

Using Contractors To Create a Project Team: Legal Issues to Watch

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You've landed a great contract, a contract so great that you can't do all the work yourself or your current staff. You know just the person to do the number crunching so you can work on the strategic direction and client management. Before you call her, keep the following issues in mind and you will have a better chance that you and the technician realize all the potential benefits the contract offers. Each of the issues below is potentially complex, and will be discussed in more detail in future articles. This should give you an idea, though, of the issues you need to consider even before you consult with your lawyer. For more perspective on many of these issues, consult my prior article on client agreements at <http://library.soa.org/library-pdf/SCF0406.pdf> on page 9 of that issue.

Intellectual Property Issues

You need to consider IP issues to protect your own intellectual property, and to make sure you are buying the rights to the contractor's work that will allow you to fulfill your commitments to the client. Make sure the contractor acknowledges that any materials he will access during the assignment are your intellectual property, and that he agrees to keep it confidential. If the contractor's knowledge of the information would give the contractor a leg up in competing with you, then the agreement should contain a tightly drafted non-compete limiting the contractor's ability to offer a competing product or service for six months to a year. The contract should provide that any work by the contractor is "work for hire," which means that his work product belongs to you. If the contractor retains ownership rights in his work product, then the agreement has to provide that he grants you an irrevocable fully paid license to sell the IP as a part of your product and service and to grant similar licenses to your customers.

Non-Competition / Non-Solicitation

You also want to make sure that your contractor does not divert the client or other future business opportunities from you in the future. These agreements can take two forms: a non-solicitation clause that restricts the contractor's right to do business with a specific client, or a non-compete clause, that restricts the contractor's right to do business in a certain sector in a certain geographical area for a period of time. A non-solicitation clause should provide that the contractor may not do any business with the client for six months to a year. Areas of flexibility are making the non-solicitation apply only to a certain division, if the client is large, or allowing the contractor to provide non-competitive services to the client. Allowing the latter, however, risks diluting your contacts with the client. If you become aware of an opportunity to provide service to the client that is not in your area, you probably want to reserve the ability to either subcontract out the work, or at least be able to hand a plum assignment to someone who might be able to return the favor in the future.

There are two theories in drafting non-compete agreements: either draft a very broad non-compete in hopes that it will be enforced to the full extent the law allows, or narrowly draft the non-compete specifically to protect your materials interests. In the context of dealing with a fellow-professional in a short-term assignment, the latter theory is preferable. You do not want your profit on the deal eaten up in re-negotiating a draconian non-compete to reach a result that will be acceptable to your contractor. Spend some time thinking about how to define the business you want to protect, and the actual geographical area in which you do business. You

will end up with an agreement is less likely to sour the relationship with your contractor, while making it more likely that a court will enforce it.

Employee vs. Contractor

One of the most important issues to address in the agreement, especially one that is longer term, is to make sure that the contractor will not be considered an employee. Employee status means potential liability for unemployment, worker's compensation, employment taxes and employee benefits such health insurance if you have a group plan. So long as you only have one employee, you generally don't have to worry about statutory employment laws like discrimination and employee-benefit statutes. There are twenty factors that go into determining whether someone is an employee or a contractor. The following web site has a good list:

<http://www.bsrvm.berkeley.edu/procure/purguide/20lawfac.html>. One factor not listed is that a contractor is less likely to be considered to be an employee if payment is contingent on the payment to the prime contractor. All the factors do not have to be present, but you should structure the transaction, and have the agreement contain acknowledgments, that establish as many as possible. These factors are weighed differently in different situations, and it can be quite difficult to determine ahead of time how a court or the Department of Labor will rule in a specific instance. Keep these issues in mind and try to address as many as you can, and you will probably be okay.

Payment Terms

If the contract is an hourly contract, it is appropriate to pay the contractor less than the rate you are billing to your client. Like a placement firm, you should be compensated for the benefit the contractor is getting from your sales and marketing expenses. One of the more controversial issues with payment terms is whether the contractor gets paid only when you get paid on the prime contract. Guaranteeing payment does increase the chance the contractor would be classified as an employee, so if it is a close case, you may want to insist on payment to the contractor depending on you getting paid. One way to address the issue is to separate the compensation into two parts: one portion paid hourly and guaranteed, and the rest being some form of profit sharing paid upon completion of the project. If you do have some type of profit sharing, make sure the agreement provides that profit is determined after direct and indirect expenses on the contract are deducted, including some portion of your fixed overhead.

With attention to a few of the legal issues noted here, you can successfully use contractors to create just the right virtual firm to handle a wide variety of projects that you could not handle on your own, but without shouldering the burdens of full-time employment.

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