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Negotiating a Turnkey System: The Vendor's Viewpoint

MY TALK TODAY WILL be from the viewpoint of a business manager responsible for product development, product marketing and product service, while at the same time meeting established goals for profitability. It is not my intention to give a highly technical or legalistic presentation. First, I am not qualified to do so, and second, you are more likely to benefit from understanding the general concepts involved in contracting and leaving the legal details to counsel.

Before I begin my talk I would like to digress for a few moments on the subject of profits and the free enterprise system. In order to understand the vendor's position in a negotiation it is important to understand the framework within which he operates.

3M Company is a collection of little businesses that are connected. Library Systems is one of those businesses and, like the others, is identified as a profit center. Profits are regarded by some as antisocial, but they are in fact essential to the functioning of individual firms and of the entire economy. Money is invested in a publicly held company like 3M by private individuals and by other companies. They risk their investment in the hope of a return better than that available from safer investments, such as putting the money in a bank or buying government bonds. The corporation risks that investment money by doing research, developing new products, building new plants to produce those products, and hiring more people to sell those products.

Forty-eight percent of pretax profits go to the federal government for corporate taxes. Obviously, some part of that tax is then redistributed for various social purposes, including the funding of libraries. Approximately one-half the remaining 52 percent is distributed to the stockholders, the investors who risked their money initially. This dividend is one of the incentives that causes millions of individuals to provide the capital needed to keep this country going. The remaining part of the profit is used to build new plants, hire people and develop products needed by customers. Obviously, without profits a business cannot continue long, nor even continue to support equipment or systems previously sold to customers.

Library Systems is a profit center within the 3M Company organization; that is, 3M keeps track of the expenses and income of its Library Systems unit as a separate entity. That entity is expected to contribute profits to the corporation and to show growth from year to year, and is judged on how well it succeeds. The business entity and its manager are judged upon growth in sales and growth in profits.

As a unit within a very large corporation, Library Systems naturally has many corporate resources on which to draw. For example, there is a fine staff of lawyers who can provide counsel on contractual matters but who charge their services back to the operating units. This expense becomes part of the ongoing operating expense of each profit center and must be recovered as part of the income generated from sales. There are no free lunches. This should help to clarify why a vendor must make a profit by selling products and services. Profits are a necessary element of a vendor's ability to continue in business and to provide after-sales support.

In discussing negotiation from the corporate viewpoint, there are several points to consider: the general philosophy of negotiation, some of the vendor's concerns, some of the more common problems encountered in drafting contracts, some thoughts on what should be considered elements of the contract, what to do if performance of the contract does not go according to plan, and a little more philosophy in closing.

NEGOTIATION PHILOSOPHY

Basic to a satisfactory negotiation of a contract is a meeting between the two parties in good faith and trust with full disclosure of the facts from both sides, and a willingness to negotiate. In other words, there must be a willingness to listen to the other party, and a willingness to give as well as take. Both sides must be open with each other. This does not mean that there cannot be some plan of negotiation on each side, with

some points that won't be negotiated and others that will be waived. However, important facts should not be concealed if the negotiation is to work.

An enormous amount of time, money and energy is wasted each year by parties that should never have reached the negotiation stage in their discussions. On one hand, it is a waste for a prospective purchaser to enter negotiations with a supplier if the purchaser does not have or cannot get the funding required for the purchase. On the other hand, it is senseless for a supplier to negotiate with a prospective purchaser if he does not have a product that suits the user's needs. These two elements are necessary for any constructive negotiation to begin: the ability to purchase and the ability to supply.

At the end of the negotiation when agreement is reached, it is important that the agreement be reduced to writing. If this cannot be done, then the negotiations have failed. The contract document should incorporate the understanding reached by the two parties. It may appear that there is a conflict between creating an atmosphere of trust while at the same time preparing a careful documentation of the understanding reached. This is not so. The contract is not a weapon to be used against an adversary; it is a tool to avoid misunderstanding.

A third equally necessary but less tangible element in negotiation is a relationship of trust and good faith between the parties. It is senseless to negotiate with a contractor to build a home if there is a good chance the builder will go bankrupt.

If a contractor built ten houses and all of them have been shoddily constructed, why should the eleventh be different, no matter what the contract specifications call for? If the salesman trying to sell a used Cadillac is shifty and evasive in answering questions about the history of the automobile, it would only be natural to be cautious. Similarly, in professional relationships with vendors, questions should be answered directly and accurately and requests for references met. Vendors should receive the same treatment from the purchasers.

If you need a bicycle to get from home to work (one-half mile away) it makes no sense to negotiate the price of a used Greyhound bus because you think you can buy one cheaply. If you need to haul your son's high school hockey team to games each week, there's no sense economizing by negotiating on the price of a motorcycle with sidecar.

In both cases your needs will not be satisfied. In the one case the product is too much for your needs, in the other too little. These examples are absurd, but then so are some of the real-world situations that I see each year. (As an aside, I would comment that it is far more usual to request more than is needed than less.)

A successful contract negotiation will result in terms and conditions to which both sides can adhere. A seller will be looking for a fair return on his investment, and the buyer should be looking for the lowest fair price, not necessarily the lowest price.

I frequently deal with supplier companies, some of which are quite small. During contract negotiations it is not unusual to have to ask a supplier whether the prices quoted are actually high enough to cover costs adequately. An error in judgment can work a great hardship on a company and will usually result in its becoming a less than satisfactory vendor. Unusual cost situations, such as a sudden increase in the price of a raw material, may necessitate modifying a contract to allow for a corresponding price increase.

Why should we have these concerns for the other person's point of view as well as our own? 3M has been in business for seventy-five years and plans to be around for many years to come. Thus, it is necessary to consider the point of view of others as well as 3M Company's own. Developing a good relationship with a supplier increases our ability to rely on him. We don't want a supplier to let us down in the middle of a critical job or to drag his feet, unwilling to go the extra mile because of the financial loss he is already taking as a result of contract terms. Furthermore, costs must be properly segregated, i.e., in the right place. A supplier losing money on one job will naturally plan to make it up on the next one — which means the next time we deal with him our costs will be distorted, probably in a way we hadn't projected. This in turn can result in selling prices being distorted in the marketplace compared with what they might have been, and perhaps compared with our competition. Why don't we try to put the screws to the supplier and let him make it up in his dealings with others? Again, the answer is the same: orderliness, continuity, predictability, etc. Why should a supplier continue to work with us if he can find other people who will treat him better? We would then have to go through the learning curve all over again with a different company.

It would be wrong to get the impression that 3M is a big pushover for any request, no matter how unreasonable. However, it is very important to 3M that both negotiating parties come out with a contract that benefits each of them. More generous contract terms cost the user in some way.

I don't personally consider the Golden Rule to be an absolute truth; however, from a pragmatic point of view, it is the only way to operate. There is no way to be certain of getting fair treatment from others, but treating them fairly gives the best chance. It is simply good sense from a self-serving viewpoint. With this in mind, let me turn now to some of the concerns of the vendor.

THE VENDOR'S CONCERN

Probably the first concern of the vendor is to know and have documented exactly what is expected of him. Goods and services can then be priced in order to make a reasonable profit. Any vagueness or uncertainty, any expansion or increase in the scope of requirements must result in an increase in price, for it will certainly increase the vendor's cost.

Another major concern of the vendor is that after the vendor accepts a contract, the purchaser may take an unreasonable position in expecting more than the vendor had agreed to supply. This could happen for a number of reasons:

1. The two parties did not really understand each other's position in the first place.
2. The purchaser changed his mind.
3. The purchaser's needs changed.
4. New capabilities are developed.
5. The buyer is flighty or irrational.

It is for these reasons that the vendor is likely to be extremely reluctant to warrant fitness for purpose. He should have no reluctance in warranting compliance with his own published specifications or in the specifications of a contract that he has signed. From the vendor's point of view, fitness for purpose is a serious problem because purpose is normally not documented, but exists only in the mind of the purchaser. This causes the definition of purpose to keep changing.

COMMON STUMBLING BLOCKS

Purchasing Agent Role

The purchasing agent often creates difficulty in arriving at a satisfactory contract. He is usually a very busy, overworked individual. He would like to do things in the routine way, the way approved by the system within which he works. Adherence to the routine minimizes the time and effort spent in recognizing and reconciling the needs of both parties.

When a formula has been developed that gives the agent the protection he wants, he may be extremely reluctant to take the time to use a modified approach. The individual purchasing agent finds it much easier to go with the system than to try to modify provisions to state the concepts to which the parties have agreed.

Often an understanding is reached between the librarian and the vendor about the general terms and conditions that are suitable, but the contract details are then turned over to the purchasing agent who until that time has had no involvement in the discussions. Ideally, the counsel and purchasing agent should be involved before turning over a draft

contract to them. If nothing else, it is simply a matter of courtesy to advise them of the upcoming need for their assistance so they may plan it in their schedules. More important, though, is that when their help is needed they will already be familiar with the terms and will not have to go through a time-consuming updating process.

State Codes

From the vendor's viewpoint, the great variability from state to state of purchasing procedures, required provisions, forbidden provisions, etc. creates an enormous work load. Many organizations, including the American Bar Association, recognize this problem. The ABA has drafted a proposed Uniform Procurement Code which is under consideration in many states. Some day it may be adopted as was the Uniform Commercial Code; when it is, it will greatly simplify contracting. At the moment, what one state demands might be absolutely forbidden by another. The vendor is usually somewhat flexible and willing to negotiate, but sometimes the state is not.

Applicable Laws

Often the final clause of a contract will state that the document includes all of the agreement between the two parties. However, this can leave ambiguous whether agreement has been reached that items not addressed by the contract are governed by provisions of the appropriate law (e.g., the Uniform Commercial Code), or whether this statement merely indicates that the items have not been discussed or negotiated.

Uniform Commercial Code

It is important to realize that the provisions of the Uniform Commercial Code (UCC) govern contracts for the sale of goods but not services. The UCC allows some of its provisions to be modified by the parties; others cannot be modified, even if both parties try to do so. Where it is appropriate, these modifications should be made part of the contract. For example, the "fitness for purpose" concept for computer systems is one which is at best difficult to apply, even though this concept is a part of the UCC provisions.

Limits of Responsibility

The vendor will naturally attempt to define the limits of his responsibility. If he cannot satisfactorily do so, it should be expected that he will charge more to cover the extra risk that he is absorbing. Of course, if he feels that the risk he is being asked to assume is totally unreasonable, then he should not enter into the contract.

Indemnification

Most contracts contain language which indemnifies and holds the buyer harmless from loss or injury (personal or property) which occurs during the performance of the contract, whether it is caused by the negligence of the vendor, third parties, or even the buyer. Frequently, however, there is a difference of opinion as to the way in which this intention is expressed. In fact, a number of judgments have given opposite interpretations of the meaning of virtually the same language, even by courts in the same state. Usually the point of contention is whether the contractor should be held liable for damage resulting from sole negligence of the buyer. This is unreasonable, and it is in fact held to be against public policy in a number of states. The buyer should have insurance to cover himself against his own negligent actions. Moreover, the contract should specifically state that the contractor is not liable for loss or damage resulting from sole negligence of the buyer. 3M's position as a vendor on indemnification is to be "reasonable" in the legal sense. 3M prefers to accept responsibility for its own negligence in the areas where it has responsibilities. This then defers resolution of any situation of conflict involving damages to common law.

The library's insistence that the vendor accept all responsibility (whether for damage done by the library or not) has several harmful effects. First, costs will increase — and the purchase price will have to be increased to reflect these increased costs. Secondly, from a long-term viewpoint, there will be serious social consequences. Insurance costs will increase. Many companies will eventually be unable to get insurance. This could even lead to the total destruction of small and even medium-sized companies that are unable to insure themselves and would thus have a serious impact on the entire free enterprise system.

Liquidated Damages

Another common stumbling block is the subject of liquidated damages. If it is recognized in advance that it would be extremely difficult or impossible to assess the amount of damages resulting from default on a contract, this is an appropriate situation for the use of a liquidated damages clause. When the two parties recognize and agree on this difficulty in advance, they should negotiate to establish a formula for liquidated damages.

Liquidated damages should not be used as a penalty; not only is this objectionable to the vendor, it has been found objectionable by many courts. A financially sound and responsible company should be willing to reimburse a purchaser for any proven damages resulting from negligence of the company. If such damages are not covered voluntarily, litigation in court is normally a straightforward procedure for recovering such damages.

The vendor does find objectionable any agreement to pay liquidated damages as a penalty when that penalty has no relationship to the loss suffered, and when damages, if any, can be easily assessed. If the loss can be quantified, the recovery should equate to the loss. If the loss cannot be estimated, an appropriate liquidated damages settlement should be negotiated.

The problem in most cases is that the liquidated damages provisions are not negotiated, but are imposed on the vendor under a "take it or don't bid" situation. A satisfactory settlement cannot be prescribed by the buyer without giving the contractor an opportunity to negotiate the amount of settlement, yet this is a common situation.

Enhancements

Another sticky area is that of enhancements. There will frequently be a need to modify or customize either hardware or software in order to suit the user's needs more precisely as the contract work proceeds. It is important that these anticipated modifications be defined to the greatest extent possible in the contract. Also, a means of later emendation of the contract to incorporate enhancements should be determined so that the user is not left in a helpless situation.

The library should be satisfied that the system offered to meet its needs is the best currently available, and that it can be enhanced by additional or improved modules, or even by radical change. However, it should be understood that the vendor cannot guarantee unlimited compatibility with unknown future developments.

Expansion of the contract's scope should not be handled through informal verbal agreements. New features should be incorporated as an amendment or change order to the contract and provision made for an equitable adjustment to the purchase price.

What tends to happen is that the written descriptions, if any, are very sketchy. This may lead to a misunderstanding between the buyer and the contractor about the scope of modifications needed. The most frequent problem with enhancements concerns new features that have not previously been tested (or perhaps even developed). As these modifications are implemented and observed, the buyer may realize that there has been a misunderstanding and that his needs will not be fully met. This type of situation arises frequently on large contracts. It is a situation in which good faith — give and take — between both parties is essential. A more dangerous situation is that in which the buyer continues to expand his view of the functions that ought to be performed by the system as the system is in the process of being implemented.

Fitness for Purpose

Most contractors are frightened by contract language calling for the contractor to warrant fitness for purpose. There are basic problems with this approach and the clause should not be needed if the characteristics of the system to be provided have been carefully specified. The usual problem with fitness for purpose clauses occurs when the purpose is only hazily defined and most of the definition is in the mind of the buyer. This can lead to a situation in which the buyer demands a seemingly endless chain of modifications and adjustments beyond that contemplated by the contractor. To avoid this, a comprehensive description of the system should be incorporated and embodied as part of the contract. This will greatly assist in another area: acceptance.

Acceptance

Reaching an agreement that the work outlined by the contract has been completed will be facilitated by incorporating in the contract a fully detailed description of the functional performance of the system being supplied. Totally unworkable (in the vendor's eyes) will be acceptance by an individual based on his impressions rather than on system performance as compared with the stated specifications. The vendor will also almost certainly demand that the contract give the parties a means for getting a binding ruling in case of dispute, either through arbitration or litigation.

INSURANCE AGAINST DISASTER

There are many provisions that should be incorporated in a contract for the protection of each party. The best way of insuring against disaster has nothing to do with the contract. It is simply to find a good vendor. However, let me concentrate on what can be done in the contract.

Contract provisions should be made in advance so that if everything does not go according to the expectations of both parties, they have a mutually acceptable means for resolving whatever problems may arise. In addition to the terms of the contract, one must also consider prevailing laws. For example, the UCC contains an extensive body of law pertaining to contracts. In general, if a situation is covered by the law, nothing will be gained by making specific references to these provisions in a contract — unless the parties agree that the general provisions of the UCC should be modified, either expanding or limiting the remedies available under the UCC or the law.

There are many ways that difficulties may be encountered and as many as possible of these should be considered and addressed by the contract. For example:

Telephone services — It is frequently agreed that the purchaser will be responsible for scheduling the installation of needed telephone services, e.g., modems, dedicated lines, etc. If this work is not completed on schedule, it will delay the contractor.

Site preparation — Provision of clear operating space, electrical utilities and air conditioning is also often the scheduling responsibility of the purchaser.

Supplies — Magnetic tapes, disk packs, computer output paper, etc. will be needed for operation of the computer system. These materials might not be included as part of the system purchased.

File building — It is usually the responsibility of the purchaser to create the files of items and patrons necessary to operate a circulation system, for example. Depending on the circumstances, this may sometimes precede the planned installation of the circulation system.

Publicity — Usually, the library will wish to do some public relations work to explain the changes that will result from the purchase of a computer system and to acquaint the public with the justification for this purchase.

Training — Before a computer system can be put into operation, the operators must be trained. While this is normally the responsibility of the vendor, the library must make the staff available for training.

The above list of items will be sufficient to demonstrate that the purchaser has many responsibilities, as does the vendor. If the buyer does not fulfill these responsibilities, installation of the computer system may be delayed, or its swift implementation may be hampered. A good contract should protect the contractor against such purchaser-related performance problems.

The contract should also cover the expected payment schedule after satisfactory delivery and/or acceptance of the system. If the library accepts the system rather than rejects it but withholds payment because a few warranty items need to be corrected, the library is in breach of the contract — and at that point the vendor may not have to do any warranty work. Cooperation between the parties will help to avoid this sort of difficulty. It must be realized that the vendor has a major investment in a system of the type discussed here. Delay by the library in providing an operating environment for the system, or delay in paying for the system, can cause the vendor a financial loss against which he must protect himself.

Some problems may arise which are created by neither the library nor the vendor, e.g., fire, flood, strike or lockout, earthquake, war, transportation problems, etc. It is usual for both parties to agree that such problems may arise and that if they do, in essence, the contract goes into a holding pattern until the plague, pestilence or famine is removed.

In addition to the list of problems possibly created by the buyer or that might be considered as acts of God, there is probably an even longer list of problems that might be contributed by a vendor. The software (or programming bailiwick) usually causes most of the problems. I will not go into the problems a vendor may create here, because I was asked to make my presentation from the vendor's viewpoint.

WHAT TO DO IN CASE OF DISASTER

What can be done when, despite all the best planning, disaster strikes? Obviously, the first step to be taken in case of unsatisfactory performance by a vendor is to discuss the situation with the vendor. The vendor should be able to explain adequately the problems encountered, and to itemize the cures to be administered and the timetable to be followed.

If all does not go well, an aggressive and legalistic approach to the problem should not be taken immediately. Filing suit against the contractor without giving him an opportunity to propose a remedy causes many problems. First, it will create a needless expense for both vendor and purchaser. Energies of both parties will be directed at preparing legal defense rather than at finding a satisfactory solution. Furthermore, to a considerable extent, the hands of the vendor become tied when a contract goes into litigation. This only makes it more difficult to achieve a satisfactory resolution.

If the vendor does not meet the first timetable as stated in the contract, he obviously begins to lose credibility. Most vendors will move heaven and earth at this point in an attempt to make good. They realize that each satisfied customer provides a referral that aids their sales effort. A dissatisfied customer can act as a wet blanket on even the most aggressive sales campaign. For these reasons, a customer rarely needs to go beyond the vendor to obtain satisfaction. However, if the vendor is technically, morally or financially incompetent, then other recourse may be necessary. For example, if it becomes clear that the vendor is technically incapable of providing what he has contracted for, there may be several options; this depends on the contract documents. The termination provisions desired should be included in the contract. In the case of nonperformance, legal counsel should be obtained, but an aggressive stance should not be taken too hastily.

It may become clear at some point that a vendor just does not intend to meet a contract's provisions. Conceivably this could happen if the vendor did not wish to continue in the business because he could not make money at it. Steps in this case would be similar to those in the case of a technically incompetent contractor.

In the case of a financially failing contractor, options may be more limited. One should also be cautious that equipment provided by a financially shaky vendor has a clear title to it. Horror of horrors, the contractor might declare bankruptcy and leave the purchaser equipment that had liens against it placed by the company supplying the vendor with hardware. Worse yet, if a vendor has been paid and subsequently declares bankruptcy, the purchaser's equipment might be claimed by a lien-holder through a perfected security interest. In general, if reasonable prudence was exercised in selecting the vendor and negotiating the contract, all that will be required to get remedy is to confront the vendor with his shortcomings. (Of course, there will be situations where a company is unresponsive and the only way to get their attention is to file suit.)

CONCLUSION

It is possible for vendors and libraries to do business with each other successfully. It happens every day. A well-conceived, well-written contract will help the two contracting parties stick to their initial understanding. If the two parties are tenacious, reasonable and work well together, the contract will probably never be referred to once it is drawn. This does not mean that it has had no value; just as with auto insurance policies, one must take precautions for all eventualities.

It is also quite likely that the intellectual work involved in drafting the contract will be of major significance. It is quite common to find that only when one attempts to set an understanding down on paper does it become clear that there is no understanding.

As I have stressed, a vendor hopes that negotiations can be approached in an open, good-faith, above-board manner between two cooperating parties. There seems to be a growing attitude on the part of both federal and state government agencies to approach negotiating with a hostile and antagonistic attitude of mistrust, which causes vendors concern. There are some serious consequences resulting from such attitudes, including increased costs to the buyer. If the present trend continues, it may be impossible for government agencies to find vendors willing to submit to the harassment of doing business with those agencies. Even worse, these attitudes can lead to decay of the free-enterprise system and the ruin of those companies which are presently heavily involved in supplying government-funded organizations.

I would like to summarize with a simple, easily remembered message. A library and a vendor have a high probability of successfully negotiating a contract for the supply of goods or services. Were it not so, libraries would be empty. One might say, "Where there's two wills, there's a way."

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