Legal Ideas

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Have a Written Contract

You should have a written agreement with the client, a contract. An oral agreement can be legally binding unless there is a law that requires it to be in writing. Laws vary from state to state, and in your state, there is probably be no legal requirement for a contract with the client to be in writing. But to proceed on an oral contract is asking for trouble. As a famous movie mogul reportedly said, “An oral contract isn’t worth the paper it’s written on.” That’s not always true, but why take chances?

An exchange of emails can be a legally binding contract (if all the elements of a contract are present), but emails tend to be informal and not

detail-oriented. Having a carefully written agreement that addresses the issues discussed below will decrease the likelihood of disputes between you and the client and increase the likelihood of getting paid.

Ideally, you would have a form of agreement on hand that was prepared by your lawyer after a discussion of your projects and the issues that are likely to come up. But that will be costly, and until you are handling projects where the risk of disputes and non-payment justifies the cost, you will probably decide not to hire an attorney. That doesn't mean that you can't draw up a contract that will serve you far better than an exchange of emails, particularly if you keep in mind the discussion that follows.

Remember one thing, though. A contract is like a lock. It serves to keep honest people honest. Just as a thief will break a lock to get what he wants, a shady client will break the contract. So the most important thing about a contract is who the other party is. So do your homework on who the client is and whether it has had issues with other service providers.

In the world of employment, when you are interviewing for a job, you are in a situation where the employer has all the credibility and yours is limited.

They are the ones deciding whether or not to hire you, after all. However, when it comes to Business to Business (B2B) discussions (as consulting is), the process is really more of a two-way street. It is entirely appropriate and valid for one party to B2B negotiations to ask references, from another, of its existing customers and vendors.

If an established company is the client, the client may have its own form of agreement that it asks you to sign. In that case, the client has paid its lawyers to draw up the agreement to protect it and is often reluctant to discard its "standard" form of agreement and adopt yours. That doesn't mean the client's form of agreement can't be modified, and you can try to negotiate changes in your favor based on the discussion below.

Remember, if you come to the table with a contract already prepared, then you both present yourself as credible and have the opportunity to have advantageous or neutral terms compared to clients who are not as prepared as you.

Scope of Services

Your agreement has to describe the work to be done. This can be done in the body of the agreement, but often the work to be done is set forth in an attachment, typically called “scope of work.” The description of the work to be done should be as specific as possible. It is also important to specify what is not included in the work.

There are several benefits to including a scope of work. The scope of work forces the clients to concretely imagine what the finished functionality is going to look like. This is extremely valuable in the selling process. There are several reasons for why. They include the idea that once people visualize something, they are more likely to get attached to it. There is also the idea that you are more likely to crystallize something you can visualize; for example, in sports or video games, you are more likely to make a complex maneuver that you visualize beforehand. It also forces them to deal with any attenuant issues that would interfere with the concrete visualization of their vision.

A scope of services statement should be very high level and describe the functionality principally in terms of the benefit to the user or customer. Don't get too specific in terms of features and details: these things are likely to change as you get feedback from the customer or the market. By keeping things high level and aimed at the benefit and described business value, you can be more likely to ensure you deliver something that keeps the customer happy.

For example, here's a good description:

> "The credit system will include the following high level functionalities
>
> 1. transactions (buy and redeem)
> 2. display of credits
> 3. change rate (credits per minute)
> 4. charge of credits"

This is specific enough because a lot of clients haven't fully resolved the issues of interface detail; they haven't made a full spec, for example. But this is enough detail to get going into a business relationship where you can properly bill them for helping firm up a

more detailed specification.

A description that would be too vague would be: “A credit system for the website”.

The time when the work has to be delivered will typically be set out in the scope of services. If you commit to deliver the completed work by a certain date and you don’t, you can be in breach of contract. See the discussion below about “Limitation on Liability” for a way to limit your exposure for failing to meet a deadline.

Payment Terms

Obviously, how you will be compensated for your work needs to be spelled out. For example, it could be a lump sum for the project, an hourly fee, or something else (stock or stock options, for example). Ideally you would be paid up-front for your work, but that is not likely to be happen. Consequently, you need to address the payment schedule.

If the payment is a lump sum, you will want to be paid as you go along (progress payments). Waiting until the project is completed to be paid increases your risk of not getting paid. The client may want to see certain milestones met before making a progress payment. You need to be specific in your agreement as to what the milestones are.

If you are being paid on an hourly basis, you should specify in your agreement the time-keeping convention that you will use to record time. Although a computer allows you to track time to the second, that's a silly way to record and bill for time. Typically time is recorded in increments. The increment could be a tenth, fifth, or quarter of an hour. The idea of an increment is that it includes a part of the increment.

Here's an example of how it works. Let's say the increment is a tenth of an hour (6 minutes) and you spend 10 minutes on the project. That comes to 2/10 of an hour because 6 minutes is 1/10 and any time spent beyond the 6 minutes takes you into the next increment. Therefore you record 2/10 of an hour and charge accordingly.

If you are charging an hourly fee, I strongly recommend that you keep time records as you go along. Each and every day you work on the project, you should record the date, the amount of time spent that day, and a brief description of the work done during that time. If the client squawks at your invoice and demands to know how you could spend so much time doing what to the client seems "such an easy task," you will be able to explain what you did and substantiate your claim. Otherwise, you are in a situation where a client unhappy about the size of the invoice may believe you are padding the invoice with hours you didn't work, and that client is likely to refuse to pay the invoice as submitted.

If you charge on an hourly basis, another thing to set out in your agreement is what you will bill for beyond writing code. For example, if you have to have phone conversations with the client from time to time about the work, is that billable or not? The same question arises as to time spent on email correspondence on the project or preparing reports.

Getting Paid

Although you have the right to sue a client for non-payment, that is a last resort. It can be expensive, time-consuming, and uncertain in outcome. Therefore you want to include provisions in your agreement with the client that will encourage the client to pay.

Your agreement should say that any rights to the work product, including the right to use it, is conditioned on your being paid in full for your services. That won't protect you against the shady client, who will go ahead and use the unpaid-for work product anyway, but it is a good lever for dealing with the honest client who has a good faith dispute with you over the invoice or the quality of the work. Expect this to be a subject of negotiation with a client making progress payments.

Your agreement should say that if payment is not made when due, you are entitled to suspend work, and if a payment is overdue by a specific number

of days, then you can stop work altogether but that the client is still responsible for paying for all work done until the work is stopped.

Another incentive for timely payment is a reasonable late charge (say, 5% or less) if the payment is late by more than a specified period. For example, you could say in the agreement that the client agrees to pay a late charge of 4% of the amount invoiced if the amount is not paid within 30 days of the date the invoice is submitted. By the way, most businesses expect 30 days to pay, but if you need more frequent payment, you can try to negotiate that. An unreasonable late charge will likely end up being disputed by the client (even if permitted by the agreement) and may not be enforceable in court. So don't try to use a late charge as a hammer. And waiving the late charge(s) is a chip you can use in negotiating with a client who is disputing your invoice.

Whether or not the client agrees to a late charge for late payment, the agreement should specify that the client will pay interest on the amount due if the client does not pay within a specified number of days of the invoice being submitted. Most states have limits on the interest that can be

charged, and the law varies from state to state. In some states, interest charged on deferred payments for goods and services provided to a business is not regulated and there is no limit. For advice on how much interest you can charge for a late payment, you will need to consult a lawyer or do some research on your own.

One solution is to provide that amounts not paid within 30 days of invoicing will bear interest at the lower of: (a) 12% per annum (compounded monthly) or (b) the maximum rate permitted by law. That way, if the specified rate (here the example is 12%) is above the legal limit, your interest clause provides that the rate will be reduced to what is legal.

If the client is a start-up, you are at risk of not getting paid if the client runs out of money. You can't get blood out of a stone. So a possible solution is to get one or more of the founders to give a personal guaranty of the client's payment obligation to you. When a cash-poor business has to choose whom to pay, a founder who has personally guaranteed your payment is likely to choose you over a liability that hasn't been guaranteed personally. Most people avoid giving personal guarantees, so this might be something that is

more likely to be considered when there is a large exposure to loss if you aren't paid, such as a lump sum payment all due at the completion of the project.

Limitation on Liability

If you enter into a contract and you breach it, you can be liable for all the damages you cause. What if you agree to deliver the work by June 1 but you don't, and the client misses a business opportunity that costs it a lot of potential profit? What if you deliver the work on time but you fouled up and there is a defect in the work that causes the client a substantial loss?

The amount of money you charge for your services can be miniscule compared to your potential liability if you don't deliver on time or make a mistake in the work you do. The solution to this problem is to have a clause expressly limiting your liability for damages, whether for breach of contract or for negligence. The clause should say two things. First, you have no liability for consequential damages. Second, under no circumstances can your liability to the client for breach of contract, negligence, or otherwise

exceed the amount of compensation actually paid to you on the project. In other words, the client gets a refund, but you don't get taken to the cleaners.

Another clause to consider is one that says that you are not in breach of contract if your delay in completing the work is due to your illness or other incapacity or for causes outside your control (say, a natural disaster knocks out the electricity for a period of time or forces you to relocate).

Intellectual Property Issues

While patent law, which protects inventions, can sometimes be involved in the work a consultant does, it's not common and won't be discussed here.

Copyright is a form of legal protection for "original works of authorship." Software can be a "work of authorship" and so it can be copyrighted. Copyright law is a complex topic, and its application to software is even more complex. Some lawyers practice exclusively in the field of copyright

law as it applies to software. What is discussed here is general in nature, and various exceptions and nuances are not mentioned.

A copyright literally means the right to copy, but it also refers to a body of rights granted by law to copyright owners for protection of their work. Copyright protection does not extend to any idea, procedure, process, system, title, principle, or discovery. Similarly, names, titles, short phrases, slogans, familiar symbols, and listings of contents or ingredients are not subject to copyright.

Under US law, the owner of a copyrighted work has the exclusive right to copy or otherwise reproduce the work, to make derivative works, and to distribute copies of the work to the public by sale, rental, license, or loan. In the case of audiovisual works (such as movies or videogames), the owner of a copyrighted work has the exclusive right to display or perform the work publicly. In the case of graphic or pictorial works, the owner of a copyrighted work has the exclusive right to display the work publicly (say, on a website).

Of course, the owner of a copyrighted work can permit others to copy, modify, or distribute the work, and this is commonly done by license. In some case, someone who does not own the copyright and who has not been granted a license may be permitted to use a copyrighted work under an implied license. Alternatively, non-licensed use may be legal under the concept of "fair use."

Work for Hire

Who is the "author" of a copyrighted work? If you are an employee, the copyright to the work you produce belongs to the employer, automatically. The employer is considered the author. But if you are an independent contractor, you're not an employee. Who owns the copyright then? You do! At least in theory.

If you're hired as an independent contractor to produce code and there is no agreement as to the copyright issues, the client probably has an implied

license as to what it hired you to produce, but you probably still retain other rights under copyright law. Obviously, if the client is paying for the work, the client wants to own all of it. So clients who have a standard form of agreement for software coders will specify in their agreement that the client owns all the rights to the work product. On its face, that seems fair. After all, they paid for it, and so they should own it.

But when you focus on the practical aspects, there are issues for you to consider. What if in the process of writing the code you produce boilerplate code (say, a website management script or a self-contained class), code that you could easily (and would like to) use over and over again. If the client owns all the rights to your work, you can't re-use your boilerplate code. So you need an exception to the provision in the client's form of agreement that states you have the right to copy, modify, or distribute your boilerplate code.

But you may also have written code that is not boilerplate but that you might like to modify and use in a future project. If you're thinking that the modified code isn't strictly a copy, remember that the copyright includes

the right to make "derivative works." So if you take code that belongs to someone else and modify it, that's a derivative work. The client will probably be reluctant to let you take the work it paid for and let you use it for a competitor, but the client might be more open to the idea if you agree that your right to make a derivative work of the code won't be used for any software that competes with the client's software.

Often the client's form of agreement will state that the work you produce will be a "work for hire." Under the copyright law, that would mean that the client is automatically the owner of the copyright. Software, however, is not subject to the work-for-hire rule (unless it is part of a motion picture or other audiovisual work, such as a videogame). Notwithstanding the fact that software isn't subject to the work-for-hire rule, many agreements with non-employee coders still recite that the work product is a "work for hire."

Can you ignore that clause in the client's form of agreement on the ground that software is not subject to the work-for-hire rule? No. The clause could be construed to be an implied grant to the client of all rights to the software. It wouldn't be automatic, as in the case of an employee or a work that is

otherwise subject to the work-for-hire rule, but it could end up being so as the result of litigation. And a client doesn't necessarily have to go to court to get to that result. When the client's lawyer starts sending you letters threatening to sue you, are you going to want to spend thousands of dollars for your own lawyer to advise you and to respond to the other lawyer? So avoid a possible dispute by making it clear in the agreement what your rights are.

If the client does provide you with its form of agreement, you should provide your own. In the typical arrangement where the client expects to be able to use your work product freely, your form of agreement would say that the client has the following rights:

1. A worldwide, royalty-free, perpetual, non-exclusive license to copy your code, to make derivative works based on your code, and to distribute copies of your code.
2. A right to sublicense others to copy your code, to make derivative works based on your code, and to distribute copies of your code.

If the client insists on owning the copyright, then you would want to retain a license giving you the foregoing rights subject to the restriction that you could not exercise those rights to compete with the sale, lease, or licensing of the code you created for the client. And you would want to retain the right to sublicense your code subject to the restriction that you are not permitted to sublicense to others who compete with the client.

Confidentiality Agreements

A confidentiality agreement, commonly called a non-disclosure agreement or just NDA, is common in the tech field. If possible, limit the scope of the confidentiality to information disclosed to you in writing. That way, you know exactly what is not to be disclosed. Make sure that the NDA does not prevent your reuse of code that you are permitted to (or not prohibited from using) by the copyright restrictions.

Representations and Warranties

Some clients will have a form of agreement that calls for you to "represent and warrant" certain things. A representation is an assertion of something as a fact that the other party can rely on, and a warranty is a contractual promise that a state of affairs will exist (or not exist). If you make a representation and warranty that a certain fact is true, then you are liable to the other party if it isn't (even if in good faith you believed it to be true). In other words, by making a representation and warranty that a certain fact is true, you take the risk that it's not, and you give the other party a legal remedy if it's not.

One common representation and warranty is that the work product you produce will not infringe on any other person's copyright. From the client's perspective, it is hiring you to produce something it can use, not something it can be sued for. There are a few issues here, however.

First, if the client is giving you code to modify, then, at least in theory, you can be sued if the copyright for the code belongs to someone else and the client has no license to copy the code or to create a derivative work from it.

So if a client gives you code to modify, you should exclude it from any representation and warranty that you make any liability on a claim arising out of the code the client gave you. In addition, the client should represent and warrant to you that it has the right to copy the code and to create a derivative work from it and that is has the right to authorize you to do so.

Second, your code might include code that is covered under a Creative Commons license or GNU general public license. In that case, you have to comply with whatever restrictions are imposed by those licenses, and your client will have to as well. If you copy code off someone's blog, you are copying code that someone else owns the copyright to; you may or may not have an implied license to use it. So if you are using code that was created by someone else, you have to make an exception for that in any representation and warranty that you give as to non-infringement of the copyright of others.

Finally, your code may require the use of someone else's copyrighted software to operate, and you want to make sure that the contract recognizes that.

Another common representation and warranty is that the work product you produce is original with you. Obviously, if you use code that was not developed by you, you can't give such a representation and warranty without qualifying it. For example, if you use code that is in the public domain, that is not original with you. If you go on an Internet forum and get help with writing the code, not all the code that results will be original with you. And if you use code copied off a blog or code that is covered under a Creative Commons license or GNU general public license, none of that is original to you. So you will have to add exceptions to a representation and warranty that the work product you produce is original with you.

Indemnification

If the client's form of agreement contains representations and warranties for you to make, it will likely also contain indemnification clauses.

Typically, these clauses say that you will pay any damages recovered against the client by a third party if you breached a representation and warranty. But they typically go further and say that you will defend the client if it gets sued because you breached a representation and warranty.

You have to make sure that you are liable for the costs of defense only if it is found that you actually breached a representation and warranty. Some of these clauses would make you responsible if there is a claim that would be covered if you breached a representation and warranty, even if the claim turns out to be invalid. You can explain that you will be responsible if there is the court finds you actually breached a representation and warranty but that you are not an insurance company and can't be responsible for defending against claims that turn out to unfounded.

Attorney's Fee Clauses

The rule in the US is that the winner in a court case gets his court costs, but that does not include the biggest cost of all, which is the attorney's fees. The two exceptions to this rule are that the prevailing party is entitled to be

reimbursed for his attorney's fees (1) if there is a statute that provides for attorney's fees (the copyright law permits recovery of attorney's fees against an infringer) or (2) there is a contract that provides for attorney's fees in the event of litigation between the parties. Aside from copyright infringement, typically, there is no statute that provides for attorney's fees to the prevailing party in a dispute between a coder and a client. The entitlement to attorney's fees will depend, then, on whether there is an attorney's fee clause in the contract, that is, a clause that provides that the prevailing party gets awarded his attorney's fees.

An attorney's fee clause is a double-edged sword. You want such a clause if you are in litigation and you win. That way, you are entitled to be reimbursed by the other party for your attorney's fees. But you most certainly don't want such a clause if you lose. Then, not only do you have to pay your attorney's fees but you also have to pay the other party's attorney's fees as well. Sometimes the attorney's fees of a party exceeds his recovery on the underlying claim!

You might think that you are better off with an attorney's fee clause because, if you have to sue to be paid, you want to get an award that includes reimbursement of your attorney's fees. But even if you have a dead-certain, slam-dunk case against the client, actually litigating it could cost upwards of $100,000 if the other party really fights it. That's money you will have to pay out of your own pocket. If you win, you are entitled to be reimbursed for your attorney's fees, but the other party might not be able to pay.

A better approach is to forgo an attorney's fee clause and instead to limit how much credit you extend to your client. In most states, there is a small claims court in which you can sue without using an attorney. The maximum dollar amount that a small claims court can award varies by state. In California and Illinois, for example, the limit is $10,000 while in New York or Florida, it's $5,000. If you keep what the client owes from going much over the small claims court limit in your state, you minimize the loss from having to sue the client, and you won't have to pay attorney's fees.

There is another situation in which the attorney's fee clause is important, and that is when the client sues you. Again, if you win, you want the attorney's fee clause, and if you lose, you don't. The absence of an attorney's fee clause in the contract can discourage the client from suing you since the amount it'll spend on attorney's fee won't be recovered and that can make the lawsuit not worthwhile.

Copyright infringement is a statutory violation, and the copyright owner is sometimes entitled by the copyright law to be reimbursed for attorney's fees. The absence of an attorney's fee clause is irrelevant (and most copyright infringers don't have a contract with the copyright owner in the first place).

If the form of agreement that you end up signing has an attorney's fee clause, make sure it provides that the prevailing party is entitled to attorney's fees. Many such clauses are written so that the client is entitled to attorney's fees if it sues and wins but you are not if you defeat the client's claim! Truly a "heads I win, tails you lose" situation. In some states, like California, an attorney's fee clause is automatically reciprocal, even if

written in a one-sided fashion, but this may not be the rule in the state where the case is brought. So, if there is an attorney's fee clause, in the contract, make sure it provides that the prevailing party (not just the client) is awarded attorney's fees.