

Telice Gillom: 0:04

Hello and welcome. You've tuned into another episode of the NASPO Pulse podcast. We are your source for positively riveting discussions about public procurement. I'm your host, Talese Gillum, and this episode will be the first in a series that we're calling the Basics of Contract Terms and Conditions. This series of episodes will be a discussion of the most common terms and conditions one would encounter when dealing with contracts. We're gonna be talking about them in more of an informal way to hopefully further the understanding of what they mean and how they're applicable to the world of public procurement.

Telice Gillom: 0:41

My guest for this deep dive into the world of contracts will be NASPO's Director of Legal Education, Megan Smith. Now just a disclaimer here Our discussion about the basics of contract terms and conditions is not legal advice, so please be sure to check your agency's legal requirements before making any contract decisions. Please also remember to subscribe to the NASPO Pulse podcast so that you don't miss an episode in this series. After all, what could be more exciting than talking about contracts? Feel free to email us with your questions and with that I'd say, let's take the pulse. Megan, thanks for joining me again today to talk about understanding contract terms and conditions.

Megan Smyth: 1:23

Thank you for having me, Talese. I'm excited to talk about this somewhat complicated but accessible topic.

Telice Gillom: 1:33

We've got the team back together. We've got the great comedy legal procurement duo back together. What do you say? Oh yeah, I mean T's and C's are hilarious, oh yeah, I mean T's and C's are hilarious, but we you and I are also hilarious, so I think what better team to talk about?

Megan Smyth: 1:52

it. Yes, we will bring the hilarity to the T's and C's.

Telice Gillom: 2:06

Now we're discussing these T's and C's because these are common challenges that come up in procurement offices between the legal and the procurement staff, and we want to provide some general insight into what these contract clauses or T's and C's mean and we want to explain how they affect the agency from a legal and a procurement perspective.

Megan Smyth: 2:22

Yes. So I think that you know a lot of times we skip ahead and we start talking about the most complicated T's and C's right off the bat, and what we really should do is evaluate what we even mean when we are talking about a contract, because contracts require certain things and I think a lot of times people think every contract is the same or they don't need to have legal look at every single contract that comes through the procurement office. But, as we will see as we discuss, the different goods and services that you are purchasing require different kinds of terms and conditions.

Telice Gillom: 3:14

So I think first, I think we probably should just get on the same page as far as the agreements that contain the terms and conditions that we'll be talking about, wouldn't you agree?

Megan Smyth: 3:26

Absolutely so. We use contracts to secure goods and services in the states. That is a legally binding agreement between two or more parties that defines the rights and obligations of each party the rights and obligations of each party. So these documents are built to protect all the parties and provide a framework or a guideline for how to

resolve disputes and ensuring that the commitments made between the parties are fulfilled. So contracts, typically we say, require seven things Offer and acceptance. So the offer must be clear and the acceptance must be unambiguous. And let me tell you Talese in law school you spend an inordinate amount of time talking about offer and acceptance, to the point that it's almost exhausting because there are so many different ways to make an offer and there are so many different ways to create acceptance. I know that's probably something that isn't a daily issue that our procurement folks deal with, but it does create the basis of the contract to begin with. Consideration is another element, something of value must be exchanged and the lack of appropriate consideration. So what we would call sort of a one-sided agreement that can void the contract Intention. And this is again something that is pounded into our skulls in law institute or in law institute. In law school Also, you talk about this at law institute.

Megan Smyth: 5:16

There must be a meeting of the minds, and that means that both parties must intend to create a legally binding agreement. You cannot dupe someone to a contract. Everybody has to understand what they're doing, what they're agreeing to and the fact that there is a binding agreement being created. The parties who are contracting must have capacity to do so. This means that they must have authority to contract on behalf of whatever entity they are. And then there's very basic requirements that really don't often come up in state contract disputes. But the contract signees must be of appropriate age. Contract signees must be of appropriate age. They must be an appropriately identified agent of the principal, which in this case is the state, and they must have appropriate mental capacity to enter into a contract. The subject matter and purpose of the contract must be legal. That sort of goes without saying.

Megan Smyth: 6:27

But you cannot make a contract for an illegal drug deal. So you know what a bummer for drug dealers. But no contracts for you. Terms and conditions. There are rights, obligations, responsibilities, remedies, damages, all of these things that we're about to talk about. That's what's lined out in the terms and conditions of a contract. And then finally, last but certainly not least, it has to be signed, and so you've got to check your obligations in your particular venue when it comes to this. Some states and jurisdictions allow countersigned contracts, where you sign one copy, somebody else signs another, but you agree that everybody signed it, and then, in some instances, everyone needs to sign the original contract. So that's something to think about when determining whether or not you actually have a contract in the first place.

Telice Gillom: 7:22

So, megan, you mentioned in the seven things that the contract requires, number six among those was the terms and conditions, and that's what we're here to talk about today. We want to be clear that the terms and conditions and the contract clauses, those terms can kind of get used interchangeably depending on the verbiage in your state. Is that correct?

Megan Smyth: 7:50

Yes, and you know, this is one of the things that I encourage my attorneys to do, which is just speak in plain English. There's no reason to get out your legal thesaurus and change simple words into difficult ones. I think that that's a stereotype that attorneys get, is that we would use 30 words when five words would do, which. I'm probably doing that by explaining things. It is a tendency that we have, but that tendency comes from a desire to be precise, a desire to be comprehensive, so it comes off as annoying. I get that, and often terms there's legalese, there are terms of art that mean a very specific thing, and so when an attorney changes a word or replaces a word, oftentimes it is because of that. It's not necessarily that we're just trying to be fancy. So that's something to keep in mind. And yes, those, a lot of these terms are interchangeable with several other terms. I've tried to highlight some of that as we go through. But, yeah, everybody has to call it something different, right, we all have to be special.

Telice Gillom: 9:05

We are all special, and who among us doesn't like to be a little fancy from time to time? I know I do Just a little fancy.

Megan Smyth: 9:14

Just a little bit. I mean maybe not monocle fancy? No, not Mr.

Telice Gillom: 9:22

Peanut fancy. So let's get into some of these contract terms and conditions, shall we?

Megan Smyth: 9:38

Absolutely so. First up, we thought we would talk about warranty. Yes, so everybody has heard of a warranty. Right? If you've watched television in the last 50 years, you've seen some salesmen on TV guaranteeing that the product that they're selling you will work. But a warranty has a very legal definition, which is an assurance by one party to a contract, which again requires all those things we just said of the existence of a fact upon which the other party may rely. So in a state government context, a warranty would be a guarantee or an assurance that the vendor or supplier provides to the state regarding the quality, the performance or the condition of the goods and services they're providing to the state government. So a very simplistic example of this is I guarantee you that the ice I am shipping you will arrive in ice form. It will not arrive in liquid form. That is a guarantee that is fundamental to the performance of the contract. So if the ice cart arrives and everything's melted, that is a warranty issue and this is important because it protects your interests. So if that when that train car arrives and the ice is melted, it's not the state's responsibility to refreeze it or to find a replacement, you go back to the contract and see what type of warranty is in the contract and how you should go about enforcing that warranty.

Megan Smyth: 11:19

There are multiple kinds of warranties, which makes everything even more exciting and spicy. There are express warranties. These are specific promises that the vendor makes about the product, so guaranteeing a very specific level of performance. So this is a good example of this. Is in your technology space, is in your technology space. I guarantee that this software, we will be able to patch it and update it for five years and it will be good for five years and we promise that. Well, if three years in that software service suddenly no longer becomes available and you have to replace it with something else, your warranty might kick in because the company guaranteed you a certain durability or performance level for the product or service they're providing.

Megan Smyth: 12:13

There's also implied warranties. These are unspoken assurances that the goods will be fit for their intended purpose and are of a mercantile quality. And this goes back to some very fundamental contract law. All attorneys know that the UCC, the Uniform Commercial Code that is a very basic legal code that governs how we all build and litigate contracts. So when you look in that stuff like mercantile quality, that sounds very fancy and silly and I'm probably not even pronouncing it correctly the entire way. All that means is is it good enough to be on sale to the public, right? Is this a good enough quality thing? Would you put this out in the public marketplace? And then for its intended purpose? This is, again an implied warranty. You can't sell ski goggles that don't have any glass in them, right? That is not fit for its intended purpose.

Megan Smyth: 13:17

And one thing that I think our members really need to pay attention to, especially the attorneys reviewing these contracts, is is there a specific time period in which this warranty is valid?

Megan Smyth: 13:28

I just recently saw a news report about homeowners who were trying to get their punch lists fulfilled before the year warranty of their house goes out, and that is a strategy on behalf of the suppliers.

Megan Smyth: 13:43

That's a strategy on behalf of your home builders, because, past a certain point and it's a logical, it's a reasonable

argument Look, past a certain point I can't guarantee that this thing is going to continue working, because there may be normal wear and tear, you may have abused the product in some way.

Megan Smyth: 14:01

There's just a certain level at which you can't really guarantee the quality of the product in some way. There's just a certain level at which you can't really guarantee the quality of the product. This is why Chick-fil-A won't, you know, do delivery right. They want to ensure the quality of their product when it leaves the store, but 10 minutes down the road they can't guarantee that it's going to arrive in the way they want. So this is sometimes about quality control, but you're also limiting your liability on how long you are responsible for replacing or curing an issue with the product. So we've definitely talked about the technical aspects of the warranty. From the legal perspective, Talese, I think it would be a good point for you to interject some practical application of some of the things we've talked about.

Telice Gillom: 14:50

Sure, Megan. So warranties are important to state procurement processes because they are essential to protecting the government procurement office's interests for the goods and services that they buy. And, as any good procurement officer knows, we are supposed to be good stewards of the taxpayer dollar and having a good warranty in place and enforcing it ensures that we are doing that right. It ensures that we are spending that taxpayer money wisely. Also, the enforcement part is the key as an enforcer of that warranty and it's important to know what it covers, what it says, I mean right down to the letter. You are holding your suppliers accountable for what they are saying they're going to do, clause or can be, because the supplier may presume that you, the procurement officer no-transcript.

Megan Smyth: 16:46

Emphasize for every lay person and attorney there are no magic words. You know, if you're looking through the contract and you don't see the word warranty, that doesn't mean there isn't one in there. It's just worded differently. So it's important to not trust your control to determine if there's a warranty or really any of these clauses in the contract.

Telice Gillom: 17:15

If you get a contract from a supplier that does not have a warranty clause or anything akin to a warranty clause, you should not enter into that contract with that supplier because something's wrong. If they would not give you a warranty for the product, something's probably fishy about it.

Megan Smyth: 17:39

Yeah, of any type. If they're not willing to agree to any length of warranty, yeah, that would be a red flag for me, especially when you probably have other vendors who would agree in your vendor pool. And it doesn't have to be the same. One size doesn't fit all. One size does not fit all when it comes to warranties and when it comes to remedies, for that matter. There might be some situations where you want the company to repair or replace and that is going to be exponentially cheaper for you in the long run than starting the procurement over again. I imagine that's not a thing that people want to do in the procurement office.

Telice Gillom: 18:28

Definitely not. There's a really good example. When Chromebooks came out, a lot of school systems were excited because they were inexpensive and it was relatively easy for school systems, regardless of their size, to be able to buy them for students. What they didn't know was that the Chromebooks had a lifespan that varied based on the year that they were manufactured. The resellers were not always transparent in telling the school systems this.

Telice Gillom: 19:17

The contracts that the school systems purchased these Chromebooks on did not include a remedy for replacement

of the Chromebooks, and so when those Chromebooks expired, they were not able to be repaired because there was no repair clause in the contract, and they were not able to be replaced because there was no replacement clause either, and there was no warranty beyond the standard 30 or 90 day warranty clause in the contracts. So what happened was that there was a lot of school districts that ended up with essentially rectangular Frisbees Very expensive Frisbees, very expensive Frisbees. Yes, it's sad to say, because we're talking about students who could greatly benefit from having an inexpensive laptop that they can do their homework on. So it's very important again to read those warranty clauses and ensure that they really do cover you for what you need them for, because you don't want to end up with a stack of rectangular Frisbees.

Megan Smyth: 20:34

Absolutely, and we all know that the tech companies have planned obsolescence built into their, their system somewhere, to their system somewhere. And look, it may be that a school district in that situation says, yeah, it's worth it to us to get them very cheaply and then just replace them every two years instead of entering into a longer term contract that you know may end up costing the same over time. I mean, I'm just making that up, but that's possible. So cost is a consideration, because you're gonna have to pay for it somewhere, right, okay? So another benefit of warranties is that they can help ensure quality. They're managing some of your risk as you move forward and they're protecting public funds, which is key when we talk about accountability and the use of taxpayer money. So in your Chromebook example, I would argue that there was some malfeasance there in the use of taxpayer money, in not ensuring that there was a warranty or some type of remedy in that contract for it. The fact that they may all fail after a year. Also, there's a difference between a breach of performance and a breach of warranty. You hear about both of those things and the difference is when they occur. If it's a breach of performance, that's before you have accepted the product and if it's a breach of warranty that has occurred after you have accepted the product. As you know, it arrived, it was all together, it seems fine, you signed for it, that's acceptance. So once that has completed, performance has ended and your warranty term begins. So that is also something to keep in mind, because until you actually receive the product, your warranty doesn't mean anything.

Megan Smyth: 22:33

So, final advice Talese, when it comes to warranties, I think we can give a few practice tips, best practice tips. Ask yourself, when you sit down and read the contract, what assurances would I need to make me feel very good about this contract working? And some of those things can include the description of the goods. Is the description enough? Is it descriptive enough? Is color important? Is size important? Are there things about the goods that you have not described or put in any type of guarantee? Are there samples or models of the goods that the supplier has provided you in the past that you then write into the contract and say the sample provided by company on x date to x specification shall be the type of product that is reproduced, etc. Etc. So then you have something to compare, uh your goods against and say this is of quality or of not.

Megan Smyth: 23:42

Not quality also express statements of fact. So again, this is just quality or of not quality Also express statements of fact. So again, this is just about being very, very clear in your description of what type of remedy, what you will allow the contractor to do, how long you will allow them to have time to cure before other remedies kick in. So you know, even if you have a warranty and you say you know the warranty is good for a year, the vendor will have 30 days to attempt repair, replacement or a cure. If it doesn't work, in that 30 days, to the satisfaction of the parties, you know you can move on to other remedies. And then, finally, a statute of limitations can always void a warranty. So you want to talk to your state attorney and make sure that they are aware of the statutes of limitations in your state with regard to these types of claims, because it might be that the company agrees to a 10-year warranty when they know that no court is going to uphold one past five. So these are things to look out for.

Telice Gillom: 24:50

And these are things to ask your suppliers in your solicitation, because you can specify that they, you know, spell that out in their proposals. What is your statute of limitations? You know how long would we have if we needed to, sometime in the future, have an arbitration if there's an issue, if we needed to go to court about something, if

there's an issue with the product or service, to go to court about something. If there's an issue with the product or service, what is the statute of limitations? You can ask them to spell that out in the proposal, especially for bespoke or custom items, goods or services, anything that's extremely expensive or a capital project. It's a very good idea or best practices to ask that question in the solicitation because that way you know ahead of time and potentially save yourself a little bit of hassle on the front end. Better that than to find out you after you get into the contract that they would say, yes, the statute of limitations is 10 years, knowing that they know that no court would hold it up past five.

Megan Smyth: 26:17

Yeah, sure, let's agree to 50 years. Who cares? I would get really skeptical. I would find that very sus that they agreed to a warranty for that long. That tells me you think you might not be in business in 50 years. But yeah, just have healthy skepticism about what the company offers you on the first round of negotiations for sure, all right let's move on to limitation of liability. Lol, but it's not very funny.

Telice Gillom: 26:53

It's definitely not funny.

Megan Smyth: 26:55

Yep, okay, talse, I feel like we've all heard the words limitation of liability or LOL, as we attorneys like to shorthand because we think we're cool. I think attorneys are cool, we are, we are, we try, but what does it mean? What does limitation of liability mean?

Telice Gillom: 27:20

Well, it definitely doesn't mean the same thing as LOL.

Megan Smyth: 27:23

No, it does not. Fortunately, or unfortunately, it is not, in fact, a laughing matter. Ha See what we did there. Ha ha ha. Okay, so let's talk about what a limitation of liability is and exciting for the audience. Following this, we will talk about indemnification. So you can sort of point out the differences between limitation of liability and indemnification, because a lot of times those two words are just too much and even lawyers get confused about which is which. So let's sort of talk through it just a little bit.

Megan Smyth: 28:02

Limitations of liability cap your damages that are available for harm that comes from performance or non-performance of the contract. So how could you possibly have damages come from the performance of the contract? Well, the contractor could not necessarily be violating any terms of the contract and an accident happens on the construction site, for example, happens on the construction site, for example. That could be a harm that arised just within the performance of the contract. There was no nefarious performance. The damages could also arrive from non-performance. So if the building is not finished on time, if your products do not arrive at all situations like that and what you should ask yourself when you're thinking about what kind of liability is there here? What do you know that you are giving up. So what risks are you exposing yourself to by agreeing to whatever the limitation of liability, if there is one in the contract? Know what you're giving up. And the only way to do that is to do a risk assessment. And nobody wants to do that, do they? Because that sounds really awful and boring.

Telice Gillom: 29:26

But it sounds like a risk assessment team will come into your office with briefcases and starched suits and they will glower over everyone in the office.

Megan Smyth: 29:37

I wish the risk assessment fairy would visit each night and leave a memo on all of our desks that outlines the risk

that we have. That would be ideal. No-transcript people in the room. Well, you ask yourselves questions like who could get hurt? If someone got hurt, who would be responsible for that? Who should be responsible for that? How likely is so?

Megan Smyth: 30:25

Let's say you have five huge risks that you can identify which one of those is actually likely and which one of those is like an earthquake or you know, in the past we have put terrorism clauses in contracts that became very popular after 2001 for obvious reasons. What is the likelihood of each of those risks? And then that helps you determine what you should really focus on and what you should, for lack of a better term, die on a hill about. Risk is a risky proposition for the state. It's a risky proposition for a supplier, especially if you are a small business, which we know. States want diversity of suppliers, and so the truth of the matter, the deep down, actual reality, is that limitation of liability clauses, especially unlimited liability clauses, are rarely used. In fact, maybe four or five years ago at a law institute, one of our speakers, out an audience of 100 state procurement attorneys said raise your hand if you have ever had to use an unlimited liability clause that you put in your contract. And not a single one of them raised their hands.

Telice Gillom: 31:55

Not surprising.

Megan Smyth: 31:56

Yeah, that really stuck in my brain because as attorneys it's really easy to get married to doing a thing because it helps you sleep at night, when in fact what you're doing is exposing the state to more risk. Because a company that's willing to bet everything to roll the dice put everything on the line for one government contract. When something goes wrong, they're just going to declare bankruptcy and disappear. I think you'd be better off negotiating terms with a well established company that is not. I mean, you know, if you look at it from their perspective, it's almost like you know you don't want someone crazy contracting with you and who in their right mind, would bet their entire company on one contract with the state.

Telice Gillom: 32:55

Right, and you also don't want a company that is desperate. Who would do that? A company who's desperate might consider or might do it. But you also don't want that supplier either, because they would be the one who would just declare bankruptcy and run off. But they were desperate to get the contract and who knows when along the contract performance period that issue would pop up right, the payment schedule has started. They needed the money and this is not beat up on supplier day, of course.

Megan Smyth: 33:35

Right right.

Telice Gillom: 33:36

But these are. You know, these are things that you and I likely have seen along the course of our careers. They needed the money and, you know, something happened. And they were willing to agree to that unlimited liability because they needed the money, because you know it takes capital to run a business. They were desperate and they said we'll agree to it. And then something happened and, just like Speedy Gonzalez or Wile E Coyote, they go away.

Megan Smyth: 34:09

Speedy Gonzalez or Wile, E Coyote, they go away. Yeah, I mean, you know scary stuff can happen in those situations. So and you know we have we have many ways to start verifying our suppliers. You know we have tools like GovLend and Procurement IQ and we can Google and we can talk to a phone, a friend and all the things you can do to sort of figure out if the company you're dealing with is a legitimate company. I remember during the

pandemic Talese I'm sure you do as well this desperate attempt to verify these companies as real. You know who were offering PPE to the states, and it was harder than one would expect to follow the LLC trail or figure out where this company actually exists.

Telice Gillom: 34:59

And it ended up that a lot of those companies weren't real. You know, they popped up overnight because things were so backlogged and so jammed and everyone knew it, and especially, you know, the folks who knew that there was the potential for contracts for PPE and they knew that it would be harder to verify them. And again, not beating up on anyone, but the truth of the matter is that a lot of those companies did not end up being legitimate and hey, yeah scary.

Megan Smyth: 35:45

So you know, an important thing to remember is there are reasonable ways to determine liability. Let's take, for example, cybersecurity. Ibm puts out a report every year that lists the estimated cost per breach. You know per individual information leaked. You know per individual information leaked. These are, there are tools in the industry that you can use to say, okay, well, if there are 10,000 people with PPI in this particular system, we can estimate that if there was a breach it would cost X number of money to put these people in credit reporting systems and, you know, make them whole.

Megan Smyth: 36:33

That's a legitimate, real world, concrete way to determine how much liability is in a contract. That's not always possible to determine, and when you have things like an entire social security system breach, you're going to go way over whatever amount you agreed on to begin with, and so that makes the non-commodity IT contracts the most difficult to determine the value for, and attorneys are always going to err on the side of more. But it's important to remember that you advise and your clients decide. So telling your client that you need liability coverage in a certain scenario, that's a legal decision, that's what we have to tell you and that you need to have it, or it may even be required by statute. But how much you get and what tools you use and how much you value, that's all a business decision that can be influenced by the attorney, but ultimately is the purview of the procurement officers.

Telice Gillom: 37:42

I'm really glad you mentioned IT contracts, because from the procurement side, because from the procurement side, this limitation of liability clause is of the utmost importance in IT contracts for hard goods like laptops or tablets or, you know, whatever IoT items that come with a software package, that come with a software package, so smart thermometers, any types of smart products, but also software software as a service or platform as a service, anything as a service, but especially for IT goods and services, this is the contract clause, or terms and conditions. This is the one to focus on, because suppliers will want you to settle for less when it comes to the limitation of liability For cybersecurity incidents, for whatever the liability could possibly be. This is the one to focus on. If you buy access to a PDF bookstore and it costs, the subscription costs \$199.

Telice Gillom: 39:07

And I'm saying this from an experience of a contract that was just a PDF, a subscription to a PDF bookstore of Native American authors and the subscription cost, limitation of liability, and they wanted it to be the amount of the contract, which was \$199. But in order to access the PDF bookstore, you had to go online. The students could download the PDFs, but they had to log in to do it. So there is a potential for a cybersecurity incident because they have to go online first, right, so they are accessing the Internet and we could not agree to \$199 as the limitation of liability because they're accessing this via the Internet, which you know opens up a whole different world of potential for an incident.

Megan Smyth: 40:26

Mm, hmm.

Telice Gillom: 41:03

Mm. Hmm, this is the one of the contract clauses that I would implore procurement officers to really dig into, really get with your legal team and talk about at length, because it is very important for IT contracts to, when you're negotiating, to understand how you, when it comes to IT projects because the potential for data breaches or some other cybersecurity incident can run into the millions of dollars and or bad press, which I would argue costs a lot more than the millions of dollars that you know they would potentially have to pay. Think about any number of the incidents that you may have heard about on the news or saw on any of the news websites that you follow. The bad press does a lot more harm. So this is the one. This is the one to really pay close attention to when it comes to IT contracts, especially if you're buying tires.

Telice Gillom: 42:04

The limitation of liability for a tire that you're using on a riding mower or even a push mower Remember those old push mowers that had the blades on them and you kind of walk back and forth in the summertime sweating until you get some lemonade. That's one thing, but for IT goods and services, this is definitely the one to focus on Because, again, you're being good stewards of the taxpayer dollars and you don't want to leave your agency at a disadvantage by agreeing to that \$199 cap on the liability for your agency and let the supplier say our liability will be limited to the \$199 you paid for this.

Megan Smyth: 42:58

Yeah, and they are going to attempt other opportunities to limit their liability If they can't get an unlimited liability clause or they don't think that the warranty they've agreed to is advantageous. For example, they can do things like add narrow, limited warranties. They can give you an exclusive remedy. Now, that is something I really want our attorneys and our procurement officials to look for. Anytime the contract says this is the only way we will cure or remedy an issue. That is a red flag because not every situation is the same and so not every situation will be solved with the exact same remedy. You also want to look for right to cover. This is often sometimes called right to cure.

Megan Smyth: 43:56

So their ability to replace non-conforming goods. So if they send a whole shipment again of ice and it ends up melted, they can say well, in the contract you agreed that we would have 14 days to send you trucks of ice that did conform, and if we don't perform in that amount of time, then we can start talking about, you know, actual liability. They can just cap the liability. So you know, looking for a liability cap or an exclusion of a category of damages. They want to exclude punitive damages. They want to exclude liquidated damages. They want to exclude any category of damage they can, especially one that requires cash money to deal with, they will narrow their performance obligations. So you know, we only have an obligation to performance in this specific instance. If none of these other instances exist, they may put in exceptions to performance obligations.

Megan Smyth: 44:58

And so I can sum all of that up and say that you should never rely on a template, and you should certainly never rely on a template that's sent to you by a supplier. You want to read every single line, every single clause, and look for things that are disguised as other things. So read it out loud, as you would anything else, and if you can't understand it as a procurement official or a procurement attorney in the state, there's something wrong with it. It's not you, it's the contract, because if people don't understand it, if there's no meaning of the minds, if there's no understanding about what we are really agreeing to here, there's no gotcha in contracts. That's never a good moment, so make sure that you understand every line in the contract. It should be clear to a lay person reading the contract who's obligated to what.

Telice Gillom: 45:59

And I would even argue that, and I'm sure everybody knows this.

Telice Gillom: 46:03

But for any of our listeners who it is not their standard practice listeners who it is not their standard practice I would argue that standard practice should be that you ask your suppliers to provide a copy of their intended contract in their response to the solicitation so that you have time to read it.

Telice Gillom: 46:24

In your evaluation you have a chance to look at it, read it again and read it again. And if you are considering their offer, that would be the time that you have a chance to take your red pen out and go through it. At that time and in your negotiation process, go back and forth with your red pen and show them the parts that are unclear, the parts that your agency cannot accept, et cetera. But at the time that you are considering their offer, you have a good chance to read through it, get your legal team involved if there are any of their contract clauses that you don't understand. You would have given yourself however long your evaluation process is. You would have given yourself that length of time advanced time to read it you know multiple times, and that way you would have more of an understanding of what it says, rather than waiting until you are starting the negotiation process to read it.

Megan Smyth: 47:39

Yes, absolutely, and with issues of liability and indemnity, which we're about to talk about, and even warranty, it is also really important for the state to be upfront with the suppliers about what they can negotiate and what they cannot. And when I say non-negotiables, I don't mean the lore of the procurement office about what we can and cannot agree to. I mean and I don't say that in a nefarious way it's that that's how we learn right. We get handed down information from those who've been doing it before us and it's just sometimes a game of telephone where things get misinterpreted or changed over time or something becomes a quote unquote office policy, but isn't necessarily in your code or in your statute.

Megan Smyth: 48:26

So ask questions and this is an easy out, and I've used this in my practice a thousand times. If you're reviewing a contract or a document and you have no idea what something means, but you don't want to sound ignorant, which you aren't and there's, you know you're asking a legitimate question All you have to do is write. I think that this section really needs some clarification. I think there would be some difficulty understanding this by you know someone else reading this, and you don't have to say what you think it should say, just say it needs clarification. Yes, yes, yes, quite, quite that quite needs clarification, yes.

Telice Gillom: 49:05

Monocle. This is the part where the monocle comes in. This is the part you should be wearing a monocle, I think, and an ascot perhaps, absolutely Going back to the fancy things, because if you're going to say, yes, quite, quite, quite right, you should be wearing a monocle.

Megan Smyth: 49:20

I agree and, speaking in a British accent, probably yes, absolutely Okay. Indemnification Moving on to indemnification yeah, this was a trigger word for me for a long time. To lease, because when I first started practicing, one of my first big cases was this huge indemnity situation amongst and between insurance companies and amongst and betwixt persons, and I suddenly became the indemnification go-to person in my law office and that made me sad for approximately seven years. So here I am again talking about indemnity.

Telice Gillom: 50:01

You know why I like you? Because when you said among and between, the next word that popped into my head was betwixt, betwixt and then you said betwixt, you said betwixt and I was like Megan is my friend.

Megan Smyth: 50:17

I love the words. So okay. So what is an indemnity clause? Uh, sounds super fancy. All it really is is a contractual

provision in which one party agrees to answer for any either specified or unspecified liability or harm that the other party might incur. Now we're going to talk about what that means. It can. It's also sometimes a lot of people call it a hold harmless clause or a save harmless clause. That latter one is less often used, but hold harmless.

Megan Smyth: 50:54

I hear a lot of people say indemnity, hold harmless, or indemnify and hold harmless. So look for those terms. When we're talking about indemnity and when we say specific or unspecified liability, we mean it's going to depend on the type of contract you have, right. So let's say that you have an IT contract and your issues are a cyber breach. There's tons of issues, but let's just focus on cyber breach. Okay, you're going to have some indemnification, potentially language in there about what happens if there's a cyber breach. But if someone in the IT office is walking back and forth between computer terminals and they slip and fall and break their arm, there's nothing about your contract with your IT provider that is going to require them to make you hold for something like that, right. So it's contextual, it's about the situation that you're in and what you are agreeing to between the parties when it comes to damages, loss and liability. So there are no magic words. You don't have to say the word indemnity, you don't have to call it an indemnification agreement, it's just used, it's just created when you use the words that express an intention to reimburse or hold the other party harmless for the damage. So how do we keep from getting into an indemnity clause we don't want to be in? Well, one way is to just very clearly state in your contract terms nothing in this section, nothing in this clause, nothing in this contract as a whole should be interpreted to create any obligation whatsoever for so-and-so to hold harmless X company or anyone else for that matter. So you can basically and look, this is the thing people don't understand too. It's these are bespoke contracts. Okay, these are fancy monocle contracts, because and when I say bespoke, that just means that your attorneys are creating these individually and specifically for each commodity and service that you're purchasing. So what is the issue? What is the harm that is potential, and then you control for that.

Megan Smyth: 53:20

A duty to defend is sometimes lumped in with an indemnification, but those are different. You can agree to indemnify or hold someone harmless and you can agree that you have a duty to defend, or you can agree to both of them, and this can be expressed or implied. So, very generally, a duty to defend is your obligation upon tender and that means upon trigger right, so upon told the defense obligations and I'm talking legal litigation, defense obligations and costs of another. That can include a thousand things. It can include your experts that you hire to determine the thing that you need to determine to show liability in some situation or another. They could mean medical experts, medical evaluations all kinds of things could be part of a defense obligation.

Megan Smyth: 54:19

So, agreeing to a very general duty to defend, bad, very bad. Most attorneys general in the states who have said anything about this have said that a government entity may not ever agree to defend a contractor against any claims, even if the claims arise from the government's own acts or omissions. That's how bad a duty to defend is. Why would they ever duty to defend?

Telice Gillom: 54:47

is why would they ever want to defend a contractor for anything?

Megan Smyth: 54:51

Never.

Telice Gillom: 54:51

They wouldn't.

Megan Smyth: 54:53

Never. And you may be thinking well, what's going to happen to the poor, defenseless contractor? Well, they're

going to have their own attorneys. And what a lot of people don't think about when it comes to this and I do, because this is the type of law I used to practice is it's all about insurance. So the state may be self-insured. They may have very specific types of insurance.

Megan Smyth: 55:19

We talk plenty at NASPO about cybersecurity insurance very specifically. That you can get. That will protect you against, will not protect you against the breach. It will help you clean up after the breach, because no one can help protect you from the breach. It will help you clean up after the breach, because no one can help protect you from the breach. It will come eventually.

Megan Smyth: 55:32

But whether or not that's in place can be a huge difference in just the getting off the ground and getting a claim rolling, because if you're going to spend time arguing about who has the duty to defend, the insurance companies are going to argue amongst themselves and try to put liability on the other insurance company and then they sit around and try to decide whose insurance is primary. So there may be layers of insurance coverage. There's the contractor's coverage, there's the state's coverage, there may be a subcontractor coverage, there may be a homeowner's policy involved somewhere, there may be a local entity's insurance. All kinds of things can happen, and it's very clear that you make sure your contract considers all of those potential things. And that may make some of us attorneys feel like chicken little sometimes, but you don't want to face the situation where you're dealing with something that you didn't contract for and you have to go to the court and get the court to tell you what to do and that's just going to cost money and time and energy when you could have just agreed to it up front.

Megan Smyth: 56:45

All right, sovereign immunity. So what do we think about when we hear the word sovereign? Do we think kings? Do we think queens? Do we think Versailles? I think about all the time I have wasted watching these royal movies in the past that have nothing to do with that. Yeah, exactly, exactly, all right. So, uh, sovereign. The term sovereign immunity does, in fact, come from old english law. Most of our law is derived from english common law. Um, and this, this was an idea that the king, who in medieval times may have been considered appointed by God, was immune to criticism from the people.

Megan Smyth: 57:37

Right, which is that you cannot file a suit against a state in a federal court without the state's consent or a very specific congressional action that allows the state to be sued and that allowance would be in the interest of the public. It would be a situation where a state needs to be held accountable for their actions and Congress has met and debated and passed a law as such. Otherwise, it is a violation of the 11th Amendment, which provides the state's sovereignty and that's what creates our federal system of you know. We have the federal government, the state government, the local government, and there's a hierarchy there government the state government, the local government and there's a hierarchy there. It also allows the state immunity from suit in its own state courts. So I cannot walk down to the Kentucky Circuit Court, the Fayette County Circuit Court, and file a lawsuit against the Commonwealth of Kentucky. It will just get dismissed and you cannot file in state court against another state. So I could not file a lawsuit in the Commonwealth of Kentucky against the state of Tennessee unless that immunity is waived, and rarely this is a rare situation where immunity is waived.

Megan Smyth: 59:05

Those exceptions are pretty much an express waiver due to a public service obligation of some type or an exception or an extenuating circumstance, a congressional obligation, which is the Congress has actually gotten together. They met together and decided that it was in the interest of their constituents that the state be suable under X circumstance, and this would be exceptions under state law, like breach of contract or tort. So when I was practicing, we defended some school districts and in a lot of situations, because the school district is a function of the state, the school district is immune from lawsuit. However, if there's a snow day and someone falls in the parking lot of the school, they can sue the school board to recover, and that's in the state of Kentucky. Of course,

everybody's different, but that's an example of a tort that is allowed against the state based on a very specific set of circumstances, and there are more reasons why that is allowable, but we don't need to talk about that today.

Megan Smyth: 1:00:17

And then, finally, with this, with regard to generally indemnification, the state cannot budget, uh, beyond the budget sent to them from the legislature, right? So we? We have three branches of government, um, and this is part of the checks and balances system, so the, so the legislature, sets the budget and then the executive branch, the state government. They execute on the budget. They cannot change the. They may be able to move money around within certain budgets or you know and reappropriate, but they cannot do that without the legislature.

Megan Smyth: 1:00:54

So in a long-term, complicated contract and you know states don't often contract beyond three or five years, you know, maybe if you're in a very long-term service type contract you would go beyond that.

Megan Smyth: 1:01:13

But you have to consider with a true amount of the risk the state is carrying from year to year. So if you have and a lot of this can happen when you have put, let's say, you're planning an event for the following year and you sign a contract with a hotel for the cost of that event, but the event hasn't happened yet. However, if you decide at any point that you're going to cancel that event, you have to pay a fee. Let's say it's five thousand dollars. Well, from the date that you sign that contract until the date that you have the event, you're carrying around this liability of \$5,000 that you may or may not have to pay, given this situation. So when we talk about anti-deficiency or appropriations issues, what these mean is that the state cannot budget beyond what they have right. So they can't do that. In a sense, they can't contract forward and spend money that the state has not appropriated through the correct legal channels.

Telice Gillom: 1:02:22

And that's borne out in the procurement codes as well, because it is stated very clearly that there is a standard length, or there should be a standard length years, because the appropriations that the state has made, they have not set the budget for the next 10 years. So you can't say we're going to buy these widgets from you, Joe's Widget Company, for the next 10 years because that hasn't happened at the state level for the budgets yet.

Megan Smyth: 1:03:06

Exactly, exactly, I mean you know. Think about it in your own life when you sign an agreement to pay your insurance for a year. You know you budget for that right. You know it's going to come out on this day and it's going to come out on this day. It's the same principle and you just want to make sure that you understand that and that you've talked to your counsel about that, and that may require you to cut the contract term down, have a renegotiation at some point, or to even just say that flat out on the contract. You know that we are budgeted to this amount. If you know, if the state has specific terms, they can put in that explicitly lay out the situation.

Megan Smyth: 1:03:49

Nothing's a secret in the state Right, you want to see the budget, you want to see the appropriations, you want to see it. You know FOIA is your friend, so it's hard to keep a secret like that that you're carrying liability. It's going to come out in an audit, so it's important to to address that before you get called to the auditor's office.

Telice Gillom: 1:04:11

I want to thank my co-host, Megan Smith, for joining me to talk about contract terms and conditions, and I hope you'll be sure to keep tuning in and catch the rest of our episodes in this series. We have much more information to share and some hilarious surprises along the way. Thanks for listening.