

How not to get pwnd by your clients

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How not to get pwnd by your clients

*In your service contracts, there are certain things you should never agree to,
and there are certain protections you always need.*

*Otherwise you're essentially betting your future on the hope that nothing will go wrong.
Ever.*

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How not to get pwnd by your clients

What to watch out for:

1. Beware “Standard” Contracts and “Standard” Provisions
2. Indemnification: *All Your Business Are Belong To Us*
3. Intellectual Property Assignment: *What’s Mine Is Mine, And What’s Yours Is Mine*
4. Warranties: *If At All Possible, Disclaim Them*
5. Audit Rights: *Now You Show Me Yours*
6. Negotiation Strategies: *Strategery Is Key*

Beware “Standard” Contracts and “Standard” Provisions

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1. Is it “standard”?
2. Does *everyone* sign it?

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When you *indemnify* someone else, it means you agree to pay for their losses and damages.

This could put you out of business.

Indemnification:

All Your Business Are Belong To Us

Sample indemnity clause:

*“Sucker, LLC (“Sucker”) agrees to indemnify, defend, and hold harmless **Big Corporation, Inc.** and its employees, contractors, agents, managers, members, representatives, advisors, and subcontractors (collectively “**Big**”) from and against any claims, losses, damages, demands, liabilities, costs, and expenses, including, without limitation, reasonable attorneys’ fees (collectively “Costs”), incurred by **Big** and resulting, directly or indirectly, from any of the following: (i) **Sucker’s** access to **Big’s** network, computers, or other equipment or software, or placement, operation, or discontinuance of operation on **Big’s** network of any of **Sucker’s** hardware or software; (ii) **Sucker’s** modification of any of **Big’s** equipment, computers, or any device, configuration, or software, whether in whole or in part; (iii) any allegation that, if true, would constitute a breach of any of **Sucker’s** obligations under this Agreement; and (iv) any recklessness, negligence, willful misconduct, misrepresentation, fraud, or criminal acts by **Sucker.**”*

Indemnification:

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What does this “standard” provision mean?

“Sucker, LLC agrees to indemnify, defend, and hold harmless”

These three things all mean basically the same thing: if Big has a problem, you will pay.

“any claims, losses, damages, demands, liabilities, costs, and expenses, including, without limitation, reasonable attorneys’ fees”

This covers nearly anything bad that could happen. Note that it not only includes damages, but also attorneys’ fees. This could be huge.

“resulting, directly or indirectly, from any of the following:”

Indemnification:

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What does this “standard” provision mean?

“(i) Sucker’s access to Big’s network, computers, or other equipment or software, or placement, operation, or discontinuance of operation on Big’s network of any of Sucker’s hardware or software”

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What does this “standard” provision mean?

“(i) Sucker’s access to Big’s network, computers, or other equipment or software, or placement, operation, or discontinuance of operation on Big’s network of any of Sucker’s hardware or software”

This could be rewritten:

“(i) a total network crash resulting in millions of dollars of losses to Big and Big’s customers, just one of which could put Sucker in debt for life”

If Big asks you to pay for its customers’ losses, it could be the end of your business.

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“(ii) Sucker’s modification of any of Big’s equipment, computers, or any device, configuration, or software, whether in whole or in part”

This could be rewritten:

“(ii) any failure of any of Big’s hardware or software that Sucker touched or walked past”

At least one clause will often connect you in some way to just about anything. Allowing yourself to be held responsible for everything can be extremely risky.

Indemnification:

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What does this “standard” provision mean?

“(iii) any allegation that, if true, would constitute a breach of any of Sucker’s obligations under this Agreement”

You would be responsible if you *actually* breach, if anyone *claims* you breached, or even if any allegation could *imply* you breached the agreement.

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“(iv) any recklessness, negligence, willful misconduct, misrepresentation, fraud, or criminal acts by Sucker”

Is this a list of things you wouldn’t do? How about “negligence”? If you were merely negligent—if you simply forgot to do something that you should ordinarily do, what lawyers call a failure to act with reasonable prudence—you’re on the hook.

Indemnification:

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How do you avoid this problem?

One good option: set limits.

- Leave the entire indemnification section alone, but limit compensation to your total fee.
- This may seem like a small change, especially if a non-lawyer is reading it on the other side, but it means that most of the clause will be nearly meaningless, because the most you could lose is what they paid you.

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Another option: get a lawyer.

- Then carefully change the language in small ways to remove potential liability.
- Do not try this at home.

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If possible, get the other company to indemnify you.

Intellectual Property Assignment:

What's Mine Is Mine, And What's Yours Is Mine

**“This land is your land, this land is my land.
It looks like one of us . . . has forged the deed to this land.”
— Dave Barry**

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When you perform a service, you often also create a product, known as *intellectual property*. And someone must own that product. When rights to intellectual property are transferred from one person to another, it is known as *assignment*.

Intellectual Property Assignment:

What's Mine Is Mine, And What's Yours Is Mine

Sample assignment clause:

*“Sucker acknowledges that all intellectual property rights in and to any product or material created or used work performed under this Agreement, including without limitation all software and modifications, improvements, or derivative works to any of the foregoing, are and shall remain the property of **Big**.”*

Intellectual Property Assignment:

What's Mine Is Mine, And What's Yours Is Mine

Sample assignment clause:

*“Sucker acknowledges that all intellectual property rights in and to any product or material created or used work performed under this Agreement, including without limitation all software and modifications, improvements, or derivative works to any of the foregoing, are and shall remain the property of **Big**.”*

Two problems:

- If your business model is to using existing products and enhance them, you could end up granting the rights to those enhancements to Big—*all* modifications, whenever you made them.
- You may not be able to grant the rights to improvements to OpenSource products.

Intellectual Property Assignment:

What's Mine Is Mine, And What's Yours Is Mine

How do you avoid these problems?

Set limits:

- Only agree to assign rights to modifications done in the scope of the contract, not to material you merely use in your work.
- Exempt any improvements to OpenSource software.
- Agree to grant Big a perpetual license but not ownership of your work.

The key is to make sure you can continue to build your business, so that as you become more successful, Big won't come looking for a piece.

Warranties:

If At All Possible, Disclaim Them

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A *warranty* is an *express or implied* promise in which a party to a contract guarantees something in furtherance of that contract.

Warranties:

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Sample Warranty:

“Sucker represents and warrants the following: (i) that the rates charged for the goods and/or services purchased pursuant hereto shall be no higher than Seller’s current rates to any other customer for the same quality and quantity of such goods or services; and (ii) that all goods and services delivered pursuant hereto will be new, unless otherwise specified, and free from defects in material and workmanship and will be suitable for their intended purpose.”

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- Warranties can be dangerous, especially with service that involves software and scripting.
- Be extremely careful about what you agree to warrantee.

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What does this “standard” provision mean?

“that the rates charged for the goods and/or services purchased pursuant hereto shall be no higher than Seller’s current rates to any other customer for the same quality and quantity of such goods or services”

This prevents you from charging different prices for your work.

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This prevents you from charging different prices for your work.

- Do you want to charge all customers the same?
- If you decide later to charge another customer less, do you want to issue the earlier customer a refund?

Note that in certain government contracting, this may be a requirement.

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What does this “standard” provision mean?

“that all goods and services delivered pursuant hereto will be new, unless otherwise specified, and free from defects in material and workmanship and will be suitable for their intended purpose”

- This is boilerplate manufacturing language, but you’re not selling \$500 ashtrays.
- You may produce results resembling products, but you’re really selling services.
- If you recognize some of the language, it’s probably because this is the sort of thing usually *explicitly disclaimed* for computer work.
- You want to avoid being called back in five years to work for free to fix an alleged bug.

Warranties:

If At All Possible, Disclaim Them

How do you avoid this problem?

One option: set limits.

Limit the length of time you can be held responsible for a problem.

Another option: specifically disclaim all such warranties.

“SUCKER DISCLAIMS ALL WARRANTIES REGARDING THE SYSTEM, EXPRESS AND IMPLIED, INCLUDING WITHOUT LIMITATION THE WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE.”

This is in all capital letters because the Uniform Commercial Code, which governs the sale of goods, requires that all such disclaimers be “conspicuous.”

UCC §2-316.

Audit Rights:

Now You Show Me Yours

What are audit rights, and are they a problem?

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- Private investigations and public prosecutions of fraud are on the rise.
- Many companies are requiring their contractors give them “audit rights”: the rights to inspect books and records to ensure compliance with private contracts and the law.

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- For work in certain foreign countries, I have advised clients to refuse to work with any contractors that will not agree to grant audit rights.
- In certain industries and regions, this is the rule.

If the rights are not too broad, this is an annoyance but not a major problem.

Audit Rights:

Now You Show Me Yours

Sample audit rights clause:

*“Sucker shall maintain records relating to its obligations under this Agreement. **Big** may appoint an independent auditing firm to inspect and audit **Sucker’s** accounting and sales books and records that are relevant to **Sucker’s** obligations under this Agreement, provided, however, that **Big** provides **Sucker** with reasonable notice prior to such audit and any such inspection and audit shall be conducted during regular business hours in such a manner as to minimize interference with normal business activities. **Sucker** shall make available to **Big** all invoices, supporting receipts, and detailed documentation for all services invoiced to **Big**, as well as make available for interviews, if requested by **Big**, all of **Sucker’s** employees who performed services or incurred expenses on behalf of or for the benefit of **Big**.”*

Audit Rights:

Now You Show Me Yours

Audits can be expensive:

- If a company decides to exercise its audit rights fully and often, it could cripple your business.
- The company could also use this as a bargaining chip: *“Either you modify the contract and charge us less or add something new, or we will exercise our audit rights. Repeatedly.”*
- If you are doing business with a large company that comes under investigation, whether by the government or its Board of Directors, you could get caught in the crossfire.
- Audits can be expensive and time consuming, and they can severely disrupt your business.
- If you are forced to pay for the audit, it could force you into bankruptcy.

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- *Consider requiring a “certified auditor.”* This will increase the cost to the company of an audit and, therefore, make them think twice, again.

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- *Limit the frequency and length of audits.* Once per quarter is too often.
- *Consider requiring a “certified auditor.”* This will increase the cost to the company of an audit and, therefore, make them think twice, again.
- *Exempt certain documents from any audit:* material protected by a confidentiality agreement with another party; material that contains trade secrets; material classified by the government; and material subject to any applicable privilege, including the attorney-client privilege and the attorney work-product doctrine.

You do not want to choose between violating a contract that requires a full audit and violating a contract that prohibits you from disclosing confidential material.

Negotiation Strategies: *Strategery Is Key*

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- *Which one of you is under time pressure?* You can do the deal quickly or drag it out.
- *Will the other side use a lawyer?* Even larger companies allow sales people to negotiate contracts.
- *Know whether you can walk away from the deal.* If you can, you are in great bargaining position. If you cannot, you may have to be less aggressive—or more thoughtful about your negotiation strategy.

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Questions

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