

**VIVEKANANDA COLLEGE
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NAAC ACCREDITED 'A' GRADE



Topic: Initial Contracts of Startups

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Preliminary contracts

Preliminary **contracts** are contracts entered into by the promoters on behalf of the company before its incorporation with third parties.

It is usual for the promoters to enter into these contracts of purchases of assets on behalf of the company about to be formed but before it is actually formed. They generally enter into these contracts as agents or trustees of the company, which has not yet come into existence.

Such contracts are legally not binding upon the company even after it comes into existence. The company can neither ratify those contracts nor sue the vendors on them after its incorporation because ratification requires existence of the principal at the time when the contract was entered into.

A company cannot adopt contracts entered into before its incorporation even by passing a special resolution or with the unanimous consent of its members. Thus, preliminary contracts will either have to be left as mere "gentlemen's agreements" or the promoters will have to undertake personal liability; which of these courses will be adopted depends largely on demands of the other party.

'Since the reincorporation contracts purported to be made by a company which does not exist is a nullity, neither the company when formed nor the promoter whose signature is added can sue or be sued on contract.

'Though a company cannot ratify a reincorporation contract, it may make a new contract after it is incorporated to carry into effect a contract made before it is formed.

The nature of the liability of the promoter on preliminary contracts depends on the tenor of such contracts. He can be held personally liable if he has purported to act as an agent and the non-existence of the company was known to both the parties.

This is because where a contract is made on behalf of a principal known to both the parties to be non-existent the contract is deemed to have been entered into personally by the actual maker.

But, if the contract is purported to be made by the company itself, the person so acting i.e., the promoter, cannot be held personally liable, for he shall be taken to have simply authenticated the contract and the company shall be taken to have entered into the contract and the company being non-existent the contract shall become nullity.

In order to avoid their liability, the promoters usually insert a clause in the original contract to the effect that if the contract is not adopted by the company after its incorporation within a limited time, both the promoters and the third party will be exonerated from liability. Some of the promoters simply agree to the draft contract to be entered into by the vendor and the company after incorporation.

However, Specific Relief Act, 1963 provides relief in case of preliminary contracts. Sections 15(h) and 19(e) of the Act provide that a contract entered into by the promoters on behalf of the company before its incorporation can be enforced by or against the company, if the following two conditions are satisfied:

(a) If the contract is entered into, for the purposes of the company and such contract is warranted by the terms of incorporation. The term “for the purposes of the company” implies that the contract should be for the working purpose of the company.

(b) The company accepts the contract after its incorporation and communicates such acceptance to the other party to the contract.



Types of contracts a startup needs

[Source: <https://blog.lawgeex.com/>]

These are contracts your startup needs in order to come into existence as a company and make sure the company has the rights it needs to provide a product or service.

- 1. Founders Agreement** – cover issues like ownership, responsibility, decision-making, and operating procedures
- 2. Assignments of IP** – Co-founders assign their relevant intellectual property rights to the company. Learn more about protecting your IP here.

Getting Funded

These are contracts your startup is likely to use in the process of getting funded.

- 3. Finder Agreements** – You agree to pay a finder for getting you money for your company. We discuss some of the issues and risks [here](#).
- 4. Investment Agreements** – These are agreements between a company and an investor in which the investor gets a certain share of ownership in the company in exchange for money.
- 5. Investment Term Sheets** – statements of the terms under which an investor would invest in your business. We discuss five ways to reduce your risk [here](#).
- 6. NDAs** – Startup founders often want potential investors to sign NDAs before they share their brilliant business ideas. However, as we discuss [here](#), many investors won't sign NDAs. Also, as we talk about [here](#), ideas are hard to protect – and the idea is only about 1% of a company's value. The real value is in the *execution* of the idea, the skills of the team, etc.

Renting Space

At some point, most startups will need their own commercial space. Running a business from your home can violate the terms of your residential lease and/or local zoning ordinances.

- 7. Commercial Leases** – We talk about some of the risk factors here.

Hiring People

To succeed, your startup will probably need to grow beyond the original group of founders.

- 8. Employment Agreements** – these state the terms of employment, such as salary, benefits, vacation time, stock options, etc.
- 9. Assignments of IP** – These may be part of employment agreements or stand-alone agreements. Issues include whether the employer owns inventions and business ideas that the employee comes up with, as we discuss [here](#).
- 10. NDAs** – Again, these can be part of a general employment agreement or a separate document. NDAs sometimes include non-competes, which aren't enforceable in all states. We talk about non-competes [here](#).

Getting and Providing Services

All startups need to obtain certain services. Some startups also provide services.

- 11. Services Agreements** (Development Services, Consulting Services) – You use these for getting vendors to provide you with services (such as app development, launch party catering, or office cleaning) or to provide services to others.
- 12. Statements of Work (SoWs)** – These detail the nature of the services and deliverables, and are usually part of a services agreement.

Getting Stuff to Customers

Whether you're selling widgets or licensing software, your startup needs to get your products to customers. Some startups are able to do this directly, but many use third party help.

- 13. Distribution Agreements** – These are usually between a manufacturer or vendor and distributor. Some key terms are the duration of the agreement, whether it's exclusive, and the territory covered.
- 14. Reseller Agreements** – These are agreements with companies that buy products and generally "add value" (for example, by combining a product with other products or services) before reselling it.

Licensing Stuff

Whether access to your software or service is free or paid, you want to control how others use your IP rights.

- 15. End User License Agreements (EULAs)** – These are usually non-negotiated shrink-wrap or browse-wrap agreements. They govern how users can use the software. They generally limit the licensor's liability and prohibit things like reverse engineering. You can read about some ridiculous clauses [here](#).
- 16. Software Licenses** – Although a EULA is also a software license, when people talk about software licenses they're often talking about something that's more elaborate and negotiated than a EULA click-wrap. For example, with big deals, big clients, and custom software there's more likely to be a negotiated agreement.
- 17. Evaluation Agreements (Trial License, Test License)** – These let potential buyers check out products (such as software) before buying them or paying for a license.