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Amelia Island, FL  
March 13-16, 2017



67% of delegates are director level or above, of which 43% are VP/C-level

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MAYER • BROWN

# SIG Webinar: Contracting for Agile Software Development

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December 6, 2016

# Presenters



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**Dan Masur** is the partner-in-charge of Mayer Brown's Washington, D.C. office and is recognized as one of the leading lawyers in the outsourcing field by *Chambers Global*, *Chambers USA* and *Legal 500*. *Chambers* has described Dan as “phenomenal” and the “expert of experts,” noting clients say he “has incredible knowledge of outsourcing, inspires confidence in others and has great business intelligence.” He has represented national and international clients in a broad range of on-shore, near-shore, and offshore information technology and business process sourcing transactions involving global and niche sourcing providers, offshore captives and various hybrid structures.



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**Derek Schaffner** is counsel in Mayer Brown's Washington DC office and a member of the Business & Technology Sourcing practice. He represents clients in a wide variety of information technology and business process outsourcing transactions and other information technology licensing and development transactions. *Chambers* noted that the support Derek provides clients on the most critical deals “earns him the respect of clients, who give him ten out of ten.”

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- Advised on more than 300 significant outsourcing transactions valued at an aggregate of more than \$100 billion

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“Their knowledge in this area is tremendous. They know us so well they blend into our deal teams and become a natural extension to our in-house team.”  
~ *Chambers USA 2014*



# Agenda

- Overview of Agile Software Development
  - What is it?
  - Waterfall explained
  - Agile Software Development process
- Top 7 Challenges of contracting for Agile Software Development
  - Pricing
  - Termination Rights
  - Assurances the “thing” will be built
  - IP Rights
  - Warranties
  - Client obligations
  - Documentation
- Final Thoughts

# Overview: What is Agile Software Development?

- A way to create software based on closer collaboration between developers and business stakeholders.
- Emphasizes frequent delivery of business value by small, self-organizing, cross-functional teams.
- Does not rely on detailed specifications created at the outset.
- Instead, the teams work from a concept of the “thing” to be built and refine as the work progresses.
- Agile is a umbrella term for a set of methods and practices based on The Agile Manifesto.
  - But there are many frameworks to develop software using an agile approach, such as Scrum, Lean, and Extreme Programming (XP).
- Does it produce better results?

# Overview: Key Terms

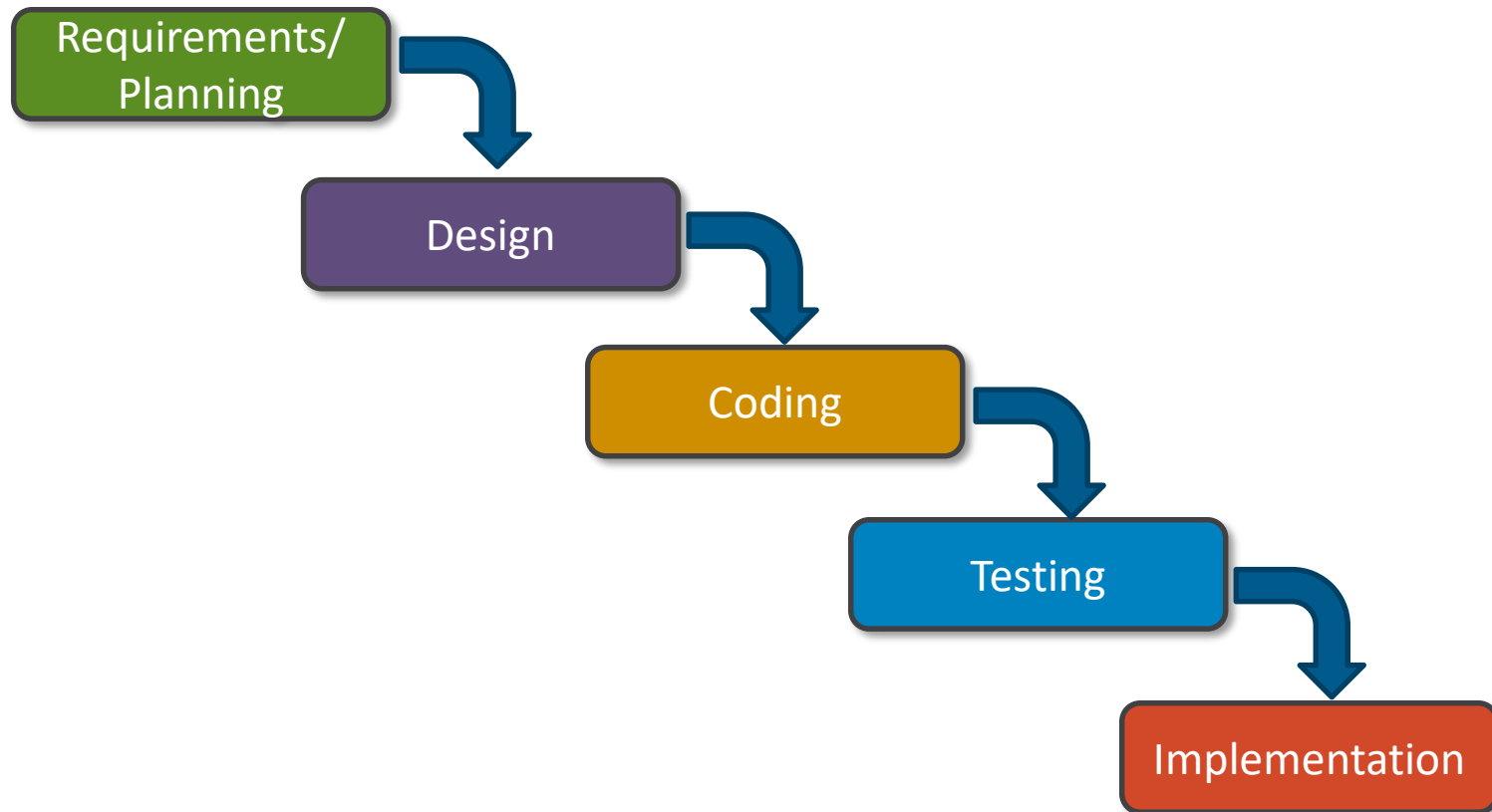
Term	Meaning
Scrum	The most widely-used Agile framework.
Product Owner	The single person on a Scrum team who is responsible for project ROI, has the high-level vision of the product to be built, and has final call on requirements.
Scrum Master	The facilitator on a Scrum development team who removes roadblocks, but has no management authority and does not perform project management functions.
Scrum Development Team	A self-organizing, self-managed cross-functional team responsible for delivering commitments from the Product Backlog.
User Stories	Describe what the end product and its components should accomplish at the end of development. A product will usually have multiple user stories.
Product Backlog	A list of features or technical tasks which the team maintains and which, at a given moment, are known to be necessary and sufficient to complete a project or a release. The Product Backlog can be updated as features and functionality are added or removed.
Sprint (aka Iteration)	A time box of usually 2-4 weeks when the Scrum Dev Team develops items from the Product Backlog.

# Polling Question

- Which statement best describes your organization's experience with agile software development?
  - a) None, but we are considering it
  - b) Some, but no great impetus to push
  - c) Some, and looking to do more
  - d) The majority of our projects use agile



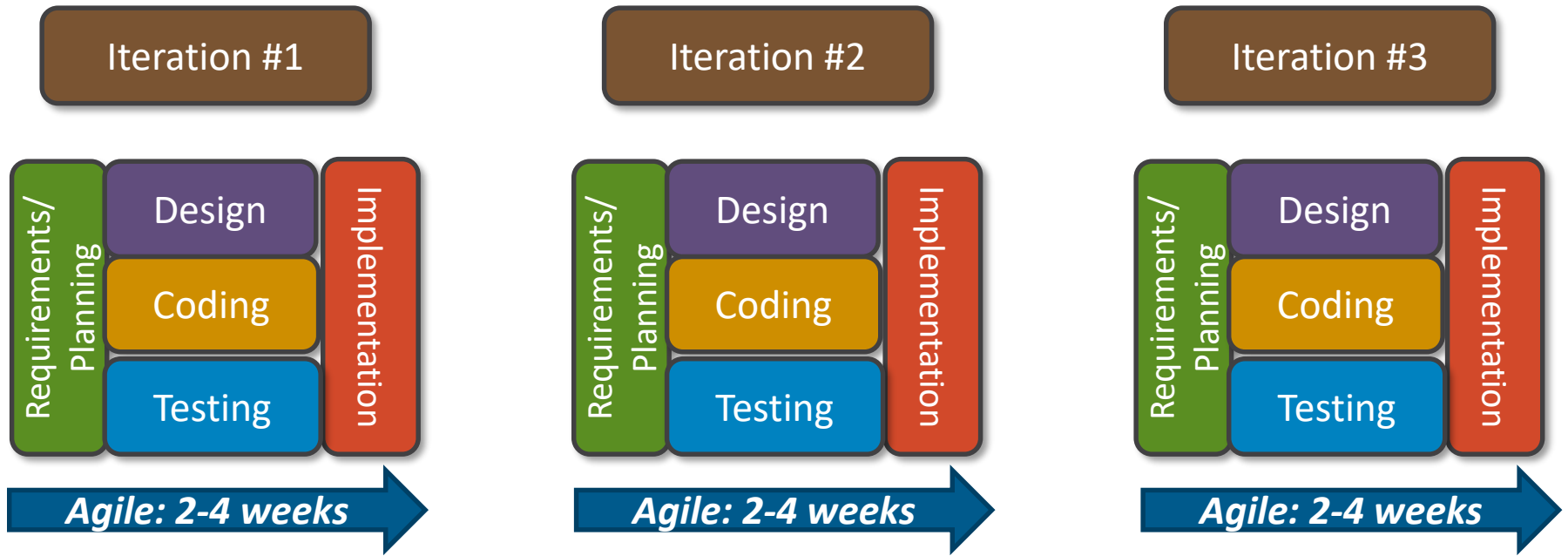
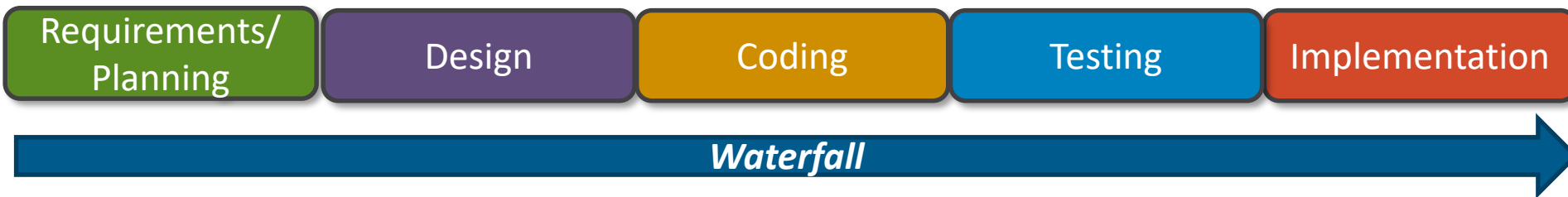
# The Waterfall Approach



# Criticisms of the Waterfall Approach

- Not appropriate if project requirements are uncertain or fluid.
- Does not promote (and perhaps discourages) creativity during the process.
- Business owner has little interaction with development team after initial specifications are created.
- Problems may not be discovered for a long time (e.g., in testing).
- Client does not receive value until the end of the process.
- Difficulty of specifying all requirements upfront, combined with a rigid change management process and frequent change order and price adjustments leads to disappointment.

# Overview of Agile Software Development



# Why Do Developers Like Agile?

- The software development process is more fluid, requiring greater interaction between business and technical teams as the project moves through the development life cycle.
- Agile enables software to be developed in continuous cycles based on short iterations, which developers find more efficient and creative (i.e., more quick wins, fewer long slogs).
- Focus is placed on producing working code (fun) and not on documentation and testing (dull).
- The need to test the entire system is minimized since testing (and acceptance) occurs at each iteration.
- More client participation throughout the process.





# Making the Shift to Agile

- How do you deal with the client concern that the contractual clarity and upfront planning /milestones under waterfall are absent under agile?
  - Not truly a leap of faith
  - Each party's interests are more aligned; at a well-run scrum meeting, you cannot tell which sides the members are from
- Clients need to have some people trained in an agile methodology
  - But don't need to know how to program; agile brings developers and business teams closer together via iterations/sprints
- Does agile scale for large, mission-critical projects?
  - Yes (e.g., SITA)
  - Some enterprises are moving away from an annual IT project funding process to a quarterly process thereby matching the speed at which software is developed and the agile iterative approach.

# Contractual Issue #1: Pricing

- **CORE ISSUE**: How do you structure the pricing model to motivate the right behavior and the desired result?
- Waterfall projects: Because the deliverables, requirements and scope of work are defined upfront, the parties can agree to a fixed price, with payment tied to the successful completion of defined milestones.
- Agile projects present greater contracting challenges from a pricing perspective
- Agile projects are lighter on upfront specifications, and rely more on collaboration and trust
- As a result, it is difficult for a provider to estimate the required level of effort and commit to a fixed price
- And, clients are reluctant to agree to an uncertain price for a loosely-defined product.



# Summary of Agile Pricing Models

Pricing Model	Pros	Cons
T&M	<ul style="list-style-type: none"><li>• Supports fluid work flow</li></ul>	<ul style="list-style-type: none"><li>• Total project fee uncertain</li><li>• Increased monitoring</li><li>• Incentive to rack up hours</li></ul>
Fixed Fee (Entire Project)	<ul style="list-style-type: none"><li>• Fee certainty</li></ul>	<ul style="list-style-type: none"><li>• Difficult to estimate given lack of specs</li><li>• Scope changes more difficult</li></ul>
Fixed Fee (Per Iteration)	<ul style="list-style-type: none"><li>• Fee certainty (but only for that Iteration)</li></ul>	<ul style="list-style-type: none"><li>• Total project fee uncertain</li><li>• Continual negotiations</li></ul>

# Contractual Issue #1: Effective Pricing Options

- T&M pricing, with bonuses tied to early or on-time completion
- T&M pricing, with hold back of defined percentage (e.g., 25%) of fees until entire project or defined project segments completed
- Commitment that project can be completed by specific date or within defined number of sprints (with free or discounted sprints if more required)
- Pool of development hours for discounted fixed price
- Fixed price per iteration/sprint
- Fixed price for “must-haves”
- Use of milestones/outcome-based contracting to align interests (tied to known outcomes or set on sprint-by-sprint basis)
- Flexible termination rights (but also a risk)



# Contractual Issue #1: Use of Outcomes in T&M

- Outcome-based contracting via milestones can be used under agile T&M projects; for example,
  - Create a milestone tied to payment when your application successfully connects to Google Maps
  - Contract for a certain outcome by the 3<sup>rd</sup> sprint, but provide an incentive if completed by the 2<sup>nd</sup>
- Three options to pay T&M upon milestone completion:
  - Pay all T&M charges upon completion
  - Holdback a defined percentage until completed
  - Pay T&M weekly, but contract for a bonus mechanism weighted for early delivery
- In the end, trusted, frequent partners may offer the greatest assurances
  - Highly motivated to perform well and keep price in check

## Contractual Issue #2: Termination Rights

- T&M is palatable under Agile Software Development due to more relaxed termination rights.
  - Remember, the goal of each agile iteration is to produce workable code.
- The typical Agile Software Development agreement allows the client to terminate at the end of each iteration with no termination charges.
  - If the client does not see value, it can walk away.
- No termination charges due to lack of future requirements, so bench costs should be minimal.
  - But a client should weigh stranded/bench costs against the need for developer personnel continuity.



## Contractual Issue #2: Termination Rights (cont'd)

- To fully take advantage of this termination right, the client should contract for other protections such as:
  - Limiting the developer to only use tools and code that the client can license from third parties or the developer; and
  - Commitments from the developer to conduct knowledge transfer.
  - **Risk:** *Agile Software Development involves minimal software documentation, so restarting a terminated agile project may be more costly since new developers will need to get up to speed.*
- Developers know switching costs are high and will try to lock in clients throughout the project.



## Contractual Issue #3: Delivery Commitments

- *Risk: Lack of clearly-defined specs and easier termination rights jeopardize final delivery of the “thing.”*
- An agile project begins with a high-level concept of the product to be developed (the “product vision”).
- The product vision is used as a guide to create “user stories” and eventually the “product backlog” - a list of items to be developed during the project.
- The parties decide on prioritization of items from the product backlog and define what the successful completion of each iteration means.
- The lack of milestones and continual re-assessment allows the parties to adjust on the fly; the final product may be very different than what was originally envisioned.



## Contractual Issue #3: Delivery Commitments (cont'd)

- Developers will offer fixed fee for agile projects ...
  - But may add a risk premium to deal with uncertainty and ask for more money upfront to understand the unknowns;
  - And will seek to include a light-weight change control mechanism to modify the price as it learns more.
- Use the agile process to reduce the “cone of uncertainty” to plan and contract for outcomes:
  - Each party needs to understand the broad business outcomes and divide into smaller projects;
  - The agile team should then create high level specs for each project (“epics”) and then define the technical architecture;
  - With this information, the developer can provide “indicative” pricing; the client can then contract for “not to exceed” or fixed-fee pricing for these outcomes to be further refined as code is developed.

## Contractual Issue #4: IP Rights

- More complicated due to client/developer collaboration.
  - Scrum masters should create a journal with notes on all code and ownership rights
  - Need to track daily and close out at the end of each iteration/sprint
- At a minimum, the client should have an unrestricted license to the developed product (including pre-existing materials brought by developer).
- Also, potentially seek restrictions on the developer's use of proprietary ideas contributed by the client.



## Contractual Issue #5: Warranties

- Lack of project specs, but the developer could warrant that the working code produced during each iteration meets the specs for that iteration.
- As more working code is built in later iterations, include warranties that (i) the integrated pieces will work together and (ii) the entire product will perform in accordance with the summation of the specifications from each iteration.



# Contractual Issues #6 & 7: Other Concerns

- Client Obligations:
  - Increased collaboration with the client throughout an agile project increases the probability that the developer can blame the client for a failed project.
  - E.g., weak/inexperienced scrum leader or the client tries to manage the development like a waterfall project.
- Sufficiency of Documentation:
  - Agile prioritizes working code over all else, which means deliverables like documentation may be less than what the client is accustomed to under a waterfall approach.
  - Therefore, include a contractual provision that commits to a certain level of documentation detail and quality.

# Conclusion

- Agile Software Development is the future.
- Contracting for software development projects using agile is not as simple as a waterfall approach.
- However, contract levers exist to motivate the right behavior under agile projects.

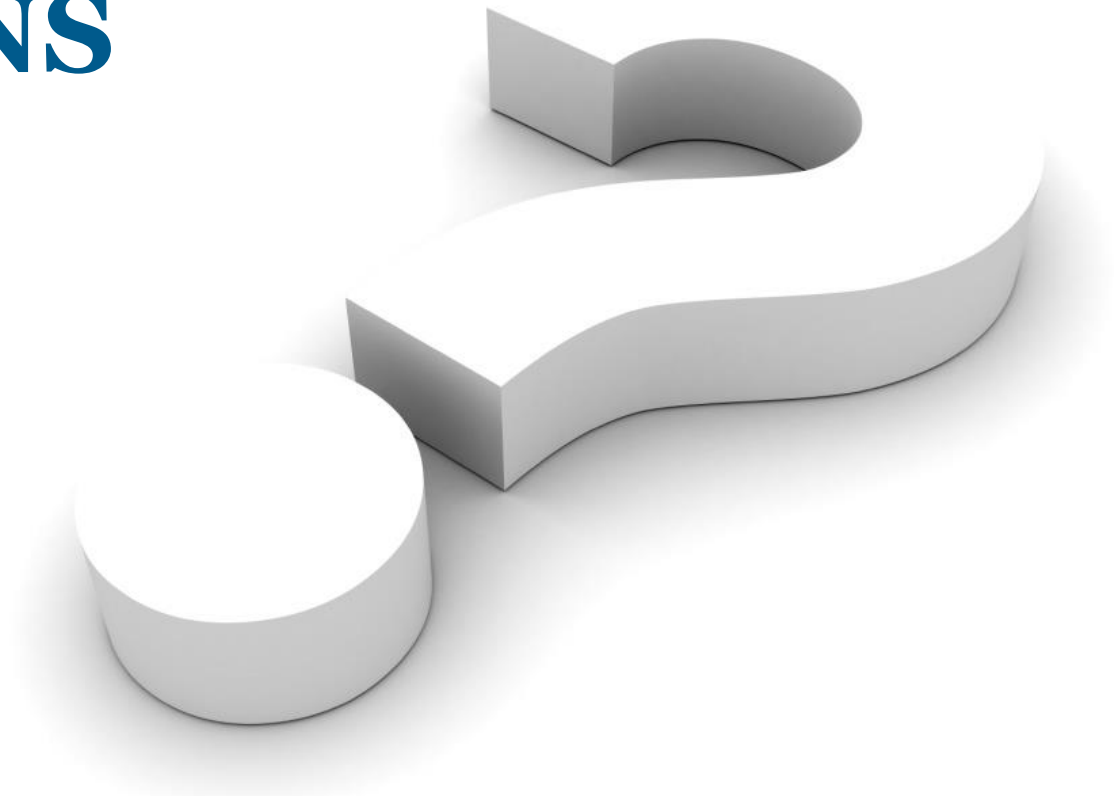
# Resources

- Agile manifesto *available at* <http://www.agilemanifesto.org>
- CIO.com “How to contract for outsourcing agile development” *available at* <http://www.cio.com/article/3090569/outsourcing/how-to-contract-for-outsourcing-agile-development.html>
- Law360: “Agile Software Development Brings New Contracting Issues” *available at* <http://www.law360.com/articles/809900/agile-software-development-brings-new-contracting-issues>
- [Agile Contracts: Creating and Managing Successful Projects with Scrum](#), Opelt *et al* (ISBN: 978-1118630945)

# QUESTIONS

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