



Contracts for Start-Up Companies: Preserving and Enhancing Value

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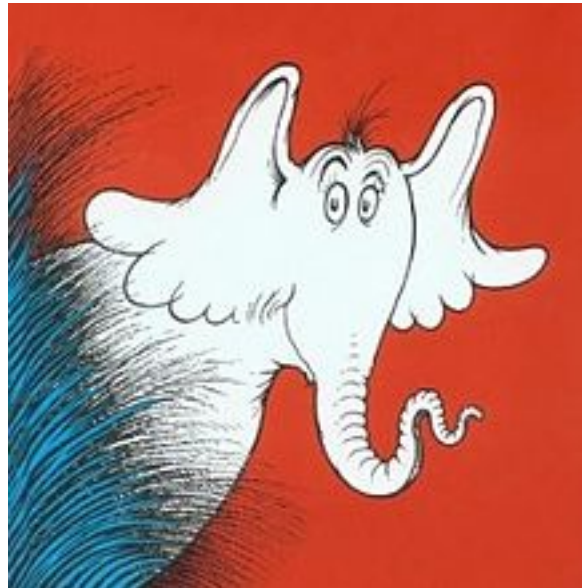
AGENDA

START-UPS ARE DIFFERENT!!!

- Basics of Contracts
- 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!)

LESSONS FROM A LEGAL SCHOLAR!

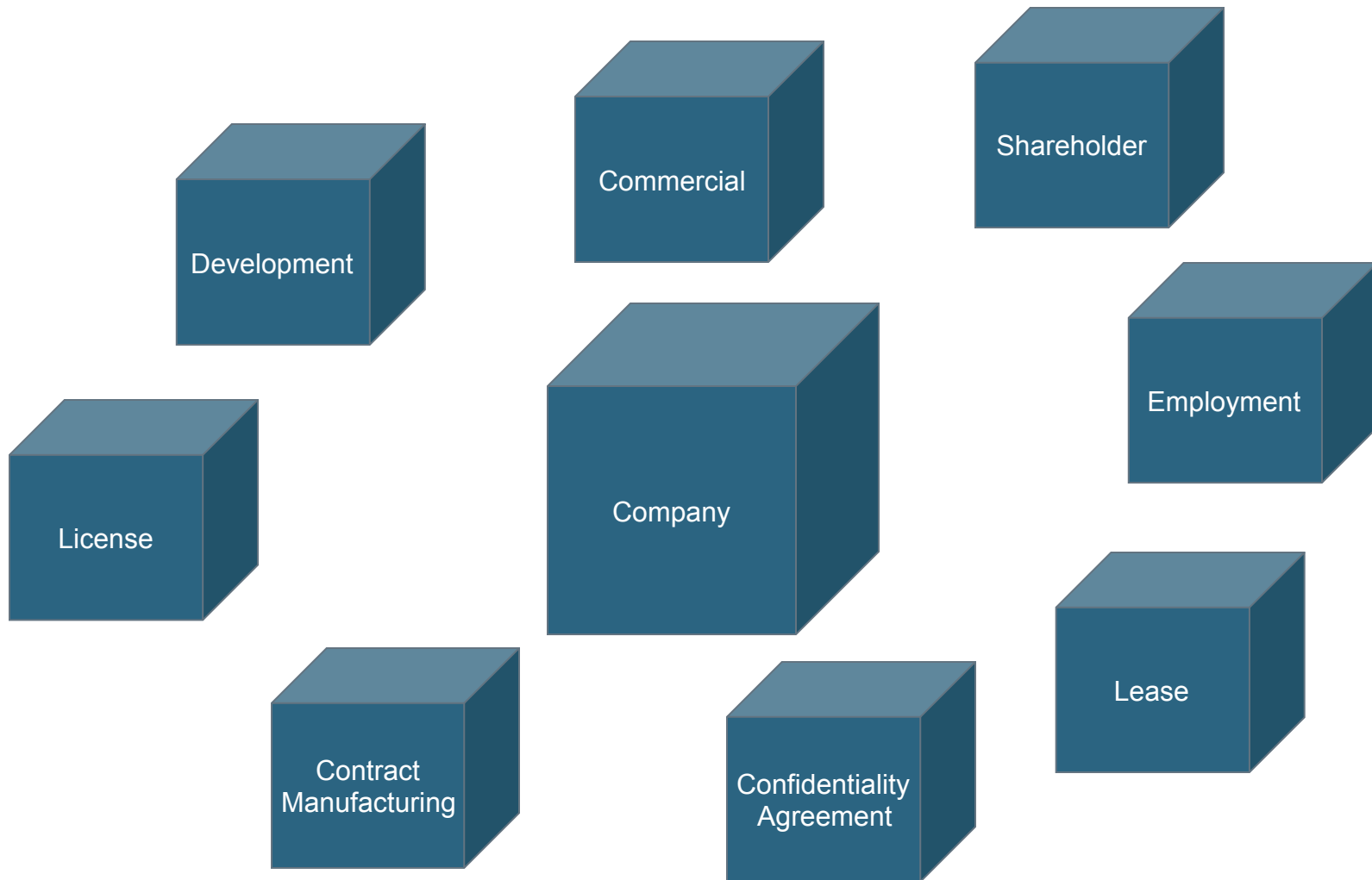
"I meant what I said and
I said what I meant."
--Dr. Seuss



WHAT NOT TO DO!



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
 - Cloud on title
 - What are the rules
 - Potential liability



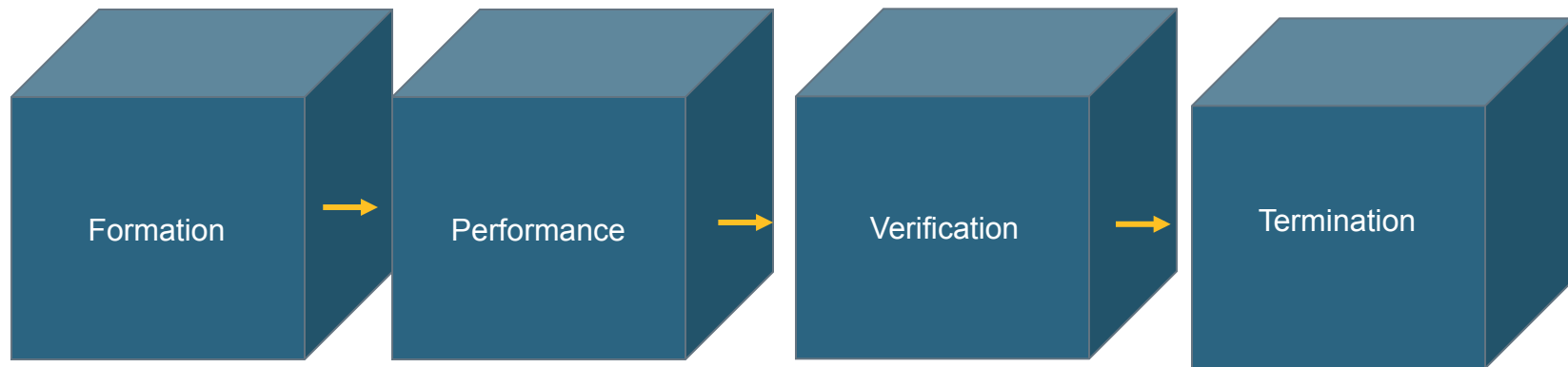
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IMPORTANCE FOR THIRD PARTIES

-
- Potential Third Parties
 - Investors
 - Purchasers
 - Examples
 - Limitation of Liability
 - Amount
 - Incidental/Consequential Damages
 - Assignment



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!!!

MONITOR AND VERIFY

-
- 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)



END OF TERM



- 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?
 - In a joint venture, who gets what assets and assumes what liabilities?

FAILURE OF PERFORMANCE

- Remedies
 - Termination (out-license)
 - Damages (e.g., failure to manufacture)
 - Injunctive relief/specific performance (e.g., reseller)



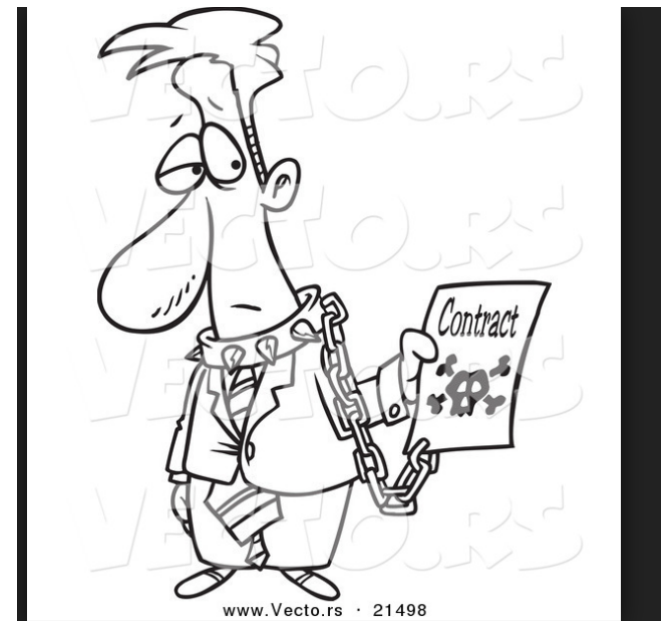
DISPUTE RESOLUTION

- **Avoid Disputes**
 - Information exchange
 - Align interests/identify different interests
 - Create disincentives to breach
 - Quality partners
 - Consider escalation/mediation
 - Ask the “What if’s”



RECENT EXCLUSIVE LICENSE EXAMPLE

- Remedies for breach:
 - Termination
 - Equitable remedy (no bond)
 - Conversion of exclusive to non-exclusive
 - Damages
 - Consequential damages
 - Collect legal fees and costs
 - Favorable jurisdiction

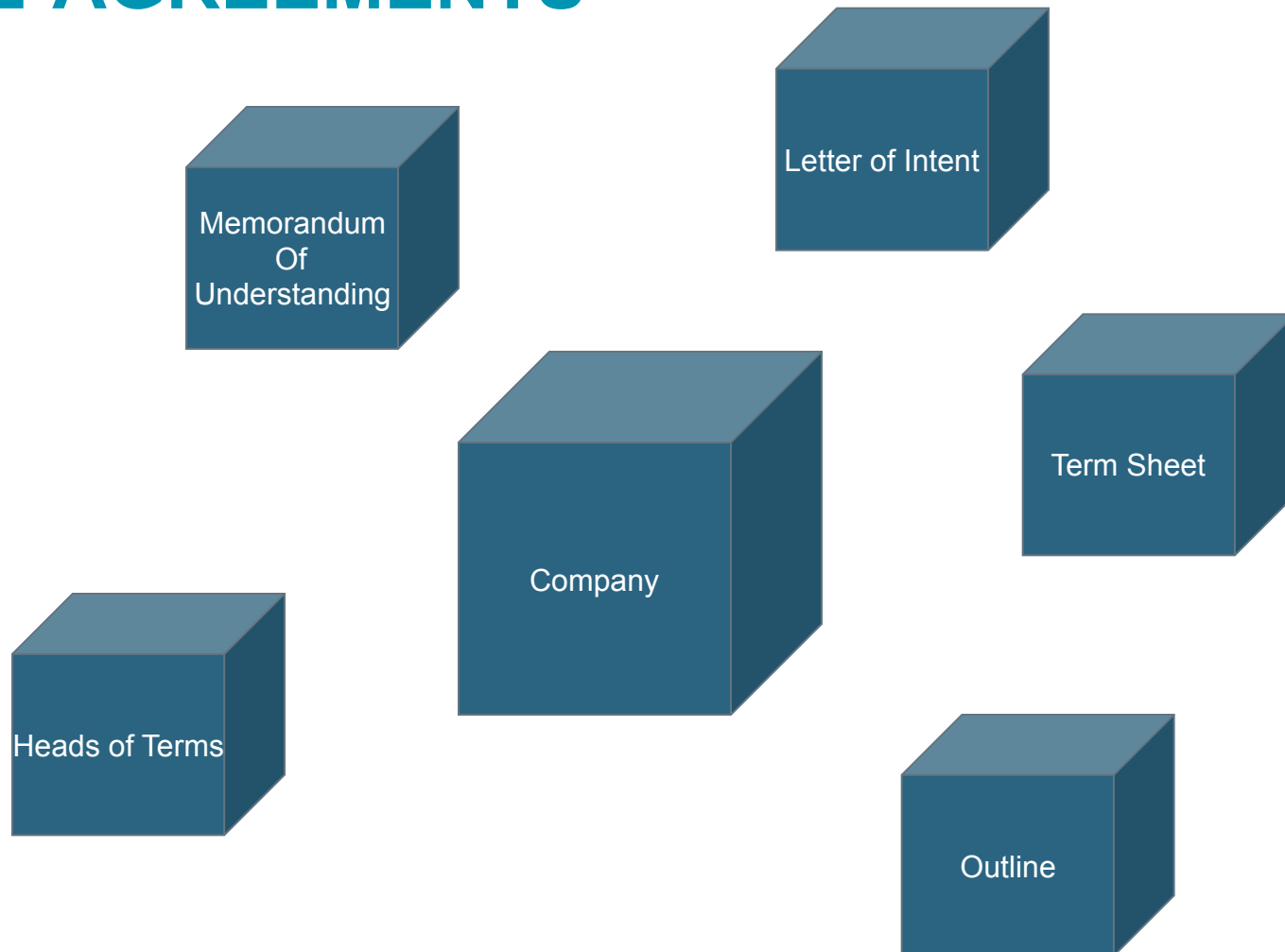


DISPUTE RESOLUTION (CONTINUED)

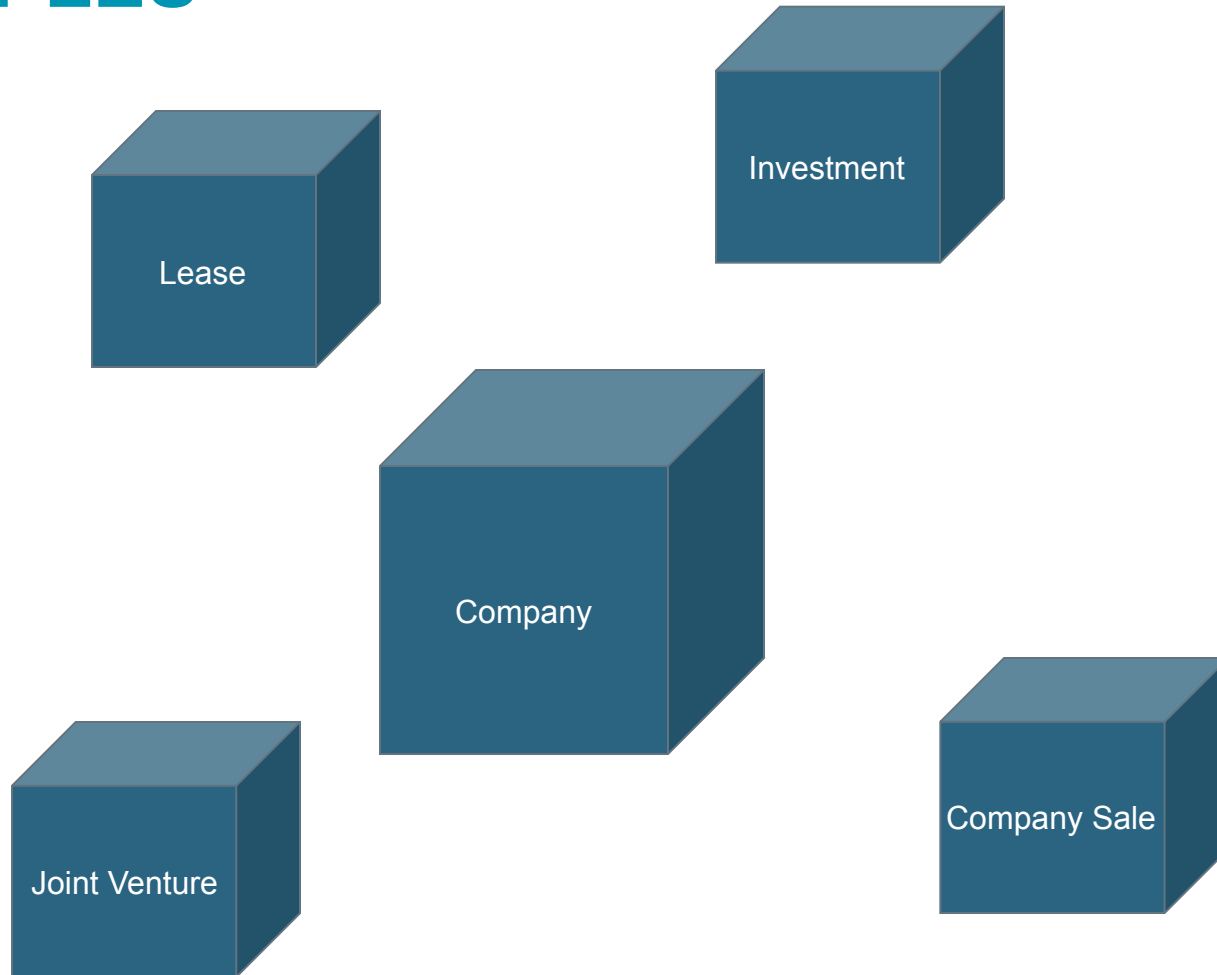
- Where does the fight occur?
 - Venue
 - Forum
 - Arbitration v. Court
 - 1 arbitrator v. 3 arbitrators
- Governing Law
- Who pays for the fight?
- What happens during the fight?



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.

\$10-Billion Jury Verdict Against Texaco Upheld

December 11, 1985 | DEBRA WHITEFIELD | Times Staff Writer

- Remember Pennzoil v. Texaco
 - 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

See Oil and Honor, by Tom Petzinger

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

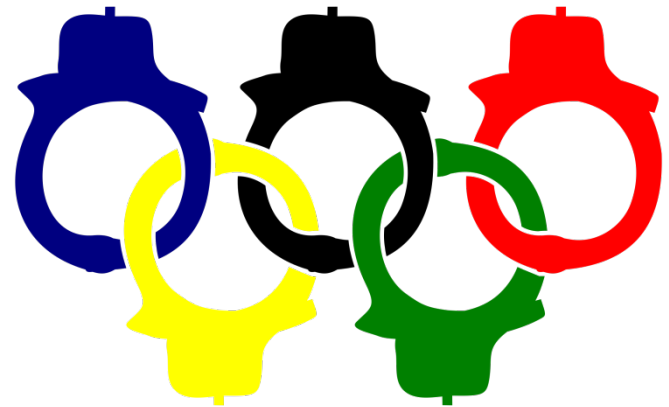


EMPLOYMENT AGREEMENTS – START-UPS

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- 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
 - Improvements/derivatives

IN-LICENSES – START-UP COMPANIES

-
- Termination/Assignment
 - Transferability (sale of company)
 - 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 Concerns for start-ups:
 - Design/collaboration
 - Early termination/extension
 - Expansion/reduction of space
 - 24/7 Access
 - Security
 - Pets, bicycles and climbing walls
 - Signage
 - Utility access



COMMERCIAL CONTRACTS



SELL TO LIVE: USING CONTRACTS IN SALES

- 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



REFRESHER: WHY YOU CARE ABOUT YOUR SALES CONTRACTS

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



SELL TO LIVE

- Commercial contracts are not tombstones



- Tell a living story

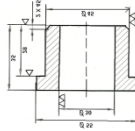

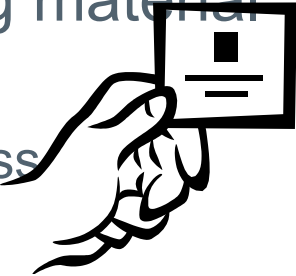
Which authors can

To advantage of clients



- As clients sell
- And long after sale is complete

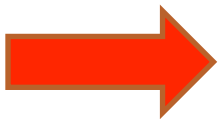
LIVE TO SELL

- 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 aforesaid blah blah herein below blah blah indemnifies part of the first part blah blah blah more gobble dygook blah blah liability that will kill my company but what the heck I am dead without this contract anyway blah blah blah and what the heck is indemnification again that is too hard to understand blah blah blah noon ere adsthisstuff 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 within 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 witnesseth the due execution hereof blah blah blah where do I sign and get this over with



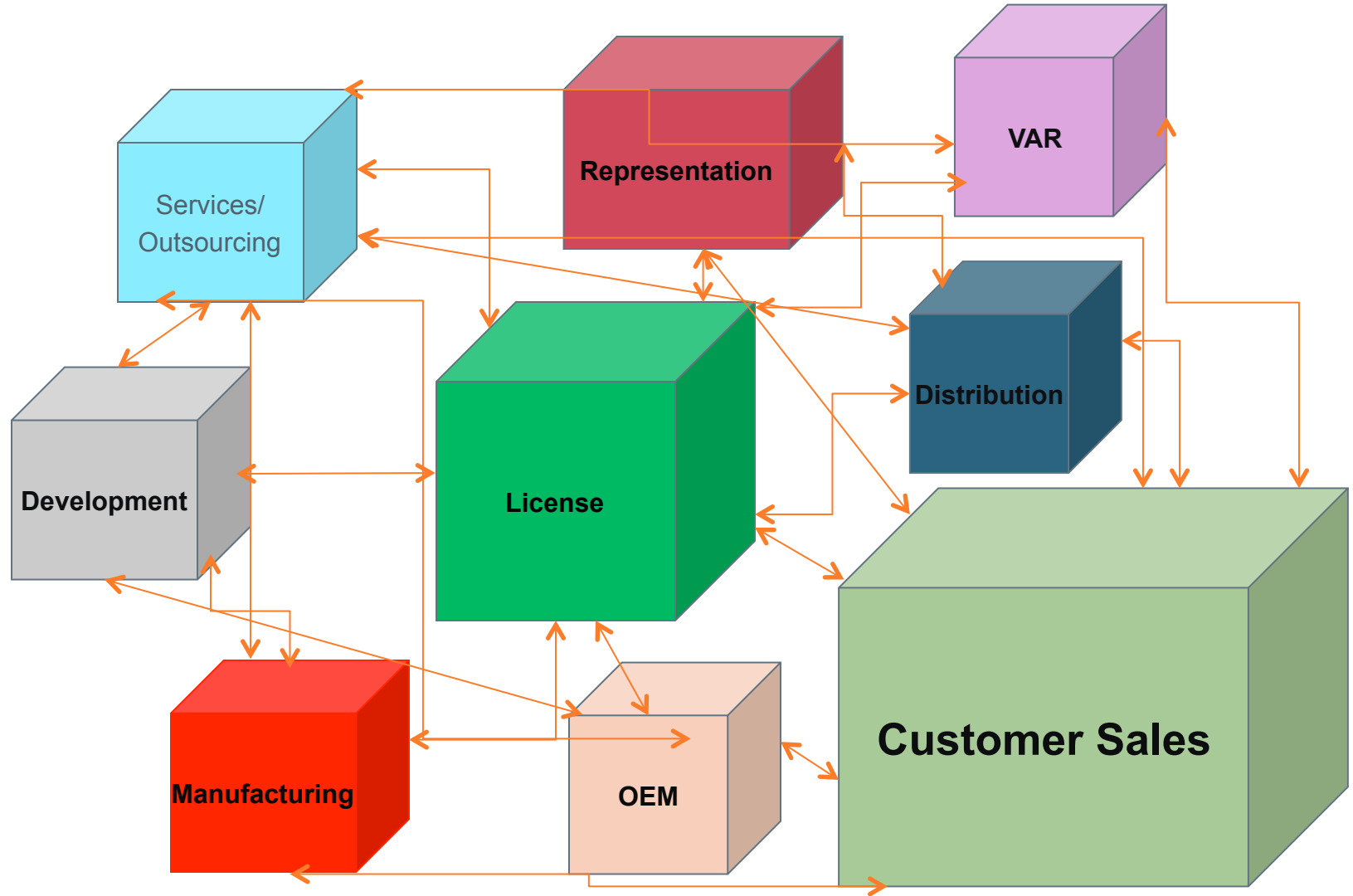
Sign here: _____

HOW LAWYERS VIEW CONTRACTS:

Fitting each provision
into a 3-D
puzzle



FIGURE OUT FAST WHICH BOX APPLIES



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

- Questions?

