

Transcription

Contracts

Key Aspects of Contracts



Thinking about contracts any consensus between two parties can be termed a contract but from experience we know that it is always better to have things in black and white on paper, so it's going to be very important for us to understand how contracts work from some of our subject matter experts.



At a very basic level contracts represent the terms on which people's minds have met. Contract could be verbal, contract could be written. Verbal discussions could also be contracts if indeed there is meeting of minds but the reason the world thinks and we advise you that contracts should be understood in written sense is because it brings about clarity. When you don't have contracts very often the commercial term is left to interpretation, the way you think about does not necessary mean the way the counter party thinks about it and therefore to bring the complete clarity to what the commercial deal is between the two of you, you normally enter into contract which clearly puts forth in writing, leaves very little scope for misinterpretation or to put things in doubt, that is the primary purpose you need to enter into contracts.

KEY ASPECTS OF A CONTRACT:

1. Term of Contract

- Long Term Contract
- Short Term Contract

2. Termination

3. Exclusivity

4. Payment Term

5. Representations and Warranties



So when you see a contract, what are really the key terms? The key terms could be the first would be the

1. Term of Contract

If you are dependent on the product, if that product is highly important to your services, if the pricing is right you would like

•Long Term Contract

On the other hand if you are not in the right market situation and things would be such when you would prefer to negotiate another day.

•Short Term Contract

Focus on the term. What is the duration that I have to lock my mind into this contract, that's the first thing. The second thing is you need to kind of think the link to term is in what situations I can get out of this contract. There could be breach, there could be a cure period and once I satisfy the cure period how do I get out of it and how painful is going to be the exit period?

That is why you need to focus on Term.

2. Termination- The termination issue is all about what is going to be the way in which the party is get out of the relationship?

3. Exclusivity- What does exclusivity mean? Exclusivity mean you got to provide your services or you got to take goods only from one person, the counterpart or when you are supplier you can't supply to the rest of the world but for your counterpart. But exclusivity focus on it, why? Because if you miss the exclusivity which is very often slipped into contracts you could find a situation where you thought you got the right partner but you are precluded from dealing with the rest of the world and that diminishes your value dramatically.

4. Paid- when is the money to be paid and if there is noncompliance on those what are the consequences. Each contract is built with a particular purpose and they have a tilt for whatever it is worth make sure you hire a lawyer or you make sure you consult someone wiser who has done this before and is advising you correctly on this.

5. Representations and Warranties

These would be, when you deal with corporate you need to make sure they have proper authority to enter into those contracts. When you deal with office of a company very often they may not be authorized or the company is just not in a position to deliver what they had said. So you need to take your representations and warranties. In addition to that, you need to think about the

6. Indemnity -If there is a loss caused to you for a specific breach or for a specific representation or warranty having gone wrong you have a clear claim to money.

Founder and Employee Agreements

TYPES OF CONTRACTS:

1. Founder Agreement

- Decision Making Authority
- Right to Vote
- Shareholding Pattern
- Onus of Funding
- IP Ownership
- Expertise Remuneration



What we just saw was the basics of a contract and why even you need a contract for your business and what are the key terms of a contract so now that you understood should be basic terms exclusivity and confidentiality you may then be wondering what are the different types of contracts you need for a business so 1 of the foremost contracts you need is your

1. Founder Agreement -that you will enter into with your other key founders, now this often varies upon you're the co-founder or is this a venture stepping up with family members or with friends and family, so depending upon the background through which you are setting up your company and who are the key shareholders of your company .i.e. it's just family, its friends and family, you are the only founder or if there are other founders those are the key aspects which will govern the terms of your founder's agreement.



As a budding entrepreneur there are a lot of contract types you will come across and as you move forward in your journey you will have consultants and legal experts who will help you understand all of these but that being said there are few basic contracts that you should be aware of and be able to understand so I think it's going to be important for us to understand from our subject matter experts the few basic type of contracts that are of significant importance's to a budding entrepreneur.



If you are a founder setting up a company with some of your friends or even family. This is an aspect that many founders tend to bypass because unlike your vendor contracts or unlike your customer contracts where you are dealing with entirely unknown parties because you are dealing with people that you know and are excited to get this show on road, you may tend to forget about contracts because you are proceeding on a good faith basis. While all that is very well and good, sometimes you tend to forget what the commercials were especially when you are 4-5 years down into the business.

TYPES OF CONTRACTS:

1. Founder Agreement

- Decision Making Authority
- Right to Vote
- Shareholding Pattern



A founder's agreement which is actually fairly prevalent in other jurisdictions is not very common in India and is only starting to pick up because of all the subtleties and nuisances which are involved for example who calls the shots, when 3 of you have difference of opinion does any member on the board have a casting vote or not, is there a concept of chairman on the board, are all three of you on equal footing. But even if you all are meant to be on equal footing what happens if one of the founders has more than 50% shareholding in the company. In such a scenario where a shareholder does have more than 50%, you defector to have control over the company and if you have more than 75% it's even more control by being able to pass certain critical shareholder resolution. So in those situations depending upon what your shareholding is even if you are starting out as friends it is good to lay down who really calls the shots or if there is going to be deadlock, what happens in that scenario? When to approach funding for example? While one founder may think that that company is ready, another founder may think that you still need to grow and scale to a particular level and become more mature company in order to be able to attract a good valuation. You should agree that in the initial stages the company does require some amount of funds to operate. So who is the founder that's bringing those funds? Is it all three collectively, is it a joint responsibility to raise those funds? Who is going to take on this responsibility?

If one founder really is committed to bringing funds and the whole basis of your business plan is dependent on this founder delivering on that, it's good to put it down in an agreement so that there is no misunderstanding later on where you are suddenly left overnight with no cash coming in and you are suddenly running on fumes.

The last critical aspect is ownership in the company of certain of its key aspects like intellectual property several founders tend to apply for IP, your intellectual property registration in the founder's name. But this could create huge implications. Initially a founder may think that he is protecting his interest by registering in his name but ultimately if you are looking at taking the company to next level you need to make sure that all the assets are in the company that the value lives in the company.

It's good to have the company's assets in the company's name and the founders whatever is the arrangement whether it's funding or bringing expertise to the company to just have it all documented.

Where it may become complicated is where one founder is bringing in the finances and one founder is bringing the technical expertise. That's when it's important to lay it out in your shareholding structure and

factoring in how that expertise is being remunerated. Is it merely by the way of salary to the promoter or is it by virtue of his equity ownership in the company.



Just like having a solid founders agreement is going to be critical for your venture it is equally important well formulated and cleanly employee contract as well.

TYPES OF CONTRACTS:

2. Employee Agreement

- Exclusivity
- IP Assignment
- Employment Termination

A woman with dark hair, wearing a black sleeveless top and a white skirt, is sitting and speaking. In the background, there is a blurred office setting with the "#startupindia UpGrad" logo visible in the top right corner.

2. Employee Agreement –

So what are the key terms of an employment agreement from a founders prospective or what you need to do to protect the company and also what is something employees want so you have a good halfway point and are presenting a fair contract.

So one of the key aspects here which are their even in business contracts is exclusivity. If your signing on an employee who is not an consultant but an employee you will want him in and whole time services for your business it could be some standard carve outs of investments there are certain other activities so long it does not harm or affect the obligations of the company, of the basic terms of an employment contract is to make sure your employee is rendering services Exclusively to you and is not an employee in multiple organizations The 2nd most important aspect is IP assignments, we have discussed earlier the importance of IP where the IP and where the IP should rest but end of the day if you have employees is generating certain work specially

when it comes to creative content or any other aspect relating to the business it is important to have an IP assignments clause, which states the employees generates will be owned by the company, if you don't have these Clauses then the employee is under law regarded as the author of that work and there could be potential conflicts of who owns the IP for all the business that is being created.

The Other tricky aspect of a relationships is that of non-compete we have discussed exclusivity and how an employee should work exclusively for you but what happens when the employment is terminated.

let's see you have hired an employee an very key employee at the inception stage of the company who had a critical role to play at the initial stage who has contributed and had access to sensitive information, if or what for any reason the employee terminates his employment or if things don't work out and if he joins his competitor with that sensitive information that could leave the company significantly exposed.

So from the employer and employee prospective of whoever is the employee many start-ups end up thinking a one pager offer letter is would suffice just setting out the terms of remunerations and basic terms and leaving everything to be governed by the leaf policy but it is always advisable is to have a simple employment agreement not a very detailed one even a 2-3 pager will do just to make sure that intellectual property, confidentially and sensitive related data is adequately protected.

Vendor and Customer Contracts



It was very interesting to see the various aspects that one has to keep in consideration while drafting a good employee agreement now it's going to see how to draft agreements when it comes to external people like customers and vendors. Now it's going to be important to understand how to handle vendor and as well as customer contracts.

TYPES OF CONTRACTS:

3. Vendor Contracts

- Refund Policy
- Tax Clause
- Exclusivity
- Termination Clause

4. Service Contracts

- Third Party IP Infringement
- IP Ownership
- Timelines for Payment



So apart from contracts have with your own shareholders or own employees the third important segment is contracts you will have with other third parties weather is third parties of availing services from mainly your customers to who your delivering services to and this is the key aspect of various businesses are either called customer contracts or your .

3. Vendor Contracts

However there is no one sizes fits all set of contracts that any business will have to factor in mind or enter into uniformly, these are the types of contracts that will differ from business to business and the types of services of goods that you are providing. So why would you need a supply contract or why would you need a vendor contract with someone you are availing services, there could be a multiple reasons depending upon your back to back arrangements with your customers

What are grounds for Refunds? For Example you have availed this product and you have sold it on the website and there is a defect you may have your own internal quality check etc. but you should have specific grounds which will allow you to refund your products, you have the ability on having detailed vision on how the

• Tax Clause

Will work as well, are you buying goods from 1 stage to another stage, what are all the indirect taxes, so they could be the cost of the goods that you paying for plus different taxes you will have to pay on the sale price as well as taxes to be deducted at source the other aspect is also once again we coming back to is

•Exclusivity

Is this person by the goods specifically for you for your website can this vendor provide services another entities if they are providing to different entities what is the price mismatch etc.

• Termination Clause

So what If there is a lock arrangement you are entering into an agreement with the supplier on the guarantee that you will supply and you will purchase goods from him for ex number of years or do you want to be

protected from the sense he will not abruptly terminate the arrangement because you are depending on him for your website you may want to lock in from both angles from the person supplying you from the goods and also from your perspective of you being in a position why that kind of guarantee so your term in and terminations is also something critical especially a lock in arrangement it's good to think through these 2-3 critical heads and when you are looking in the consideration and providing that in brief contract, there could be other legal clauses which is overwhelmed founders come to dispute resolutions, governing law, various other provisions are technical and are fairly standard at least on the commercial aspect it is good to have understanding and have these out in the contracts.

Another type of contract that you could consider are you.

4. Service Contracts

Like we looked at earlier you may not have all services been rendered by employees in-house especially in a start-up stage you may not have the bandwidth to pay employees on a regular basis to provide those kind of services for example you might have certain types of content to be created or let's take the type of your website you may not be able to design your website in-house it's quite common for companies to outsource this activity for which you will have to have a services contract with the person creating your website so here again comes the question of Why do you need a contract for someone who created a website as long as they created and deliver it and paid them their consideration services there is no real need to have a contract with them, so let's see what aspects you need to protect:

For example the originality of the work you would think certain aspects are implied that they will render original work when the work that they are will not infringe any other person's intellectual property rights.

The other critical aspect is who owns the IP and here you are looking at someone who has created the product for you and you are able to use it, but who really owns it again you may think it's implied that ownership vests with you but it's important to spell it out in the contract that anything created by the services providers is owned by you.

Secondly to the extent not owned they assign all rights to work created specifically in your favour, the other aspect is the timelines for payments, sometimes after completion of work sometimes it is assumed that certain portion of work upon paid of signing up from someone and paid up later

TYPES OF CONTRACTS:

5. Customer Contracts

- Legal Liability
- Terms & Conditions
- Nature of Business



Next comes your Customers Contracts who your customers are and why should you have a

5. Contract With Your Customers

That once again depends on the type of services you are rendering and the business is engaged in, if it's a certain types of businesses there no set of contracts what if you are in aggregator of certain products or you're a website as an intermediary let's say medical services or if you just have the customers logging in you are let's see connecting them with medical practitioners on the face of it they could not on the face of it they no need for an agreement with your customers' but then what about

- Legal Liability

What is your exposure as a mere middle man when you are connecting 2 people together so that could be various conversance aggregating insurance policy aggregating medical services or aggregating any other basic information online, what should be your role intermediary or if you are guarantying the quality of certain service it is important to limit your liability to the extend you wish to set out in your arrangement with customers you must have noticed when you log into certain website you have click wrap agreement where you just sign and you are accepting the terms and conditions of that website, many of us really don't read it but that the processes many businesses disclaim liability and you agree to the terms and conditions of that website is offering so if not an actual contract you may want to have certain.

- Basic Conditions

On your website to your customers to know if they actually getting into. Ofcourse the very nature of customer contracts implies that it's a B2C business where you dealing with consumers on a 1 on 1 basis where you not dealing with an end consumer and it's more a B2B business where you just dealing with other entities and engaged in any other type of business.

So only when you are dealing with actually businesses or customers depending upon the type of goods and services you are providing you actually go into what type of contracts you need of what should be documented and what can be preceded on and a mere purchase order basis so at the end of the day some up if it's going to be B2C you need to think through what kind of terms and conditions you want to have with your customers' and how do you want to disclaim liability and if its B2B you may not have a that many terms and conditions and you may be acting merely as a vendor to a 3rd party where standard services agreement.



So it's important for us to make that first investment of 7-10 days versus just going and quickly and on boarding the guy instantly. But that's really the sales cycles, 3-4 weeks for a midsize customer. For an enterprise customer it tends to be much larger, because they go through a lot of hoops. Let me put it that way, you will typically make a proposal or there will be a RFQ. You will go meet the guy a couple of time. You will really explain why they should work with you. Then they will negotiate with you on pricing for 2 weeks or for 4 weeks or 6 weeks, all of the drafting will happen, so we have a standardised contract for the midsize player and a bespoke contract for the enterprise right. So when you do that, the contract goes for 2-3 weeks. So the whole thing can take up to 3 months with an enterprise customer. And with the very small customer, you just have a digital contract on your website, you just log on, just tell us so you could be Sahil@sahiljams.com if I make jams and I say yes I want to use Delhivery service, tick, tick tick, here are my jams, this is where I am, somebody just call me and get started and that will be like two days.

Summary - Contracts



So in this session we started understanding the importance of contracts.



We then moved on to understand the various key aspects involved in contracts:

- a) Terms Of Contract
- b) Termination
- c) Exclusivity
- d) Payment Term
- e) Representation and Warranties And finally
- f) Indemnity



Thereafter, we also looked at the various types of contracts.

We started with founder agreement, second employee agreement .Then,

- Vendor Contracts
- Service Contracts and
- Customer Contracts

Hope you enjoyed this session and I look forward to seeing you soon.

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