

Understanding software license and services agreements

JAMES B. RILEY, JR., ESQ. • PHILIP P. McGUIGAN, ESQ.

Introduction

Hospitals, dialysis facilities, and nephrology practices are continuously purchasing and upgrading their software in order to more efficiently operate their businesses and enhance the quality of care provided to their patients. Whether relating to billing, electronic medical records, or other software, vendors present these providers with Software License and Services Agreements (the "Software Agreement"). This article provides an overview of the contracting process, a review of the more important elements of a Software Agreement, and a checklist of the significant provisions that should be included.

It is also important to keep in mind that the licensing of new software may require the purchase of additional hardware. Hardware requirements should be part of your initial inquiries with vendors so you can accurately establish the overall cost of the project.

Scope, price, performance

It is generally recognized that the three most important elements to be addressed in a Software Agreement are: scope, price, and performance. *Scope* means the functionality provided by the software; *price* is the amount that you pay for the software license and continuing maintenance services; *performance* relates to the software's ability to perform in accordance with the documentation and specifications provided for in the Software Agreement.

Before undertaking a software licensing and services initiative, it is important that

you set your expectations with respect to all three elements. Once that is done, you can begin to ask questions related to the software's functions, the vendor's background, and the tentative timetable and budget for the project. Those responses will influence "vendor of choice" with which you will enter into negotiations.

It is important that you make it clear to the vendor that you **require a detailed schedule of delivery that sets forth critical milestone dates**, and makes payment of licensing fees contingent upon adhering to that schedule

Implementation and acceptance issues

Before negotiating the Software Agreement with the vendor, you should consider how you want the technology to be implemented and how the software should be tested.

Implementation. Implementation involves establishing and integrating new technology. A number of considerations are brought forward, including the qualifications of the personnel installing the software and the amount of training and support that the vendor is willing to provide to you. The Software Agreement should describe the steps necessary for effective installation, and identify the tasks required for implementation, including the responsibilities of each party in completing those tasks, together with the timetable for comple-

tion. Ultimately, you want to be able to require the vendor to remove personnel from the installation project with whom you find it difficult to work, and you should be able to restrict the vendor from replacing or re-assigning personnel during the implementation process. It is important that you make it clear to

the vendor that you require a detailed schedule of delivery that sets forth critical milestone dates, and makes payment of licensing fees contingent upon adhering to that schedule. This will set the expectations prior to contract negotiations.

It is also important, in this initial phase, to reach a general understanding as to which responsibilities will be yours and which will be the responsibility of the vendor. Vendors are generally required to be responsible for installing their software packages into your system, and providing the training and customization necessary to ensure the effective use of the licensed software. You should be prepared to assist as necessary and to provide appropriate access to your information technology employees or independent contractors.

You should also negotiate to obtain additional integration services at fixed per-hour rates during the term of the Software Agreement so that you are protected from price increases if you need additional work done. An example of additional work might be a result of changes to your operating system.

Acceptance Testing. Vendors and customers undertake acceptance test-



Riley



McGuigan

Mr. Riley is a partner in the law firm of McGuireWoods LLP, based in Chicago, Ill., and is co-chair of the health care department. He serves as co-editor of *NN&I's* Legal Angle column.

Mr. McGuigan focuses his practice on commercial and financial technology transactions and corporate law and finance. He is a partner in the Technology & Business Department at McGuireWoods.

ing to determine whether the software meets the requirements set forth in the Software Agreement. It is most common to have two acceptance tests performed, the first, prior to taking the software live; and the second, immediately after the so-called “go-live” event. During the pre-go-live stage, the software

is tested under simulated conditions to minimize the risk of an unsuccessful go-live implementation.

In the post-go-live stage, the software is tested under real-time conditions, and it is normal to discover some defects. In addition, post-go-live testing should last at least one billing cycle and a signifi-

cant payment should be withheld until successful completion of this test. The vendor should be aware of your expectations with respect to acceptance testing, and your intention that the Software Agreement will provide for the return of all fees paid if the software does not meet acceptance-testing requirements.

Table 1. Software agreement checklist

Scope of license

- ▶ Exclusive/nonexclusive
- ▶ Transferable/nontransferable
- ▶ Restricted to specific:
 - 1) hardware
 - 2) operating system
 - 3) site or location
 - 4) number of users or concurrent users
 - 5) level or type of usage
 - 6) other
- ▶ Extent of distribution/sublicensing rights
- ▶ Source code vs. object code
- ▶ Limitations/restrictions on use
- ▶ Number/location of copies (and documentation)
- ▶ Updates, enhancements, releases

Purchase of hardware

- ▶ Available warranties / pass-through of manufacturers’ warranties, indemnities
- ▶ Ability to upgrade

Implementation

- ▶ Description of services to be provided
- ▶ Timing of service delivery
- ▶ Licensee’s obligation
- ▶ Training: cost, duration, attendees, location, materials
- ▶ Availability and cost of additional services (price locks and caps)
- ▶ Project plan/schedule/milestones - milestone credits?

Acceptance testing

- ▶ Procedures/criteria:
 - 1) pre-live
 - 2) post-live

3) omitted test criteria

- ▶ Duration of:
 - 1) tests
 - 2) retests
- ▶ Correction commitments
- ▶ Effects of failure to accept
- ▶ Remedies for failure to meet dates

Term and termination

- ▶ Term of license (perpetual vs. limited duration)
- ▶ Renewal terms; evergreen extensions?
- ▶ Termination rights and required notice
 - 1) for cause
 - 2) for convenience
 - 3) force majeure
 - 4) other
- ▶ Effects of termination; ramp down costs? Termination fees?

Confidential and proprietary information

- ▶ Definition of confidential information
- ▶ Exclusions/exceptions
- ▶ Standard of care; duration
- ▶ Disclosure to service providers (“need to know”)
- ▶ Return/destruction
- ▶ Publicity - terms of agreement, SEC
- ▶ Special requirements – HIPAA/GLB

Warranties

- ▶ Quality of services
- ▶ Performance of software
- ▶ Express remedies for breach of warranty

Remedies

- ▶ Events giving rise to remedies
- ▶ Available remedies

Indemnification

- ▶ Types
- ▶ Limitations

Limitation of liability

- ▶ Mutual
- ▶ Maximum amount of direct damages
- ▶ Other

Payment terms

- ▶ Payment form, amount, schedule
- ▶ What is included
- ▶ Payment schedule/critical milestones
- ▶ Segregate license fees from services payments, collateral obligations

Source code escrow

- ▶ Escrow agent
- ▶ Timing of deposits - initial and updates

Disaster recovery support/maintenance

- ▶ Scope of coverage
- ▶ Term
- ▶ Fees
- ▶ Out-of-scope work (price/timing)

Other

- ▶ Bankruptcy Code §365(n) applies
- ▶ Force majeure – terrorism?
- ▶ Assignment
- ▶ Dispute resolution
- ▶ Applicable law; forum, venue
- ▶ Insurance
- ▶ Nonsolicitation / noncompetition
- ▶ Survival/severability/no waiver
- ▶ Security interest in hardware/software

In the post-go-live stage, the software is tested under real-time conditions, and it is normal to discover some defects. In addition, post-go-live testing should last at least one billing cycle and a significant payment should be withheld until successful completion of this test.

Vendor “form” software agreements

Once the foregoing issues have been addressed and a “vendor of choice” has been selected, it is traditional for the vendor to provide to the customer its “form” Software Agreement. It is critical to understand that vendors expect customers to negotiate from the vendor’s initial draft. In this regard, it is well recognized in the industry that vendors both love and fear circumstances where the customer chooses not to negotiate. They love the fact that it is an easy sell and they can book the revenues quickly. They fear that once the customer finds out how much the vendor has left on the table, the customer is likely to be quite angry.

The nature of the vendor’s initial draft will be influenced by a number of factors,

including the vendor’s corporate culture and perception of the customer’s capabilities. If the vendor understands what the customer’s business, information technology, and legal teams want, and are ready to move forward, the likelihood of receiving an overreaching initial draft from the vendor will be substantially reduced. If, on a scale of 1 to 10, a customer-friendly agreement is a 1 and a vendor-friendly agreement is a 10, the best that the customer can expect from the vendor’s initial draft is something in the range of 3.5 or 4. This is because the vendor expects negotiation and is prepared to be negotiated up to at least a 5, representing a fully balanced agreement that favors neither vendor nor customer.

If the vendor knows that you are a

prepared, ready, willing, and able buyer, you have the best opportunity to close the agreement at the 5 level, or better, if the vendor really wants the deal. It is important to note, however, that vendors and sophisticated customers alike understand that a Software Agreement is hopefully the beginning of a long-term relationship. It is in neither party’s best interests to be overreaching when negotiating the contract.

High-level software agreement issues

Among the most important aspects of the Software Agreement are those relating to warranties, indemnities, support and maintenance, and source code escrow.

Warranties. An informed customer will require that the vendor provide warran-

ties of quality of performance, speed of response time, limited length of downtime, and adequacy of documentation, among others. The performance warranty involves the vendor warranting that the software will perform in accordance with the software specifications and documentation as contemplated in the Software Agreement, and will contain a general provision that the software is free from material or frequent errors. All of these warranties should continue during the term of the Software Agreement, and for as long as the customer is paying for support and maintenance. The response-time warranty is one in which the vendor warrants that the software will process ordinary transactions within a specified period, usually in less than a second. A downtime warranty is one in which the vendor warrants that the software will not be unavailable for use for more than a specified period of time. The adequacy of documentation warranty relates to the vendor's warranty that the documentation is complete, and that future versions delivered with updates and upgrades will be at least as detailed as the original documentation. In addition, you will want to require a disabling code warranty that provides that the software does not contain elements causing it to stop running upon the occurrence of certain events. A no virus warranty that provides that the software is not infected with a virus, should also be included. The warranty period should not begin to run until completion of post go-live acceptance testing.

Indemnification. It is traditional that the vendor indemnifies the customer for damages incurred because the software infringes the intellectual property rights of a third party. Indemnification provisions also provide for indemnification by both parties for bodily injury or death, or property damage caused by the negligent acts or omissions of the indemnitor.

Support and maintenance. Under most Software Agreements relating to software that is not required to be highly customized, vendors will agree to correct programs and bugs, make minor improvements to programs, and often provide enhancements

or new features generally available to other customers. In the best circumstances, the customer should require a guaranteed time by which problems are resolved (depending on the severity of the problem), and customers should seek a cap on future increases in support fees. For example, support fees may be capped for three years and then increased based on a commonly used cost-of-living index.

Source code escrow. Particularly when dealing with a smaller vendor, it is critical that the customer requires the source code relating to the software being licensed is deposited on a regular basis with an independent escrow agent. Should the vendor go out of business, declare bankruptcy, or if there is a material breach in the Software Agreement, sufficient documentation for the customer to take over the management of the software should be arranged.

Software agreement checklist

Table 1 is a comprehensive Software Agreement Checklist that may be used

to ensure all significant issues are appropriately addressed in the Software Agreement, as applicable. The checklist has been designed to function much like a preflight checklist, ensuring that no items of significance are omitted from the Software Agreement.

Conclusion

It is clear that health care providers entering into software agreements must cast a watchful eye on a variety of issues arising both in the development, as well as the ongoing maintenance, of computer software. Providers should review these agreements carefully. In addition, your degree of success in entering into a Software Agreement will be significantly enhanced if the project is led by a team of informed business, information technology, and legal professionals. It is of particular importance that your legal advisor is experienced in technology matters in general, and software agreements in particular. ♦

STARTING NEXT MONTH:

Improving Revenue Collection: A Primer

Dialysis and practice management billing would seem like a fairly simple process. Nephrology is one of the few medical specialties that relies primarily on one payer—Medicare—to bill.

So what's the problem?

There can be plenty. Medicare billing requirements are so precise, poor preparation can lead to thousands of dollars in rejected claims. Wrong coding can lead to revenue losses – or be labeled as fraudulent billing practices. And commercial group health plans have their own mindset on when they pay their bills. How can you avoid mistakes?

In a three-part series beginning in the November issue of *NN&I*, we discuss the most common errors clinic and practice managers make in the bill-

ing cycle. Jamie Constein, vice president of operations for Brandywine Medical Management and a veteran at helping dialysis clinic managers improve revenue collection, will author the series. "We don't just help clinics collect outstanding revenue, we show them how to improve their systems so they can reduce their outstanding debt long-term," says Constein. The articles will cover the following topics:

Part 1—Changing the mindset over collecting revenue in today's health care environment

Part 2—Understanding the billing cycle and handling payer issues

Part 3—Claims follow-up and billing analytics