

# Contracts for Start-Up Companies: Preserving and Enhancing Value

David J. Lehman

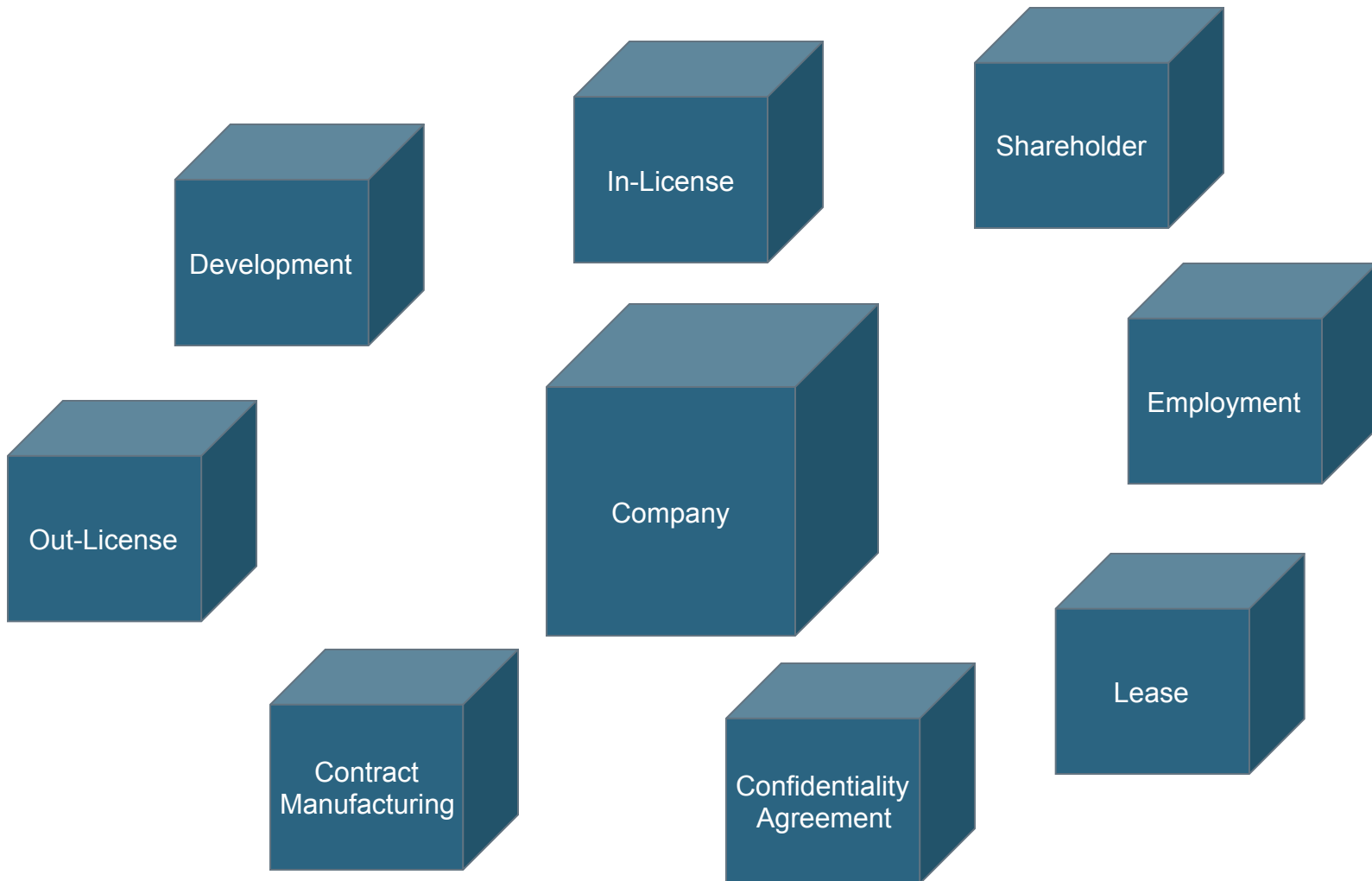
Susan P. Altman

September 24, 2015

# AGENDA

- Basics of Contracts – formation, performance, remedies
- Pre-negotiation issues (letters of intent, MOU's)
- Examples of common contracts for start-ups
  - Confidentiality agreements
  - Employment agreements
  - Licenses
  - Leases
- Using contracts for sales
- Questions and Answers (But Don't Wait!)

# LOTS OF CONTRACTS




# BASIC REQUIREMENTS

---

- Formation
  - Offer
  - Acceptance
  - Consideration (or detrimental reliance)

# BEWARE OF ORAL CONTRACTS

- 
- Oral contracts are enforceable – with limited exceptions (Statute of Frauds). Exceptions include:
    - Promises to marry
    - Suretyships/guarantees
    - Sale of land
    - Agreements that can't be performed within 1 year
    - Contracts for the sale of goods valued in excess of \$500 (note: course of conduct exception)

## BEWARE OF ORAL CONTRACTS (CONT.)

- 
- Examples of contracts that are not exceptions:
    - Employment Agreements and the terms
    - Equity arrangements (promises to give equity)
    - Investment agreements
    - Short-term debt instruments
    - Licenses or promises to license

# IMPORTANCE OF CLARITY FOR START-UPS

- Start-ups cannot afford ambiguity
  - They need the performance (e.g., employment)
  - They can't afford litigation
    - Legal fees
    - Distraction
    - Ambiguity during dispute

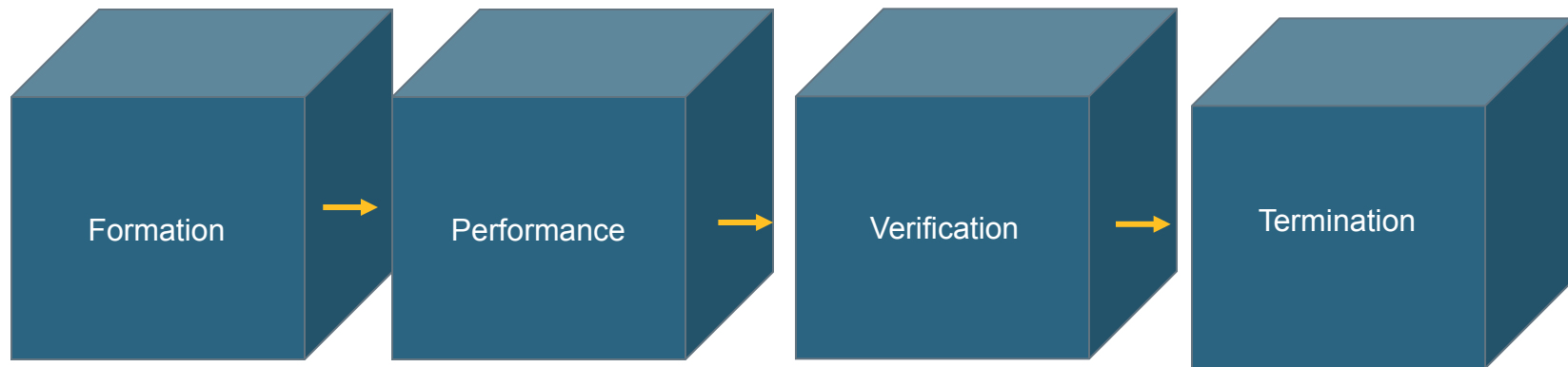


# IMPORTANCE FOR THIRD PARTIES FOR START-UPS

- Potential Third Parties
  - Investors
  - Purchasers
- Example
  - Limitation of Liability
    - Amount
    - Incidental/consequential Damages



# LIFE OF A CONTRACT



# FORMATION- CLARITY OF OBLIGATIONS

---

- Who is doing what and when?
  - Employment Agreements – Role and compensation
  - Vesting of options – When and how much?
  - Lease – What premises and when? Who is constructing the premises and when?
  - Convertible debt – when will it convert into equity, how much equity and into what equity?
  - License – What technology is being licensed? Improvements?

**DON'T LEAVE THIS TO THE LAWYERS!!!**

# VERIFICATION OF PERFORMANCE

---

- How do you know whether the other party is performing?
  - Reports
  - Audit rights (e.g., royalties)
  - Inspection rights (e.g., contract manufacturer)
  - Third party certifications (e.g., insurance certificates)

# TERMINATION OF CONTRACT

---

- What happens when the contract terminates?
  - In an NDA, does the party return or destroy confidential information?
  - In a license, what happens to sublicenses?
  - In a lease, what obligations does the tenant have to return the property to its original condition?

# FAILURE OF PERFORMANCE

- Remedies
  - Termination (out-license)
  - Damages (e.g., cure)
  - Injunctive Relief/specific performance (e.g., reseller)

# DISPUTE RESOLUTION

- Avoid Disputes
  - Information Exchange
  - Align Interests/Identify different interests
  - Create disincentives to breach
  - Quality Partners
  - Consider escalation/mediation
  - Ask the “What if’s”

# DISPUTE RESOLUTION (CONTINUED)

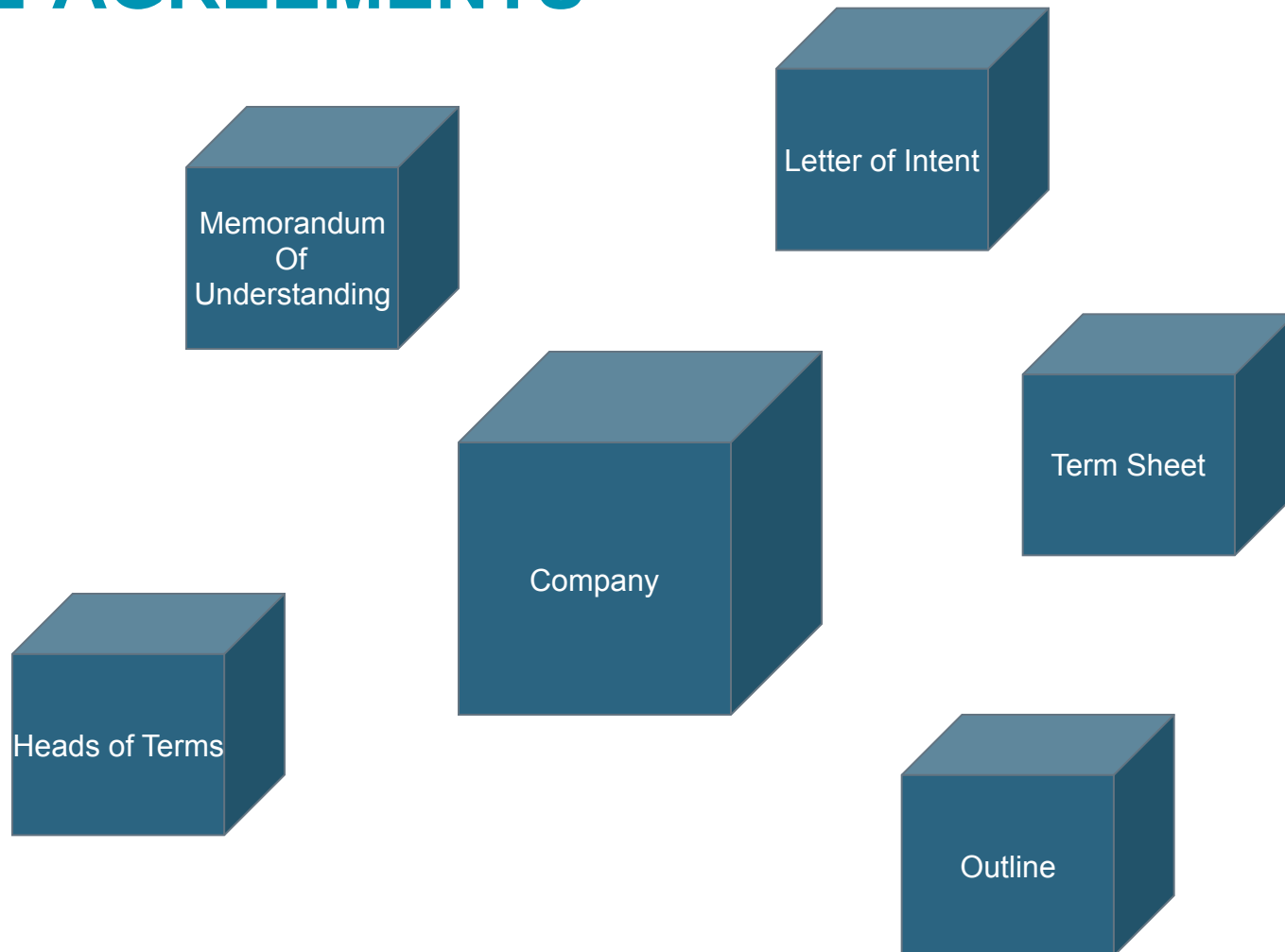
- Where does the fight occur?
  - Venue
  - Forum
    - Arbitration v. Court
    - 1 arbitrator v. 3 arbitrators
- Governing Law
- Who pays for the fight?
- What happens during the fight?



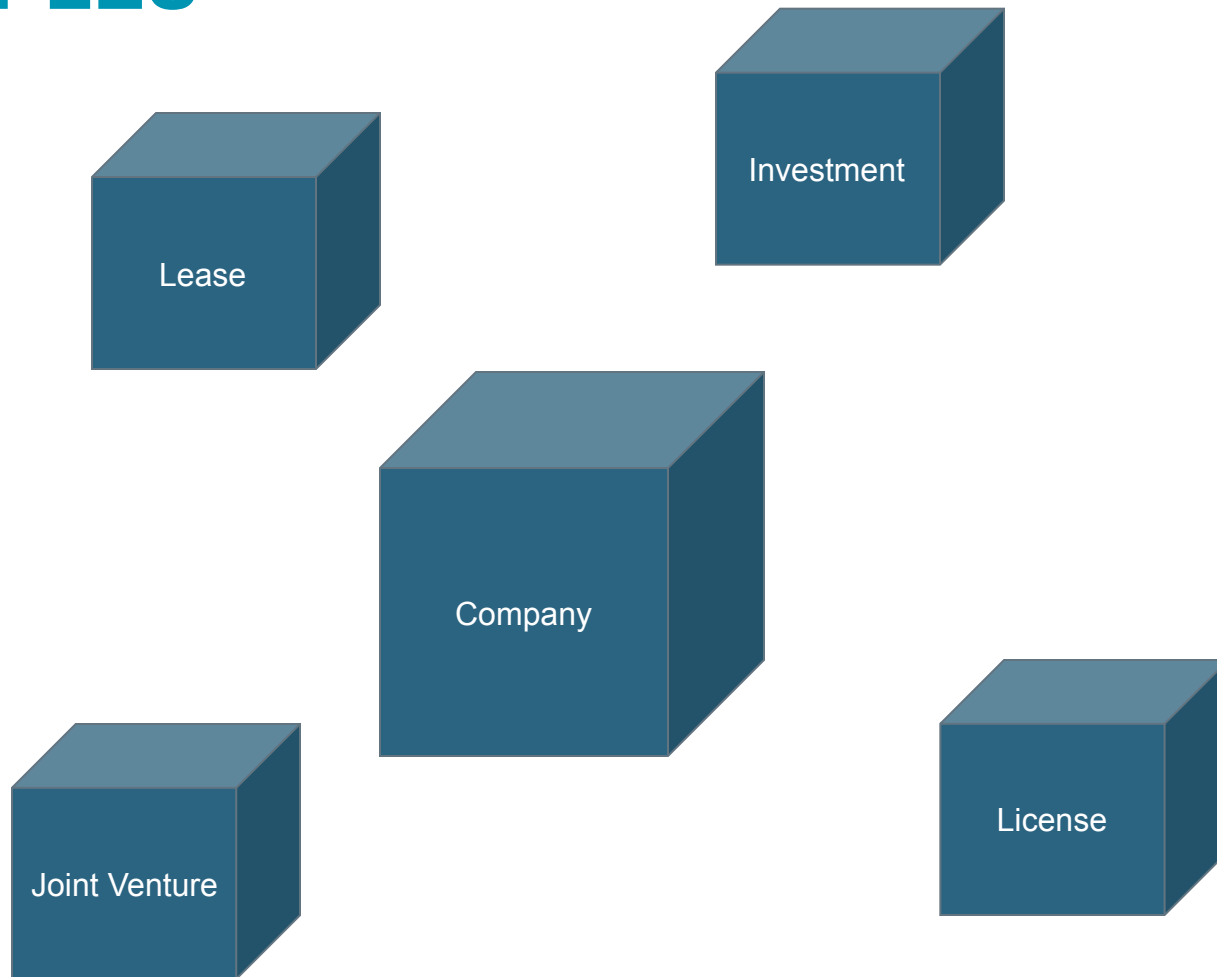
# ASSIGNMENT – COMMON ISSUE

- Third Party
- Competitors
- Successors
- Bankruptcy

# PRE-AGREEMENTS



# EXAMPLES



# KEY ISSUE: BINDING V. NON-BINDING

---


- Examples of Binding Provisions:
  - Confidentiality (information and discussions)
  - Exclusivity during negotiations
  - Period of negotiation
  - Common provisions (e.g., dispute resolution, legal fees)

# KEY ISSUE: BINDING V. NON-BINDING (CONT.)

---

- Seemingly Non-Binding Provisions:
  - Terms of the proposed transaction
  - Agreement to negotiate
- Dangers
  - Binding contract
  - Failure to negotiate in good faith
- Remember – Ambiguity is not a friend of a Start-Up

## EXAMPLE OF MAGIC LANGUAGE

- 
- This letter of intent is non-binding and, except as set forth in this paragraph, no party (whether a signatory to this letter of intent or not) shall have any rights, duties or obligations hereunder, including without limitation, any obligation to enter into final agreements relating to the transactions contemplated herein. The obligations of the parties are subject in all respects to the execution of the final, binding agreement. Either party may, at its sole and absolute discretion, terminate this letter of intent and neither party hereto shall have any further rights, duties or obligations. Without limitation of the foregoing, upon termination of this letter of intent, no party shall have any rights to make any claims based upon failure to negotiate in good faith, or otherwise. Notwithstanding the foregoing, paragraphs \_\_\_\_ of this letter of intent shall be binding on the hereto until terminated in accordance with this paragraph.

- Remember Pennzoil v. Texaco (1985)
  - Letter of intent between Getty and Pennzoil
  - Texaco bought Getty
  - Litigation ensued
  - 5-1/2 months of trial
  - Found
    - Contract (even though there was only a letter of intent)
    - \$7.53 Billion in compensatory damages
    - \$3 Billion in punitive damages

# LESSONS ON PRE-AGREEMENTS

- 
- Be clear on what is binding and non-binding
  - Use magic language in Pre-Agreement
  - Continue to act in a manner consistent with Pre-Agreement

# NON-DISCLOSURE AGREEMENTS

---

- Key Operative Provisions:
  - Confidentiality
  - Limited use of Confidential Information
  - Return of Confidential Information

# NON-DISCLOSURE AGREEMENTS (CONT.)

---

- Key concerns for Start-up company:
  - Importance of having NDA's
  - Definition of Confidential Information
  - Term of Confidentiality (note: trade secrets)
  - Remedies/cost of enforcement
  - Alleged possession/use of third party Confidential information

# NON-DISCLOSURE AGREEMENTS (CONT.)

---

- Key lessons for Start-up company:
  - Don't rely on confidentiality agreement
  - Stage disclosure
  - Obtain NDA's (Remember third parties)
  - Beware of NDA's for third party information
  - Pay attention to the term of the agreement
  - Consider remedies (collection of legal fees, etc.)

# EMPLOYMENT AGREEMENTS

---

- Key Operative Provisions:
  - Job
  - Compensation
    - commission and tail for sales
  - Benefits
  - Equity (vesting)
  - Term (at-will employment)
  - Severance

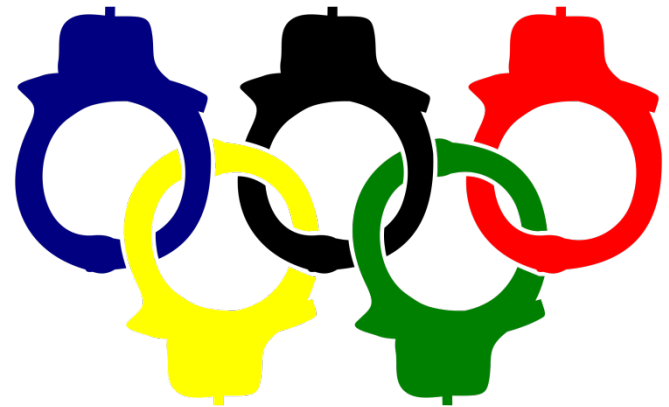
# EMPLOYMENT AGREEMENTS – START-UPS

---

- Use of third party confidential information
- Confidentiality
- Invention Assignment
  - Definition of Invention
  - Present assignment
  - Future obligation

# EMPLOYMENT AGREEMENTS – START-UPS

- 
- Restrictive Covenants
    - Non-Compete
      - Consideration
      - Reasonable scope
      - Reasonable geographic scope
    - Non-solicitation of customers
    - Non-solicitation of employees



# EMPLOYMENT AGREEMENTS – START-UPS

---

- Enforcement of Restrictive Covenants
  - Injunctive relief
  - Stock buy-back
  - Governing law
  - Collection of enforcement costs
  - Extension for non-compliance

# IN-LICENSES (E.G., FROM UNIVERSITY)

---

- Key Operative Provisions:
  - The technology with specificity
  - Territory
  - Field of use
  - Exclusivity v. non-exclusivity
  - Royalty
  - Term

# IN-LICENSES – START-UP COMPANIES

---

- Key Provisions for start-ups:
  - Transferability/sublicense
  - Improvements/Derivatives
  - Right to buy-out the royalty
  - Right to terminate by licensee
  - Restricted right to terminate by licensor

# LEASES

---

- Key Operative Provisions:
  - The leased premises
  - Rent
    - Base rent
    - Additional rent
    - utilities
  - Term
  - Build-out of premises/availability of space
  - Parking
  - Signage

# LEASES - START-UP COMPANIES

---

- Key Provisions for start-ups:
  - Early Termination/extension
  - Expansion/reduction of space
  - 24/7 Access
  - Security
  - Pets, bicycles and climbing walls
  - Utility access



# USING YOUR SALES CONTRACTS TO SELL MORE, SELL FAST, CLOSE ANYWHERE

- Basic Truths
  - In order to thrive, companies must successfully sell goods or services
  - People sell through commercial contracts: offer and acceptance
  - Commercial contract law is a pillar of modern legal systems in which ownership of private property is respected



# SELL TO LIVE



- Commercial contracts are not tombstones

- Tell a living story

Which authors can

To advantage of clients

- As clients sell
- And long after sale is complete

**SHAPE**

# REFRESHER: WHY YOU CARE ABOUT YOUR SALES CONTRACTS

- No Contract = No Remedy
- Weak Contract
  - Inadequate or No Remedy (Plaintiff)
  - High Liability

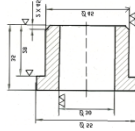



# REAL LIFE PAIN

- *Failure to include Terms & Conditions can lead to real consequences as one company learned from past experience:*
- **>\$10M**
  - ***Product defect, no contract with supplier***
- **~\$4M**
  - ***Product defect, recall, no warranty from supplier***
- **~\$15M in potential exposure**
  - ***Product defect, P.O. only, battle of the forms, no indemnity***
- **~\$0.5M in potential exposure**
  - ***Product sold to large customer included defective component, unable to determine if T&Cs provided to supplier***
- **~\$10M in potential exposure**
  - ***Claimed defect in product sold to large customer, no T&Cs provided to customer***



# LIVE TO SELL

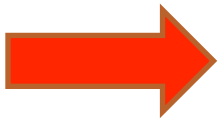
- A well-constructed commercial contract is:
  - Blueprint of the relationship 
  - Rulebook 
  - A calling card as important as any marketing material
    - Announces who you are
    - Announces whether you understand your business
    - Announces your market power
- Contracts are like English: Many can speak it, few can master



## HOW (SOME) NON-LAWYERS VIEW CONTRACTS

### AGREEMENT

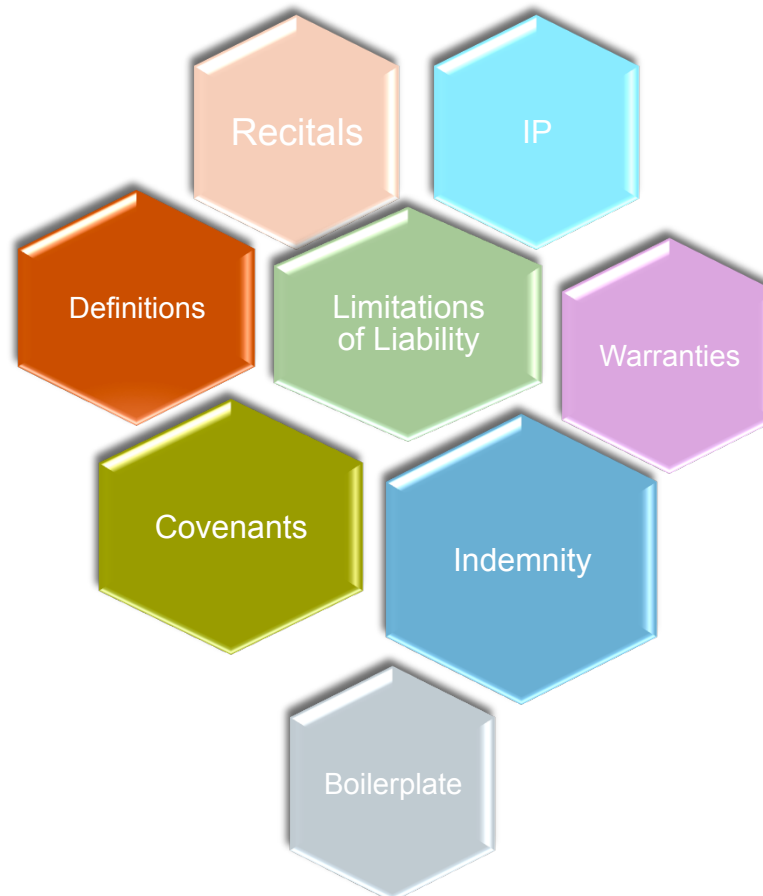
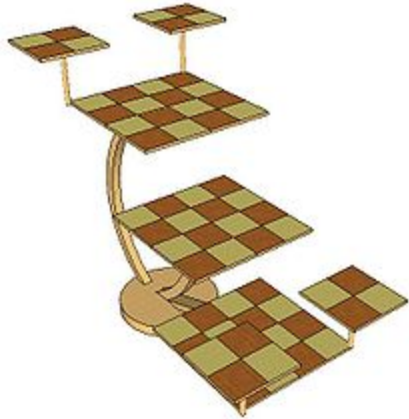
Whereas blah blah blah blah blah shall deliver blah blah blah aforementioned blah blah herein below blah blah indemnifies part y of the first part blah blah blah more gobbledygook blah blah liability that will kill my company but what the heck I am dead with out this contract anyway blah blah blah and what the heck is indemnification again that is too hard to understand blah blah blah noon ere ad sthis stuff anyway blah blah blah and anyway this relationship is built on trust not on a piece of paper blah blah blah the indemnified party shall notify the indemnifying party with in ten (10) days blah blah blah and / or this will happen blah blah blah notwithstanding blah blah blah such aforesaid terms shall apply blah blah blah the parties agree blah blah governing law is Timbuktu blah blah blah witnesseth the due execution here of blah blah blah where do I sign and get this over with



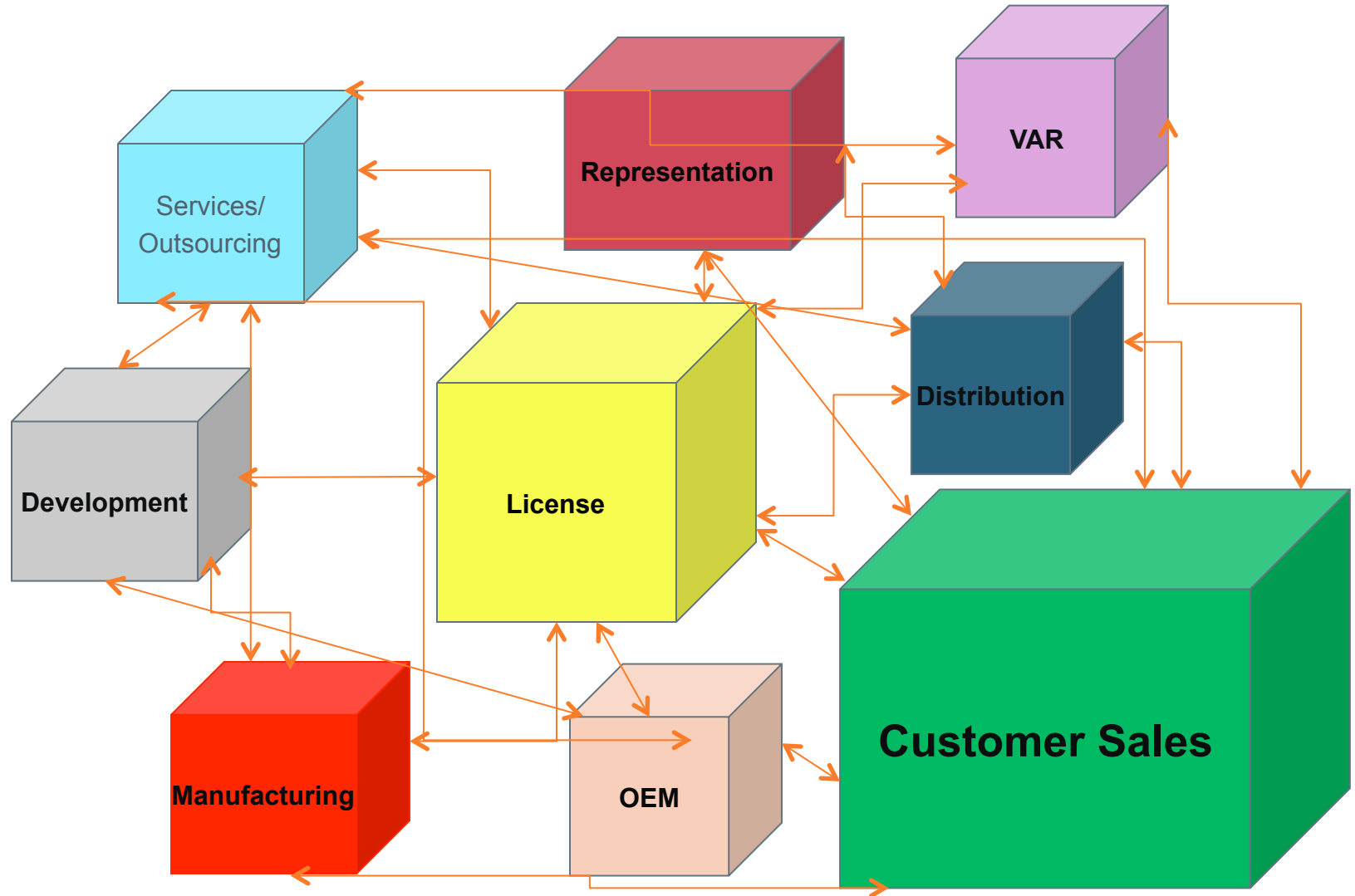
Sign here: \_\_\_\_\_

# HOW LAWYERS VIEW CONTRACTS:

Fitting each piece  
into a 3-D  
puzzle



# FIGURE OUT FAST WHICH BOX APPLIES



# BASIC PARTS OF A COMMERCIAL CONTRACT

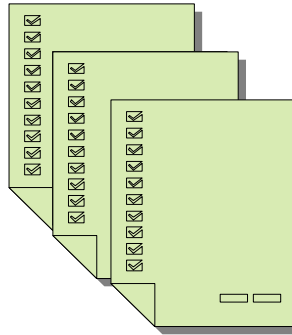
- Introduction (Optional)
  - Preamble
  - Recitals
  - Consideration Clause
- Body of Contract:
  - Language of Performance
  - Obligations and Prohibitions
  - Discretionary Language
  - Language of Declaration
    - Representations and Warranties
    - Acknowledgements
  - Language of Policy
    - Definitions, boilerplate, term, etc.

# KEY PROVISIONS OF A COMMERCIAL CONTRACT

- Business terms: Clear description of goods or services, financial terms (fees, payment terms, currency), length of contract, insurance
- Termination rights
- Limitations of liability
- Indemnification
- Ownership (if licensing or development involved)
- Additional remedies (liquidated damages, service credits, equitable relief)
- Dispute resolution

# SELL MORE, GROW FAST:

- Modularization and Forms



- Know what's market



# PRESENTATION HELPS SELL MORE, FASTER

- Sophisticated plain English is expected
- It doesn't cost much to dabble in graphic artistry within the confines of Word but don't go crazy!
- You look sophisticated
- You are sophisticated
- You close sales faster

# CLOSE ANYWHERE

## Global Marketplace Beckons

- Only an in-country lawyer knows the local law in depth
- American lawyer cross-border capabilities:
  - Provide some counsel on forum selection, arbitration, choice of law
  - Awareness of major anti-bribery, anti-corruption and privacy efforts
  - “Internationalize” American-style contracts



# BOTTOM LINE: USE CONTRACTS TO SELL MORE, GROW FAST, CLOSE ANYWHERE

Any questions?

