



Mary Hanson



## About the Business Advisor

The Business Advisor is written and published by Mary Hanson, a business attorney in Torrance, California.

Mary Hanson has a law degree from the University of Wisconsin and an MBA from the University of Southern California. She has practiced business law exclusively for more than 30 years.

She provides legal services related to owning, operating, buying, selling, and structuring businesses. Her clients are business owners in many different industries. She handles corporations, LLCs, new businesses, new ventures, and a broad range of contracts and business decision-making.

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## SOME IMPORTANT CONTRACT ISSUES

by Mary Hanson

**C**ontracts are a basic feature of human interaction and have been around for a very long time. Examples of contracts exist in the earliest written languages of the world. Elements of American contract law can be traced back to European trade practices in the 1200s or earlier.

Almost every subject matter for a contract – a sale, a loan, a commission, an exchange of products, insurance, investing in a business activity, co-ownership, a commitment to provide services – has probably been covered in contracts for thousands of years. In the world of contracts, there is nothing new under the sun.

Every state and country has laws that apply to contracts, establishing requirements for the creation of contracts and rules for interpreting the contents of contracts. Basic principles of contract law may be set out in both statutes and legal precedents from many years of court decisions. In California, statutes set out many of the basic principles of contract law. Because of well-established contract laws, a party with a contract claim should be able to determine whether the claim is viable.

Despite the benefits of having a strong backdrop of contract law, businesses still need to take on the responsibility for addressing the particular requirements for a contract or a business relationship. Much of contract law covers basic contract principles, such as when a contract is

formed, what terms are included in the contract, whether the contract is enforceable, and who can bring a claim for breach of contract. Basic principles do not answer the questions that arise in a particular contract. A business owner must take steps to assure that his or her contracts cover the concerns of the particular business in the particular transaction.

### Your Terms

An enforceable contract can be formed by e-mail, fax, text message, phone call, or other brief methods of communication. Getting your own terms included in the contracts you are bound to can be a challenge.

If your only document is an e-mail, a quote, or a purchase order, recognize that this is your "contract," and make sure the terms that are important to you are included. Where possible, have a formal contract signed that includes all appropriate terms. If each customer does not sign a separate written agreement, make sure your terms are made part of your quotes or otherwise included in the documentation of your contract as accepted by the other party.

It may be necessary to rework your sales procedures to get your contract terms to apply to every sale, whether this requires a separate contract, the use of templates, or some other method to assure that sales people include the terms as part of every transaction.

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## The Master Agreement

I recommend that every business have its own master agreement for its key business activities – typically the sale of goods or services. Whether that agreement is the 50 page tome covering every conceivable circumstance or a brief coverage of the key concerns, every business should have a contract that covers the concerns of the business and contains the terms the business owner knows, wants, and is familiar with.

Ideally, the master agreement will solve most of the problems that occur in the particular industry, answer most questions that will arise in the performance of the contract, and benefit the business with both predictability and advantageous terms.

At a minimum the master agreement should cover the obvious potential disagreements or problems in any transaction. It should cover late payments, reimbursement of expenses (travel and meals for service contracts, freight and insurance for sales of goods), and attorneys’ fees and the costs of collection in the event of non-payment.

The contract should anticipate some typical changes in the transaction. If flexibility is not built in, it may be necessary to negotiate every change or additional item. A contract for services should include an hourly or daily rate, so that the value of additional services can be calculated and a sales contract should use a per unit price if additional quantities might be added to the contract.

If terms and conditions for additional goods or services are not included in the original agreement, additional

goods or services should not be provided until both parties agree on appropriate terms.

You can’t unilaterally add terms to an agreement after the contract is signed (or the contract is established by other means). For example, a late charge added to an invoice without being set out in a prior agreement is not enforceable. If you intend to charge a late fee or interest on an unpaid balance, your contract terms and conditions provided to the other party prior to the provision of goods and services must say so.

## Ownership of Work Product

If you are entering into a contract to obtain services that will result in the creation of some written work product, including software code, the contract needs to cover the issue of ownership in a manner that is correct under copyright law.

Under U.S. copyright law, work product that is literature or software belongs to the author or programmer, unless the author or programmer is an employee and the work is done as part of that employment. If such work product is being obtained by contract, you need to have the contract include explicit transfer of the author's or owner’s ownership and copyright rights to you. If ownership and copyright rights are not assigned to you, you will not be the owner of the software, no matter how much you have paid for the work.

If work product may be protectable under trademark, copyright, or patent law, make sure you have all the information you need (including advice from patent counsel) to

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properly preserve or transfer the rights to the work product.

### Warranties

If you are providing goods, you must consider whether you wish to provide any stated warranties, and how to disclaim warranties that are implied by law. You are likely to need the assistance of someone familiar with specific warranty laws, since this is not just a matter of good business sense. There are both state and federal laws that apply to warranties.

The topic of warranties can't be covered adequately in a short article, but there are two key points about warranties that must be understood. One is that warranties must comply with both state and federal law. There are descriptions, such as "full warranty" and "limited warranty" which must be used in compliance with specific statutes.

The second important point is that commercial laws covering the sale of goods provide implied warranties. Most terms and conditions for the sale of goods disclaim these implied warranties. In order to make the implied warranties inapplicable, a warranty disclaimer must be stated in language described by law and printed in a print size that meets legal requirements.

### Termination

Every contract should set out the bases for termination, and the consequences of termination. The contract terms should set out how a contract can be terminated, and why. Both termination for cause (such as breach of the contract by the other party) and

termination without cause should be covered.

The contract may provide that the contract can be terminated for any reason without cause with a certain number of days' notice, and for cause, with shorter notice provided. Termination rights are always important, and the issue always warrants a clear vision of what rights are necessary or appropriate for a particular transaction.

A service contract can provide that a termination fee be paid in the event of termination without cause. If the services are unique enough, the service provider may be able to negotiate a contract that is non-cancelable, so that the full term (e.g., 6 months) would have to be paid, even if the services are terminated.

### Remedies

Although state contract law sets out remedies for breach of contract, I recommend setting out specific remedies for default in the contract terms, whether restating the state law that applies or establishing other remedies or an amount to be paid in the event of breach.

The benefit of a good written contract is not only that it is enforceable, but also that it provides a guideline for the parties as the contract is being performed. A clear contract, setting out remedies for breach in plain business language, can persuade a party to the contract to perform his or her obligations.

### The Business Owner's Involvement

The business owner really needs to



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a resource for business owners

FROM THE LAW OFFICE OF MARY HANSON

## Publisher's Note

A contract is never "complete." It is not possible to cover 100% of all potential issues. A contract can never cover every possible fact situation and all the consequences of the passage of time. However, most businesses over time build a great knowledge of the terms and conditions needed in order to handle potential disputes in their industries. For example, businesses that sell a high volume of products may gain a high level of expertise in such sales. Their terms and conditions reflect the knowledge gained from the repetitive transactions.

Even small businesses should try to constantly improve their contracts. I recommend keeping a folder for every contract or type of contract. By keeping notes from preparation of the contract, notes from negotiation of the contract terms, and notes of questions, complaints, and comments that have arisen, the business can benefit from those experiences and use the knowledge gained to improve the contract when other updates are done.

Mary Hanson  
Attorney/Publisher

understand the importance of controlling – or at least being totally aware of – the contract terms under which goods or services are sold. There is little excuse for not having standard provisions and a procedure to assure that your sales or service commitments are on acceptable terms.

Unique transactions, such as the sale of a business, buyout of a partner, or engaging a firm to develop a custom software program for the business, present different challenges. Business owners as well as sales personnel typically don't have experience with these types of transactions. Business owners most often rely on experienced attorneys and other professionals for key recommendations on the transaction.

Business owners need to recognize the importance of being involved in

unique transactions. No matter what expertise outside consultants have, they don't have the business owner's knowledge of the business, his or her needs, the importance of some issues to the business, and whether the business owner is really willing to walk away from negotiations.

Often only the business owner has the business experience to visualize the objectives, the limitations, the consequences, and the day-to-day challenges involved in the transaction. The business owner has the insight necessary – as well as the final authority – to put off the transaction, insist on better terms, walk away from negotiations, find a better partner for the proposed transaction, or rework the business plan so that the proposed transaction makes sense. **BA**

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