Demystifying Contracts

A Workshop by UCB Law’s New Business Practicum Covering:
• How to make, review, and enforce agreements
• Common contracts for start-ups
• Template agreements to share

Agenda

Demystifying Contracts
• Why use Contracts?
• How to make a Contract?:
  ▪ 3 Minimum Steps
• How to read Contracts?:
  ▪ 5 Common Concerns Addressed in Contracts
  ▪ 4 Common types of Contract Language to know
  ▪ Boilerplate
• How to Enforce Contracts?

Appendix: Common Contracts for Start-ups
• Independent Contractor Agreement
• NDA/Invention Assignment
• IP Licensing Agreement
• Commercial Lease, with Extension
• Founders’ Agreement
• Restricted Stock Agreement
• Promissory Note
• Website Terms of Use/Privacy Policy

*Disclaimer: This is general legal info, not a substitute for Legal Counsel!*
Why Use Contracts?

Contracts help you manage

Successful Entrepreneur

=  

Successful Manager of Many Different

RELATIONSHIPS
### Why Use Contracts?

#### Key Relationships & Key Agreements

<table>
<thead>
<tr>
<th>Category</th>
<th>Agreements/Instruments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Founders</td>
<td>- partnership/LLC operating agreements, restricted stock purchase agreements</td>
</tr>
<tr>
<td>Workers</td>
<td>- independent contractor agreements</td>
</tr>
<tr>
<td>Capital</td>
<td>- loans, convertible debt, stock agreements, grants</td>
</tr>
<tr>
<td>Suppliers</td>
<td>- supply agreements, vendor/contractor agreements, commercial leases</td>
</tr>
<tr>
<td>Insurance</td>
<td>- insurance agreements</td>
</tr>
<tr>
<td>Consumers</td>
<td>- sales agreements, website terms of use/privacy policy</td>
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### Why Use Contracts?

It’s important when things go wrong

![Image of business people discussing, possibly planning contracts.](image-url)
**Why Use Contracts?**

Do I need a contract with my friends or family?

- It’s not just about trust; it’s about clarity, so they realize exactly what they are getting into.
- Easy to forget what you agreed on, helps minimize disputes.
- Makes your business look more serious.
- Future investors will want to know how you started, so you will need a paper record of all capital transactions.

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**How to Make a Contract**
3 Minimum STEPS to create a CONTRACT

1. OFFER
   • Parties accept offer on the same terms
   • Watch for counteroffers!

2. ACCEPTANCE
   • An exchange of something of value

3. CONSIDERATION
   • An exchange of something of value

Note: Oral Agreements are also enforceable, unless the agreement falls under the Statute of Frauds – (1) prenuptial agreement; (2) paying another person’s debt; (3) interest in real property of > 1 year; (4) agreements that cannot be performed within 1 year; and (5) sale of goods ≥ $500. All these contracts must be in writing to be enforceable.

Offer and Acceptance

“A meeting of the minds”

• Parties must intend to create a contract
  ▪ or outwardly show that they do
    ▪ Subjective / hidden intentions irrelevant

• Parties must agree on the main terms to create a contract
  ▪ all of the terms are not necessary, but you need the basics. Payment? Service? Time?
**Consideration**

- Essentially a trading of something for value
  - If you cater my reception, I will pay you $1000 = catering services traded for money
- Past acts don’t count
- Pre-existing duties don’t count
- Value of Consideration is Irrelevant
  - Can be $1

**How to Read Contracts**
5 Common Concerns Addressed in a Contract

1. **Money**  
   - Payment arrangements, who gets how much?

2. **Risk**  
   - Who is on the hook, for what, when?

3. **Control**  
   - Who has the decision making power, in what areas?

4. **Standards**  
   - When there is a vague or missing term, what do we use to fill in the gap?

5. **Beginning/End Game**  
   - When do these terms begin to apply? When do they cease to apply?

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REAL-WORLD EXAMPLE

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</table>
4 Basic Contract Drafting Tools

- **Representations**
  - “This used car has 50,000 miles on it.”

- **Warranties**
  - “This used car is in good working condition at time of sale. If it breaks down within 90 days, buyer can void the sale.”

- **Covenants**
  - “Seller agrees to sell the used car to Buyer for $10k”

- **Conditions**
  - “Seller agrees to transfer title and the keys once Buyer has paid the full purchase price.”

Boilerplate (AKA The “Fine Print”): usually includes

- **Dispute Resolution**
  - Ability to seek means other than litigation to resolve disagreements (e.g., mediation or arbitration)

- **Integration Clause**
  - All side agreements have been included in the final written contract

- **Modifications**
  - Governs changes to the contract. Usually only with the agreement of both parties, with possibility of waiver

- **Assignment of Rights**
  - Governs assignment of the rights in the contract to a third party, usually with the agreement of both parties
### Boilerplate: usually includes

<table>
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<tr>
<th>Section</th>
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<tr>
<td>Governing Law</td>
<td>Which state’s laws will govern the contract</td>
</tr>
<tr>
<td>Notice</td>
<td>Requirements for how notice to a party has to be given</td>
</tr>
<tr>
<td>Severability</td>
<td>If a provision is found to be invalid, the remaining contract provisions will survive.</td>
</tr>
<tr>
<td>Force Majeure</td>
<td>Liability arising from events beyond one’s control are excluded</td>
</tr>
<tr>
<td>Waiver</td>
<td>One-time surrender of a right doesn’t mean it’s permanent.</td>
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### What if someone breaks a promise?

![Contract Image](image)
### 5 Options for Enforcing a Contract

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<tr>
<td><strong>Negotiation:</strong></td>
<td>• Roughly 80% of cases are resolved by the parties on their own, before getting to court.</td>
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<tr>
<td></td>
<td>• A great first option – judges always want to see that a party tried.</td>
</tr>
<tr>
<td><strong>Mediation:</strong></td>
<td>• Both sides agree to have a trusted middle person hear each side and assist them in reaching a decision</td>
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<tr>
<td></td>
<td>• Free community resources: <a href="http://www.seedsrc.org">www.seedsrc.org</a>, [<a href="http://www.jamsadr.com">www.jamsadr.com</a>]</td>
</tr>
<tr>
<td><strong>Arbitration:</strong></td>
<td>• Both sides agree to have a trusted middle person hear each side and impose a binding judgment outside of court</td>
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<tr>
<td><strong>Lawsuit (go to court):</strong></td>
<td>• Small Claims Court – your claim must be less than $10,000; No lawyers allowed.</td>
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<td></td>
<td>• State Superior Court – usually with lawyers, usually big $$$ and may take months.</td>
</tr>
<tr>
<td><strong>Do nothing:</strong></td>
<td>• Litigation usually takes lots of $$, time, and hassle – not to be undertaken lightly</td>
</tr>
<tr>
<td></td>
<td>• It may be the case that there was no harm—no harm, no foul.</td>
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### Questions?

For more information, or to apply for service, visit our website: [www.law.berkeley.edu/new-business-practicum](http://www.law.berkeley.edu/new-business-practicum)

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Deputy Attorney: Kevin Xu – kxh@law.Berkeley.edu
Appendix: Common Contracts Businesses Use

Independent Contractor Agreement
NDA/Invention Assignment
IP Licensing Agreement
Commercial Lease, with Extension
Founders’ Agreement
Restricted Stock Agreement
Promissory Note
Website Terms of Use/Privacy Policy

Independent Contractor Agreement:

- Independent Contractor Status Checklist
  - Key is to minimize the degree of control
- Require Confidentiality
  - Maintain reasonable protection of trade secrets
- If doing risky stuff, require insurance and indemnification
- Clarify who supplies what: materials, equipment, out-of-pocket costs (usually = IC)
- Clarify IP assignment (note: NOT “Work for Hire” arrangement.)
Non-Disclosure and Invention Assignment Agreement

- Usually Unilateral Contract; Possible Mutual
- Define what is “Confidential”
  - BE INCLUSIVE – Identify specific items if possible
  - OK to exclude prior stuff that came before
- Invention Assignment
  - Will cooperate in securing IP rights
  - Warranty – sole ownership
  - Indemnity if not sole owner and causes damage

IP Licensing Agreement:

- Define Scope
  - Geographic
  - Temporal
  - Exclusivity
- Identify any Warranties
  - Full disclaimer? Limited?
- Include any Limitations on Liability
  - Types of damages
- Provide for Indemnity, if needed
  - Attorneys’ fees, court costs
Commercial Leases:

- Fewer Consumer Protections for Commercial Tenants
- Each LL will have OWN lease --no “Standard”, so read carefully –always ok to negotiate your needs
  - LL may try to pass along costs (e.g. mntce, ADA)
- Generally Comml. Leases are LONG TERM and BINDING – lots of $$ at stake (no walking away)
  - Know about termination, extension, subleasing
  - Short-term, renewable leases are usually safer.
- STRONG REC: Have lawyer review before signing

Founders’ Agreement:

- Helps clarify “the DEAL” before an entity is formed (usually then integrated into the formation documents):
  - Corp: Shareholder Agreement
  - LLC/Pship: Operating Agreement
- As to the Deal, generally need to determine up front:
  - Contributions ($ in)
  - Distributions ($/losses out)
  - Decision Making Power
  - Admission/Withdrawal
- If Equity is involved,
  - be sure to complete all securities filings (see e.g., Restricted Stock Agreement)
  - Check with an Accountant about tax consequences
- STRONG REC: Have lawyer review before signing
Restricted Stock Agreement:

- Distinguish: Vested? Fully-Vested?
- If Vesting involved, need Vesting Schedule
  - Standard 4-year vesting w/ 1-year cliff
  - Single/Double Trigger Acceleration
    - Single: Acquisition/change of control
    - Double: Acquisition/change of control + termination
  - 83(b) Election Notice – VERY IMPORTANT
    - Tax ramifications
- Securities Compliance
  - Purchasers: Insiders or Accredited Investors
  - Need to file issuance notice with shareholder’s state
  - RECOMMENDATION: Always have attorney review.

Promissory Note:

- Promise to Pay should include:
  - Amount borrowed
  - Interest (watch Usury rates)
  - Repayment Schedule
  - Terms re: collateral
  - Default process
- Generally wise to set up auto-debit repayment
- STRONG REC: Have lawyer review before signing
Website Terms of Use/Privacy Policy:

- Contract with Web Users – set by clicking or prominent display
  - **TOU:**
    - Sets expectations as to use vs. misuse (e.g., “no commercial use”)
    - Right to modify at any time
    - Website provided “as is”
    - Waiver of Liability
    - Be sure to account for all of website’s functionality
      - Content posting by Users – include copyright ownership/ infringement “take down” process
      - Personal Identifiable Info sharing – rules of conduct needed, possible blocking
      - Sales – need to set up credit card/debit transaction portal (or contract out)
  - **PRIVACY POLICY**
    - Sets expectations as to use of User’s identifying information
    - Usually allows for sharing aggregate/non-ID information with others
    - Certain circumstances when have to share with Government
    - Check with focus group re: User’s likely expectations (private vs. ads)

**Bottom Line:**

*If using a Template, ALWAYS SHOW IT TO A LAWYER BEFORE SIGNING*

*Especially IMPORTANT with Capital Transactions and Leases*