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Making Effective Contracts: To Advance Organizational Success in a Changing Competitive Marketplace

APICS – [REDACTED] Woburn, Massachusetts , April 13, 2010

- Selling Products or Services
- Developing Custom Software
- Licensing Technology
- Distribution of Products
- Subcontracting other Consultants

By Robert A. Adelson

EXAMPLE (Hypothetical and Fictitious)

DreamSoft Consultants – Making Effective Contracts

Suppliers (Buying)	DREAMSOFT	Customers (Selling)
	CONSULTANT	
-Service Subcontractor		Licensg/ Software Dev
	Waltham, MA	
-Equipment Vendor	Cambridge, MA	VAR/ Distributor

The Team (Producing) – “Partners”

Stephanie “Steve” Sprielsberg formed DreamSoft Consultants several years ago and now has offices in Waltham and Cambridge. Her software work has picked up lately and contracts questions have arisen.

To help work flow Sprielsberg hired subcontractor Ford Harrison full time, but recently Sprielsberg worries Ford might get a fulltime job with one of Ford’s top customers MCA or work for Sprielsberg’s rival Georgia Lucas. Fortunately, Sprielsberg got Ford to sign an NDA when he started, but Ford still says he can use what he knows however he wants. Dreamsoft cash flow problems also worsen their relations.

However, at least Ford does a good job. Sprielsberg though is angry about poor performing *AI* and *Minority Report* equipment and a threatened infringement suit over the *Coming to America* program-all bought from shrewd vendor Tomasina Cruz. Problems have harmed Dreamsoft’s output and reputation. Tom offers to repair or replace defects or refund part of the purchase price paid, but...“Only if the fault isn’t from your misuse! Read your PO, Steve: it’s in BOLD face!”

Besides Cruz, Sprielsberg has problems with the ever changing demands of MCA as DreamSoft develops Sprielsberg’s *Indy Jones4*, adding first the Connery and now the Flockhart applications, claiming each covered by the original deal. Dreamsoft is paid against acceptance and MCA is a tough tester, and even threatens to make the changes needed itself (taking the source code from escrow) if Steve can’t meet deadline.

There are also problems with DreamSoft’s longstanding royalties from *Jurassic PK* program Sprielsberg gave over to VAR Jackie Valenti years ago. Jackie gets 80% on her sales but she doesn’t sell or market much. Per their old handshake deal, the split is 50/50 on royalties from big reseller Paramount Jackie lined up but she threatens to pay Dreamsoft 20% if there’s not renewal of her contract (ends 3 years). Steve wants it over now.

One place Sprielsberg is glad she has no contract is with her new “sort of” partner. Sprielsberg talked with Jessie Katzenberg who had a lucrative job with DizkneeSoft. Boss CEO Michelle Estner fired Jessie, who never saw her office again. Despite other offers, a 50-50 partnership with Sprielsberg attracted Jessie. She put time and money into the Cambridge office, neglected since Sprielsberg’s last partner Dave Griffin left (who programmed much of pioneer *ET* and *Jaws* programs still lucrative to Dreamsoft but Sprielsberg dismisses his “work for hire” since nothing formal was signed). Now, Jessie’s drive, cash and contacts revived Cambridge and Sprielsberg is glad they signed nothing. “OK Jess”, she recently said “I’ll get the lawyers to finish a buy-in for you. You’ve been doing great managing Cambridge – keep it up.” Jessie bristles being called a manager since she left Dizknee to be partner not employee, but Sprielsberg is happy keeping it oral so if Jess makes trouble, she’ll fire her too.

Sprielsberg’s lawyer charged plenty for a “draft” LLC and handled her divorce from hubbie Griffin. Steve seeks an IP lawyer who knows contracts to: put off/fire Jessie, stop Ford’s poaching, get damages from Cruz, better terms with MCA & speedy end with Valenti. She’s now arrived at Rob Adelson’s office.

What should I be looking for in my contracts?

What makes for a good and valid contract?

...And Other Questions to ask along with finally –

When is a good time to ask Rob Adelson’s help?

1. What makes a contract enforceable? Do I need a signature? Can we use fax or e-mail? Can we use click-through?
2. Are there times when I don’t want the contract to be enforceable? What should I say or do so not to be bound? Can an oral contract bind me?
3. What makes a good contract? What are you setting out to accomplish? Are you planning ahead? Are you relying upon any

- special facts or circumstances to occur? Was there something said you rely on?
4. Are you hiring a subcontractor? Is he or she 1099 or W2? Full-time or part-time? Who controls the work? Is risk of payment shared? Is the project “work for hire”? Are you concerned about contractor “poaching” clients?
 5. Are you buying or selling equipment or products? What warranties offered on quality, service or performance? Against IP infringement? Remedies?
 6. What are your compensation terms? Are you paid by hourly/day or the job? Do you get an advance/retainer? Are you paid/reimbursed expenses? Are non-cash considerations used? Do you get equity or debt? On what terms?
 7. Are you hiring or offering services? What warranties exist on experience, standards compliance? Reports, deliverables? What restrictive covenants – confidentiality? nonsolicitation? Noncompete? Scope and Considerations?
 8. Are you doing software development? Who owns IP? What specifications what payment milestones, what protections against changes asked?
 9. Do you have a VAR/ Rep/ Distributor agreement? Is it exclusive? What territories, applications are covered? Royalties determination? What Quotas and what obligations, stocking, customer service? Rights on termination?

MAKING A VALID CONTRACT

► What makes them unenforceable?

- Parties / Subject Matter
- Consideration
- Completion / Finality
- Mutual Assent – normally signed assent
- Electronic Agreement / Elements for valid E-contracts

► When to leave things unenforceable?

- Due Diligence in process
- Playing the field / Other offers in process
- Need based on other factors – Hedge bets, see what happens
- Financing and other contingencies

► Can Oral contracts be enforced too?

- Enforceable elements (see above) need to be met orally
- Party seeking enforcement acts in Reliance upon oral contract
- Doctrine of Implied Contract despite absence of signed document
- Party denying enforcement has received benefits from oral deal
- Doctrine of Unjust Enrichment to force disgorgement of profits

MAKING A GOOD CONTRACT

► *Mission – Define mission, Cover the scope of contract*

- What do you want to accomplish now? In next several years?
- What else is effected by this service or product

► *Conditions – State Variables, Contingencies to performance*

- What assumptions are made that would cause a back-out or change deal?
- Hedging your bet on things turning out as you expect & need them to occur

MAKING GOOD ON CONTRACT (Continued)

► *Reliance – State Warranties/representations made each side*

- Has there been “touting” some aspect or quality of product or service
- Was there reliance so that if it did not occur you would not have agreed

► Consideration – What each contributes regardless of form

- What are the motives for this deal – How are you being paid
- Cash – if so what payment terms? Equity – recite all terms of equity
- Non-cash considerations? Technology Back-license? Contacts? Experience?

► Mutuality - Requiring each party to contract to “ante up”

- The considerations by both parties need to be recited
- These need to be real considerations – new things each offers to other

► Commitment – Mutual vulnerability & Remedies to default

- Bargaining positions dictate vulnerability in timing of contributions
- Clarity in conditions, contingencies – penalties for breach /failure to close
- Rights on termination of agreement including surviving covenants

SEEKING GOOD CONTRACT VALUE

► How to cut legal costs to enforce the contract

- Greater the uncertainty – greater litigation risks
- Legal \$\$ upfront for clear contract save \$\$\$\$ in dispute /litigation

► When should I seek Rob Adelson’s help?

- When you think you have a deal – that terms important to you covered
- Do a businessman’s term sheet – what you think you agree on
- State non-binding – Each side to review – Attorney draft binding contract

Production/ Supply Contracts /Purchase Orders

1. Battle of Forms: Buyer PO, Seller Invoice, UCC
2. Price: changes, adjustments
3. Payment and Credit Terms
4. Conditional sales, security interest
5. Delivery, Orders, Risk of Loss
6. Second Source v. Requirements contract: Notice of Delay; Right to cover; Ramp-Up; forecasts
7. Inspection; Acceptance; Repair
8. Warranties: Copyright/ IP infringement, legal compliance, express or implied product warranties, damages
9. Liabilities, Remedies and Damages: Incidental (mitigation), Consequential loss, period of time to seek damages
10. Term; termination; Return Buyer’s Property; Information, trade secrets
11. Miscellaneous: Assignment, change orders, integration, arbitration, attorney fees, jurisdiction

Subcontractor / Service Provider Agreements

1. Specific Duties: Ongoing Responsibilities, Particular job, assignment, work excluded
2. Independent contractor status
3. Reports and Deliverables: reporting function
4. Fees/ Compensation: periodic (hr. wk., mo.) Cost plus overhead, project milestone payments
5. Personnel/ Staffing: qualifications, requirements
6. Manner of Performance: legal reqs., standards
7. Ownership of Proprietary Rights: copyrights, work for hire, inventions, new and existing trade sec.

8. Insurance Coverage/ Independent Contractor
9. Warranties etc.: Copyright/ IP infringement compliance with law; Express or implied product warranties; Incidental or consequential damages
10. Term; Termination; short notice period; return of client information, plans, materials
11. Confidentiality: proprietary info., exceptions
12. Surviving Restrictive Covenants: No assignments for competitors, no solicitation of client's customers, no hiring of service provider personnel

Software Development Agreements

1. Design Specifications: Function, Response Time, Platform, system compatibility
2. Deliverables: Code, documentation, components, reports/ tests
3. Schedule and Performance Milestones
4. Payment: periodic, cost +, milestone
5. Ownership of IP Proprietary Rights
6. Facilities and Cooperation
7. Files Conversion: Training and Installation Support
8. Acceptance and Testing
9. Warranties etc.: no (known) copyright infringement, compliance with law, regulatory standards, no express or implied product warranties, no incidental or consequential damages
10. Indemnity on infringement
11. Maintenance after Initial Warranty
12. Source Code Escrow
13. Term; Termination; short notice period; return of client information, plans materials
14. Confidentiality: proprietary info., exceptions
15. Surviving Restrictive Covenants: No assignments for competitors, no hiring of service provider personnel
16. Miscellaneous: assignment, subcontracting work, force majeure
17. Other User Issues: Progress reports, response time warranties, staffing, most favored customer

Dealer and Distributor Agreements

1. Territory: Customers, market, geographic division
2. Exclusive or Non-Exclusive
3. Relationship/ Statutory Requirements
4. Sales levels: Minimum, inventory, staffing, best efforts, loss of exclusivity
5. Pricing: Discounts, volume discounts
6. Credit terms
7. Product Availability and Allocation
8. Parts, Supplies, Service
9. Marketing and Promotional Arrangements
10. Order Entry
11. Sales Contract Terms (same issues PO p.5 above)
12. Termination: Supplier Rights: Selling existing inventory, successor buy back
13. Termination: Return Buyer's Property: information, trade secrets, tools, equipment, materials, no use of trademarks
14. Miscellaneous: Assignment, change orders, integration, arbitration, attorney fees, jurisdiction

Sales Representative Agreements

1. Alternative to direct sales – customized svcs/products
2. Installation, training and other services
3. Paid on commission or discount basis (if stocking rep) Not Agent, no authority to act for supplier

Value Added Reseller Agreements

1. Scope of License
2. Pricing and Payment Terms
3. Value Added contributions
4. Exclusivity; multiple channel issues
5. Product delivery; Source code
6. Protections of Proprietary Rights
7. Non-competition

8. Termination, Warranties and Other standard Supplier/Distributor issue

Product Licensing

1. Types: Use Manufacture, Distribution, Trademarks, Licenses, OEM, VAR Agreements
2. License Terms
 1. Grant, Field of Use, Exclusivity
 2. Improvement, Back Licenses
 3. Royalties and Audit Reports
 4. Intellectual Property Protection
 5. Warranties, Liabilities, Expert Controls
3. Software Licensing Issues
 1. Source Code, Object Code, Escrows
 2. Manufacture limitations, Modifications
 3. Shrinkwrap, Clickwrap licenses, Enhancements

ABOUT THE SPEAKER AND PRESENTATION

These materials were prepared by Robert A. Adelson, Esq., Partner at Engel & Schultz, LLP, 265 Franklin Street, Suite 1801, Boston, MA 02110, (617) 951-9980, fax: (617) 951-0048, e-mail: radelson@engelschultz.com

Mr. Adelson is a graduate of Boston University, *Phi Beta Kappa*, and Northwestern University Law School in Chicago where he was a member of *Law Review*. He has an LL.M. degree in Taxation from New York University, and is a member of the Massachusetts, New York and U.S. Tax Court Bars. He began his legal career in 1977 as an associate at major New York City law firms, first Dewey Ballantine and later Weil Gotshal & Manges, before returning home to Massachusetts in 1985, where he has been a partner at several Boston firms before joining his present firm as senior business law partner in 2004.

Mr. Adelson is specialized in corporate, taxation, business and technology transactions. In those areas, he frequently represents (1) small companies with their various business needs, including shareholder and employee issues, financing, commercial contracts, intellectual property, joint ventures, mergers and acquisitions, succession planning (2) senior executives, in negotiations over severance, employment, relocation, stock options, compensation and stockholder arrangements, and (3) consultants – in liability protection, intellectual property protection, trade identification, vendor, client and subcontractor arrangements.

Mr. Adelson's firm, Engel & Schultz, LLP, is a small but broad service law firm of 6 attorneys in Boston's Financial District. The firm complements Mr. Adelson's work in business and tax law with seasoned attorneys in family, probate, real estate and litigation matters.

Mr. Adelson is a frequent speaker at business forums and Chairman of IEEE Boston Entrepreneurs Network www.boston-enet.org. Further information on Mr. Adelson's background and his past published articles is available at his law firm website. To view many of Mr. Adelson's past articles, see <http://www.engelschultz.com/index.php/category/publications/> or <http://robadelson.wordpress.com/>

The speaker thanks **Kenneth Glasser** for the invitation to speak for **APICS – The Educational Society for Resource Management**, North Shore Chapter on the topic of *"Making Good Contracts: To Advance Organizational Success in a Changing and Competitive Marketplace"* at the Bickford's Grille, Woburn, Massachusetts on April 13, 2010.

The example on page 1 of these Materials are hypothetical and fictitious although the questions on page 2 are drawn from actual client questions. The purpose of the example is solely to illustrate contracts issues, strategy and planning concepts and stimulate meeting discussion. The remainder of these materials are to offer rough outlines of broad areas of major contracting situations for technology based business. It is hoped that these materials will inform discussion and be useful reminder of topics covered for the attendees. These materials are not legal advice and not intended as any substitute for professional advice or counsel in a particular case.

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