Contract Review and Negotiation Strategy

HealthShare LMS for RMC

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Vendor Contract Review

The HealthStream Learning Center learning management system has been selected by Regional Medical Center (RMC) through a detailed Request for Proposal (RFP) process. It is typically HealthStream's policy to start from their standard contract to begin contract review and negotiation, however RMC has provided a draft contract as part of the RFP process, modified from a generic software licensing contract. In reviewing the contract, HealthStream has identified a number of critical issues to be modified and negotiated with RMC.

Of primary importance to HealthStream is the billing and revenue model. HealthStream has been requested by RMC to provide its software in a software-as-a-service (SaaS) model. As a SaaS provider, HealthStream pays recurring monthly fees for bandwidth, server capacity, monitoring and maintenance to a third-party. Rather than one-time, upfront license payments, and low recurring annual support fees, HealthStream requires monthly revenue that mirrors the usage of the customer during that time-period. HealthStream must be able to fairly allocate the usage fees for the hosted services to the appropriate customer, rather than attempting to spread it evenly across all customers that may vary greatly in size.

As such, HealthStream will need to remove the definition of "renewal fee" from the contract and replace it with a definition for **recurring fees** (monthly) that are tiered based on the number of **concurrent users** on the system, as well as a **minimum monthly base** fee in order to maintain continued access to the system. The tiered fee schedule will be maintained in Schedule B and must be allowed to be increased annually, upon 30 day notification to the customer, based on

inflation (consumer price index or similar) as well as higher in the event that unexpected, unusual and significant increases are made by HealthStream's third-party hosting providers.

The minimum monthly base will be applied whenever RMC falls below the established number of purchased licenses (1000 users) in order to maintain access. HealthStream cannot be held responsible for providing continued access to the system if the customer has not paid for more than 60 days and non-payment beyond 90 days will no longer obligate HealthStream from maintaining an active or backup copy of the customer's data. The contract must also stipulate the ability for HealthStream to collect interest on late payment. If the customer stops using the system they must continue paying the minimum fee to maintain access to data, and any APIs that would allow them to export the data for conversion to another system.

HealthStream will not restrict access to the number of concurrent users that are allowed to access the system. HealthStream must be free to track the number of connected users and monitor the peak/maximum number of users that access the system. Contract section 4.4 (Auditing) may be modified to remove any language associated with on-site audits of system usages, and replaced to indicate that HealthStream will monitor and record all system access. HealthStream will compute the monthly service fee based on average across the past three months for 95% of the peak value of connected users.

A second critical issue, the draft contract stipulates that HealthStream must maintain compliance with all future updated versions of SCORM standards. While this is certainly HealthStream's intention, and likely to be done, HealthStream cannot commit wholly to supporting future

standards that it is not aware of and may be incompatible with its current or future design and technology. HealthStream will only commit to making reasonable commercial efforts to support updated SCORM standards within a timeframe of the next regularly scheduled product release that follows 6 months after updated SCORM requirements are published.

Another critical issue, at present, the contract allows RMC an unlimited amount of time to use the system during the acceptance period, relying on their efforts to demonstrate meeting the system requirements on their timeframe. It shall be assumed that the system meets all requirements and will be incumbent on RMC to test the system and demonstrate otherwise. System acceptance and the initiation of the monthly billing will be deemed to have occurred as soon as the customer begins actively using the system, as measured by the number of concurrent users, or 30 days after system delivery, whichever is later. The first 30 days after system delivery will be considered the trial and testing period ("acceptance period"). If the customer identifies issues that cause them to be unable to actively use the system during this period, upon written notice to HealthStream, the acceptance period can be extended no more than to a total of 90 days, at which time the minimum monthly fee will begin.

With the SaaS agreement, the Service-Level Agreement (SLA) is of critical importance. If HealthStream could avoid making any formal service-level commitments, they would, but will probably be unable to get away with that. HealthStream uses a third-party hosting provider and has an SLA in place with them. HealthStream cannot commit to any service levels and remedies that are above and beyond those committed and guaranteed by the hosting provider for infrastructure uptime. The service level must be measured over a reasonable long period of time

– ideally a year – and any remedies provided on that basis. A single, isolated outage, though unfortunate, should not lead to substantial penalties. Remedies to RMC should be limited to a small percentage of each month's fee and paid out annually, or at most quarterly, to avoid any major financial short-term burden to HealthStream that they cannot survive. Performance to the SLA should be monitored and reported. RMC will be given access to HealthStream's administrative dashboard in order to monitor both system utilization and uptime. The contract should also specify how much support time (hours or calls) and how much customization and training is included, to avoid abuse of those services by the customer.

Other issues include:

(1) HealthStream requires ability to access the customer's data for purposes including, but not limited to, providing billing, technical support, data backup and disaster recovery, tracking system and feature utilization, recording errors, and assessing feature improvements. Further, HealthStream may use de-identified, aggregate data representing system usage, compliance, and benchmarking for the purposes of academic research and publications. HealthStream may provide such de-identified, aggregate data to third-parties for the purposes of improving and developing additional learning content. HealthStream would like to stipulate the ability to use RMCs name and logo in marketing and advertising material for promotional use, as well as to direct customers to contact RMC as a reference and for site visits (one per year).

Although this is an important criterion for HealthStream, some of these data-usage stipulations may be eliminated if the customer strongly objects. HealthStream requires access to data for

billing and support services, but may be willing to forgo the ability to use and share de-identified aggregate data, excluding this customer from any data aggregation.

(2) The customer should be excluded from reverse engineering the software for any purpose (not just selling or distributing). The system software is the proprietary ownership of HealthStream. As currently stated, the customer could reverse engineer the system for their own internal usage and potentially allow third-party hosted access without technically selling or distributing.

HealthStream may be willing to settle on the current language because they consider it to be a low-risk that the customer would be able to effectively reverse engineer their software and that any threatening usage of that reverse engineering could be effectively argued to be considered either sales or distribution.

(3) The current infringement statement indemnifies HealthStream only from the customer's violation of patent or copyright. This indemnification should be expanded to include other general misuse of the software, including but not limited to the breach of HIPAA requirements.

Other protections in the limitation of the warranty and remedies may be sufficient to consider the current infringement statement satisfactory for HealthStream.

Negotiations

HealthStream expects pushback from RMC on a number of these issues. RMC may object to a variable monthly cost. If they currently do not have a good understanding of their actual usage needs and patterns, this may cause concerns. HealthStream may be willing to set a fixed monthly fee – 20% higher than the currently proposed minimum and adjust that monthly fee at least annually based on actual usage. In the cloud-based SaaS model, HealthStream incurs direct additional costs when RMC's usage increases for data storage, bandwidth, and CPU utilization. If RMC objects to the potentially variable monthly costs, a premium over the standard monthly price will be necessary to ensure HealthStream can cover all associated costs. HealthStream will seek to understand RMC's concerns and needs in this area and create a "win-win" solution that works for both parties. Although the exact details of the specific pricing may be adjusted at the end of negotiations, the pricing model is a critical component of the SaaS model and should be well understood and addressed directly at the start of the negotiation process. Price negotiations may get contentious – customers may believe they could do it more cheaply if they just hosted it internally themselves, ignoring many of the hidden costs. If conversations become antagonistic or heated, HealthStream must "go to the balcony" to avoid reacting. Customers may use different tactics to try to receive special price breaks or advantages and HealthStream should recognize watch for and recognize these tactics. Because the monthly pricing bundles both license costs and supporting costs, it is important that HealthStream maintains their target margin to maintain profitability – they can't "give it away" and lose money on one customer, with the hope of making money for another, no matter how important a reference site RMC may be.

As indicated above, RMC may object to certain usage of their data. HealthStream will require access to the data for support and backup purposes, but will be willing to exclude this customer from any data aggregation and publication at RMC's request. RMC has not included any contractual requirements for maintaining data security and privacy and HealthStream should expect to see reasonably requirements added to protect RMC's data. HealthStream should minimize the allowed damages that can be claimed for any data breaches that occur. As an LMS, HealthStream does not intentionally host or store any protected health information (PHI) subject to HIPAA requirements and breach penalties. They should specify that any obligation to protect PHI from breach will be the sole responsibility of RMC, should they record any PHI in the system in any way.

HealthStream does not expect much pushback from RMC on the timing constraints for supporting new version of SCORM standards. All vendors in the industry, including those generating new content to the new standards, will also need time to implement changes. If RMC does object to this stipulation, it may indicate that RMC is simply trying to accumulate "wins" in the negotiation. HealthStream should request a prioritized list of issues and concerns from RMC and work the negotiation in that order. This will force RMC to consider which items are of critical importance to them and allow the parties to spend their time and energy on coming to agreement on the most important issues and avoid wasting time on the less important items.

Source Code Escrow

Although the LMS is an important system to the HCO, it is not truly mission critical for the daily operations and treatment of patients. As such, loss of access to the LMS would not cause immediate operational impact. HealthStream does not typically receive requests for source code escrow from their clients and as such, does not have an internal escrow service. A third-party escrow agent would be required and HealthStream will insist that RMC be responsible for all costs associated with maintaining the source code escrow. RMC should periodically export or print all training records and store locally as a backup, in the unlikely event that they lose access to the LMS. Alternatively, they could request that HealthStream provide them a backup copy of the database, and an "offline" utility to extract data, if needed.

Warranty

HealthStream expects pushback from RMC on the warranty statement in section 7.2, that HealthStream does not warrant that the software meets the requirements. The specific requirements that the software is expected to meet should be documented in a Schedule along with the contract. At present, nothing in the contract seems to give any indication what the system is expected to do, so it is difficult to determine and prove when it does not meet specifications. HealthStream can only warrant that the software meets specifications if they are explicitly documented or reference in the contract and that they will make reasonable commercial efforts to correct any deficiencies that may occur, upon notification by RMC.

HealthStream cannot warrant any deficiencies that occur at the fault of actions by RMC or their specific environmental conditions.

BATNA

HealthStream's best alternative to a negotiated agreement (BATNA) may simply be to walk away and seek another customer and another sale. Although they have invested a large effort in the sales and RFP process on RMC, and the sales a contract team may be trying hit their quota, selling to RMC below target margins or conceding so much to RMC that they will wind up an unhappy or abusive "high maintenance" customer is not a desired outcome. Alternatively, HealthStream could license the LMS software to RMC in a more traditional local installation, instead of the SaaS model. Price is likely to be the key negotiation item. Particular features and content – such as the patient safety training modules can be negotiated to be excluded from access to reduce the price. An extended trial period may also be negotiated beyond the first 30 days. Another concession that HealthStream could make would be to cover some of the cost of the source code escrow if RMC insists on it.