

Project Contracts

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PMG323

Lecture 6



Contract Terms

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PMG 323

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Lecture

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- Confidentiality/Confidential Information

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Fees/Pricing/Fees and Payments

FEES\PRICING\FEES and PAYMENTS

Fees/Pricing/Fees and Payments

Payment clauses generally provide for the time and manner of payment, along with interest in the event of late payments.

Here is a typical clause:

Client agrees to pay all of the Professional Services Fees described in Schedule “B” to this Agreement. All invoices for fees charged by Company in connection with the Services shall be due and payable within 30 days from receipt. Interest will accrue at a rate of eighteen percent (18%) per annum (or the maximum rate permitted by applicable law, whichever is lower) on all amounts that are overdue and shall be payable by Client to Company upon demand. No payment shall be deemed overdue if received net 30 of the invoice date. Client agrees to pay all fees and costs of collection, including all attorney fees.

Fees/Pricing/Fees and Payments

It is easy to focus too much on the legalese of a “payments” or “fees” clause and miss the key issues. When is payment due and for what? In this example, carefully scrutinize Schedule B, which might say something like the following:

Professional Services Fees

(a) Client agrees to pay the hourly rates described below for Services requested by Client:

Senior Developers - \$200 per hour

Business Analysts - \$175 per hour

Junior Developers - \$150 per hour

Fees/Pricing/Fees and Payments

It is easy to focus too much on the legalese of a “payments” or “fees” clause and miss the key issues. When is payment due and for what? In this example, carefully scrutinize Schedule B, which might say something like the following:

Professional Services Fees

(b) Client further agrees that work performed outside of Company’s Normal Working Hours shall be billed at 1.5x the rates noted above.

In this example, it might be wise to suggest language in the Fees paragraph requiring all invoices to detail the work performed by each type of worker. It might also make sense to cap the total amount billed in a given month absent written permission to exceed the cap.

Fees/Pricing/Fees and Payments

Sometimes payments are required in advance of performance, sometimes after performance, and sometimes along the way as milestones are met. Buyers should generally try to avoid or limit advance payments. If the other party's performance falls short of expectations it is always easier to force corrections or fee reductions before payments have been made.

Another concern worth noting is the fact that prepaid fees are generally not recoverable if the other party declares bankruptcy. On the other hand, the performing party may have legitimate reasons for seeking full or partial payment up front, particularly if expensive materials must be bought, new employees hired, or other lucrative work foregone.

Fees/Pricing/Fees and Payments

In such cases, the buyer should carefully negotiate milestone payments – i.e., an upfront payment to cover materials, progress payments upon the completion of measureable or otherwise quantifiable milestones, and a final payment upon completion and “acceptance,” a concept discussed below.

The buyer should also insist on clauses suspending payment obligations in the event of the other party’s non-performance.

Intellectual Property/Proprietary Rights

Intellectual Property/Proprietary Rights

Discussions of intellectual property rights come in many forms and under various headings, including “*Proprietary Rights*,” “*Intellectual Property*,” “*Inventions, Copyrights and Patents*,” “*Content and Marks*,” and “*Ownership of Deliverables*.”

Intellectual property issues are among the most difficult for non-lawyers to adequately understand and address. Consider seeking competent counsel to help with any agreement involving the creation, modification or transfer of important intellectual property rights. The scope, nature and complexity of the issues and potential problems surrounding intellectual property rights are issues that exceed the limits

Some of the general concerns, however, include:

- Protecting trade secrets and other proprietary information through appropriate confidentiality and ownership clauses;
- Ensuring, where appropriate, that you are the sole owner of any intellectual property being created for you as “work for hire” by the other party;
- Clarifying who owns and controls intellectual property rights that arise in the course of the relationship;

Some of the general concerns, however, include:

- Ensuring that any licenses to intellectual property contain all of the appropriate terminology to fully and accurately capture the parties' understanding; and
- Requiring the other party to sign documents or take other appropriate steps as appropriate to perfect or protect your intellectual property rights arising under the agreement and giving you a "power of attorney" to sign on the other party's behalf in the event of their unavailability or unwillingness to take such steps.

Example:

Here is an intellectual property clause defining Party A's very limited rights to use Party B's intellectual property. In this case, Party A might be subscribing to an online data or research facility operated by Party B:

Company A acknowledges that in conjunction with the Service, it will obtain access to Proprietary Items (as defined below). The Proprietary Items are trade secrets and proprietary property of Company B, having great commercial value to Company B. All Proprietary Items provided to Company A under this Agreement are being provided on a strictly confidential and limited use basis. Company A shall not, except as expressly permitted by this Agreement, directly or indirectly, communicate, publish, display, loan, give or otherwise disclose any Proprietary Item to any person or entity, or permit any person or entity to have access to or possession of any Proprietary Item.

Example:

Here is an intellectual property clause defining Party A's very limited rights to use Party B's intellectual property. In this case, Party A might be subscribing to an online data or research facility operated by Party B:

Title to all Proprietary Items and all related patent, copyright, trademark, trade secret, intellectual property and other ownership rights shall be and remain exclusively with Company B, even with respect to such items that were created by Company B specifically for or on behalf of Company A. This Agreement is not an agreement of sale, and no title, patent, copyright, trademark, trade secret, intellectual property or other ownership rights to any Proprietary Items are transferred to Company A by virtue of this Agreement. Company A agrees to use the Service and the Proprietary Items solely for its own internal use or benefit and not to provide or otherwise make available, in any form, any portion of the Service or any data generated by the Service to any person or organization other than Company A.

“Work for Hire” Issues

Copyright principles are a common source of confusion for inexperienced contract drafters. Many persons intuitively assume, for example, that the act of hiring and paying someone to create written or artistic content automatically transfers ownership of the content created to the party paying for it.

Under copyright law, the person who *creates* “original works of authorship,” including literary, dramatic, musical, artistic, and certain other intellectual works, is the copyright owner.

“Work for Hire” Issues

The phrase “work made for hire” comes from the U.S. Copyright Act of 1976 and it alters the default rule of copyright ownership. Ordinarily, an author automatically owns the copyright to a work upon its creation. But where “work made for hire” provisions are properly used, the person paying for the work, not the creator, is treated as its author.

Example of “Work for Hire” Issues

Pacific Rim Creative acknowledges and agrees that all Content, Marketing Materials, Video Footage and other content and material created hereunder for Rainy City Walking Sticks (“Works”) shall constitute “Work for Hire” and Pacific Rim Creative further acknowledges and agrees that the Works and all rights therein, including but not limited to copyrights or patentable inventions, belong solely to Rainy City Walking Sticks. Should the Works or any part thereof not be considered a work made for hire under applicable law for any reason, Pacific Rim Creative hereby sells, assigns, and transfers to Rainy City Walking Sticks and its successors and assigns, all right, title and interest in and to the copyright in the Works, including any registrations and copyright applications relating to the works and in and to all works based upon, derived from, or incorporating the Works throughout the world.

“Work for Hire” Issues

Further, be careful to strike any text that conflicts with the “work for hire” language. Some third party templates with “work for hire” provisions also include language suggesting that the intellectual property rights will be transferred to the purchaser upon payment of all fees owed under the agreement. Such provisions inherently contradict the concept of “work for hire” and should be avoided.

Patent Law Issues

Similar intellectual property rights issues can arise under patent law. A patent for an invention is the grant of a property right to the inventor, issued by the United States Patent and Trademark Office. A patent grants an inventor the right to exclude others from making, using, offering for sale, or selling the invention in the United States or importing the invention into the United States.

Patents fall into two primary categories, utility patents and design patents:

- Utility patents may be granted to anyone who invents or discovers any new and useful process, machine, article of manufacture, or composition of matter, or any new and useful improvement thereof.
- Design patents may be granted to anyone who invents a new, original, and ornamental design for an article of manufacture.

Patent Law Issues

Similar intellectual property rights issues can arise under patent law. A patent for an invention is the grant of a property right to the inventor, issued by the United States Patent and Trademark Office. A patent grants an inventor the right to exclude others from making, using, offering for sale, or selling the invention in the United States or importing the invention into the United States.

Patents fall into two primary categories, utility patents and design patents:

- Virtually any business relationship with a consultant, developer, engineer, or other party in a technical, creative or problem solving capacity is capable of producing rights subject to patent protection and, hence, worth addressing with appropriate language. A product company with a strong negotiating position might be able to impose provisions on an engineering or industrial design firm

Patent Law Issues

Creative and technical experts are often quite sophisticated about protecting their own interests and will often propose language to do so. Most commonly, they will argue that they come to the relationship with substantial intellectual property of their own that is likely to find its way into the “deliverables” and that assigning away such rights exceeds the value of the agreement in question. Proposed language to address their concerns might look like the following:

Example:

Notwithstanding any other provision of this Agreement to the contrary, this Agreement does not obligate Industrial Solutions, Inc. to assign or offer to assign to Big Manufacturer, Inc. any rights in any invention for which no equipment, supplies, facilities or trade secret information of Big Manufacturer, Inc. was used and which was developed entirely by Industrial Solutions, Inc. prior to the Effective Date of the Agreement (“Retained Intellectual Property Rights”), whether or not incorporated into any Inventions. Industrial Solutions, Inc. agrees to let Big Manufacturer, Inc. use any Retained Intellectual Property Rights that are incorporated into any Inventions in Big Manufacturer’s business.

Patent Law Issues

At a minimum, where issues like these arise, ensure that the other party grants you a global, unlimited, perpetual, non-exclusive, royalty-free, worldwide license to use, practice and transfer any such inventions. Even with that suggested fix, the license granted would be “nonexclusive,” allowing the other party to share the same “retained intellectual property” with others, including your competitors. This may or may not be a problem.

As noted at the outset, intellectual property issues can be some of the most challenging for non-lawyers. If the stakes are high, consider bringing in competent counsel for assistance.



Confidentiality/Confidential Information

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Confidentiality/Confidential Information

Confidentiality/Confidential Information Chapter Three, Negotiation, addressed the need to protect confidential information from misuse and disclosure. Before providing sensitive information to another party in a negotiation, require the other party to sign a reasonably restrictive NDA.

The same types of restrictions against misuse and improper disclosure need to be included in any commercial agreement.



Example of Confidentiality/Confidential Information

Protection of Proprietary Information. Each party acknowledges that in the course of performing its obligations hereunder, it will receive information ("Proprietary Information") which is confidential or proprietary to the other. Each party shall not use or disclose the other party's Proprietary Information except as contemplated herein, and shall not disclose such Proprietary Information to any third party except to employees who participate directly in the performance of the receiving party's obligations hereunder and disclosures to such employees shall be subject to such employees being bound by written obligations of confidentiality and non-use with respect to the other party's Proprietary Information that are at least as restrictive as the provisions of this Article 11. The parties hereto hereby agree that they shall not use or disclose the other party's Proprietary Information in order to develop products or services that directly or indirectly compete with the disclosing party's products or services.

Example of Confidentiality/Confidential Information

Each party shall protect and safeguard the Proprietary Information of the other party using at least the same degree of care such party uses to protect its own confidential information of like importance, which in any event shall be at least industry standard levels of protection as appropriate for the nature of the Proprietary Information.

Proprietary Information Defined. For purposes of this Agreement, Proprietary Information includes any information and data which is, or should be reasonably understood to be, confidential or proprietary to the disclosing party, which may include, without limitation, information relating to proprietary technical, financial, personnel, marketing, pricing, sales, customer lists, and/or commercial information with respect to the products and services of the parties, as well as ideas, concepts, designs, computer programs (including source code, object code and APIs) and inventions and all record bearing media containing or disclosing such Proprietary Information which are disclosed pursuant to this Agreement, provided

Example of Confidentiality/Confidential Information

however, oral disclosures of Proprietary Information shall only be treated as such for purposes of this Agreement if:

(i) at the time of the disclosure the information is identified as Proprietary Information;
and (ii) the Proprietary Information is reduced to writing and provided to the receiving party within seven (7) business days of initial disclosure, such writing to identify: (x) the nature of the Proprietary Information; (y) the date and time of disclosure; and (z) the parties present at the time of disclosure.

Similar protections should always be included in a company's Terms of Use or Terms and Conditions, whether delivered online or otherwise in-connection with its products or services.

Term and Termination

Term and Termination

Term and Termination provisions determine when a contract starts and when it ends. They also determine, in many cases, why and how it ends. Before signing a contract, you should have a clear understanding of how long each of the parties will be bound. Negotiating advantageous Term and Termination provisions requires asking oneself questions about the future and about how the relationship might play out.

“What If”

Asking the right termination and other remedy-related questions and addressing them in an agreement requires creative thinking, not unlike the “thought experiments” of philosophers and scientists – essentially, lots of “what if” questions.

In theory, each party is interested in locking up the other party on favorable terms for the longest period that suits that party’s interest, ideally with flexible, unilateral rights of termination in case the other party underperforms or a better opportunity comes along.

Unless one of the parties is in a dominant negotiating position, the parties’ competing interests and pressures to compromise often drive contracts toward fairly generic Term and Termination clauses.

Auto-Renewal

As a starting point, with many types of agreements, one year contract terms are fairly common, as are provisions stating that the agreement will “auto-renew” for additional one year terms unless either party gives notice of its intent to not renew within a prescribed number of days prior to renewal. Auto-renewal provisions are helpful for preventing situations where parties realize their contract has inadvertently been allowed to lapse, which can raise concerning issues about their respective rights and obligations.

Conversely, realizing belatedly that an undesirable contract has autorenewed can be equally troubling, as was the case recently with the unhappy customer of a commercial uniform company. In this case, the customer realized just a few days too late that their overpriced Uniform Supply Agreement had just auto-renewed for another five years. The uniform company stubbornly refused to let the customer out of the agreement.

Termination for Convenience

As discussed below, mutual rights to terminate at will or “for convenience” after a short “notice” period are common in some types of contracts and less common in others, often depending on the importance of the relationship to one or both parties. Consulting agreements, for example, often have mutual rights of termination for convenience with little or no notice. Commercial uniform supply agreements are apparently much stickier.

Termination for Breach or Insolvency

Rights to terminate for “cause,” or “breach,” however, are common, as are rights to terminate if the other party enters bankruptcy or ceases to do business. In fact, the word “breach” commonly only appears in clauses describing rights of termination.

Here is a typical Term and Termination clause:

Term and Termination. The initial term of this Agreement shall begin on the Effective Date and end one year thereafter, unless extended prior to termination by mutual written agreement of the parties (the “Term”). In addition to termination rights elsewhere set forth in this Agreement, this Agreement may be terminated as follows: Either party may terminate this Agreement at any time during the Term upon thirty (30) days’ prior written notice to the other party, if such other party breaches any term or condition of this Agreement and fails to cure such breach within the thirty (30) day cure period. Either party may terminate this Agreement at any time during the Term, immediately upon written notice to the other party, if such other party ceases to conduct business in the normal course (other than through acquisition or merger, if the successor or survivor continues to perform such party’s obligations hereunder), makes an assignment for the benefit of creditors, is liquidated or otherwise dissolved, becomes insolvent, or is adjudicated bankrupt.

Termination for Breach or Insolvency

In the above example, the term is one year, with no right of “termination for convenience.” That means that neither party can terminate unilaterally absent a breach by the other party or other specified occurrence such as insolvency.

And note the phrase “breaches any term or condition of this Agreement.” This is a potentially low bar for triggering a right of termination in a situation where rights of termination for convenience were apparently considered undesirable by one or both parties. Any misstep by a party that technically violates the agreement and that cannot be cured within 30 days gives the other party the opportunity to terminate, possibly inflicting harm out of proportion to the other party’s breach.

Termination for Breach or Insolvency

The more common practice is to insert the word “material” before the phrase “term or condition” so it is clear that the breach needs to be somewhat substantial.

The following are important questions to ask when drafting or reviewing Term and Termination provisions:

- Will it be important for you to know that you will have the other party’s services for a certain period of time and at certain pricing?
- Or does skepticism of the other party warrant a shorter term, or perhaps an initial “test” or “pilot” term?
- Should one party be able to terminate more quickly or easily than the other?
- How quickly and easily can you terminate for the other party’s breach?
- What if you are not happy with the other party’s performance but they are not quite in breach?

Termination for Breach or Insolvency

The more common practice is to insert the word “material” before the phrase “term or condition” so it is clear that the breach needs to be somewhat substantial.

The following are important questions to ask when drafting or reviewing Term and Termination provisions:

- What if the deal does not turn out to be as profitable as you had hoped?
- If a longer relationship is contemplated, should the contract have a fixed termination date one or more years out, or does the need for flexibility warrant a shorter initial fixed term with successive terms of auto-renewal unless a party opts out?
- If “termination for convenience” is not allowed, what acts or omissions constitute grounds for termination and what is the process?
- What payment obligations are there following termination?
- What other rights, liabilities or obligations survive termination?

When and Why Termination for Convenience is Appropriate

Such rights are appropriate for a wide range of services and give the buyer maximum flexibility in managing its business. Although sellers may be less interested in agreeing to such clauses, they are perfectly appropriate where one party is buying common or commoditized goods or services from another.

Examples of this might include consulting agreements, as noted above, as well as advertising or advertising placement services, any type of professional services billed on an hourly basis, and any supply relationship where the goods in question are readily available elsewhere.

In general, buyers in fairly liquid markets often have the most to gain from termination for convenience clauses. Easy termination rights provide maximum flexibility to respond to market pricing changes or to broader changes impacting a party's business model.

When and Why Termination for Convenience is Appropriate

At the other end of the spectrum, sellers expecting to incur significant up-front costs in an agreement will be far more resistant to flexible rights of termination, at least by the other party. Such costs might be in the form of new plant and equipment or staffing necessary to meet contractual commitments. In such cases, the seller might not expect to break-even financially for several years and an early termination clause would be illogical.

Alternative Right of Termination Triggers

In situations where a seller with significant performance obligations resists “termination for convenience,” the buyer might consider other options to clarify and enhance its rights of termination beyond a generic “material breach” provision. Rights of termination drawn more narrowly than for simple convenience but that fall short of actual breach might be more easily negotiated, provided they are specific and reasonable, as in the following example.

In addition to the other grounds for termination described herein, Company A shall have the right to terminate this Agreement upon thirty (30) days notice to Company B in the event that Company A has generated sales of Company B's products totaling less than \$100,000 in each of two successive calendar quarters.

Alternative Right of Termination Triggers

This example is intended to show that termination for cause can be defined in any manner the parties agree. Buyers should use creativity in negotiating such provisions to prevent themselves from becoming locked into long and unprofitable or otherwise unsuccessful relationships. Sellers negotiating to avoid broad rights of termination for convenience might use similar creativity to move the discussion in their favor.

In addition to the other grounds for termination described herein, Company A shall have the right to terminate this Agreement upon thirty (30) days notice to Company B in the event that Company A has generated sales of Company B's products totaling less than \$100,000 in each of two successive calendar quarters.

Cure Provisions

Other potentially important but often overlooked issues lurk in common “cure” provisions like the 30-day example above.

First, each party should consider whether the stated period is acceptable. Depending on the listed factors that constitute breach in an agreement and the nature of the performance in question, is it too long or not long enough? Buyers, for example, have to consider whether or not it is really okay if the seller cannot meet its obligations for an entire month.

On the other hand, a party that could be significantly harmed by termination and that might foresee needing more than 30 days to fix a potential problem might push hard for a 45 day cure period.

Cure Provisions

Secondly, while “cure” clauses always provide a cure timeframe, they rarely limit the number of times a party may breach and cure, breach and cure. Buyers should always consider negotiating a cap on the number of “cure” periods to 2 or 3 instances, after which any additional breach is grounds for immediate termination.

Lastly, consider explicitly carving out some types of potential breaches from any cure period. Reasonable candidates for an immediate right of termination might include data security breaches, breaches of confidentiality, violations of law or regulation, or violation of third party intellectual property rights.

Cure Provisions

As suggested by the example above, common bases for termination include bankruptcy, insolvency, or change of control. Carefully consider how such provisions might work to your advantage or disadvantage. If your company is in the development stage and might face financial difficulties, you might not want an insolvency or even a bankruptcy termination trigger in an important contract. If that is not possible, negotiate lenient cure provisions or other protections.

On the other hand, protecting yourself in any agreement with a party that could become insolvent before completing its obligations is tricky and probably warrants consulting with a lawyer, especially where substantial upfront payments or similar commitments are involved.

Change of Control Issues

Lastly, if a change of control is potentially in your future, i.e., a sale of your company's assets or capital stock, strike change of control termination triggers whenever possible and make corresponding fixes as necessary to any "anti-assignment" clauses as well. Negotiating away such provisions in important agreements prior to the closing of a change of control transaction can be both distracting and expensive.

On the other hand, if you suspect the other party might be acquired by somebody you do not want to do business with (i.e., a potential competitor), you may want to insist on a change of control termination right.

Effect of Termination

Effect of Termination

Effects of Termination

As just discussed, it is important to know when and how a contract can end. It is often equally important to think through and provide for what should happen post-termination. These questions are frequently addressed under the heading *Effects of Termination*.

Sometimes the implications of termination are obvious and fairly routine, as in the above examples. In other cases, though, post-termination winding up or unwinding activities could be more substantial.

Examples of concerns of Effects of Termination

- In software agreements, the buyer, or licensee, often agrees to remove versions of the seller's software from all of the buyer's systems at termination of the agreement.
- A video production agreement might require the production company to certify in writing that it has turned over all video footage created for the purchaser and to sign intellectual property assignment agreements in favor of the purchaser.

Examples of concerns of Effects of Termination

- Termination of an agreement with a call center provider might require the provider to transfer one or more phone numbers to the next provider and to take other steps to migrate customer service data to the new provider and platform. The price for this cooperation is likely to be much lower if negotiated up front.
- Joint marketing agreements often call for a mutually acceptable communication to customers announcing the end of the relationship and describing the effects, if any, on customers.

Examples of concerns of Effects of Termination

- A product distribution agreement might require the return of unsold inventory and provide for a refund for that inventory.

In general, the more important, complex or sensitive a commercial relationship is, the more important it is to think through post termination rights and obligations.

- How will deeply integrated services or systems be unwound or migrated?
- How will intellectual property rights be shared, transferred or otherwise protected?
- How will relationships with mutual customers be managed?
- Should fees be waived or refunded or should liquidated damages be provided for in the event of termination for cause?

Examples of concerns of Effects of Termination

The last bullet above alludes to the important idea that post termination rights or obligations can and should vary depending on whether the termination is due to the natural lapsing of an agreement or a party's failure to properly perform.

Termination by Itself is a Weak Remedy

Termination for breach often involves hardships for the party exercising the right. As will be discussed in the next section on *Remedies for Breach*, a party forced to cut its losses because of the other party's non-performance will almost certainly look back at the agreement hoping to find some form of damages, fee clawbacks or other make-whole clauses.

Often, that search for relief will be disappointing. Many commercial agreements are woefully silent regarding compensation for another party's poor performance.

Termination by Itself is a Weak Remedy

As a general rule, sellers of goods or services shy away from exposure to liabilities of any kind for poor performance beyond basic simple repair, replacement, refund, or re-do obligations. As discussed next under *Remedies for Breach*, captions by that name or otherwise mentioning “Remedies” or “Damages” are virtually non-existent in commercial agreements.

Most agreements in fact specifically disclaim the kinds of financial harms that are most likely to arise due to a party’s poor performance – lost profits, missed market opportunities, and wasted resources.



Thank You