



# Onerous Contracts

## **Dealing with Troublesome Contracts**

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# Disclaimer:

- I am not a lawyer
- What I say should not be construed as legal advice.
- Comments made by attendees, even if they are lawyers, are for general discussion purposes only.
- Consult a competent attorney to discuss your specific situation.

# Agenda

- Evaluating Risk
- Risk Mitigations
- Real World Examples
- Negotiation Tips
- When to say “No”

# You Got the Job! ?

- You demonstrated a clear understanding of their problem.
- You convinced them of your keen technical abilities.
- You sold them on your charming personality.

And they said, “Yes, you got the job!”

# What's Next?

Time to start working on the project, right?

**NOPE!**

# The Contract

Do not even think of working without one!

Needed to:

- Enforce your rights.
- Prevent them from unjustly claiming that you breached your obligations.
- Be viewed by third parties:
  - Judges, juries, auditors

# Your Contract or Mine?

- It's best to offer up your own *fair* contract.
- Small or new companies are more likely to accept these.
- Large companies usually force their own contract on you.
- These are typically very one-sided and put a lot of risk on you.

# Onerous Contracts

- What do you accept and what do you negotiate?
  - It's a judgment call.
  - Only you know your tolerance to risk.

# Onerous Contracts

- Factors to consider
  - Your “Risk Footprint”
  - Your ability to negotiate
  - Effect of the negotiation process on your client
  - Likelihood of payment
  - Your ability to make claims and recover damages

# Know your Risk Footprint

A “Risk Footprint” is a way of quantifying your risk based upon factors such as:

- Risk Amount
- Risk Duration
- Who Controls the Risk?
- Risk Mitigations
- Probabilities

# Risk Amount

Is it specified or open ended?

- Specified:

*“If the Work Product is delivered more than five (5) days after the Due Date, the Consultant shall be liable for a penalty of one thousand dollars (\$1,000).”*

- Open Ended:

*“Consultant shall defend such claim and shall indemnify the Company against any loss, cost, expense, or liability arising out of such claim.”*

# Risk Duration

Is it forever or time limited?

- Forever:

*“Consultant shall defend such claim and shall indemnify the Company against any loss, cost, expense, or liability arising out of such claim.”*

- Time Limited:

*“For one year from the Delivery Date, as specified herein, Consultant shall defend such claim and shall indemnify the Company against any loss, cost, expense, or liability arising out of such claim.”*

# Who Controls the Risk?

Are all risks due to your direct actions?

- What about third party claims?
- Did your work “fail” or was it used in a way that it was never intended to be used?
- Is your work integrated with someone else’s work? Who’s to blame?
- Technical risks
  - Your code works, but the third-party library you use does not.

# Risk Mitigation via Insurance

- Is the insurance required or is it your choice?  
Give “Insurance Specs” to your broker
- Errors and Omissions Insurance
  - Occurrence Made
  - Claims Made
- Business Insurance
- Bonding
  - Sometimes asked for, but useless for the one person shop

# Risk Mitigation

## via Contractual Changes

- Get rid of Hold Harmless clauses, especially for 3<sup>rd</sup> party claims
- Does your risk increase depending upon how the client uses, markets or distributes your work?
  - If so, tighten up the clause to limit indemnification to your direct actions only.
- T&M vs. Fixed Fee differences

# Probabilities

- Probability of each risk
  - Is the risk likely or are you chasing ghosts?
- Probability of profit:
  - Big bucks or chump change?
  - Probability of follow on work
  - Probability of early termination
- Technical Risk



# REAL WORLD EXAMPLES

The following are clauses taken from a real contract.

Do ***not*** use these as a basis for your contract!

# Yes, You Are an Independent Contractor ...

*“The relationship of the Consultant to the Company is that of an **independent Consultant.**”*

*“In accordance with its status as such, the Consultant covenants that it, its employees, and its Subcontractors will **conduct themselves consistent with such status; ...**”*

# ... But You are Contractually Obligated to Act as an Employee

*“All Work hereunder shall be performed under the direction of and to the satisfaction of the Company’s Project Manager.”*

*“The Consultant shall perform specific assignments of Work, as directed by the Project Manager, when the Project Manager determines the service to be necessary.”*

*“No approval or direction of the Company shall relieve Consultant of any obligation hereunder.”*

# Payment Constraints

*“...the Company shall make payment subject to the following conditions, which are ... conditions precedent to payment:*

- The Contractor is not, in the **Project Manager’s and/or Procurement Specialist’s opinion**, in breach of any terms or provision of this Contract;*
- The Project Manager has accepted the Work.”*

# So What's Wrong With That?

- Non-payment is not breach of the contract!
- You may have to sue under the doctrine of *Unjust Enrichment*.
- Contract should be written so that:
  - If Consultant does A, B and C,
  - Then Client shall pay \$X within Y days.

# We Can Withhold Your Money

*“When the Company has reasonable grounds for believing that a meritorious claim exists or will exist against the consultant or the Company arising out of the negligence of the Consultant or the Consultant’s material breach of any provision of this Contract; then the Company may withhold payment of any amount otherwise due and payable hereunder.”*

*“Any amount so withheld may be retained by the Company for such period as it may deem advisable to protect the Company against any loss ...”*

# We Can Withhold Your Money

- Really? **They** think a claim ***might*** possibly be made in the future and they can withhold my money?
- What if they are wrong?
- You guessed it...

***“No interest shall be payable by the Company under any amounts withheld under this provision.”***

# Who Owns the Work?

*“...the Work shall belong to the Company for use within the Company. All Work which may be so considered is **works for hire** within the meaning of the Copyright Act. ...”*

*“Upon request of the Company, the Consultant immediately shall execute ... **a transfer of rights** in a form specified by the Company.”*

*“The Company, at its option, may regard this Contract as an **assignment by Consultant of its rights to all Work developed hereunder.**”*

# Unconditional Transfer of Rights

- In the previous clause, the Consultant transferred full rights of their work.
- Keep ownership of the Work if possible.
- If you must transfer your ownership rights, then it should *only* be done after payment in full!

# Limitations of Actions

*“No action shall lie or be maintained against the Company on any claim based upon this Agreement, or arising out of this Agreement, or out of anything in connection with the Agreement unless such action shall be commenced within four (4) months from completion of the Work hereunder or the earlier termination of this Agreement.”*

# All Payments Electronically Deposited to Your Bank Account...

*“ALL authorized payments to Contractor will be made by the Company via Automated Clearing House (“ACH”) procedures.”*

## ...But, No Claims After Accepting Final Payment

*“The acceptance by the Consultant of the final payment hereunder ... shall be a release to the Company for all claims of liability to the Consultant or its successors for anything done or furnished under the terms and provisions of this Agreement, except for claims expressly reserved in writing upon accepting final payment.”*

# But Terms are Poorly Defined

- How can you **not** accept an ACH payment?
- How does one define a “final payment”?
  - If you haven’t received another payment, then I guess you received your final payment!

# The Terminator

*“The Company may at any time, for its **own convenience, terminate** this Contract by written notice to the Consultant specifying the termination date.”*

*“The Consultant shall be paid such amount as shall compensate him for the Work satisfactorily performed prior to the termination date.”*

*“Such amount **shall be fixed by the Company**, after consultation with the Consultant.”*

# Termination for Convenience

- Did you give them a quantity discount?
  - Did they just get the million widget rate after buying only 10 widgets?
- Independent Contractor issues:
  - Should have significant penalties for any party that prematurely terminates the contract.
- Is your overhead covered?
  - Time spent writing Scope of Work
  - Time going thru the procurement process
  - Spec development for fixed fee contract

# Hold Harmless Clauses

Hold Harmless clauses come in many forms:

- Patent and IP Infringement
- Non-disclosure Agreements
- Third Party lawsuits
- Personal Injury

# Hold Harmless Clauses

- Especially watch out for “Hold harmless, indemnify and ***defend***”
- You get to pay legal fees even if it is a frivolous lawsuit!

# IP Infringement Indemnity...

*“The Consultant warrants that any products developed hereunder do not infringe upon or violate any patent, copyright, trade secret, or any other proprietary right of any third party.”*

## ... Backed Up with a Hold Harmless Without the Words “Hold Harmless”

*“In the event of any claim alleging the aforementioned against the Company, the Company shall promptly notify Consultant and Consultant shall defend such claim, in the Company's name but at Consultant's expense, and shall indemnify the Company against any loss, cost, expense, or liability arising out of such claim, whether or not such claim is successful.”*

# IP Issues

- You are an engineer, not a Patent Attorney.
- The client may be hit by a “Submarine Patent” or by a “Patent Troll”
- You do not know what licensing arrangements the client has in place.
- Watch out for Open Source software
- Best Bet: Promise not to *knowingly* infringe. Also, no liability if client forewarned of potential IP issue.

# A Non-Disclosure Agreement...

- *“The Consultant, its employees and its Subcontractors shall keep confidential **all information** and material provided to it, its employees, or its Subcontractors or which it may be **exposed to** in the course of Work hereunder including, without limitation, proprietary information of third parties.”*

## ...Protected by a Hold Harmless Clause

*“The Consultant shall defend, indemnify and hold the Company harmless from and against any loss, cost, liability or expense (including reasonable counsel fees) arising out of any breach or claimed breach of this provision.”*

# What Was Wrong With That NDA?

- NDAs should be for
  - Well defined and truly confidential material
  - Limited duration (unless dealing with trade secrets)
  - Info not previously known to you at the time of disclosure

# NDA Escape Clauses

- No longer confidential when:
  - Info enters the Public Domain
  - Received by you from someone who has not violated an NDA
  - Disclosed with permission of the Client
- No penalty if disclosure occurs when the
  - Same level of protection is applied by Consultant as by the Client



# **NEGOTIATION TIPS**

# Negotiation Tips

- Get the client “hot” for you
- Reduce their risk by demonstrating competency
  - Demo past work
  - “Risk start” their project if it makes sense.

# Negotiation Tips

- Generate positive feelings and a “can do” attitude regarding the technical project
- Offer up your own contract as the fair and “Let’s get down to work” option.
- It’s their onerous contract that is standing in the way!

# Negotiation Tips

- Build a relationship with someone high up in the corporate food chain
- Have them push for a balanced contract.
- Avoid HR!

# Know the Procurement Process

Small companies:

- Engineering management might negotiate directly with you.
- Personal touch needed.
- The process can sometimes be “overruled” by upper management.

# Know the Procurement Process

Large companies:

- Have Procurement Departments
- Many levels of sign off
- Alphabet Soup: SOWs, RFPs, and RFQs
- You deal with Project Manager and Procurement

# Know the Procurement Process

Governmental and military companies:

- Procurement Department only
- Special rules may hinder communication
- Watch out for Purchase Order language wiping out everything previously negotiated

# Is it Time to Lawyer Up?

- Have your competent counsel negotiate for you.
- If not using a lawyer, you should:
  - Know the basics of contract law
  - Understand IC vs. Employee Determination
  - Have the final draft reviewed by competent counsel

# Procurement Excuses

- *“We don’t make changes.”*
- *“Everybody signs that contract.”*
- *“Take it or leave it.”*
- *“You can’t speak with Legal.”*

# Getting Past Procurement Excuses

Point out clauses that put the client at risk:

“Your contract has some clauses that run counter to recent court rulings regarding Section 1706 of the Tax Reform Act of 1986. In light of increased enforcement, without modification, **both of our companies could be at risk for severe penalties.**”

“I have made changes to the contract to reduce these risks. Please have your legal department review these changes and contact me.”

# Know when to hold 'em, Know when to fold 'em

- After all mitigations have been made, and probabilities are factored in,
- Does the Risk Footprint overshadow your likely long term profit?
- If so, walk away!

# Conclusion

- Don't blindly sign any contract!
- Identify the level of risk and the probability of that risk for each clause
- Determine the “upside” range of income, factoring in the potential for early termination or follow on contracts.
- Mitigate risks via negotiation and insurance
- Walk away from a bad deal!

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