



Chapter highlights

- **Purpose:** This chapter presents methods and strategies for negotiating an IT contract, risks to avoid and proven methods for reaching agreement that will support a successful relationship and mutual project success.
- **Key points:**
 - An effective negotiator is thoroughly prepared and knows the technical and business requirements as well as the strengths and weaknesses of his/her position versus the other negotiating party.
 - Successful negotiation begins with preparation at the outset of the procurement, even before the development of the solicitation.
 - Key areas of preparation include understanding the business needs, understanding the market and contacting customer references.
 - Negotiating a contract for software licenses presents some unique negotiating considerations.
 - There are usually more costs involved in a technology acquisition than the initial sale price. The costs of support and ancillary technology far outweigh any sticker savings that may seem appealing on the original item purchase.

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26.0 Introduction

[§2.2-4302.2\(A\)\(3\)](#) of the *Code of Virginia* states in part:

3. For goods, nonprofessional services, and insurance, selection shall be made of two or more offerors deemed to be fully qualified and best suited among those submitting proposals, on the basis of the factors involved in the Request for Proposal, including price if so stated in the Request for Proposal. In the case of a proposal for information technology, as defined in [§ 2.2-2006](#), a public body shall not require an offeror to state in a proposal

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any exception to any liability provisions contained in the Request for Proposal. Negotiations shall then be conducted with each of the offerors so selected. The offeror shall state any exception to any liability provisions contained in the Request for Proposal in writing at the beginning of negotiations, and such exceptions shall be considered during negotiation. Price shall be considered, but need not be the sole or primary determining factor. After negotiations have been conducted with each offeror so selected, the public body shall select the offeror which, in its opinion, has made the best proposal and provides the best value, and shall award the contract to that offeror. When the terms and conditions of multiple awards are so provided in the Request for Proposal, awards may be made to more than one offeror. Should the public body determine in writing and in its sole discretion that only one offeror is fully qualified, or that one offeror is clearly more highly qualified than the others under consideration, a contract may be negotiated and awarded to that offeror;

Procurement by negotiation is a process of arriving at a common understanding through bargaining on the elements of a contract, such as delivery, specifications, price, risk mitigation and allocation and terms and conditions. The interrelation of these factors, together with intellectual property ownership rights, existing legacy systems, Commonwealth strategic and/or enterprise objectives, Commonwealth architecture and security requirements, data protection and user access to proprietary software make negotiating a technology contract more complex than non-technology contracts.

An effective negotiator is thoroughly prepared and knows the technical and business requirements, as well as the strengths and weaknesses of his/her position versus the other negotiating party. Only through awareness of relative bargaining strength will a negotiator know where to be firm and/or where permissive concessions in price or terms may be made.

In addition to the insight of the technology experts and subject matter experts (SMEs), negotiation teams benefit from the input of legal, purchasing and/or the business units that will be using the technology. Negotiation experts say that the most common cause of a breakdown in negotiations or in a contract is the failure of one or both sides to define their end of the deal clearly. A well-rounded negotiation team helps to ensure a successful contract by developing a clear and complete negotiation strategy.

Successful negotiation begins with preparation at the outset of the procurement, even before the development of the solicitation. A well-prepared solicitation will outline any negotiation rules or procedures that the agency expects suppliers to follow. This strategy strengthens the Commonwealth's negotiation position.

26.1 Contract negotiation steps

26.1.1 Preparation

Key areas of preparation include understanding the business needs, understanding the market and contacting customer references. These steps may have been performed earlier in the procurement phase, but revisiting them at this stage will help in developing a clear and complete negotiation strategy.

- **Understand the business needs.** Consider who will be using the solution and why they need it. Determine if the need is critical or desired and how soon it is needed. Discuss contingency plans for what to do if the desired solution cannot be obtained within the timeframe needed. Determine how many users will need the solution, how they will use it and what type of usage is anticipated. Test or witness demonstrations of

the proposed solution(s). What a supplier states in their proposal and what the proposed solution actually delivers may be very different.

- **Understand the marketplace.** The suppliers' proposals may be a great source of current market data that directly relates to the IT project. Research the market and determine what others are paying for the same IT goods or services. Look at different pricing models and determine which model would provide the best value for the product or service being procured. Generally, the solution you want has been implemented before. This means that comparable pricing information should be available in the marketplace or from other users. Conduct a market survey, if one has not been done already. There are various sources of information (Gartner, Forrester, internet sources, etc.) to help you better understand the marketplace.
- **Contact customer references.** Those provided by the supplier will likely provide positive reviews. Checking with other references can prove insightful. Determine where the supplier has done similar work for other customers and call those customers.

26.1.2 Conduct a risk analysis

Identify potential project risks based on the selected proposal(s) and the RFP requirements. This will help to ensure that you have covered all areas to take to the negotiation table. You will include them in the final negotiation strategy. The second tab of Appendix A, Risk Mitigation Worksheet, provides a valuable tool for ensuring a comprehensive look at possible project risk areas to negotiate around. Such areas include but are not limited to the following:

- Commonwealth and/or VITA technology strategies, standards and dependencies affecting a successful project might include:
 - Network, internal architecture, major application and/or server upgrades
 - Interface issues
 - Lacking requirements in the statement of work (SOW)/functionality/business processes
 - Phased development/growth/enhancement
 - Schedule (interdependencies on other applications/systems/hardware/software components/subcontractors/partners/data availability, etc.)
- Price (requirements analysis/customization/data conversion/scope creep)
- Spending risks/out year budgets
- Changes
- Supplier accountability/viability
- Supplier customer service experience from references
- Supplier product/service/performance limitations
- Licensing restrictions/issues
- Supplier assumptions/exceptions to technical/functional/business requirements
- Supplier assumptions/exceptions to terms and conditions
- Supplier assumptions/exceptions to other areas
- Unclear proposal statements

26.1.3 Develop the negotiation strategy

Bring the completed risk analysis into the negotiation strategy. Document the final negotiation strategy using the Appendix A spreadsheet, Tab 1, Negotiation Strategy Worksheet. Documentation should include requirements in business, legal, technical/functional and price. Establish positions on each issue: best, likely and least acceptable. Below is a list of negotiation strategy areas to review:

- Determine final scope/functionality from RFP and selected proposal(s) and/or any “now vs. later” or phased elements.
- Resolve any internal or VITA-required platform/architecture standards or legacy dependency issues.
- Confirm maximum budget.
- Identify those elements of the RFP and selected proposal(s) on which you can afford some degree of negotiation flexibility and those on which you cannot.
- Define non-negotiable, primary “key,” (proposed vs. target), secondary (proposed vs. target) and “walk-away” negotiation factors. Determine how granular you want to go. These factors should include but are not limited to:
 - Price
 - Scope
 - Schedule
 - Milestones/deliverables
 - Performance measurement/service level agreements/remedies or incentives
 - Software license
 - Source code/escrow
 - Business/functional
 - Technical
 - Functional/performance testing
 - Final acceptance criteria
 - Warranty period
 - Warranty
 - Training/documentation
 - Maintenance and support
 - Transition services
 - Change process/administration
 - Project management
 - Key personnel, if any
 - Reporting requirements
 - Security/information technology resource management (VITA ITRM) policy requirements
 - Invoicing/payment
 - Payment withhold schedule, if any
 - Terms and conditions

26.1.4 Assign negotiation team and roles

Typical roles include the following. The single point of contact (SPOC) will communicate with supplier(s) and make all agreements; the scribe (which may also be the SPOC) will document all agreements; the business lead will represent the project’s business needs; the technical lead will represent the project’s technical needs; and the legal expert will validate legality of the agreements. Conduct an internal trial run of negotiations to test the negotiation strategy and practice the assigned negotiation roles.

26.2 Conducting negotiations

Once the preparation, risk analysis, negotiation strategy and assignment of roles are complete, it is time to enter into negotiations with the supplier(s). It is recommended that the agency negotiate with more than one supplier deemed to be fully qualified and best suited among those submitting proposals. It may be helpful to inform the supplier(s) that negotiations are being conducted with others, but never name the competition. While every negotiation is unique, there are some common practices that should be followed.

- **Prepare an agenda for the meeting.** Items might include an introduction, supplier presentation, issues identification, common ground, negotiation topics, problem solving, and wrap up. Send the agenda to all participants prior to the meeting.
- **Negotiate with the right people.** Verify that the supplier representatives you are meeting with have the authority to make decisions and commit their company to agreements.
- **Avoid quick and hurried negotiations.** Informing the supplier about internal deadlines or restrictions may not be to the agency's best interest, unless possible impacts and concessions have been evaluated and included in the negotiation strategy.
- **Confirm all of the requirements, expectations and supplier promises in writing.** These are based on the solicitation and the supplier's proposal. Include these as part of your final contract.
- **Use the agency's approved contract form.** Customize the agency's contract template as needed with final negotiations. Do not allow the supplier to provide the contract form or any drafting assistance.
- **Use consistent terminology.** Make sure all parties use the same terminology to avoid conflicts and misunderstandings.
- **Lock down the scope of the work to be performed.** Be sure to include services, related costs and all performance levels to be met by the supplier. Most IT suppliers are willing to negotiate performance-based standards. All customer requirements as well as how the supplier plans to meet those requirements should be fully negotiated and included in the contract.
- **Strive for a "win-win" negotiation outcome.** Be flexible in negotiations and willing to yield on points that are not critical. The purchasing agency's negotiation strategy should identify critical and non-critical negotiation points and the value that should be attached to each. Obtain concessions in the right places. Talk with the supplier's references and learn what the supplier's sticking points were during their negotiations. If a supplier is known to be inflexible about its service pricing, for instance, get concessions in other areas, such as license fees. Strategically plan your trade-offs.
- **Protect your agency's and the Commonwealth's interests.** Conduct a thorough review of the contract, including legal review. If possible, have a peer and an attorney provide input prior to and during your negotiations to reduce the possibility of re-work after negotiations have been completed.
- **Do not be undersold.** To set a realistic pricing target for negotiation, conduct a market survey or contact other customers of the supplier who had/have similar projects to obtain their pricing agreement.
- **Use payments as leverage.** Negotiate supplier payments based on certain performance milestones and written formal acceptance by the agency. Payments tied to milestones provide an incentive to the supplier to ensure that the project meets the schedule, the price and the solution, service or product acceptance requirements. Final acceptance payment should not be released until after the agency completes testing,

confirming that the system meets all performance requirements, and is able to use it in a production mode.

- **Identify key personnel in the contract.** If the solution being provided includes key supplier personnel (project manager, technician, etc.) that are critical to the project's success, make sure they are clearly identified in the contract. Make sure that the contract includes language requiring that the agency must approve any changes to supplier personnel.
- **Consider the project's future needs.** Agency needs may change over time. License fees for future additional seats should be included in whatever volume discount is negotiated as part of the initial contract. The time to negotiate these issues and any other foreseeable points is before the contract is signed.
- **Protect the Commonwealth's investment.** Protecting the IT investment should cover the project's lifespan, (i.e., total cost of ownership) and should be given due negotiation consideration. The agency should negotiate supplier support from post-warranty maintenance and support to source code availability and access in the event of certain unforeseen events, as well as post-contract transition services. Depending on the hardware and/or software components that compose an IT project, the life span of those individual components may range anywhere from two to 20 years. It is advisable to:
 - Negotiate terms and prices of post-warranty maintenance and support.
 - Negotiate terms for placing the software source code into an approved escrow account;
 - Negotiate the right to recruit the supplier's technical staff to support the product or provide transition services in the event the supplier ceases doing business, goes bankrupt, is acquired by another company or the contract is terminated early for any reason.
- **Beware of "evergreen" clauses.** Evergreen clauses are automatic renewal clauses that extend the contract. Some suppliers will want to include clauses that automatically extend the term of a service agreement if the supplier does not receive notice of contract termination by a certain date. While some suppliers defend this policy as a customer convenience to prevent gaps in service, it could also mean that an agency could be obligated to pay for service that is no longer needed. Refer to [§2.2-4309](#) of the *Code of Virginia* for statutory guidance on contract modifications.

Defining the scope of the deal is often more difficult than either the agency or supplier expect. In the case of hardware, this includes not only the product specifications, but also the cost of training, the terms of service and/or warranties and the cost of any professional services required to integrate the equipment into an existing environment. For software, the agreement should define the license cost and the costs of support, training, patches/ upgrades and professional services associated with implementation, integration or customization.

26.3 Special negotiation issues

26.3.1 Software licensing negotiations

Negotiating a contract for software licenses presents some unique and critical considerations. The form of license grant, ongoing fees and supplier requirements for monitoring software usage are a few examples. It is very important to read [Chapter 27](#) of this manual, Software Licensing and Maintenance Contracts, for important information on

understanding and negotiating intellectual property, software types and licenses, warranty and maintenance support, risks, etc. Generally, key negotiation points for software licensing include:

- Rights to use/access, and use/access restrictions
- Licensee's intent to release to third parties
- Definition of the parties entering into the licensing arrangement
- Accurate definition of software to be licensed
- Operating systems and versions supported
- Source code availability (escrow)
- Right to modify
- Limitation of liability
- Warranty period
- Right to copy and distribute (manuals, backups, training, replacement, testing)
- Acceptance criteria definitions

Whether the purchasing agency will be granted a software license directly from the supplier or from a value-added reseller (VAR) on behalf of a software publisher, VITA recommends beginning with this type of license grant requirement language in the RFP: "a fully paid, perpetual, worldwide, nonexclusive, transferable, irrevocable object code license to use, copy, modify, transmit and distribute the Software and Documentation including any subsequent revisions, in accordance with the terms and conditions set forth herein and subject only to the limitations and/or restrictions explicitly set forth in this Contract."

Suppliers prefer to limit and restrict usage and access rights as much as they can; however, careful consideration should be given to negotiating acceptable license rights, both for usage and access. Limitations on license usage may negatively impact the agency's ability to fulfill its future goals and/or the Commonwealth's strategic and/or architectural requirements.

The agency may consider supplier-provided contract language only when the supplier is a reseller of the software and the software publisher requires an end user license agreement (EULA). In such case, the supplier should be advised that a License Agreement Addendum (LAA) is required to address terms and conditions of the EULA with which the agency or the Commonwealth, by law or by policy, cannot agree. Supplier shall have sole responsibility for ensuring that any such Software Publisher executes the LAA. License Agreement Addendum templates (one version for VITA use, another version for other agency use) are located under the Forms section of this VITA SCM website: <http://www.vita.virginia.gov/scm/default.aspx?id=91>.

If the purchasing agency is an executive branch agency, board, commission or other quasi-political entity of the Commonwealth of Virginia or other body referenced in Title 2.2 of the *Code of Virginia*, the license shall be held by the Commonwealth. If your organization is a locality, municipality, school, school system, college, university, local board, local commission, or local quasi-political entity, the license shall be held by that public body. If the purchasing body is a private institution of higher education who is allowed to purchase from VITA's statewide contracts, the license shall be held by that institution.

The type of software license(s) required for your project should have been identified in the solicitation, based on the project's current and future business needs. The solicitation should have requested various pricing scenarios to accommodate additional license purchases should they be needed in the future. These final prices will be a negotiation item. The

agency will negotiate pricing for one or more of the following license types: designated CPU concurrent use, project specific, site, and/or enterprise-wide. Refer to [Chapter 27](#) of this manual, Software Licensing and Maintenance Contracts, for a definition of these license types.

Since software license terms may charge per the number of users/seats/etc., a supplier may want to ensure through scheduled audits that they are being paid the correct licensing fees. If the supplier requires this in the contract, be sure the contract specifies the details of how that audit will occur. The inclusion of an audit term and condition should be considered a strong concession to the supplier; look for something in exchange. Here are some key points to include in the contract regarding audits:

- Define how often they can take place (once per year is common), and for how long after expiration of the contract.
- State that all audit costs will be paid by the supplier.
- State that all audit results will be provided to both parties.
- State that audits may only occur during business hours (clearly define these, as it pertains to you), and require prior written notification several days in advance.
- Define where the audit will take place.
- Define what information will be available during the audit, and clearly specify particular areas not covered (such as personal data).
- Define any agency or Commonwealth limitations and restrictions, and security or privacy standards.

26.3.2 Technology pricing negotiations

There are usually more costs involved in a technology acquisition than the initial sale price. The costs of support and ancillary technology far outweigh any sticker savings that may seem appealing on the original item purchase. Many suppliers are willing to reduce their initial sales prices to generate more revenue during the course of the contract.

- **Hardware.** When negotiating an IT contract, remember that pricing for hardware, software, and services follow very different models. Hardware often is priced like a commodity unless the product is new or unique. Usually, supplier margins on hardware are small (one to 15 percent).
- **Software.** The margin for software is often large. Software is priced based on value to the customer and to recover the initial investment to develop the software, not the incremental cost to the supplier for each license, so license prices often can be negotiated down substantially. Maintenance and support are an ongoing cost of software ownership that can cumulatively exceed the cost of the license itself in a few years. Be sure to define what is to be provided for the cost of maintenance and support. If the supplier is requested to provide support with projected resolution time and specified availability windows (could be 24/7 or just during business hours), these are requests that may increase the agency's costs. Annual fees are usually set as a percentage of the license fee. These should be based on the final, negotiated license fee, not the Supplier's list price. Setting the maintenance and support fee at 15 to 20 percent is a good target; however, validate current market prices before establishing a target. The software supplier also may want to be able to increase the fees over the term of the contract. Any increases should be capped at an absolute percentage (3-5 percent is typical) or based on a standard inflation index. Often, agencies can negotiate a freeze on any increases for the first few years of the contract. Often, suppliers who are/will be strategic partners will negotiate more favorably for a long-term relationship.

- **Services.** Services are usually based on labor rates and are marked up based on the demand for those skills (15-50 percent).
- **Licensed Services.** Application hosting services or software-as-a-service suppliers usually offer an annual subscription rate based on the number of application users. Always try to negotiate a pay as you go rate, so that you are only charged per number of actual users, if your user base is subject to fluctuation. Obtaining concurrent user licenses will also reduce these fees depending on your user base access needs.
- **Telecommunications.** Because of common carrier regulations, it may be difficult to get major concessions when acquiring traditional telecommunications services. Often, concessions are won by agreeing to revenue commitments annually or over the term of the contract. It may be unavoidable to commit to a revenue commitment over the term of the contract to achieve rate savings, but revenue commitments should be entered into with caution. Have a firm understanding of your telecommunications spend. You need to know how much is actually spent before you can responsibly commit. If the supplier proposes a commitment based on an agency's current spending, ask for documentation of the basis for that proposal, including how much of your current spend is represented by the commitment. Aim for commitments no greater than 75 percent of the agency's historical spend to ensure flexibility and competitive leverage in the future. If a purchasing agency is using supplier data to evaluate a commitment, include contract language whereby the supplier acknowledges that the agency is relying on their data and agrees to reduce the commitment if their data is later found to be inaccurate. Provide for business downturns. If demand for services is reduced through cutbacks in agency operations, the contract should allow for such an adjustment.

26.3.3 Data processing negotiations

Negotiations regarding the protection and privacy of Commonwealth data should result in the highest standards for that protection and privacy, as well as security. Some suppliers providing software as a service or application hosting services may not assume responsibility or liability for the loss, compromise, corruption, unauthorized access, or other vulnerabilities with pushing data into their application. Supplier terms may also state they can share your data with their third-party providers, partners, or subcontractors. It is critical that you negotiate terms that align to the level of data protection and security that your project needs, especially when processing confidential information, personal information, personal health information, or citizen information. Your negotiations must not result in non-compliance with required Commonwealth Security, Enterprise Architecture and Data policies and standards that cannot be formally waived or any federal requirements, such as HIPAA or other statutory privacy acts. It is also critical that your negotiations result in your ability to retrieve your metadata within two to four hours of your request and that you have all your metadata returned at the termination or expiration of the contract within a quick, but reasonable time. Equally important is to negotiate that supplier facilities and backup/disaster recovery facilities, and those of any supplier third-party providers, partners or subcontractors, are located within the continental U.S.; that your data will be backed up daily; and, that supplier notifies you immediately of any compromise to the security or privacy of your data. Another important factor is the positive negotiation result for service or performance levels for the uptime you require for business continuity.

26.4 Post-negotiation activities

All agreements that have been negotiated must be finalized in writing and placed in the contract for signature. All other agreements (verbal, e-mails, etc.) will not be enforceable.

Negotiations are complete when you have signed contract offer(s) from the supplier(s). Ensure that those signing the contract have the proper authority to do so. This may have been provided in the supplier's proposal; however, validation binding signature authority may be requested from the supplier. Proceed to [Chapter 29](#) of this manual, Award and Post-Award of IT Contracts, which discusses verifying any federal or *Code of Virginia* compliance requirements that must be validated with supplier prior to award.

26.4.1 Conduct an internal "lessons learned" meeting

After contract award, it is recommended that an internal meeting with the agency's negotiation team be held to identify what went well, areas for improvement and any other insights that could help make the next negotiation even more effective. Holding the meeting soon after negotiations are completed allows the team to review issues while they are still fresh.

26.4.2 Negotiation file requirements

Ensure that negotiation team members submit any negotiation records to the agency's procurement lead or single-point of contact (SPOC) when the negotiations are finished and the procurement is completed. It is recommended that the negotiation risk assessment and negotiation strategy documents, if used, be included in the main procurement file.

26.5 Basic negotiation guidance

Below is a list of best negotiation practices:

- Know that anything in the contract can be discussed. Just because something is in print does not make it non-negotiable. Be well prepared and know the agency's position on each item of negotiation.
- The agency's procurement lead; i.e., single-point-of contact, should host and lead the negotiation sessions.
- Identify each point to be negotiated, using a written agenda.
- Establish parameters of discussion for each point.
- Identify important issues first and consider appropriate points in time for their negotiation.
- Try to settle one point before moving to the next.
- Discuss budget limitations, policy and restrictions related to the program or the procurement.
- Be prepared to discuss alternatives.
- Negotiate on an even basis. If the supplier has legal or technical support, bring the agency's qualified counterparts or vice versa.
- Avoid arguments, interruptions and quick deals.
- Be ethical, fair and firm.
- Attempt WIN-WIN results so that both parties realize a satisfactory contract at the conclusion of negotiations and share balanced risks and responsibilities.
- Never underestimate the ability or knowledge of the other party as they have probably done their homework too.
- Avoid narrowing the field to one supplier.
- Never neglect the other side's problems or issues.
- Do not let price bulldoze other interests or issues. A cheap price will not compensate an agency for a system or product that does not meet all of its requirements.
- Search for common ground without spending an irrational amount of time.
- Always have a fall back position.
- Never disclose contents of other proposals to suppliers.
- Do not negotiate areas beyond the scope of the solicitation; i.e., scope creep.

- It's fairer to trade by making a concession and obtaining a concession.
- Try not to accept the first "no." Express concern, make a counter-offer and/or invite alternatives for discussion.
- Be persistent when it comes to pricing and agency budgetary restrictions.
- Be patient, reasonable, fair and respectful.
- Never compromise your business needs or compliance requirements.

Appendix A
Negotiation Strategy Worksheet/Risk Mitigation Worksheet

A current version of this worksheet may be located under the Tools section of this VITA SCM website: <http://www.vita.virginia.gov/scm/default.aspx?id=91>