

## Essential Contracts for Growing Businesses

written by Aurelia Menezes | October 18, 2022



Have you wondered what makes parties to a business transaction adhere to their promise?

In the fast-growing economy of the present-day era, corporate and growing businesses transactions have increased manifold. To grow such transactions, businesses have often made use of the instrument of contracts. The contracts law in India is one of the oldest laws of mercantile, governed by the Indian Contract Act, 1872.

India, as a developing country, is giving rise to various new businesses and start-ups across the country. The government has introduced several schemes such as Make in India and Start-up India to further increase India's standing in the global market. Every business or start-up necessarily undertakes business transactions, both unilateral and multilateral, for sales, services, transfer of property, and so on. Any such transaction requires the interested parties to enter into a contract, which may be either a unilateral contract or a bilateral contract.

Any such contract is an agreement that is intended to be legally enforced and specifies the rights and liabilities of the parties to the contract. In case of a breach of contract, the aggrieved party has the right to approach the appropriate court and seek damages or the specific performance of the contract. This way the interests of all the parties are ensured and protected, especially for new and upcoming businesses. There are several contracts essential for growing businesses. This article will first highlight the significance of such essential contracts, followed by a brief explanation of a few of these essential contracts including:

- Employment Agreement
- Non-Disclosure Agreement (NDA)
- Shareholders Agreement (SHA)
- Founders & Co-founders Agreement

What Are Essential Contracts?

Several contracts are essential for upcoming businesses to secure their interests and achieve their objective. Some of these essential contracts, which are governed by the principles of the contracts law of India, are:

- Employment Offer Letters
- Confidentiality & Investment Assignments
- Service Contracts

- Confidentiality Agreements
- Website Terms of Use Agreement
- Letters of Intent
- Stock Purchase Agreement
- Lease
- Loan Agreements
- Founders Agreement
- Intellectual Property Rights Assignment Agreements
- Bylaws
- Shareholders Agreements

#### Significance Of Essential Contracts

These essential contracts are very important to ensure that the business runs smoothly without any misunderstanding and without accidentally incurring any legal liability in the early phases for the following reasons:

- Contracts govern the relationships of the business with its customers, employees, shareholders, and all other such stakeholders. This is usually done by way of unilateral contracts, wherein the business agrees to pay for a specific act, or by way of a bilateral contract between the business and the employee, etc. It also enables the parties to enforce their rights based on the terms of the contract.
- A contract forms a comprehensive proof of information since all the details discussed and agreed upon by the parties are laid down on paper. Contracts such as the NDA ensure that the confidentiality of sensitive business and internal information is maintained.
- A contract further provides a written record of all terms governing commercial transactions, which can be used as evidence in a court of law as well. This aids in seeking remedies in the event of a breach of contract.

#### Essential Contracts: Explained

##### Employment Agreement

An employment agreement is a contract between the business organization and its employee to avoid any misunderstanding with the employee which could lead to legal liability for the organization.

The contents of an Employment Agreement include:

- Terms & Conditions of Employment
- Compensation
- Roles and Responsibilities of the Employee
- Confidentiality Clause
- Working Hours
- Grounds of Termination
- Reporting Structure
- Non-compete/non-solicit
- Intellectual Property Ownership (to remain with the business)
- ESOPS (if any)
- Company Policies
- Dispute Resolution mechanism

##### Non-Disclosure Agreement (NDA)

- A Non-Disclosure Agreement is a confidentiality agreement. The parties signing such a contract, especially the employees of the growing businesses, undertake that they will not share any confidential and/or sensitive information with anyone.
- Confidential information may be any such sensitive information about business

ideas and strategies of the organization, sensitive financial and investment records, work conditions, legal and regulatory affairs, assets, inventory, intellectual property, trade secrets, etc. In simple words, it is any non-public information concerning any aspect of a business. Such information is owned only by the organization and no individual can disclose it beyond the organization unless required by law.

- The time frame of every NDA is unique and depends from organization to organization. However, generally, the time frames range from 1-10 years. But depending on the nature of the confidential information, the time limit may be altered and can also be indefinite.
- A very common example is that of Apple, which has maintained strict confidentiality of its technology and future products unless they are ready to be released.

#### Shareholders Agreement (SHA)

A Shareholder's Agreement describes the internal management structure of the company and outlines the rights and obligations of the shareholders to successfully safeguard their interests in general. This is a legal document that is primarily a contract between some or all the shareholders of the company.

The general contents of SHA are:

- The proportion of shares held by each shareholder/share capital structure
- Representation and warranties
- Transferability, voting and dividend rights
- Rights of different classes of shares for different categories of shareholders
- A mechanism for share transfer or sale
- Exit rights
- Indemnity
- Management of the company (Shareholders/board meeting etc)
- Liquidation preference
- Anti-dilution rights

#### Founders & Co-Founders Agreement

- A Founder's Agreement is a contract signed by the co-founders of a company that describes the equity participation goals and position/role of each founder. It includes the obligations, benefits, positions, promoter lock-in period, IPR, non-disclosure obligations, share vesting, dispute resolution and remuneration of each founder. Terms may be used in an LLC or a partnership agreement, including a company strategy, goal statement, etc.
- The Pre-Incorporation Contract can form the foundation of this contract as it delineates the nature of each ownership share.

#### Conclusion

The number of growing businesses and start-ups has significantly stressed the need to regulate business transactions safely and smoothly. Essential contracts that growing businesses should enter into aid in securing business transactions through their certainty, thereby preventing any ambiguity leading to disputes. Further, since these contracts are governed by the contracts law of India, they render a legal identity to all such business transactions.

The age of technology also increases the importance of securing business transactions, with the introduction of new and upcoming forms of contracts such as smart contracts, etc. The advent of globalization has also posed

multiple challenges with the increasing number of start-ups with foreign investment etc. Proper contract management, thus, becomes key to regulating and safeguarding the interests of growing businesses.

Frequently Asked Questions (FAQs)

What are the 3 common types of contracts used in business?

The 3 common types of contracts used in business are:

1. Employment Agreement
2. Licensing Agreement
3. Non-Disclosure Agreement

What all documents are required for start-ups?

Under the Start-Up India Scheme, 2016, the following documents are required for start-ups:

1. Incorporation - Partnership Agreement/Certificate of Incorporation for Pvt. Ltd. or LLC.
2. PAN Card
3. Details about Patent and Trademark
4. Articles of Association
5. Non-Disclosure Agreement
6. Employee Contracts and Offer Letters
7. Shareholders' Agreements
8. Bylaws
9. Founder and Co-Founder's Agreements

What are common contracts?

Common contracts are business contracts usually encountered in the operation of small businesses. Most common contracts can be categorized into three broad categories:

1. Sale-related contracts
2. Employment-related contracts
3. General business contracts

Contributed by Aurelia Menezes, Partner & Abhilasha SG, Associate