

Chapter 8

The Legal Environment



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Protecting Your Ideas

- Suppose you have a marketable idea for a product or service.
- You know you need help to put the idea into effect, but you don't want someone to steal your idea.
- What can you do?
- Depending on your product, you have several options.
- The group of laws that affects how ideas are protected is called **intellectual property law**.
- Before you can learn how intellectual property laws can help you protect your ideas, you need to define what it is you're trying to protect.
- If you want to protect an invention of some type, that falls under *patent* law.
- Protecting a logo for your business is a *trademark* issue. If you write music, software, or books, your protections come under the headings of *copyright law*. And you create recipes for food, you will deal with *trade secrets*.



Patents

- A **patent** is a grant to an inventor that gives him or her the exclusive right to produce and sell an invention.
- It lasts for a period of 21 years from the date of application.
- The invention must qualify under the rules of the Patent and Trade Office.
- **The Process** – To protect your invention, you should file a disclosure document with the Patent and Trademark Office (PTO). This statement costs \$25 to process. In the application, you confirm that you are the inventor of your product and describe it in detail. Within two years you must file an application with the PTO.
- **The Patent Search** – While the PTO researches the patent application, the patent is said to be in **patent-applied-for** status. This means that the public can't look at the application and drawings. If the PTO decides your claims are valid, it will issue you a patent. It may, however, decide that some or all of your claims are not valid. In that case, you may revise them and resubmit your application. Once the PTO declares that your claims are accepted, your patent is in **patent-pending** status until the patent is actually issued. If you are marketing your product at that point, you must put the phrase *patent pending* on the product or packaging.



Copyrights

- A **copyright** is similar to a patent, except that it protects original works of authors. These works include such things as books, movies, musical compositions, and computer software.
- If you plan to publish (or make public) your work, copyright law recommends that you do two things. First, place a notice of copyright in a prominent location on the work. This notice must include the symbol © or the word *Copyright*, the year of the first publication, and the name of the copyright holder. Second register your work with the Copyright Office. The office is a branch of the Library of Congress.
- You should be aware that a copyright protects only the form in which the idea itself. For example, if you write a database software program, the program that produces the database is protected, but the idea of a database as a tool is not.
- A copyright lasts for the life of the author plus 50 years.
- After that, the work goes into the **public domain**, which means that it can be used by anyone free of charge.



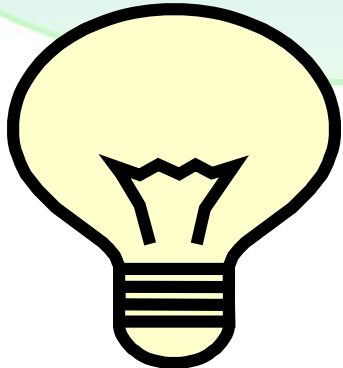
Trademarks

- A **trademark** is a word, symbol, design, or combination of these that a business uses to identify itself or something it sells.
- Trademarks are followed by the registered trademark symbol ®.
- For example, a rainbow-colored apple with a bite taken out of it is the trademark of Apple Computer.
- It is recognized worldwide.
- Similarly, a design or symbol that describes a service business is called a service mark. The stylized M on a McDonald's sign is an example of a **service mark**.
- Like a patent or a copyright, a trademark provides legal protection.
- If a business registers its trademark with the PTO, the trademark cannot be used by a competitor. However, a trademark cannot be registered with the PTO until it is actually going to be used. Like a patent applicant, a business seeking trademark status for its symbol must prove that the design is original and distinctive.
- Unlike a patent, a trademark can be held indefinitely – unless it becomes common usage in the English language.
- Words like *aspirin*, *yo-yo*, and *thermos* were once registered trademarks.
- Today they are no longer exclusively by the businesses that created them.
- They have become generic terms.



Patent and Trademark Rules

There are four rules that determine if your invention can be patented.



1. The Invention Must Not Contain Prior Art.

It shouldn't be based on anything publically available before the date of the invention.



2. The Invention Must Fit Into One Of Five Classes.

It must be either a machine (e.g., a rocket, fax), a process (e.g., chemical reactions), articles of manufacture (e.g., furniture), a composition (e.g., gasoline), or a new use for one of the four categories.



3. The Invention Must Be "Unobvious."

The invention must not be obvious to someone with skills in the field. It should be new and unexpected.

4. The Invention Must Have Utility.

This means it must be useful, not just whimsical or silly.



Laws Affecting Starting Up Your Business

- Certain legal requirements are fundamental to your ability to do business.
- If you cannot meet the requirements, you cannot even start up your company.
- There are three categories of laws you should be aware of before you start your business:
 - Permits and Licenses
 - Contracts
 - Choosing a Location



Permits and Licenses

- Before you can officially open the doors of your business you must get a business permit from your local government.
- This permit allows you to do business in your community.
- It will most likely have to be renewed annually.
- You will be required to pay periodic fees throughout the life of your business.
- The size of the fee is usually based on how much the business earns.
- You may also have to get a license.
- Certain professions require you to show that you have the necessary education and training to do the job.
- For example, doctors, nurses, barbers, accountants, and counselors all need special licenses.
- Such licenses protect consumers from unskilled or unqualified business operators.
- Licensing requirements vary from one state or locality to another.
- Be sure you have the necessary licenses before you start your business.
- Check with your local government or your state department of licensing and regulation for information.



Contracts

- A **contract** is a binding legal agreement between two or more persons or parties.
- As an entrepreneur, you will sign contracts to start and run your business.
- Some contracts will be with vendors or landlords, others with clients, and still others with clients, and still others with government agencies.
- Most people fulfill the requirements of the contracts they sign.
- However, when one of the parties fails to meet his or her obligations, the other party may be entitled to monetary damages.
- The right to these damages is usually determined in court.
- This is why it is important to draw up a legally binding contract that clearly states the intentions of all parties.
- To be a valid legal contract a document must contain certain elements:
 - Agreement
 - Consideration
 - Capacity
 - Legality



Agreement

- Agreement occurs when one party to a contract makes an offer or promises to do something and the other party accepts.
- For example, suppose a vendor offers to sell your business a fax machine.
- There is no agreement until you have either sent the vendor a purchase order or a check signifying that you accept the offer.
- If you change any of the terms of the vendor's offer, you have created what is called a counteroffer.
- This is a new offer that now requires the acceptance of the vendor to form a new contract.



Consideration

- **Consideration** is what is exchanged for the promise.
- The money you pay to the vendor for the fax machine is valuable *consideration* and causes the contract to be binding.



Capacity

- **Capacity** means that you are legally able to enter into a binding agreement.
- By law, minors, intoxicated persons, and insane persons cannot enter into valid contracts.
- If they do sign such a contract, the agreement can be considered void.
- This means that the contract never existed.



Legality

- The final contract element is legality.
- For a contract to be valid, it must be legal.
- In other words, it cannot have any provisions that are illegal or would result in illegal activities.



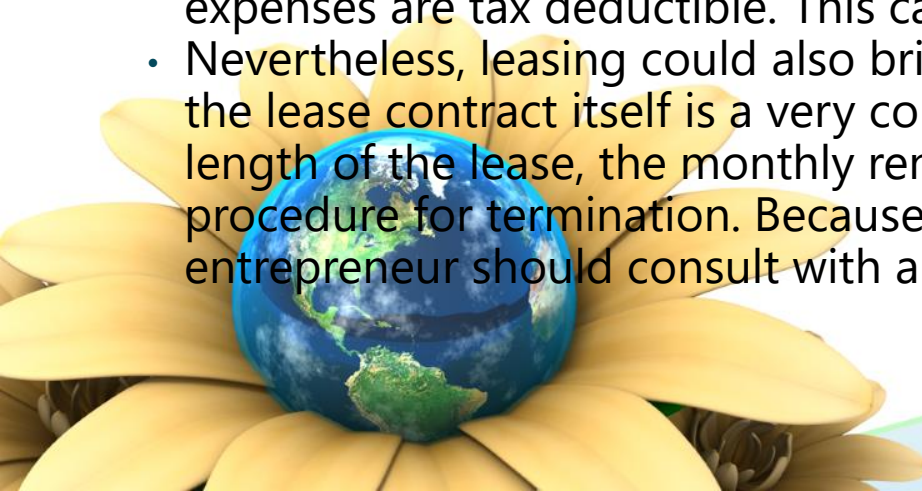
Choosing a Location

- Before you start your business, you need to decide where to locate it. The type of business, need for foot traffic, and location of competition are factors. The law also affects where you place the business.
- **Zoning Laws and Building Codes.** If you build a new facility or locate your business in an existing building, you will need to conform to local zoning laws. Cities typically designate particular areas, or zones, for certain uses. Zones are usually specified as residential, commercial, industrial, or public. For example, you cannot locate a tire manufacturing plant in the middle of a residential neighborhood. Zoning laws also address environmental issues. They may restrict such things as the disposal of toxic waste, noise and air pollution, and incompatible building styles. For example, a residential neighborhood might permit office buildings, but only those that are low-rise and fit in with the residential architecture. Zoning laws may also define the type and style of signs that businesses can use and the appearance of the buildings. In addition to restrictions on use and appearance, you need to check the laws that relate to the actual construction of your facility.
- These are called building codes. Building codes set standards for construction or modification of buildings. These standards include such things as the strength of concrete, the amount of insulation, and other structural requirements.



Choosing a Location (Continued)

- Local governments employ inspectors to verify that building code requirements are met at each stage of construction.
- How can you meet the requirements?
- Licensed building contractors or architects should be familiar with local building codes.
- You can assure that your facility is built to code by hiring such as person to supervise your project.
- **Leasing.** Most entrepreneurs start with few resources and little money. Therefore, prudent entrepreneurs will usually lease buildings and equipment for a specified period of time. The lessee (the person who is leasing the building or equipment) has no ownership rights. Those belong to the lessor (the person who owns the building or equipment). Leasing usually does not require spending a large amount of money up front. The money saved can be used for purchasing inventory and supplies and hiring employees. This can be a definite advantage for a new business. Another advantage is that some lease expenses are tax deductible. This can reduce the tax liability of the company.
- Nevertheless, leasing could also bring on its own set of troubles. For example, the lease contract itself is a very complex document. It states the terms: the length of the lease, the monthly rent, the penalty for failing to pay, and the procedure for termination. Because a lease is a long-term contract, an entrepreneur should consult with an attorney before signing one.



Hiring Your Employees

- Businesses, both large and small, are affected on a daily basis by the laws of federal, state, and local governments.
- We can't discuss all the laws that affect business here, but this section will touch on some of the major ones.
- It will give you a better sense of what you need to know before starting your own business.
- If you start a business, you will probably hire employees.
- There are many laws that affect the hiring, firing, and paying of employees:
 - Laws Against Discrimination in Hiring
 - Wrongful Termination
 - Equal Pay Act of 1963
 - Fair Labor Standards Act
 - Occupational Safety and Health Act



Laws Against Discrimination in Hiring

- The **Equal Employment Opportunity Commission** (EEOC) is charged with protecting the rights of employees.
- It ensures that employers do not discriminate against employees because of age, race, color or national origin, religion, gender, or physical challenge.
- An employer cannot refuse to hire, promote, or give pay increases to an employee based on any of these characteristics.
- If you give any tests or use any screening devices to check out potential employees, the U.S. Department of Labor states they must be related directly to the job.



Wrongful Termination

- When an employee is fired for wrongful reasons, it is called **wrongful termination**. As a business owner you should be very careful about important events related to each employee.
- Notify employees who violate rules in writing.
- Then get a receipt from the employee saying that he or she was notified of the violation.
- Taking care in keeping good records will help prevent unwanted lawsuits.



Equal Pay Act of 1963

- This act says that all employers must pay men and women the same wage for the same work.
- Same work involves similar skills, responsibility, and effort.



Fair Labor Standards Act

- The Fair Labor Standards Act was passed in 1938.
- The law established a minimum wage and maximum working hours.
- It also ensured that children under the age of 16 could not be employed full-time except by their parents.



Occupational Safety and Health Act

- The Occupational Safety and Health Act of 1970 was passed to ensure safe and healthy working conditions for employees.
- You have probably heard of the agency that was created by this Act – OSHA, the Occupational Safety and Health Administration.
- OSHA requires employers to look for hazardous areas in their workplace.
- Employers must maintain health and safety records provide safety trainings, keep up-to-date on new OSHA standards, and take care of violations promptly.
- OSHA frequently comes under fire from business people for the stiff rules and regulations it enforces.
- The agency also requires that a large amount of paperwork be done and charges heavy fines on companies that don't follow its rules.



Dealing With Trade Issues

- In general, the American government allows businesses to compete in the marketplace with relative freedom.
- However, since the early 1800s, many laws have been enacted that regulate and restrict business practices.
- These key trade laws were created to preserve competition and fairness in the marketplace.
- **PRICE DISCRIMINATION** - The Clayton Act of 1914 and the Robinson-Patman Act of 1936 are aimed to prohibit price discrimination. **Price discrimination** occurs when a business sells the same product to different people at different prices. Businesses must justify giving one customer a lower price than another. They must allow that the favored customer brought more, brought lower-quality goods, or to be fair to all customers when setting prices.
- **CONSUMER PROTECTION** – Most laws pertaining to trade are designed to protect the consumer. These laws protect against the following:
 - Unscrupulous sellers
 - Unreasonable credit terms
 - Unsafe products
 - Mislabeling of products
- There are also many federal agencies involved in regulating trade. Many of them function to protect the consumer as well. A list of some major federal trade regulators.



The Food and Drug Administration (FDA)

- One of the largest federal agencies monitoring product safety is the FDA.
- It is responsible for reaching and testing new products and inspecting the operations of food and drug manufacturers.
- If your new product idea is a cosmetic, drug, food item, or even suntan lotion, you will need to have approval of the FDA to market it.



The Consumer Product Safety Commission (CPSC)

- This commission serves as the watchdog for consumers over products that may be hazardous.
- It also creates safety standards for products such as toys for children under the age of five.



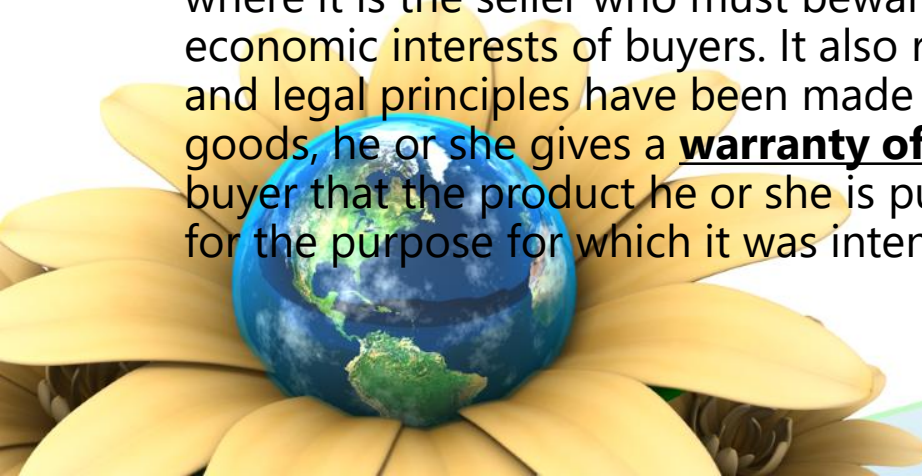
The Fair Packaging and Labeling Act

- The act requires that manufacturer labels truthfully list all raw materials used in the production of products.
- The act also requires that the size and weight of the product be on the label.
- If you are manufacturing products for the public, you will need to become familiar with consumer protection laws.
- That way you can avoid possible recalls of your product and potential lawsuits.



The Uniform Commercial Code

- The **Uniform Commercial Code** (UCC) is a group of laws that covers everything from sales to bank deposits and investment securities. The UCC has been adopted by all states.
- Since it applies to sales transactions between merchants, its provisions are likely to affect you as an entrepreneur.
- Formation of Contracts. As we discussed earlier, when you enter into an agreement to sell a product, you create a valid contract. This means that you must abide by contract laws. However, as a merchant, you must also abide by the requirements of the UCC. In some cases, the two are not the same.
- For example, in a valid contract, all the terms of price, place, delivery date, and quantity should be present. Suppose you are a manufacturer who has ordered some parts from a supplier, but you have not asked the price. When the parts arrive, you find they cost more than you expected.
- WARRANTIES AND PRODUCT LIABILITY. Have you ever heard the term *caveat emptor* – let the buyer beware? That used to be a basic principle of the U.S. marketplace. Today, however, many believe the emphasis has shifted to the point where it is the seller who must beware. The law looks after the safety and economic interests of buyers. It also regulates sales warranties. Many of these laws and legal principles have been made part of the UCC. When a merchant sells goods, he or she gives a **warranty of merchantability**. The warranty assures the buyer that the product he or she is purchasing is of at least average quality and fit for the purpose for which it was intended. The warranty is implied by law.



Truth in Lending

- Those involved in retail businesses must familiarize themselves with the Consumer Credit Protection Act.
- This act requires those who give credit to reveal all the terms and conditions of their credit agreements.
- As a result, it is called the Truth-in-Lending Act.
- Like price discrimination laws, it is enforced by the Federal Trade Commission.
- The Truth-in Lending Act applies to anything purchased over a period of time greater than four months.



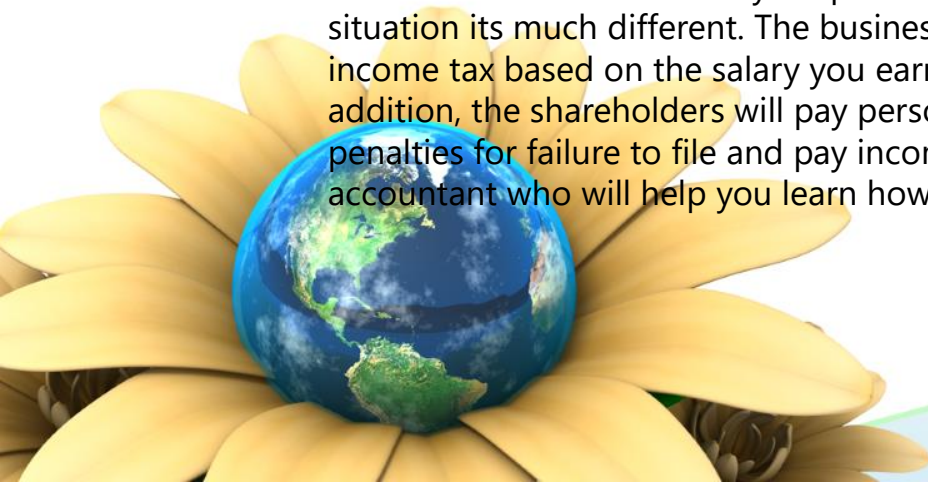
Truth in Advertising

- The Federal Trade Commission is also concerned about protecting customers from false and misleading advertising.
- The laws that address this trade issue are sometimes called truth-in-advertising laws.
- Regardless of your business, when you advertise, you should be aware of the following rules:
 - *Misleading ads.* Your advertising should not mislead customers about what your product can do. It should not claim that the product can do something that cannot.
 - *Sale prices.* You cannot offer a reduced price on your product unless it has been offered to the public at the regular price for a period time.
 - *Price comparisons.* You cannot use list price as your comparison-selling price unless your product has actually been sold for that amount. The list price is commonly the manufacturer's suggested retail price (MSRP). Also, you must have proof that your prices are lower than your competitors' if you intend to use that fact in your advertising.
 - *Bait-and-switch.* **Bait and switch** advertising uses a bargain priced item to lure potential customers into a store. Then a salesperson tries to sell them higher-priced merchandise.



Paying Taxes

- All business owners whose goals to make a profit are responsible for certain taxes. These may include sales tax, payroll taxes, unemployment tax, and income tax.
 - Sales Tax: Sales tax is a percentage of the price of an item that goes to a state or local government. The percentage varies from state to state. Retailers collect sales tax from their customers and send it to the appropriate government agency. Usually this is the State Board of Equalization. Most retailers make payments every three months.
 - Payroll Taxes: If you hire employees, you need to deduct certain payroll taxes from their earnings. One payroll tax deducted from employee earnings is the **FICA**, or Social Security, tax. (FICA stands for Federal Insurance Contribution Act). The tax is figured as a percentage of an employee's income. There is a ceiling on the amount of wages subject to the FICA tax. Wages above that ceiling are not taxed.
 - Federal Unemployment Tax: As an employer, you are required to make contribution under the Federal Unemployment Tax Act (FUTA). The act was designed to provide help to workers who are temporarily unemployed. You may also be responsible for state unemployment taxes. However, they are usually credited against the federal taxes paid.
 - Business Income Taxes: Your business is also legally responsible for paying federal and possibly state and local taxes on the income it earns. If you are a sole proprietor or a partner in a partnership the income your business earns is considered your personal income. As a result, the business income is taxed at your personal tax rate. If your business is a corporation, the income tax situation is much different. The business will pay a corporate income tax. You will pay personal income tax based on the salary you earn and any other income derived from the business. In addition, the shareholders will pay personal income on salaries or dividends. There are several penalties for failure to file and pay income taxes. Therefore, it is a good idea to consult an accountant who will help you learn how to plan for taxes.



Getting Legal Advice

- At every stage of developing a new business, you will probably need to seek some kind of legal advice.
- However, you can research a great deal of information on your own.
- There are many sources that you can use to find an attorney or get up-to-date information on your legal obligations as a business owner.
- They include the American Bar Association, the National Resource Center for Consumers of Legal Services, and the Commissioner of Patents and Trademarks. Also, the IRS can be of special help in tax matters. It often holds workshops and seminars to make business owners aware of their tax obligations.
- If your business is involved in areas regulated by government, you should consult the appropriate agencies.
- You can find contact information at your local library or on the Internet.
- You can also consult an attorney who specializes in regulatory matters.



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