyber liability insurance)
 - If fees are low, push for a higher number but expect vendor to balk when hard cap is equivalent of 10-20x (or even 100x) of fees paid in 6-12 months
 - Specify the types of costs (notification, remediation, credit monitoring services for affected individuals, and any fines or penalties imposed by regulatory authorities)
- **New area of contention**
 - Only applicable to data security incident resulting from:
 - Vendor's breach of security obligations
 - Vendor's acts or omissions
 - In other words, no strict liability and issue of burden of proof
 - Sophisticated vendors are pushing for this distinction (but not yet a market majority position)
 - Areas to review: Security Incident language, indemnification language and disclaimer of liability/warranties



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Managing the Process: Pulling It All Together

- **Involve the right internal team**
 - IT, finance, business leads
- **Involve the right negotiating team (both sides)**
 - Getting past vendors' initial level
 - Salespeople that will always say "Yes" (but can't really)
 - Contracting people that can only say "No"
 - Utilizing two-bites to your advantage
- **Give the team time to work**
 - The money and risk are in the details
 - Setting "deadlines" typically backfires (aka vendor inertia)
 - Leave time for final internal review, focusing on exhibits and SOWs



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Managing the Process: Pulling It All Together

- **Dual vendor negotiations**
 - Dual track: Early stage vs. late stage
 - Recognize limitations on internal resources
 - Stalking horse options
- **Timing and "making the quarter"**
 - Myth vs. reality
 - Setting yourself up to leverage the quarter end
 - Beware executing software license long before implementation vendor



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Thank you for attending!


Questions?

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