

Successful Software Purchasing by Healthcare Providers

By Stephen Phillips

The typical software purchase is a horrid affair for the healthcare provider, particularly the provider who does not have the business leverage or legal resources of a large healthcare system. With a detailed understanding of its product, extensive experience with how to price and sell it, and the cover of “industry standard” terms, the software vendor usually enters the sale cycle with an overwhelming advantage over the provider and no qualms using it. The most common result, either through ignorance or acquiescence by the provider, is a grossly one-sided deal no better than the click-wrap or online licensing terms a typical consumer purchases under.

But a healthcare provider using software in a clinical environment needs the vendor to be held to a higher standard. When an iPod breaks, damages are minimal. When software that controls imaging equipment fails or a vendor’s hosted electronic medical record system is breached or patient records get mismatched or corrupted, enormous damage can result, especially given the recent sharp increase in patient safety and privacy regulations and penalties. The military, faced with similar mission critical software needs, has never accepted a consumer standard for purchasing software. Why should a healthcare provider?

This executive briefing outlines a strategy for providers to fight for a fair and balanced set of software (and related service) terms. There is no secret process here: the key to a good result is foresight, preparation and execution of strategies designed to enhance the provider’s leverage. I have learned through many years of experience with software licensing (including, I must confess, as general counsel for two healthcare software companies) that in any contract negotiation, the skill of negotiators, much less the merits of the positions they advance, is of minimal importance compared to the business leverage each side brings to bear. **The number one goal of a successful negotiating strategy for providers, therefore, is to maximize negotiating leverage.**

Creating Leverage

Leverage is best enhanced by aggregating demand and proactively orchestrating the purchasing process. This requires advanced planning and action.

Group Purchasing

Very few providers have sufficient purchasing power on their own to aggregate the demand needed for significant leverage with a vendor. For most providers, therefore, participation in some form of group purchasing effort is the best way to aggregate demand and create leverage.

The most prevalent form of group purchasing involves a group purchasing organization (GPO). GPOs are a long-standing feature of the healthcare purchasing environment, yet very few meaningfully serve the health care software market. The beauty of GPOs from a provider’s

perspective is that when properly structured they are safe harbored from noncompliance with antitrust and fraud and abuse law, two bodies of law that are often the chief obstacles to provider collaboration. Moreover, GPOs are unlicensed entities, and therefore do not face the delays, cost and intrusive regulatory oversight typically associated with licensed entities. With proper legal structuring, providers are free to form with other like-minded providers a GPO to create negotiating leverage vis-a-vis software vendors. Similarly, providers are free to participate in the group purchasing programs of third parties, such as regional extension centers and community purchasing coalitions, organized specifically for provider group purchasing. The relative ease of forming a GPO makes either creating a new GPO or joining an existing one viable options, with the preferred option dependent on the particular circumstances of a provider and its market.

Bundling

Another way to aggregate demand is through bundling, whereby a provider agrees to buy a group of products from a vendor in exchange for more favorable terms. The most obvious bundling is of software and related services. Some services, such as implementation and maintenance services, are almost always bundled. Others, such as extended training and support, are not. Vendors often sell software as modules and offer discounts for a bundled package of modules.

Orchestrating the Purchasing Process

Although the aggregation of demand is the most important part of an overall strategy for successful software purchasing by a provider, how the provider orchestrates negotiations is also enormously important.

RFPs

The best orchestration is done through requests for proposals (RFP) from multiple vendors or other formalized solicitation process. The RFP process helps to tip the scale in the provider's favor by creating competition among vendors for the provider's business, setting the stage for vendors to play by the provider's rules, and setting forth within those rules the critical purchasing and licensing terms for the provider.

Orchestrating competition among vendors allows the provider to compare each vendor's product specifications against the others and weigh the pros and cons of those specifications against the prices, services, warranties, legal terms of purchase, support, and other relevant terms of sale. With each competitor unsure of the other's posture, the vendors are incentivized to offer better terms. In an RFP process it also becomes more feasible for providers to demand that vendors sell products based on the legal terms and conditions proffered by the provider. In the worst case scenario, no worthy vendors respond to the RFP, or more likely, they respond with less favorable terms than are proposed by the provider. In such instances, the terms demanded by the purchaser can then be adjusted to be more agreeable to vendors until more desirable vendors participate. This is far more preferable to negotiating with one vendor on their standard terms and conditions.

If a provider cannot use its own contractual terms, it should create a checklist of key provider-friendly terms and use it as a guide to revising the vendor's terms. It should also demand fully editable versions of the vendor's documents, not pdf files or locked Word documents designed to discourage changes. Finally, the provider should resist vendor requests to put all changes in an addendum to the contract. Such addenda obfuscate the terms and disguise their one-sided nature.

The vendors should be required to submit any changes to the provider's proposed terms and conditions as part of their bids. The RFP directions should be as explicit as possible that terms and conditions of licensing set forth in the RFP, taking into account changes proposed by the vendor in its response, will be considered final unless the provider proposes further changes. An even stronger approach is to make certain elements of the RFP response a binding contract such that any attempt to re-negotiate such agreed upon terms after acceptance of an RFP response will be a breach of contract that subjects the vendor to contractual damages and disqualification. Although many vendors will bristle at this heavy-handed approach, it is important to fight the almost predictable effort by a vendor to re-negotiate terms and conditions once its bid has been accepted, often under the guise of a misunderstanding as to the nature of the RFP rules on this point or miscommunication with the vendor's legal and/or finance departments. The more teeth put into this part of the process the better and well-worth the effort.

Timing

Either in conjunction with an RFP or without one, a provider can often increase its negotiating leverage by timing its software purchases to coincide with low demand. Software needs can spring suddenly from rapid operational, legal and administrative changes or from the collapse of existing software systems, and a provider may never feel it has the luxury of timing its software purchases. But the more a provider proactively surveys its operational environment and the software needs it generates, the better able it is to forecast future software purchasing needs and enhance its ability to initiate the purchasing of software at a time that enhances its leverage. Such periods of heightened leverage coincide with a slow sales period or a highly competitive period for vendors, such as the end of a fiscal quarter or year, the entry of new competing software offerings, or for a variety of reasons the loss of a product's market appeal.

The flip-side to provider market timing is avoiding having to buy at periods of peak market demand and avoiding end of quarter sales pressures from the vendor. Oftentimes vendors offer discounts with a short-expiration period to coincide with the end of a sales quarter, a well-worn and artificial tactic to get a customer to agree to the vendor's one-sided terms by threatening rescission of the discount. Stand firm, and the discount almost always magically reappears.

Key Terms and Conditions of Licensure and Service

Although a complete discussion of desirable terms and conditions of licensure for a provider is beyond the scope of this briefing, some of the critical terms and conditions are discussed below. The most important points are:

1. Identifying the lifecycle cost of the product
2. Properly allocating risk under the contract.
3. Providing for proper remedies for breach of the contract.
4. Providing for a viable exit strategy from the relationship.

Identifying Lifecycle Costs

Identifying the true costs to the provider of a vendor's product over its lifecycle is tricky and requires much patience and persistence. Most vendors do their utmost to obscure the true costs in a number of ways. First, vendors often provide a byzantine fee schedule with all sorts of list costs, discounts, rebates and bundled rates so that the actual out of pocket cost is unclear. Second, vendors often obscure or fail to identify all initial costs, often by failing to spell out all likely implementation and training services beyond a low baseline of services. Third, vendors often do not specify costs such as travel, lodging, and overtime, as well as future costs, except with vague references to "costs incurred", "at prevailing charges" or "then-current fees."

Software is typically upgraded and updated periodically. The provider will want the option to obtain such new versions of the software at a predetermined price. The same is true with maintenance and support services throughout the lifecycle of the product. At the very least, future pricing should be subject to caps based on external benchmarks like a CPI index. Travel charges should be subject to prior approval and other cost controls (*e.g.*, coach travel, no more than 8 hours billed for travel in one day, etc.).

Allocating Risk

Allocating risk under a contract requires understanding the risks each side creates by doing business together and then addressing those risks appropriately under the sections of the license agreement dealing with representations and warranties, indemnification, insurance, limitations of liability and termination. All of these contractual provisions work together to apportion risk under a contract. Representations and warranties should include those made by the vendor during the sales cycle. If a vendor, for example, claims that its software is certified EHR Technology, the contract should expressly state that as a representation and warranty that remains in effect through the term of the agreement. If a representation by a sales representative is not in writing, it is likely not going to be enforceable, because almost all contracts contain contractual clauses providing that any oral representations during the sales process are not binding and the product's representations and warranties are limited to those expressly set forth in the contract.

Vendors typically insist on allocating risk under the contract predominantly to the customer. They do this in a number of key areas. They will typically seek to have a series of payments, for example, due on specified calendar dates rather than upon completion of a series of performance achievements. A date-driven payment schedule should be resisted.

Vendors may also unfairly allocate risk to the provider by minimizing the representations and warranties they make about their product and services in the contract, refusing or limiting their indemnification obligations, inserting draconian limitation of liability clauses that limit their damages to the amount paid by the customer under the contract for a specific period of time and excluding recovery for damages other than direct damages. The limitation of liability clause is typically defended as a non-negotiable clause for the vendor, sometimes one required by external auditors for publicly traded companies. This position is defended regardless of the harm that the vendor's actions might inflict on the customer and without any attempt to subject the vendor to a reciprocal limitation of liability clause. Indemnity clauses are sometimes resisted as voiding insurance policies, but this concern can typically be addressed contractually without eliminating the vendor's indemnity.

Providing Proper Remedies

Providing proper remedies for breach of the contract is tightly wound up with the allocation of risk under the contract. For example, a limitation of liability clause is, besides a means of allocating risk, a means of limiting a party's breach remedies. Other breach remedies include the exclusion of damages other than direct damages, the limitation of the time period for representations and warranties to be effective and the discretion of the vendor to determine whether a product can be repaired, refurbished or replaced.

Exit Strategies

Providing for an exit from a vendor relationship is another critical element to the product lifecycle that needs to be addressed properly in the purchase contract. A vendor wants a sticky relationship (*e.g.*, a dependence of the customer on the vendor) and develops that stickiness in part by license terms that do not provide for termination for convenience, do not provide for transition assistance upon termination of the contract, charge termination fees or impose nonrefundable fees, and provide for a long initial term and automatic renewal terms, among other measures. The provider, logically, should resist all such terms and seek a contract that provides for termination for convenience after a reasonable period without financial penalty coupled with the right to receive meaningful transition assistance at pre-determined rates. Such resistance is critical because the provider needs to have a meaningful ability to terminate the relationship and migrate to a new vendor's products by being able to terminate the contract without excessive fees or any penalties and receive technical assistance in migrating to a new technology vendor without a discontinuance of patient care and operations.

Other Important Terms and Conditions

In addition to the four key terms and conditions described above, there are several other lesser but still important terms and conditions that must typically be addressed in the license and service agreements governing software purchases. These include the following.

IP Ownership

A vendor will always own the software it licenses, but the provider should, in many cases, own modifications it makes to the software using the software's templates and should always own the data it stores on a database connected to the software and carefully limit the vendor's access to and use of it. Many vendors attempt a land-grab by granting themselves a right to de-identify the customer's patient data and then assert full ownership over such de-identified data – without compensation or liability protection for the customer. This should be strongly opposed.

Embedded Third Party Software

The software systems of vendors may contain software from other vendors (*i.e.*, third party software), and the vendor may refuse to make any representations or warranties about third party software or provide any contractual remedy for its failed performance. Such an approach leaves the provider without a remedy should the third party software fail to perform or cause any liability for the provider (*e.g.*, a court order enjoining the use of the software because it infringes upon the copyright rights of another party).

Affiliates as Contracting Parties

Vendors will sometimes attempt to use an affiliate as the contracting party for software or services. If the affiliate has few financial resources, any contractual claim the provider has against the affiliate may be meaningless because the affiliate does not have the financial resources to satisfy a claim. The only protection against this danger is to refuse to permit affiliate contracting, require a parent guarantee from the vendor's parent company, or require adequate insurance provisions be put in place to protect against potential liability (*e.g.*, require the vendor to maintain insurance that is comprehensive with respect to claims and coverage amounts and names the provider as an additional insured).

Stability of the Vendor and Escrowing Source Code

The license agreement should protect the provider if the vendor becomes insolvent or files for bankruptcy. One means of doing so is to provide for the escrow of the software source code. Any escrow should be made with an independent third party, include not only the source code, but also the tools, logic diagrams, programmer notes, encryption keys, compilers and documentation necessary to operate the software, and require the vendor to escrow any updated version of the escrowed materials produced during the contract term. The escrow agent should be required to verify that the escrowed materials are complete and up to date.

HIPAA Compliance

Vendors will typically need access to patient health information as part of their maintenance and support services. Providers should require the vendor to sign the provider's form of business associate agreement (BAA) covering the responsibilities of the vendor with respect to data privacy and security and ensure that that BAA has state privacy law provisions, indemnification and cyber-insurance provisions, language requiring vendor compliance with breach notification

requirements and other privacy and security law requirements. Vendors should not be permitted to retain protected health information, use it for anything other than to provide services to the provider or, as noted above, create de-identified data out of it.

ASP and SaaS Model Software

Vendors are increasingly selling software under application service provider (ASP) and software as a service (SaaS) models, where the software is delivered to the provider as a service over the Internet. ASP and SaaS models hold the potential for lower-cost software that is easier to maintain and upgrade, but present special security concerns, because all patient and other provider data must be transmitted over the Internet and stored on the vendor's servers. Many ASP and SaaS vendors use third-party hosting companies, such as Amazon and Dell, to host the software and data, creating yet another security risk to the data. The ASP and SaaS models, therefore, require special data security protections to be addressed in the contract and in any vendor contract with a hosting company.

In addition, when software is categorized as a service instead of a product, the provider may be unable to obtain otherwise available protections under bankruptcy law if the vendor files for bankruptcy, and in litigation may not be afforded certain rights and remedies available under product liability law. Finally, the ASP and SaaS models give the vendor the technical ability to immediately terminate the provider's access to the software and its data. The provider should therefore insist on specific protections in the agreement to address bankruptcy, product liability and termination rights that would otherwise be compromised without special contractual provisions.

Conclusion

When it comes to purchasing software, the provider naturally starts at a huge disadvantage, but through proper planning, foresight and execution of strategies designed to enhance the provider's leverage, a provider can greatly neutralize the vendor's advantage. Joint purchasing, bundled purchases, creating competition amongst vendors through the use of RFPs, strategically timing purchases and fighting for the most critical contractual terms that enhance the provider's leverage can result in a more balanced set of terms.

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