

LEGAL ASPECTS OF STARTING A NEW BUSINESS

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I. CHOICE OF BUSINESS ENTITY

A. SOLE PROPRIETORSHIP (PERSONAL LIABILITY)

1. Assumed Name
2. Tax matters
 - a. File IRS SS-4 only if you have employees
 - b. May need to File Form 518, Registration for Michigan Taxes
 - c. Federal Income Tax Return – Form 1040, Schedule C
 - d. Michigan Income Tax Return – SBT and Form 1040

B. SINGLE MEMBER LLC (LIMITED LIABILITY)

1. Articles of Organization Filing Requirement
2. Tax Matters
 - a. File IRS Form SS-4 only if you have employees or need a Sales Tax License
 - b. May need to File Form 518, Registration for Michigan Taxes
 - c. Federal Income Tax Return – Form 1040, Schedule C
 - d. Michigan Income Tax Return – SBT and Form 1040
3. Operating Agreement

C. 2 OR MORE MEMBERS LLC (LIMITED LIABILITY)

1. Articles of Organization Filing Requirement
2. Tax Matters
 - a. File IRS Form SS-4
 - b. File Form 518, Registration for Michigan Taxes
 - c. Federal Income Tax Return – Form 1065 and Members File Form 1040

d. Michigan Income Tax Return – SBT and Members File Form 1040

3. Operating Agreement

4. Buy-Sell Agreement

D. S CORPORATION (LIMITED LIABILITY)

1. Articles of Incorporation Filing Requirement

2. Tax Matters

a. File IRS Form SS-4

b. File Form 518, Registration for Michigan Taxes

c. File IRS Form 2553 for S Election

d. Federal Income Tax Return – Form 1120S and Shareholders File Form 1040

e. Michigan Income Tax Return – SBT and Shareholders File Form 1040

3. Minutes of the Incorporators

a. Elect Directors

b. Adopt Bylaws

4. Minutes of the First Meeting of BOD

a. Elect Officers

b. Issue Stock

5. Shareholders may elect not to have certain corporate formalities under Section 488 of the MBCA

6. Buy-Sell Agreement

II. ESSENTIAL CONTRACT TERMS

- A. DEFINE THE PARTIES**
- B. SPECIFY SERVICES/GOODS**
- C. PAYMENT**
- D. FAILURE TO PAY**
- E. WARRANTIES AND REPRESENTATIONS**
- F. CONFIDENTIALITY**
- G. INTELLECTUAL PROPERTY**
- H. TERM**
- I. TERMINATION**
- J. INSURANCE**
- K. INDEMNITY**
- L. JURISDICTION AND GOVERNING LAW**
- M. AGREEMENT BINDING ON SUCCESSORS AND ASSIGNS**
- N. WAIVER**
- O. SEVERABILITY**
- P. ASSIGNABILITY**
- Q. NOTICE**
- R. INTEGRATION**

III. LIMITED LIABILITY COMPANIES, LIMITED PARTNERSHIPS, AND S CORPORATIONS COMPARED

Attribute	Limited Liability Company	Limited Partnership	S Corporation
Number of Owners	At least one	At least two	1 to 100
Types of Owners	Any	Any	U.S. residents and citizens and certain trusts. No corporations unless qualified subsidiary. No partnerships. No tax exemptions. No nonresident aliens. No qualified plans. No LLCs.
Classes of Ownership	Multiple classes permitted.	Multiple classes permitted.	One, but can have non-voting.
Pass-through Taxation	Yes.	Yes.	Yes.
Special Allocations	Yes.	Yes.	Yes with unanimous written consent.
Limited Liability	Generally yes.	Generally yes, other than General Partner.	Generally yes.
Management Role	No restrictions.	General Partner only.	No restrictions.
Transferability of Ownership	Varies.	Varies.	Varies.
Continuity of Life	Yes.	Usually not.	Yes.
At Risk Limitations	May apply.	Apply.	Do not apply.
Fiscal Year	Follow members.	Follow partners.	Generally calendar.
Cash Distributions	Return of basis.	Return of basis.	Return of basis.
Corporate Subsidiary	Yes.	Yes.	Yes.

IV. EASY STEPS TO HARDSHIP AND FAILURE

- A.** Start your business without considering the licensing and regulatory aspects of your business.

PROBLEM AVOIDANCE: Educate and acquaint yourself with licensing requirements of your business.

- B.** Commingle personal funds with business funds.

PROBLEM AVOIDANCE: Maintain separate books and accounts for you and your business.

- C. Start your 2 Member LLC without a written Operating Agreement.

PROBLEM AVOIDANCE: Retain an attorney to prepare an Operating Agreement.

- D. Incorporate improperly.

PROBLEM AVOIDANCE: Consult with an attorney who practices in business law.

- E. Incorporate and forget about the corporate formalities.

PROBLEM AVOIDANCE: Educate yourself on how to protect your corporate shield.

- F. Let “the other guy” worry about what the business documents mean; just make money.

PROBLEM AVOIDANCE: Read, ask questions and seek professional advice.

- G. Incorporate believing you and the other shareholders will resolve all differences because you have equal control.

PROBLEM AVOIDANCE: Protect your investment with a Shareholder Agreement.

- H. Let the landlord, manager, or seller explain what the lease or Purchase Agreement means.

PROBLEM AVOIDANCE: Read all contracts. If you have questions, seek legal advice before signing.

- I. Begin using a trademark without performing a search on it.

PROBLEM AVOIDANCE: Have a computerized search conducted at the federal and state levels to determine whether the trademark is free and clear to use.

- J. Use copyrightable materials without obtaining a copyright registration prior to an infringing act.

PROBLEM AVOIDANCE: File for a Certificate of Registration on the materials within three (3) months from the date of publication of such work.

- K. Disclose confidential information or trade secrets of your business to your manufacturer, or distributor, or possible joint venture entity without a Confidentiality Agreement.

PROBLEM AVOIDANCE: Enter into a Confidentiality Agreement with the Recipient party before disclosing any of your business' confidential information or trade secrets.

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V. NEW DEVELOPMENTS IN INTELLECTUAL PROPERTY LAWS

A. Madrid Protocol.

Madrid Protocol Implementation Act allows a U.S. applicant to file a single application in the USPTO and designate other member countries to also receive the application, significantly reducing the cost and frustration of international trademark filings.

B. Electronic Signatures in Global and National Commerce Act.

President Clinton on June 30, 2000 signed the Electronic Signatures in Global and National Commerce Act which takes effect on October 1, 2000 and provides, in part, that no contract, signature or record shall be denied legally binding status just because it is in electronic form.

C. Digital Deterrence and Copyright Damages Improvement Act of 1999.

On December 9, 1999 President Clinton signed the Digital Deterrence and Copyright Damages Improvement Act of 1999 which, in part, amends the copyright law with respect to statutory damages from \$500 to \$750 and the maximum damages from \$20,000 to \$30,000. The Act also amends the maximum damages a court may award for willful infringement from \$100,000 to \$150,000.

D. Anti-cyber Squatting Provisions.

On November 29, 1999 President Clinton signed into law the Anti-cyber Squatting provisions as part of the consolidated Appropriation Act. These provisions provide for the recovery of \$100,000 in damages if cyber squatters register domain names that are similar to a company's or person's trademark or service mark.

E. ICANN Dispute Resolution Policy.

ICANN New Dispute Resolution Policy related to domain names and trademarks was adopted by all registrars of domain names on January 1, 2000. The most fundamental difference in the new policy is that it offers a resolution to the dispute which will take place within 45 days of the complaint. The new policy does not require the trademark owner to have registered its marks, but can be a common law mark holder.

F. Patent Issued on Software and Online Business Models.

The Patent Office granted over 20,000 patents for software related inventions in 1998, which represents a 40% increase over 1997. The growth of Internet-related patents have matched the expansion of the Internet with almost 1,600 patents issued in 1998. The Patent Office recently indicated that it expects to grant over 300 patents for business models by the year 2000.

G. Online Copyright Infringement Liability Limitations.

On October 28, 1998, President Clinton signed into law the Digital Millennium Copyright Act of 1998 (the "Act"). The Act, in part, limits the liability of online service providers for claims of copyright infringement for conduct in connection with: (a) transitory communications such as E-mail; (b) system caching; (c) storage of information on Web sites (or other information repositories) hosted on the online service provider's systems or networks at the direction of users; and (d) information location tools such as hyperlinks, online directories, search engines and the like.

The limitation on liability provided under the Act results in a complete bar to the recovery of monetary damages and restricts the availability of injunctive relief in various respects for claims of copyright infringement.

For an online service provider to be eligible for these limitations it must: (a) adopt and reasonably implement a policy of terminating in appropriate circumstances the accounts of subscribers who are repeat infringers; and (b) it must not interfere with the common measures copyright owners use to identify or protect their copyrighted works.

In addition, the online service provider must merely act as a data conduit transmitting digital information from one point to another at someone else's request without modifying the content.

Once the online service provider is given notice of material which was posted on its system or network without the copyright owner's

authorization, the online service provider must immediately remove or block access to such unauthorized material at the originating site. The online service provider must designate an agent to receive notifications of claimed infringement and counter notices to the same and post notice of who the agent is and how they can be contacted on its system or network as well as inform and register the agent with the Copyright Office.

Finally, there are special rules concerning the application of these liability limitations for nonprofit educational institutions so that the institution will not be liable for the infringing acts of faculty members or graduate students. To be eligible for these limitations on liability, the nonprofit educational institution must meet the following conditions: (a) the faculty member's or graduate student's infringing activity must not involve providing online access to course materials that were required or recommended during the past 3 years; (b) the institution has not received more than 2 notifications over the past 3 years that the faculty member or graduate student was infringing; and (c) the institution provides all users with informational materials describing and promoting compliance with the copyright law.

VI. RELATIONSHIP BETWEEN TRADEMARKS, COPYRIGHTS, PATENTS, AND TRADE SECRETS.

A. Definitions.

1. Trademark/Service Mark.

- a. Trademark: A trademark is anything that identifies or signifies to the public the source of the product.
- b. Service Mark: A service mark is anything that identifies or signifies to the public the source of the services.

2. Patents. Patents are granted for new, useful, and non-obvious inventions. A patent owner is entitled to exclude others from making, using, or selling his invention for a term of 20 years from the date the patent application is filed. A design patent may be granted for a new, ornamental, non-obvious design the term of which is limited to a maximum of 14 years.

3. Copyrights. Copyrights protect the origin of writings of an author for the life of the author plus 70 years. (If the work is a Work Made for Hire, or an anonymous or pseudonymous work, 95 years from the date of publication, or 120 years from creation, whichever

expires first.) A writing can include books, jewelry, fabric design, phonorecords, plays, TV broadcasts, and art sculptures.

- a. **Non-protection of ideas.** Copyright law does not protect abstract ideas, but only the tangible expression of the idea. The idea is free to take but not the expression.
 - b. **Originality.** For an item to be copyrightable it must have originality of authorship.
4. **Trade Secrets.** A trade secret may consist of any formula, pattern, device or compilation of information which is used in a business and which gives the business an opportunity to obtain an advantage over competitors who do not know or use it and it is the subject of reasonable efforts to maintain its secrecy.

B. Trademarks, Patents and Copyrights Compared.

1. **Independent Rights.** Rights related to trademarks, patents and copyrights are independent rights. Claiming one does not prevent the claiming of another. All these rights may apply to a single product.
2. **Example.** Personal Computer:
 - a. The internal mechanism is protected by patent law. During the 20 year term anyone who makes, uses, or sells the computer patented mechanism or its equivalent without permission is liable for patent infringement.
 - b. The computer instruction manual and software programs may be protected by copyright law. During the author's life plus 70 years anyone who makes a copy substantially similar to a copyrighted work is liable for copyright infringement.
 - c. The name of the computer may be protected by trademark law. The shape of the computer may be protected under trademark law as a trade dress as well as protected under patent law as a design patent.
 - d. It should be noted that trademark law, unlike patent and copyright law confers a perpetual right. So long as the trademark continues to identify a single source, anyone who uses a confusingly similar mark is liable for trademark infringement.

VII. BRIEF OVERVIEW OF COPYRIGHT OWNER'S BUNDLE OF RIGHTS.

A. WHEN RIGHTS ARE CREATED AND WHAT ARE THOSE RIGHTS

1. Copyright rights are created as soon as the item is created and expressed in a tangible form.
2. The bundle of rights the copyright owner owns are:
 - a. The exclusive right to sell or distribute the work to public;
 - b. The right to duplicate the work;
 - c. The right to make derivative works;
 - d. The right to perform the work;
 - e. The right to display the work; and
 - f. The limited right to publicly perform a sound recording by digital audio transmission.

B. COPYRIGHT REGISTRATION AND ADVANTAGES RELATED THERETO.

1. Before an infringement suit may be filed in federal court, registration is necessary for works of U.S. origin;
2. If made before or within five years of publication, registration will establish prima facie evidence in court of the validity of the copyright and of the facts stated in the certificate;
3. If registration is made within three months after publication of the work or prior to an infringement of the work, statutory damages ranging from \$200-\$150,000 per work infringed and costs and attorneys fees will be available to the copyright owner in court actions. Without registration, only an award of actual damages and profits that can be substantiated are available to the copyright owner; and
4. Registration establishes a public record of copyright claim.

C. OWNERSHIP RIGHTS.

1. **In general.** A work is owned initially by the person who creates it. A work is created when it is first fixed into tangible form. Even if a work is prepared over a long period of time, as is a book, those portions of the book that become fixed in a tangible medium of the expression prior to the book's completion constitute a work created, and are, hence, owned by the person who creates them.
2. **Joint Works.** A joint work is defined under the Copyright Act as one that is prepared by two or more authors with the intention by such authors that their contributions be merged into inseparable or interdependent parts of a unitary whole. Joint ownership confers the same rights equivalent to a tenancy in common. Each author owns an undivided interest in the work and has the freedom to license unilaterally the work subject to the duty to account.

D. WORKS MADE FOR HIRE. A "work made for hire" is:

1. A work prepared by an employee within the scope of employment;
or
2. A work specially ordered or commissioned which falls into one of nine specific categories under the copyright act which are:
 - a. Motion pictures or audio visual works;
 - b. Translations;
 - c. Supplementary work;
 - d. Compilations;
 - e. Instructional text;
 - f. Tests;
 - g. Answer material for a test;
 - h. Atlas;
 - i. A collective work; and
3. Necessity for written agreement expressly making it a "work made for hire" under item 2.

VIII. “FAIR USE” UNDER SECTION 107 “Limitation on Exclusive Rights”.

Section 107: Fair Use. Notwithstanding the provisions of Section 106, the fair use of a copyrighted work, including such use by reproduction in copies or phonorecords or by any other means specified by that section, for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research, is not an infringement of copyright. In determining whether the use made of a work in a particular case is “fair use” the factors to be considered shall include:

1. The purpose and character of the use including whether such use is of commercial nature or is for nonprofit educational purposes;
2. The nature of the copyrighted work (factual/creative);
3. The amount and substantially of the portion used in relation to the copyrighted work as a whole; and
4. The effect of use upon the potential market for or value of the work.

IX. INTELLECTUAL PROPERTY LAW CLAIMS THAT MAY ARISE UPON USE OF THE INTERNET.

A. Copyright Infringement.

1. Elements of Proof
 - a. Ownership
 - b. Access
 - c. Substantial Similarity
2. Who is Liable?
 - a. Direct Infringement
 - b. Contributory Infringement
3. Examples of Infringing Activity on the Internet
 - a. Unauthorized downloading of software.
 - b. Unauthorized electronically published articles.

- c. Unauthorized downloading or uploading of sound recordings and/or musical works.
- d. Unauthorized use of online databases.
- e. The unauthorized cutting and pasting of sound, visual images, text, software application to create multimedia products or works.
- f. Unauthorized Caching
- g. Unauthorized Linking
 - 1. Hyperlinks
 - i. Hypertext
 - ii. Inline Links
 - iii. Framing

B. Trademark Infringement.

- 1. Elements of Proof
 - a. Ownership
 - b. Likelihood of Confusion
- 2. Example of Infringing Activity on the Internet
 - a. Wrongful use of Meta Tags
 - b. Wrongful use of Domain Names

C. Dilution.

- 1. Elements of Proof
 - a. Must be distinctive;
 - b. The senior mark must be famous;
 - c. The junior use of the mark at issue must a commercial use in commerce;

d. The junior use of the mark at issue must begin after the mark has become famous; and

e. The junior user must cause dilution of the distinctive quality of the mark.

2. Examples of Dilution Activity on the Internet

a. Wrongful use of Meta Tags; and

b. Wrongful use of Domain Names

D. Patent Infringement.

Patent Infringement may occur as a result of infringing on a patent the claims of which cover the distribution of digitized products, including video games, movies, software, books, greeting cards, sheet music, audio recordings and other information to allow record store customers to create their own customized recordings from a database of digitized songs.

E. Trade Secret Misappropriation.

Trade Secret Misappropriation by posting of trade secrets on the Internet and/or Violation Economic Espionage Act.

X. JURISDICTION IN DOMAIN NAME LITIGATION.

A. In Personam Jurisdiction

1. Something more than merely providing information to Internet Users (not passive).

2. Interactive web site (examine the level of interactivity and the commercial nature of the exchange of the information that occurs on the web site).

3. Web site operator actively and purposely targets customers in the jurisdiction and provides goods and services to customers there.

B. In Rem Jurisdiction

1. The Anti-Cybersquatting Act codifies the ability of a trademark owner plaintiff to assert in rem jurisdiction over a defendant that cannot be found anywhere for purposes of the assertion of in personam jurisdiction.

2. The Anti-Cybersquatting Act provides that the domain name shall have a situs in the judicial district in which (i) the domain name registrar, registry, or other domain name authority that registered the domain name is located; or (ii) documents sufficient to establish control and authority regarding the disposition of the registration and use of the domain name are deposited with the court.

XI. INTELLECTUAL PROPERTY POLICIES AND PROCEDURES THAT A BUSINESS SHOULD IMPLEMENT TO AVOID OR LIMIT LIABILITY.

- A. Implement Acceptable Use Policies (Internet, Voice Mail, etc.), Trademark Infringement Policies, Copyright Policies, Software Policies, and Secrecy measures
- B. Conduct Searches on Marks and register Marks with USPTO
- C. File Application for Copyright Registration with the U.S. Copyright Office
- D. Conduct Patent Search and File Patent Application with the USPTO