



SMALL BUSINESS CONTRACT LAW: UNDERSTANDING YOUR CONTRACT

PRESENTED BY: AMY ORAEFO, ESQ.
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ESTABLISHING THE PROPER ENTITY

Factors to consider when deciding which business entity to form:

- Line of Business
- Capitalization
- Taxation
- Ownership rights
- Partners and/or investors
- Limitation of Liability

TYPES OF BUSINESS ENTITIES

- Sole Proprietorship
- Corporation
 - C Corporation
 - S Corporation
- Partnerships
 - General Partnerships
 - Limited Liability Partnerships
- Limited Liability Companies

SOLE PROPRIETORSHIP

PROs

- Composed of one person.
- Easiest to form.
- No formal filing required.
- Flexibility and freedom of business ownership.

CONs

- No protection from personal liability.
- Income is subject to self-employment taxes.



CORPORATIONS

- A corporation can be formed by having one or more owners.
- There are two types: C Corporation and S Corporation.
- Both require formal filing with the Secretary of State and annual nominal fees.

PROs

- No personal obligation for corporate loss.
- Perpetual existence.
- Personal taxation is separate from corporate taxation.

CONs

- Varies on the type of Corporation established.
- Must follow specific record keeping requirements and annual reporting.
- These variations differ in taxation and corporate ownership.



PARTNERSHIPS

- Partnerships are formed by two or more people.
- Generally, governed by an operating agreement.
- There are two types: General Partnership; Limited Liability Partnership.
- States generally require a formal filing.

PROs

- Flexible and freedom of business ownership.
- May make special tax allocations.
- Easy to form.

CONs

- Personal liability protection varies on type of partnership.
- Management authority is limited based on type of partnership.



LIMITED LIABILITY COMPANIES

- Limited Liability companies are hybrid entities that possess characteristics of a corporation and partnership and/or sole proprietorship.
- Formal filing with the Secretary of State is required.
- LLCs have the least complex business structure.

PROs

- Easy to form.
- Allows the flexibility of a partnership or sole proprietorship.
- Liability protections of corporation.
- Business owners can report their profits and losses on personal taxes.

CONs

- Limited growth potential.
- Cannot exist perpetually. LLC dissolves upon the death of its members or bankruptcy.



THE ESSENTIALS OF A CONTRACT

- A contract can be defined as a written or oral agreement between two or more persons for exchange of services or goods or a promise that is enforceable.
- There are five essential elements to a valid contract:
 - Competent parties;
 - Subject matter;
 - Legal consideration;
 - Mutuality of agreement; and
 - Mutuality of obligation.

ESSENTIALS OF CONTRACT: BREAKDOWN

- **Competent Parties**- parties must be an adult and of mental competency to enter into a contract.
- **Subject-matter**- the subject matter must clearly and adequately be set out. The subject matter must not be for any illegal purpose.
- **Legal consideration**- “consideration is the cause, motive, price, or impelling influence, which influences a contracting party to enter into a contract. The consideration must be valid and lawful.” Money is the most common form of consideration. - *Chris Goddard*
- **Mutuality of agreement**- commonly known as “meeting of the minds.” Parties must mutually agree to their rights and obligations under the agreement.
- **Mutuality of obligation**- “the doctrine of mutuality of obligation provides that neither party to a contract is bound unless both parties to the contract are bound.” This requires that performance under an agreement must be mandatory, as opposed to elective. - *Chris Goddard*

UNDERSTANDING THE CONTRACT TERMS: STANDARD PROVISIONS

- A contract has the following standard provisions:
 - Title
 - Preamble (Recitals)
 - Definitions
 - Consideration
 - Covenants
 - Representations and Warranties
 - Indemnification Clauses
 - Termination
 - Remedies

UNDERSTANDING THE CONTRACT TERMS: STANDARD PROVISIONS

- **Title**- reflects the subject matter of the transaction and names the parties.
- **Preamble (recitals)**- identifies the purpose of the transaction and the parties, the description of the transaction, and intent of the parties. The recitals make the contract enforceable.
- **Definitions**- the section provides the definition of terms in the contract. This section can simplify the document and provide clarification on “terms of art.”
- **Consideration**- “a benefit which must be bargained for between the parties, and is the essential reason for a party to enter into a contract.” Consideration must have some value and be given in exchange for a performance or promise of performance between the parties. This value is usually money.



UNDERSTANDING THE CONTRACT TERMS: STANDARD PROVISIONS

- **Covenants**- this memorializes the promises being made by the parties. - *Goddard*
- **Term**- this provision indicates the life of a contract.
- **Termination**- this provision sets forth the circumstances in which an agreement can be terminated and the procedures for termination.
- **Remedies**- this provision sets forth the consequences if the agreement terminates. This provision generally specifies what the parties are entitled to in the event of termination.

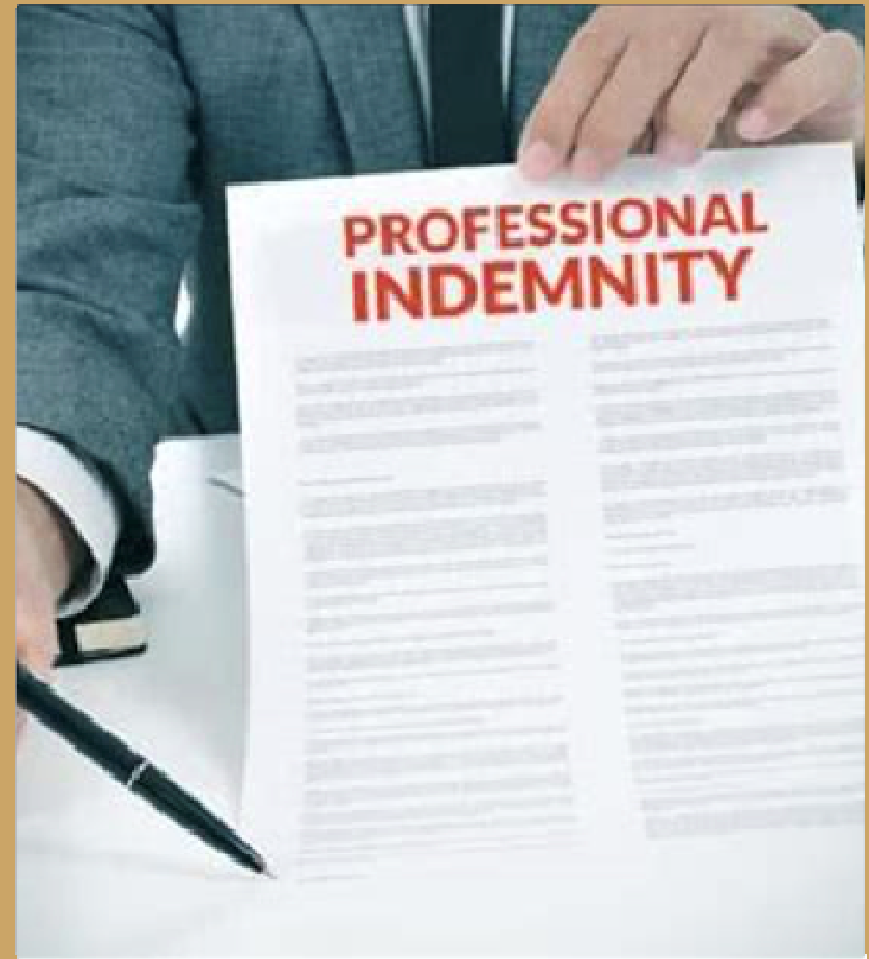


UNDERSTANDING THE CONTRACT TERMS: STANDARD PROVISIONS

- **Representations and Warranties-** Representation “is an assertion as to a fact, true on the date the representation is made, that is given to induce another party to enter into a contract or take some other action.” – Westlaw Warranties are “promises concerning the future quality or performance of goods to be sold or leased, of real property to be sold or leased, of intellectual property sold or licensed, or of services rendered.”- *Goddard*
 - Representations and warranties set forth the statements and promises that the parties rely in entering the contract.
 - If any statement is false, the other party may be entitled to void the contract based on the grounds of misrepresentation or seek damages.
 - If a warranty is deemed false, it is considered to be a breach.

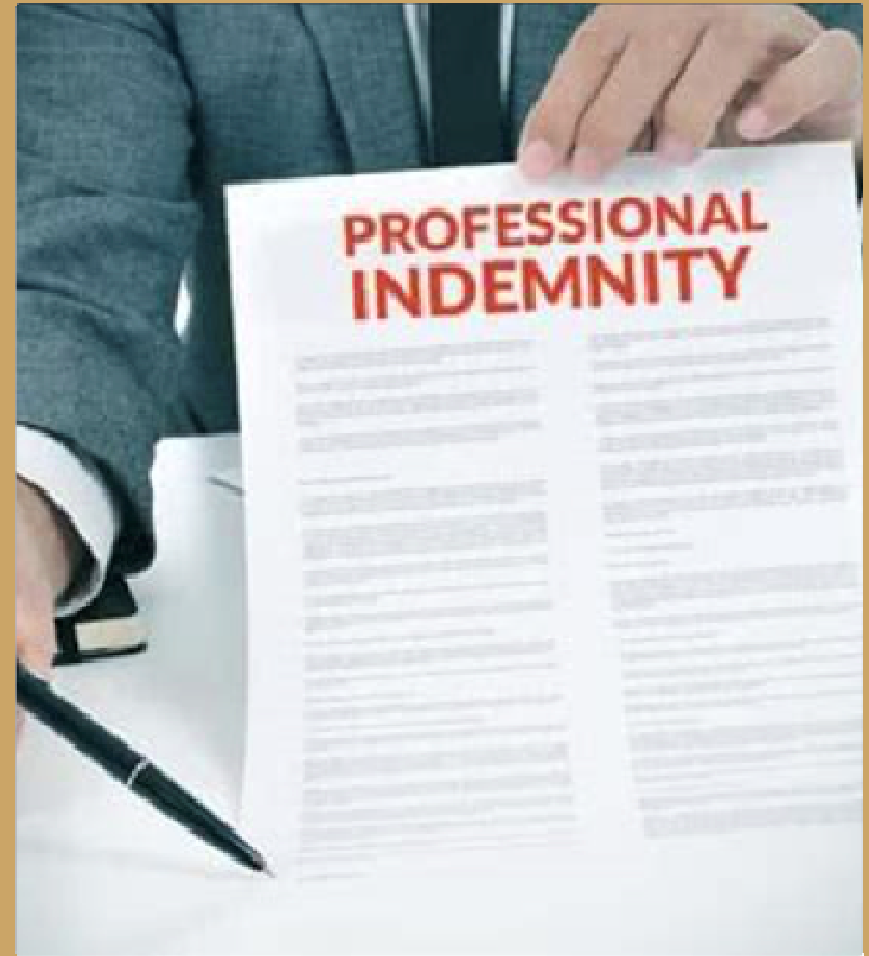
UNDERSTANDING THE CONTRACT: INDEMNIFICATION CLAUSES

- **Indemnification**- “an indemnity is a promise by one party to take responsibility for damages that the other party may suffer as a result of the first party’s breach of its warranties under the agreement.” -Goddard
- If there are representations and warranties in a contract, an indemnification clause must be included.
- The purpose of an indemnification clause is to permit one party to absorb the losses the other party may become liable for, either from losses related to the contract or losses from certain claims.
- This clause protects the indemnified party from lawsuits filed by third parties.



UNDERSTANDING THE CONTRACT: INDEMNIFICATION CLAUSES

- For example, if Party 1 agrees to indemnify Party 2 related to copyright claims to the development of a novel transcript. If Party 2 publishes the transcript and a third party files a lawsuit claiming copyright infringement, Party 1 is obligated to cover Party 2's court cost and any damages incurred if Party 2 is found liable.
- Contracting parties can limit the scope of indemnity clauses by limiting the warranties, state a cap amount a party is willing to pay the indemnified party in the event of indemnification, and purchase insurance to cover costs that may be incurred in the event of indemnification.
- It is imperative to ensure the indemnification clause is clear and concise. Additionally, the clause can be as broad or narrow per the parties preference.



UNDERSTANDING THE CONTRACT TERMS: ADDITIONAL PROVISIONS

- **Assignment**- this provision “determines whether rights, obligations, or duties can be transferred in whole or in part to another.” - *Contract Standards website*
 - Generally, rights under a contract are freely transferable unless prescribed or limited by the agreement.
 - The clause represents whether successors or another party can assume rights, obligations, or duties under the agreement.
- **Choice of Law**- the provision specifies the particular jurisdiction that will govern the agreement in the event a dispute arises.



UNDERSTANDING THE CONTRACT TERMS: ADDITIONAL PROVISIONS

- **Amendment or Waiver-** this provision specifies whether the agreement can be amended or any terms waived and the manner in which either can occur. This limits parties from amending the contract or waiving terms of the agreement without formal consent and proper form.
- **Arbitration-** this provision can be included to mandate that any dispute arising under the contract be arbitrated. This provision limits parties from contemplating pursuing a lawsuit in the event of a dispute.



UNDERSTANDING THE CONTRACT TERMS: ADDITIONAL PROVISIONS

- **Integration and Severability**
 - Integration provision declares that all prior agreements are to be disregarded and unenforceable. The purpose of such clause is to prevent a party from avoiding obligations of the current contract alleging the existence of prior agreements that conflict or supersede the contract as written.
 - Severability provisions provide the disregard for any provision found to be unenforceable while preserving the remainder of the contract. This provision may influence the court to consider an unenforceable provision to be severable from the remainder of the contract.
- **Notice**- this provision defines “a) form of notice; b) how notice should be made; c) when notice is deemed to be received.”- *Contract Standards website*
- **Authority to Sign**- this provision defines the authorization to sign a contract. The purpose of this provision is to ensure the signatory has the authority to bind a party to the agreement and possess legal capacity.

QUESTIONS?



Presented By:

**Amy Oraefo, P.C.
1100 Peachtree Street, Suite 200
Atlanta, GA 30309**

Phone: (404) 478-7844

Fax: (404) 478-9864

Email: aoraefo@aopclawfirm.com

Website: www.aopclawfirm.com