Contract Essentials for

Lawyers Advising Start-ups

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Law Insider

Introduction

Start-ups are young companies with high growth potential. Their creators (often called "Founders") typically enter the market with a vision toward disruption, profit, and scaling up.

A Founder's dream is to develop an innovative product or service, introduce it to market, and watch customers fall irrevocably in love with the Founder's brand. Well-known companies like Zoom, Uber, AirBnB, and Instagram grew successfully as aggressive startups; brands like MoviePass and Theranos entered the public awareness as warning signs of hyper-growth.

Good lawyering may not be the obvious cause of start-up success, and bad lawyering probably didn't bring down movie subscriptions and miracle cures. Still, every start-up builds on contracts and they need attorneys to help them create a healthy foundation of agreements.

Good counsel enables the Founder to focus on developing the product and growing their company instead of avoidable legal drama. When you guide Founders well on their most important contracts, they are free to do the work that drives them.

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Your Start-up Client's Goals (and Yours)

As a lawyer, start-up clients can be a boon to your career. A successful start-up might become a sustaining client for the long haul. Their incentives to grow are aligned with yours, leading to an effective partnership.

But the risk to you is also real: the temptation to be all things to your young company client can push you beyond your zone of expertise. You will be part of negotiating, drafting, redrafting, and explaining all sorts of contracts to your client. A start-up's journey from concept to IPO may include partnership agreements, LLC operating agreements, employment contracts, sale contracts, commercial leases, venture agreements, product user agreements, and loan agreements, to name just a few.

There aren't many lawyers who can make a credible claim to such diverse expertise, but sufficient fluency in contract law and a client's unique needs and business model will get you far. Combined with general competence in other commercial areas like employment and compliance, these core competencies will help you confidently and capably advise start-ups with an analytical eye.

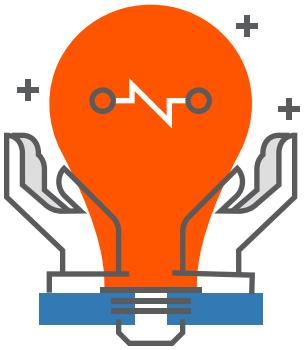
Why You Need This E-Book

As with other professions, the legal field is a bit obsessed with specialization. Certain firms will advertise as the best employment litigation firm, while the firm next door is the best IP firm; you'll find the best tax-law firm just down the street.

In some cases (like tax) a client may be better off hiring someone who can recite IRS code chapter and verse.

But in the world of start-ups, entrepreneurs don't want to rely on (or pay) eleven different firms to handle their day-to-day needs—that's where you come in.

Most attorneys who advise start-ups have an entrepreneurial bent. Are you a solo or small practice leader who knows the framework of starting an elite business? Or are you a litigator who's seen dozens of corporate deals gone wrong? Perhaps you're an in-house attorney in a small team, more similar to a small town generalist solo than a general counsel in a corporate machine. Or are you outside counsel, constantly finding new ways to serve a diverse client base?



Whatever your practice context, you're interested in becoming a value-add to your client instead of being viewed as an expensive fixed cost. How can you provide business value to start-ups based on your training as a lawyer?

By knowing your way around a contract.

What This E-Book Will Teach You

By the end of this guide, you will be able to approach a contract — any contract — with a strong analytical plan to identify:
(1) what the contract actually says, and
(2) what the contract is missing.

Contracts are notorious for their bloated, obtuse language that seems indecipherable to the lay person. This e-book will refresh some of the contract principles you learned in law school and introduce practice points that help you cut to the chase.

Whether advising a start-up client on negotiating an agreement or explaining why a particular contract has led to nasty litigation, understanding key contract elements and effectively explaining them to your client is your chief goal.

This book will show you how to level-up your contract game.

But First, A Word About Templates and Samples

Before digging into the essentials of start-up contracts, can we all admit that we're not writing the great American novel? Our craft does not require perfect originality and none of us really starts from scratch.

Very few attorneys have ever drafted a contract without copying from a starting point; many would be petrified if asked to do so. We have all been trained to start with a "model document" that has been vetted and proofread by generations of older, wiser attorneys.

Model documents used to float around attorneys' inboxes, passed from partner to associate like sacred scrolls handed down from the legal gods. Eventually, the industry figured out how to monetize these models; now they are everywhere.

You might find a sample document in a lawyer Facebook group, or your firm may have some kind of knowledge database, or you might peruse Law Insider for countless sample clauses and contracts. You can even search the phrase "contract template" on Google to find more than two million hits, many leading to template vendors of mixed quality.

In the right hands and when written by serious authors, templates and sample documents can be useful time-saving tools. But if you don't understand the contract principles undergirding the template, you can't quickly assess its quality and usefulness to the client.

As a nod to practical realism, this e-book will not assume you are drafting from scratch. Instead, we will help you assess the quality of your templates, client-provided drafts, or proposed contracts. As you negotiate, you can analyze a document with purpose, rather than read for reading's sake.

Starting Point Strategy

Congratulations! Your new start-up client has sent over a draft contract for you to review. The "draft" is comprised of seven different files totaling well over 200 pages. While it may be tempting to print everything and whip out a fresh red pen straight away, do not do this.

First, take inventory of the components. You will probably find a main agreement plus some attachments and proposed exhibits. These may include an original term sheet and other early-stage negotiation documents. Create an index of what you have to keep track of priority documents. This index will help you visualize which components are finished, under review, or close to being thrown out for lack of relevance or utility.

An index will also help you get to know the agreement components. For example, you might start to think of Exhibit 3 as the "Insurance Rider" rather than generically calling it Exhibit 3. This will avoid awkward conversations with the client after confusing Exhibit 3 with Exhibits 13 and 23.

All of the ancillary documents should flow from the main agreement. In other words, the main agreement is the one that "rules them all." The main agreement will carry the most weight in the event of litigation. Ideally, a table of contents should already exist, allowing the reader to skim the bones of the agreement. If there is no TOC, completing one should go on your list of important early tasks.

After you have organized the mess of electronic files or paper stacks, you should then get to know the main agreement. Don't start marking up the contract on your first review. Instead, while you are reading, take notes of any observations and questions to discuss later with your client. Start learning the order and flow of the various contract components. Don't be afraid to propose big format changes early in the process, before parties develop undue attachments to certain phrases or contract points.

When faced with a dauntingly ugly draft, create a one- or two-sentence summary for each contract section. This should translate the legal point into conversational text. This will slowly develop into an outline of the contract, one you can use to more easily absorb its vast breadth or intricate details.

Taking Inventory of Key Contract Elements

Once you have your contract outline, you can then compare what you have to what you need. If you don't have your own vetted models or templates to guide you, you can check your outline against the key contract elements we'll discuss below.

Scope and Defined Terms

Define the parameters and terminology of the agreement at the beginning. Don't fall into the trap of leaving the glossary of defined terms for post-negotiation drafting. It may seem obvious to your client that the purpose of a lease is to rent space or that a partnership agreement governs the relationship between partners. But a co-venture agreement or finance deal may involve hidden details and pitfalls, particularly if your start-up client is new to the industry.

Your client should fully understand and approve the defined terms as early as possible in the drafting process. Something as ordinary as defining the parties (are individuals signing on behalf of themselves or on behalf of their companies?) can quietly create massive litigation risk for a start-up.

TAKING INVENTORY KEY CONTRACT ELEMENTS (CONTINUED)

Payment Terms

Most commercial agreements involve one party paying money and another party providing a service, product, or other value exchange. Does that remind you of a contracts professor waxing wise about "consideration"?

As you learned in law school, simply stating "Payment will be transmitted within thirty days of contract signing" is insufficient. A contract's payment terms should include precise amounts, or at least a precise formula for determining amounts.

What are the exact payment terms? Are there discrete preconditions to payment? How will payment be transmitted and who bears the risk if a wire transfer goes awry? Depending on the circumstances, penalties for late payment may also be worth an extra bit of negotiation.

Whatever the terms, make sure they're clear in the negotiation phase.

Performance

Another law-school-reminiscent idea, performance (or lack thereof) is the most common reason businesses end up litigating their contracts.

Accusations of laziness, theft, and incompetence abound where contract requirements prove confusing. Whether a manufacturer is tasked with producing widgets or an executive is hammering out a compensation deal, the performance section sets forth the expectations surrounding contract fulfillment.

If you order a wedding cake, for example, simply noting the date of the wedding on the contract is insufficient. The baker will want to know when exactly you expect delivery. Do you want it the night before the reception or 30 minutes prior? You will want to specify details like flavor, number of layers, or possible food allergies.

Similarly, you must extract all the relevant details about performance expectations from your client and communicate those expectations clearly in the contract. Any ambiguities about what constitutes performance creates unnecessary risk for all involved (including you).

TAKING INVENTORY KEY CONTRACT ELEMENTS (CONTINUED)

Assignments and Transfers

Start-ups sometimes revolve around one or a small set of visionaries who are directly tied to the future success of the venture.

Perhaps your client has linked up with an angel investor who has an excellent track record for mentoring small companies into commercial behemoths. The investment agreement should name the companies as parties, rather than any rockstar individuals.

If your angel investor takes an early retirement six months later and hands the company reigns over to her less-inspiring younger brother, does that change the mechanics of your contract? Perhaps the brother decides to cash out and sells the entire portfolio to a Swiss conglomerate with a very different corporate culture, one that does not align with your client's brand. What then?

The legality of all this depends on whether the governing contract allows for parties to transfer or sell their interest to an outsider. In some cases, transfer or assignment can only occur with another party's approval (which cannot be "unreasonably withheld"). Or a contract may contain an escape clause, allowing for early termination (or even rescission) if a "material change" in company ownership occurs.

Whatever the case, good counsel should nail down transfer and assignment details in advance.

TAKING INVENTORY KEY CONTRACT ELEMENTS (CONTINUED)

Confidentiality and Trade Secrets

A start-up's early value is derived mainly from its concept, made more valuable if it is original. How will you protect that original idea?

First, train your clients to connect terms like "concept" or "business model" to the more legalistic concept of "trade secret." Every new idea is not in fact a trade secret, but if your client gets a bad feeling about exposing an important idea, better to feel reserved about sharing it.

Do you lock your car doors when parking in a shopping-center garage? The chances that your unlocked car will be broken into are slim in many areas, but we still default to protecting what is ours. In the same way, you should default to locking up your client's trade secrets via a confidentiality clause when doing business with outsiders.

Do not assume that an investor, a bank, an IT service provider, or the janitorial service that empties the office trash has your client's best interests at heart.

Intellectual Property

A start-up's concept is key to its success. This is true both at the early stages, when there isn't much else to the start-up, and later on, when the concept has developed into unique products and services, not to mention a brand with independent value.

Any contract that involves collaborating with outsiders (e.g., independent contractors, consultants, investors, new employees) can potentially put the start-up's intellectual property ("IP") at risk.

Once IP has negotiable value, it can be used as collateral in a finance agreement, as an asset similar to real property or cash reserves. You must protect your client's IP in every contract. Employees and independent contractors should have a clear understanding of IP ownership when they are contributing to the design or value of company IP.

TAKING INVENTORY KEY CONTRACT ELEMENTS (CONTINUED)

Insurance

Insurance is the heartbeat of commercial litigation.

At the beginning of the client relationship, a savvy start-up attorney will offer to review the start-up's present insurance policies to confirm adequate protection under fair terms. This should be done before any crises or lawsuits necessitating a policy claim occur.

As for the start-up's other non-policyholder contracts, any contract involving substantial money likely has one or more provisions requiring that a party obtain insurance and/or agree to indemnify others under specific circumstances.

Neglecting to insert and double-check insurance provisions can have devastating consequences. Insurance clauses are often dense and incomprehensible. Your job is to understand what your client wants, needs, and expects. Only then can you communicate that to your fellow negotiators and work toward drafting language that captures the parties' common view on insurance requirements.

Exit Strategies

Few commercial contracts are meant to bind parties in perpetuity. Just as good fences make good neighbors, a contract should clearly identify its intended life span.

Will the contract automatically renew with the same terms if no one takes action to the contrary? Or does renewal require a periodic revisiting of terms to which everyone must consent?

Along those lines, the contract should spell out the conditions and procedure for an individual party's withdrawal from the agreement. It should also define what conduct will result in contract cancellation, termination, or expulsion of any individual party.

TAKING INVENTORY KEY CONTRACT ELEMENTS (CONTINUED)

Dispute Resolution

Non-litigators do not like drafting or negotiating dispute resolution ("DR") clauses. They are similar to prenuptial agreements in that the parties are deciding in advance how to resolve disagreements if someone fails to deliver on their end of the contract.

Embrace the discomfort when advising start-ups. Don't fall into the trap of cutting and pasting DR clauses from past contracts. The old clause may be (and usually is) insufficiently tailored to meet the needs of your client.

A DR clause need not be long and complicated but it should accurately capture the parties' mutual intent as to resolving intractable disputes.

Here are some key questions to ask when drafting your DR clause:

Arbitration or litigation? Pick your poison. Arbitration is private, potentially faster, and usually requires more upfront costs to hire a private arbitrator and/or engage a reputable arbitral institution. Litigation is public, time-consuming, and sometimes will lead to amicable settlement as the marathon of time and expense convinces everyone to just make a deal. The choices may not be that attractive, but making the selection in advance is better than an adversary or judge making the choice for you in the midst of a business dispute. You may even consider a tiered approach as disagreements escalate from negotiation to mediation to arbitration.

Which jurisdiction? Though remote proceedings are more common today, you and your client may have to physically appear in court, so geography matters. While picking your client's headquarter jurisdiction may be tempting, you must still research the pros and cons of that versus other possibilities. More than one attorney has faced malpractice charges for failing to adequately investigate jurisdictional options and locking their client into an adverse legal climate.

Which venue? If you specifically want federal court versus state court or a commercial division versus a general civil court, be specific about those desires. Even if your client doesn't care, it's your job to present an informed choice. Alternatively, picture yourself spending six months (or longer) arguing the finer points of default venue rules and explaining the resulting billable charges to your client.

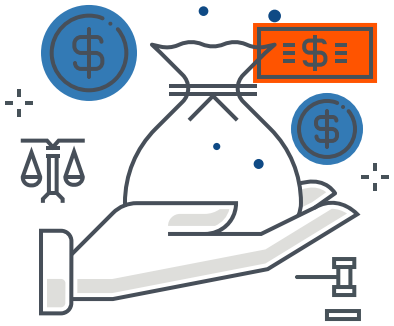
Which governing law? Selecting a particular court in a particular state doesn't automatically lead to application of local law during a contract dispute. One may select California law to govern a contract, even if the selected jurisdiction is New York. Arbitration offers even more flexibility to mix-and-match laws, venues, and jurisdictions.

TAKING INVENTORY KEY CONTRACT ELEMENTS (CONTINUED)

Attorney Fees

United States legal tradition mandates that each party is responsible for their own attorney fees, win or lose, unless there is a contract or statute to the contrary.

Do not underestimate the cost of litigation and consider whether a "prevailing party picks up the tab" clause makes sense. Also, beware the "one-way attorney fees" clause! There are several jurisdictions that will honor a one-sided attorney fee clause, allocating the power to collect fees only to the party smart enough to negotiate for that right.



Last Words: Clarity, Brevity, and Value

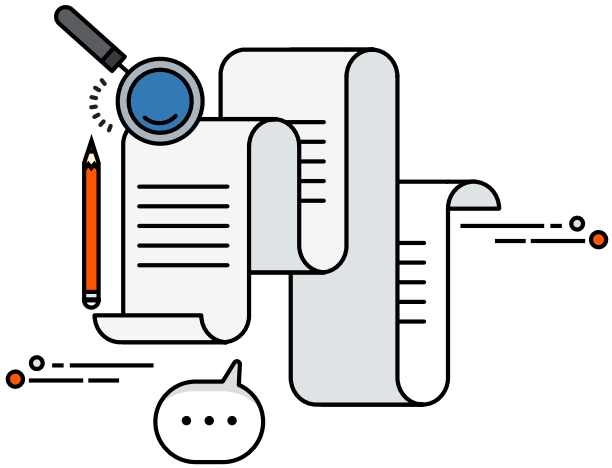
Most start-up clients appreciate an attorney who acknowledges that commercial contracts tend to be long, dense, and repetitive.

You may not be able to revolutionize the instrument itself, but you can approach the task thoughtfully and teach your clients to do so as well. If a clause is wrenchingly dull and confusing, embrace the challenge.

You can champion clarity and brevity both to your client and to whomever you are negotiating against. Don't be afraid to propose significant format changes early in the process, before parties develop undue attachments to certain phrases or contract points.

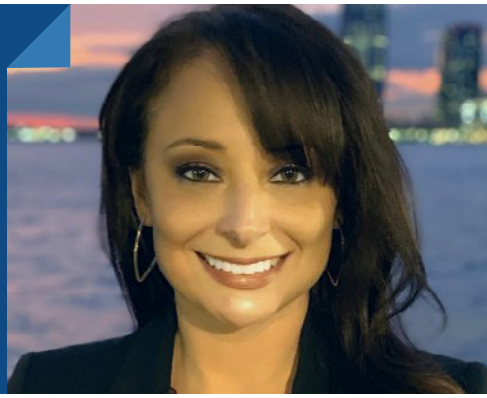
Attorneys who cling to "this is how we've always done it" are rarely bringing value to the table. Your client may not thank you for all the lawsuits you have avoided, but your track record will speak for itself.

With that value focus and the contract essentials presented in this ebook, you'll be well on your way to improving your standing with clients.



ABOUT

Linda Maria Wayner



Linda Maria Wayner is an attorney and international problem-solver, serving individuals, businesses, and diplomats. She specializes in commercial arbitration, employment discrimination, and resolving domestic legal conflicts which involve consular or diplomatic parties. Her clients are primarily foreign businesses, individual executives, global non-profits, and foreign government entities.

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