The Service Agreement Field Manual

Understanding and Negotiating
Creative Service Agreements Like a Pro

Table of Contents

INTRODUCTION **1**

It Always Starts the Same 1
Who is this Book For? 1
How to Use this Book 2
Disclaimers 2

TL;DR TEN KEY ISSUES **3**

NEGOTIATION **5**

The Negotiation Equation 5
Negotiating from the Best Position 6

THE SERVICE AGREEMENT **8**

Services and Deliverables 9

The Engagement *9*
SOW Conflicts *11*
Acceptance of Work *12*
Conclusion *14*

Fees, Costs, and Invoicing 15

Introduction *15*
Invoices *15*
Payment Terms *16*
Taxes *18*
Conclusion *19*

Intellectual Property 20

Introduction *20*
Ownership of Work *20*
Client Materials *23*
Third-Party Materials (Including Open Source) *25*
Names, Logos, and Slogans (Trademarks) *27*
Conclusion *30*

Term and Termination 31

Generally *31*
Term *31*
Termination *32*
Stopping Work *36*

Kill Fees *37*
Conclusion *39*

INDEMNIFICATION 40

Introduction *40*
Elements of an Indemnity Clause *40*
Conclusion *48*

LIMITATION OF LIABILITY AND DISCLAIMERS 49

Introduction *49*
Limitation of Liability *49*
Disclaimer of Warranties (AS IS Provision) *53*
Conclusion *55*

OTHER PROVISIONS 56

Portfolio *56*
Insurance *59*
Conclusion *61*

BOILERPLATE 62

Exclusivity *62*
Independent Contractor *64*
Confidentiality *65*
Attorney Fees *65*
Assignment *66*
Governing Law *67*
Venue / Jurisdiction *69*
Arbitration *70*
Notices *71*
Severability *73*
No Waiver *73*
Cumulative Rights *75*
Survival *75*
Injunctive Relief *76*
Integration / Entire Agreement / Amendments *77*
Counterparts *78*

CONCLUSION 79

OTHER READING 79

Introduction

It Always Starts the Same

You get a great lead and deliver an awesome pitch. The client is ready to sign up. Over comes the form of Service Agreement with the usual prod:

It's all the standard stuff. Just sign and we'll get started!

Until today, you've held your nose, signed on the dotted line, and sent the contract back–probably happy to be rid of the thing. But you also probably wished you understood contracts better or (again) promised yourself to learn a bit more for next time...

That next time is now.

Who is this Book For?

This book is for any creative firm facing c*lient drafted* service agreements. While you likely have your own form of Service Agreement, it (hopefully) has been drafted specific to your business, preferences, and risk tolerances. Incoming Service Agreements are different. They are often generic and extremely one-sided in favor of the client. This book will help you understand and negotiate those agreements into a contract you can live with.

This book considers the issues typical to design, development, branding, and related types of creative services. Regardless of your creative specialty, the agreements you face will likely contain many of the provisions in this book. Unfortunately, we can't cover everything. Every contract is different. There will always be specifics to your business, a project, or your industry that require advice and customization beyond the scope of this book. So, use your judgment about when to rely on this book and when to ask for help.

How to Use this Book

This book is arranged around the major sections common to creative Service Agreements. For each section, we'll explain in plain English what the clause means, key issues to watch out for, and some alternative approaches to consider during negotiation. Next time you are faced with a clause you don't understand or gives you concern, simply skim the table of contents for the relevant section or do a word search to find discussion on that topic.

This book has lots of examples of contract language you'll encounter as well as language you can use. Sample language will be presented like this:

This is some fine sample contract language. It has been hand-crafted with love before being delivered fresh for your review. Don't negotiate away all the best bits.

Last, a few defined terms. Whether you are a full-service agency, a growing studio, or an adept freelancer, in this book you are the *Agency* and your client is the *Client*. The agreement you are facing may go by many names: contractor agreement, master Service Agreement, customer Service Agreement, vendor agreement, Service Agreement, and the like. Whatever your agreement is called, in this book we refer to it as the *Service Agreement*. The document containing the project specific details is the *Statement of Work* or *SOW*.

Disclaimers

This book is not a substitute for having a lawyer and it isn't legal advice. Its educational material. And, what should come as no surprise to you, I'm not your lawyer. I know it seems ridiculous that I must say these things…and you're right. You can thank *some other lawyer* for that.

Negotiation

The Negotiation Equation

Behind every contract is something I call the Negotiation Equation.

$$Price = (Services + Deliverables)\ x\ Production\ Risk\ Multiple$$

Don't worry, there won't be a test. It's just a way of illustrating how the risks of a job affect price. A ridiculous example helps illustrate.

Suppose your Client asks you to develop an icon for its new mobile app. Based on experience, you know that $2,000 is a ballpark price to design the icon under normal circumstances. Consider how would you price the work under these two scenarios:

- **Scenario 1**. You develop the icon from the comfort of your studio and deliver the icon by email.

- **Scenario 2**. You develop the icon while standing on a tight rope over a pool of sharks. And the sharks have lasers on their heads.

Same set of services and deliverables in each scenario. Should they be priced the same? Of course not. In Scenario 2, you are taking on substantially more risk. In the equation, the "Production Risk Multiple" is higher – maybe substantially so. If you judged the pool of sharks to increase the risk by a factor of 10, then the price for the icon would go from $2,000 to $20,000. Same deliverables with different risks means a different price.

Keep this in mind while negotiating. When you encounter objectionable language, consider responding not with a markup but with a conversation about price:

> *The indemnification provision you've requested substantially increases our risk and the work we must do to manage that risk. We can consider it, but it will dramatically affect our price. Can we discuss alternatives on the language or would you like us to send you updated pricing?*

You are essentially challenging the Client to put its money where its mouth is: how important is that contract clause? Are they willing to pay for it?

Negotiating from the Best Position

In most projects, there is often a ballpark proposal or draft SOW circulated before the formal contract is negotiated. This initial proposal doesn't have all the details sorted yet. It's just a tool the Client uses to get a sense as to the scope and budget for the project. The key is to make clear that your fee assumes not only a certain scope of work, *but also certain legal terms*. That way, if the Client insists on terms markedly different than what you are comfortable with, you have a basis for adjusting your fee or having a discussion.

One approach is to set the baseline for discussions at *your form* of Service Agreement:

> *This scope and fee estimate assume that our final agreement will contain terms like those in Agency's standard form of agreement. If you require terms different from those provided in our agreement, our fee will be increased accordingly.*

You can also set your baseline by describing important key terms:

This estimate assumes that our final agreement will contain terms customary for deals of this size and type including: (i) mutual limitation of liability clauses; (ii) transfer of intellectual property conditioned on payment by Client for the applicable deliverable; (iii) a kill fee of 25% if Client terminates without Cause; and (iv) equal monthly billing in advance over the course of the project.

If you require terms different from those outlined above, our fee will be increased accordingly.

The above terms are just examples. Use a similar approach to detail whatever is important to you on that project or with that client. If it is a new client with an unknown payment history, maybe you want to specify that the Client use pay monthly in advance rather than on completion. By specifying that term with your proposal, you've set the expectation and can get an early read as to whether your Client will accept.

What do you say when the client insists on its own Service Agreement or ignores your key terms summary? Respond like this:

Recall that our proposal assumed XXX. These are key terms that were reflected in our price. While I'm happy to discuss the terms you requested, please note that they will impact our fee by approximately $$ to $$.

These conversations are not easy. The first time you do it is the hardest. The next one is easier and they get easier from there. The strength in this approach is that your requests are based on a bargain and a notion of fairness:

more risk costs more money // less risk costs less money.

Limitation of Liability and Disclaimers

Introduction

Down toward the bottom of a Service Agreement, it is common to find a few provisions in ALL CAPS that reads like an excerpt from a legal dictionary. These clauses are as important as they can be impenetrable. This section breaks through the jargon with the information you need to know and how to better negotiate these clauses.

Limitation of Liability

Limitations on the Types of Liability

One of the clauses you'll want to keep an eye out for is a limitation on the types of liability the contract parties can be held responsible for. A typical clause reads something like this:

> *CLIENT IS NOT LIABLE FOR ANY INDIRECT, SPECIAL, INCIDENTAL, CONSEQUENTIAL, EXEMPLARY OR PUNITIVE DAMAGES, REGARDLESS OF THE FORM OF ACTION WHETHER IN CONTRACT, TORT (INCLUDING NEGLIGENCE), STRICT LIABILITY, OR OTHERWISE, EVEN IF SUCH PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES.*

It's tough to parse, but this clause says that if there is a lawsuit, the Client cannot be liable for certain types of damages, namely, indirect, special, incidental, consequential, exemplary or punitive damages. Put another way, this clause ensures that liability is only determined with respect to the *contractual* bargain and not other business consequences (many of which may not be foreseeable).

By way of example, if you order a steak medium-rare and it arrives well done, a clause like this means your remedy is either to have the steak redone or taken off the bill (the bargain). You don't get to sue the steakhouse for a weekend's worth of lost enjoyment and punitive damages for over-cooking your steak.

Now let's talk about a few negotiating points:

- **Mutual**. It is totally acceptable for this clause to apply to both Agency and Client. If it is one-sided favoring Client, you have an easy edit and a good argument to make this work both ways. This is a key issue and appears on our tl;dr Ten Key Issues list.

- **List of Damages**. Look for the list of excluded damages to include indirect, special, incidental, consequential, exemplary, and punitive damages. The sample language above contains all of these types of damages. This is appropriate. Relatedly, make sure the list includes lost profits. The sample language above is missing this important limitation.

- **Notice Ineffective**. Ideally, you'd like to see a clause that states that the limitations apply even if the liable party has been advised that such damages are possible.

- **Make Conspicuous**. Finally, these provisions generally need to be "conspicuous" to be enforceable. To most lawyers, this means written in ALL CAPS. While this was the only way to do it when all we had were typewriters, we fortunately have choices now. Bold text, larger text, text in a shaded box are equally conspicuous. I'd avoid betting on just italics to make something conspicuous.

This clause serves the important purpose of limiting the scope of potential liability the contract bargain struck by the parties and not some other theory of liability.

Limitations on the Amount of Liability

With or near the clause limiting the types of liability is often a clause limiting the amount of liability. Like limitations on the types of liability, this important clause appears on our tl;dr Ten Key Issues list. A Client's first draft of a Service Agreement will often contain a clause like the following:

> *EACH PARTY'S MAXIMUM AGGREGATE LIABILITY UNDER THIS AGREEMENT SHALL BE LIMITED TO THE GREATER OF THE TOTAL AMOUNTS PAID BY CLIENT TO AGENCY DURING THE TWELVE (12) MONTHS IMMEDIATELY PRECEDING THE CLAIM OR ONE MILLION DOLLARS ($1,000,000).*

Clauses limiting the *amount* of liability are important to ensure that the *scale* of responsibility under a contract isn't out of whack. For example, it is entirely possible for a small, three-person Agency to do design work for a Client like Apple, Nike, or Facebook. The scale of the Client in these situations is completely out of proportion to that of the Agency. If something went haywire, the scope of damages for a company like Apple, Nike, or Facebook could be astronomical. A clause like this right-sizes potential liability to an amount appropriate for the scope and nature of the work.

The amount of the liability cap is the key negotiating point. The following are typical points along a range from most Agency favorable to least Agency favorable along with a couple general negotiation points.

- **Profits**. The most Agency-favorable cap would be to limit damages to the profit portion of Agency's fee. Should the worst happen and you end up paying damages, at least you break-even on the project.

- **Fee**. The next most favorable cap for an Agency is to set it at the total contract fee. This is probably the most typical cap. For longer term contracts, its typical to set the cap at the total fees paid over some period, 12 months is typical.

- **Insurance**. The next point on the spectrum would be to cap damages at the amount of available insurance. Depending on coverage limits, this might be a lower cap than the fee. If you do set the cap based on insurance, the Agency should be sure to describe it as the amount of insurance *collected* by Agency. This way, if insurance doesn't pay or pays a limited amount, the cap is limited accordingly. A cap tied to insurance is less common in my experience.

- **Fee Multiple**. Next on the spectrum is a cap at some multiple of the fee. Keeping the multiple lower is your goal here. Don't limit yourself to whole multiples of the

fee: a 1.5x multiple is better than a 2.0x multiple. Also, the point above about stating the cap as a multiple of fees *collected* applies equally here.

- **No Cap**. Obviously, this is the least favorable to an Agency. A contract without this type of clause arguably has no cap.

- **Make Mutual**. Like limitations on the amount of liability, it is completely appropriate for the clause to benefit both Client and Agency. Do not accept a one-sided limitation of liability clause that only limits liability for Client. Also, if it is a mutual cap on liability and the cap is set at fees paid or profits, be sure the clause makes clear that Agency's ability to collect its fee (and possibly attorney fees) is not also capped (see example below).

- **Keep Conspicuous**. Also like other liability limitations, this clause should be "conspicuous". I recommend bold text.

Clients are in a much better position (and are differently motivated) to manage liability for the scale of their business. Use these tips to ensure that Agency isn't unfairly shouldering liability for the scale of Client's business (something over which Agency has no control).

Limitations on Limitations

With both types of liability limitations, more sophisticated Clients will ask for a list of carve outs: certain things that the limitation doesn't cover. The following is a typical list of the exceptions a Client might request (all of which are reasonable):

- indemnification obligations (most notably, infringement indemnification);

- Breach of warranties regarding non-infringement

- breach of confidentiality obligations;

- breach of provisions regarding Client's data confidentiality and security requirements;

If the limitation of liability clause presented to you contains these exceptions, you'll have a hard time getting them removed. If the clause does NOT contain these exceptions,

you are typically better off *not* offering them. Even on a mutually limitation of liability clause, the exceptions generally work to Client's benefit rather than Agency.

Sample Language

A fairly negotiated limitation of liability provision incorporating many of the above recommendations might read like this:

Limitation of Liability. *In no event may either party be held liable for lost profits or any indirect, special, incidental, consequential, exemplary, or punitive damages related to this Agreement. Either party's maximum liability to the other under this Agreement will not exceed the amount paid by the Client to the Agency. These limitations do not apply to claims subject to indemnification under Section X, Client's obligation to pay fees and costs due under this Agreement, and claims for attorney fees under Section X.*

Disclaimer of Warranties (AS IS Provision)

A typical warranty disclaimer looks something like this:

EXCEPT FOR THE EXPRESS WARRANTIES SET FORTH IN THIS AGREEMENT, EACH PARTY DISCLAIMS ALL OTHER WARRANTIES, EXPRESS OR IMPLIED, INCLUDING THE IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE.

The purpose of the AS IS clause is quite simple: to ensure that only the express, written warranties (i.e., promises) about Agency's work are the ones being relied upon by Client. This isn't Agency disclaiming the quality of its work. Rather, this is just the Agency saying, "if you want specific promises about our work, let's put them down in black and white" (instead of wondering what some judge may infer).

Sometimes warranty disclaimer looks like this:

EXCEPT AS REPRESENTED IN THIS AGREEMENT, ALL SERVICES AND DELIVERABLES PROVIDED BY AGENCY ARE PROVIDED "AS IS".

The words "AS IS" are equivalent to the words "DISCLAIMS THE IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE". Sometimes the clause contains both formulations. This handbook refers to both as the AS IS disclaimer.

A few thoughts when negotiating the AS IS clause.

- **Be Sure It Is Included**. The primary negotiating point is to ensure the clause is present. This is one of the other critical provisions from the tl;dr Ten Key Issues list.

- **Mutual**. Its ok for this clause to be mutual. To be sure, the clause is of of less importance to the Client since they typically aren't providing the Agency goods and services. But hey, if the Client agrees to including the clause simply by making it mutual, go for it.

- **Title**. You'll sometimes disclaimer of the "implied warranty of title". Removing that language is a fair thing for the Client to request. If you must give up the reference to title to keep the AS IS language, that's an OK trade.

- **Noninfringement**. You'll also sometimes see this clause attempt to disclaim the "implied warranty of noninfringement". A Client won't like to see disclaimer of non-infringement. Better than trying to add a noninfringement disclaimer to the AS IS clause, you should address the scope of infringement liability in provisions relating to Client Materials, Third-Party Materials (Including Open Source), Names, Logos, and Slogans (Trademarks), and Indemnification.

Remember, the purpose of the AS IS clause is to limit the scope of promises about the quality of services and deliverables to *only those written in the agreement*. If Client pushes back about a warranty disclaimer, the proper response is to ask the Client what specific warranties the Client is looking for. Once the client identifies those things, you can

discuss whether the Client's requests are appropriate for the situation and document them accordingly.

A fairly negotiated AS-IS clause might read like this:

> ***Disclaimer of Warranties***. *Except as represented in this agreement, all Agency services and work product are provided "AS IS".*

Conclusion

Limitations on liability and warranty disclaimers are powerful protections for an Agency. If your client refuses to include either or both provisions, that doesn't mean the deal is off. Rather, you need to make a business judgment.

If you have a good relationship with the Client, the work is routine, and the project low-risk, then you may not be giving up much by losing these clauses. However, if the work is complicated or if the Client is difficult, these clauses can be extremely important. Doing custom back-end development for a Fortune 500 businesses or venture backed startup is certainly higher risk than a rebrand and website for local retail chain.

Lastly, if you can't get the provisions you want, remember The Negotiation Equation: your overall fee must compensate you for any extra risk you are taking on by doing the project without these protections.