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CUSTOMER DISCOVERY: Module 8, Episode 5

Managing & Scaling Up a Successful Pilot

TITLE:

Key Contract Terms to Watch For

DESCRIPTION:

Learn which legal terms are most important to look for when evaluating if a legal agreement is safe for your startup

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[LEARN@LIFT Episode Intro]

Welcome back everyone. In this episode, we'll be digging into a topic that some of you may want to avoid, but it's oh so very important: legal terms.

Here, I'll be breaking down key contract terms you're likely to encounter when negotiating a corporate deal. This episode is part of the scaling-up process because the legal terms you settle on will be central to the structure of your future enterprise partnership, and while you may be tempted to think this topic fits alongside something that's more logistical in nature, like procurement or setting up a vendor profile, it's an incredibly strategic piece to deciding how you'll grow and govern your business over the long-term.

Now, not all of the terms we're going to cover will be used in every deal. But building up a good understanding of all of these terms will help you determine when it's safe for your startup to proceed, and when you'll need to bring in a legal expert to help you. And related to this last point, I'm not a lawyer, and this episode is no substitute for legal counsel. To be clear, I'll repeat that. I'm not a lawyer, and this episode is no substitute for legal counsel. There is, however, lots to learn in our next few minutes together, and in a guest interview that's posted to the course page for you to listen to as a follow up.

Okay, let's get to it. The first set of terms to review are in the Non-Disclosure Agreement, or NDA for short. This type of agreement is very, very common. Some companies require an NDA for a simple introductory call, while others only require one when discussions turn more serious. While specifics inside the NDA vary, in general, it's an agreement between two parties that states they won't disclose any confidential or non-public specifics of a discussion to anyone outside of the agreement. And, any disclosure usually requires the consent of both parties. Most NDAs are mutual, meaning both parties agree to shared confidentiality. Businesses generally like to keep things under wraps for competitive reasons, and as a startup, you probably don't feel comfortable sharing the details about your company unless you know you're legally protected. However, there are instances when a business will ask you to sign a one-way NDA, which only binds you to not divulge confidential information.

The next contract term to discuss is Exclusivity. You've probably heard of this term before. In general, exclusivity in the context of startup deals means there is a period of time during which the corporate partner is the only company who can do certain things with you (such as distribute your product, for example). While this might sound like a bizarre request, there are different flavors to exclusivity. Typically, companies look for exclusivity with very early-stage companies when the business would be responsible for propelling the startupto the next level. In these cases, exclusivity is often limited to a specific industry. For example, if a startup had an interesting technology for retail stores, and their first corporate partner is an athletic apparel company, they might be limited through an exclusivity clause to only partner with that athletic apparel company for a certain period of time. However, they would still be free to sell to retailers in other industries, like grocery stores or cosmetics. In other cases, exclusivity might be geographic or global in scope, and not tied to a specific industry. Be careful with this contract term as it could be a way of hitching your wagon to a single business partner, which increases your risk level significantly. That's a good deal for your corporate partner, but not for you.

If a corporate venture capital group, or CVC, invests in your company, it's not uncommon for you to encounter the Right of First Refusal clause. Essentially, this means that if the startup receives an acquisition offer from another party, the group holding the Right of First Refusal

gets the right to match the offer. If they decline for any reason, then you are free to sell to whomever you want.

Another clause you may encounter is called the Most Favored Customer, or MFC for short. You'll often find this clause in conjunction with exclusivity, or instead of exclusivity. Basically, your business partner is ensuring that they get the best possible pricing for your product or service, meaning, you can't sell it to anyone for a rate that's cheaper than what you've sold to them. This is pretty common when you're a supplier or vendor to your partner, and they're your first large customer.

Next, if you're a software company, you may encounter a vendor security audit clause. While a vendor security audit means different things to different companies, in general, your partner is looking to make sure that any data you store is secured following industry standard best practices. Again, this is different for each company, but we're including a helpful article on this process in the reading list for you. The reason you'll want to look for this is because, if you don't already meet certain security standards, and don't negotiate around this, you may be obligating yourself to a significant commitment of time and money to comply with the requirements they'll be auditing you for.

Another clause that you may find in an agreement is focused on publicity. Some companies may want to issue a joint press release and align on the specifics of that release in the contract. Others may forbid you from publicizing the partnership without their written permission. Many agreements won't contain this clause, but it's a good one to keep in mind. If it's in there, it's likely because your partner has some sensitivities to how you can and can't use their brand, so dig into this upfront to ensure there aren't any surprises later, and expectations are aligned.

Now, let's spend some time discussing payment terms. While it might not seem obvious, payment terms can be one of the trickiest parts of the deal-making process. Corporates traditionally have their own set of standard payment terms. Larger companies in particular often have the scale to dictate very favorable terms for themselves, such as net 90 day payments, or even longer, which means they can pay three plus months after they're invoiced

by a service provider. While this may be the standard practice for regular enterprise vendors, they're often onerous payment terms that can be difficult for startups to handle. The good news is that payment terms is a clause that can be negotiated around, and your goal should be to have as short of a window as possible. Net 30, for example.

A related clause is a section on Late Payments. The idea is that should a late payment occur, a penalty fee should be paid to you alongside the invoiced amount. This penalty can be a percentage — for example, a fixed percentage of the total contract value per day late — or a flat fee based on the period of time. The main purpose of this clause is not to collect extra cash, but to serve as a deterrent to late payments. If it's not included in the contract, you'll want to insert this.

There should also be a section of the contract focused on the term, or contract length, as well as the termination. Having these two clauses explicitly stated is helpful for both parties, and it provides clarity around what happens if the agreement doesn't work out exactly as intended. The termination clause is usually split out into two different types of termination: cause and convenience. If a partnership is terminated for convenience, like a change of internal priorities at the business, make sure you're protected by requesting payment in full, and requiring advanced notice. Also, if your agreement can be terminated for cause — for example, a breach of contract arising from you failing to deliver a specific service on time — make sure there's a provision that requires advanced notice from your partner to you, or vice versa, to allow time for the breaching partner to correct the issue.

Last but not least, there should be language about limited liability in the contract. While this clause will depend on the exact nature of your product or service, you can find an example of this in the Y Combinator Sales Agreement document that's listed in the Course Resources section. The idea is to limit each side's liability in case of something going wrong in a major way, like a data breach, and it's common to ensure that liability is limited to the amount of the contract itself.

There you have it, key legal terms to look for in your next legal agreement. We're going to end the module here, so that you can spend some time checking out the template documents

uploaded in the course resources section, and listen to the guest conversation I had with Savvi Legal — a startup helping founders navigate the legal process for their own startups.

[Insert Episode Closing]