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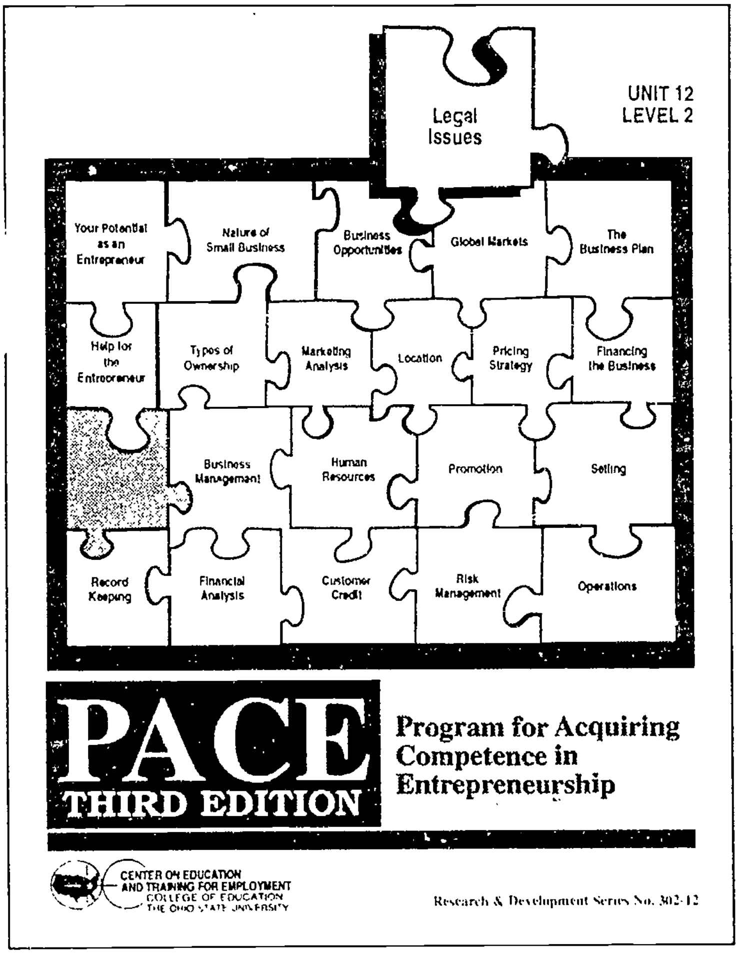
ABSTRACT

This instructor guide for a unit on legal issues in the PACE (Program for Acquiring Competence in Entrepreneurship) curriculum includes the full text of the student module and lesson plans, instructional suggestions, and other teacher resources. The competencies that are incorporated into this module are at Level 2 of learning--planning for a business in one's future. Included in the instructor's guide are the following: unit objectives, guidelines for using PACE, lists of teaching suggestions for each unit objective/subobjective, model assessment responses, and overview of the three levels of the PACE program. The following materials are contained in the student's guide: activities to be completed in preparation for the unit, unit objectives, student reading materials, individual and group learning activities, case study, discussion questions, assessment questions, and references. Among the topics discussed in the unit are the following: classification of government regulations, five essential components of a contract, major types of contracts used by entrepreneurs, methods of protecting a business idea, and liability issues for a potential business. (KC)



INSTRUCTOR GUIDE

Unit 12

Legal Issues

Level 2

Objectives:

- Classify government regulations according to whom they are designed to protect.
- Identify the regulations that affect your business idea.
- Explain the five essential components of a contract.
- Identify the major types of contracts used by entrepreneurs.
- Explain the methods of protecting your business idea.
- Examine liability issues for your potential business.

HOW TO USE PACE

- Use the objectives as a pretest. If a student is able to meet the objectives, ask him or her to read and respond to the assessment questions in the back of the module.
- Duplicate the glossary from the *Resource Guide* to use as a handout.
- Use the teaching outlines provided in the *Instructor Guide* for assistance in focusing your teaching delivery. The left side of each outline page lists objectives with the corresponding headings (margin questions) from the unit. Space is provided for you to add your own suggestions. Try to increase student involvement in as many ways as possible to foster an interactive learning process.
- When your students are ready to do the *Activities*, assist them in selecting those that you feel would be the most beneficial to their growth in entrepreneurship.
- Assess your students on the unit content when they indicate they are ready. You may choose written or verbal assessments according to the situation. Model responses are provided for each module of each unit. While these are suggested responses, others may be equally valid.

Objectives	Teaching Suggestions
1. CLASSIFY GOVERNMENT REGULATIONS ACCORDING TO WHOM THEY ARE DESIGNED TO PROTECT	
Why are government rules and regulations important?	Invite an attorney with experience in business law as a guest speaker. Have them address the class on the topics of the *purpose and source of regulations*, and *the impact of regulations on small business*.
How can federal regulations be classified?	Ask the guest speaker to discuss the main classifications of government regulations regarding small business.
2. IDENTIFY THE REGULATIONS THAT AFFECT YOUR BUSINESS IDEA	
How does the law protect competition? ...employees? ...consumers? ...environment? ...business people?	Once again, ask the guest speaker to comment on the business laws and the entities they are designed to protect.
What is a contract?	In advance, ask the guest speaker if it would be possible to bring a few examples of contracts ranging from simple to complex. Make transparencies for the simpler contracts.
What are the five essential components of a contract?	Using the sample contracts mentioned above have the guest speaker highlight the five essential components of a contract.
	Divide the class into small groups to design role-plays of people reaching a type of *agreement*. Each group should choose the role-players and as a group write the dialogue. Reconvene the class for and allow each group to present their role-plays.
What is consideration?	Encourage the class to offer examples of *consideration*. Note their examples on the chalkboard or overhead.

Objectives	Teaching Suggestions
What is contractual capacity?	Create other examples of *contractual capacity* and share them with the class.
What does legality of purpose mean?	Task the class with learning the terms related to *legal purpose.* To do this suggest they write the terms on index cards including definitions and examples.
What is mutuality of consent?	Explain the relationship between *mutuality of consent* and fraud and *misrepresentation.*
3. IDENTIFY THE MAJOR TYPES OF CONTRACTS USED BY THE ENTREPRENEUR	
What are the most common types of contracts?	The following sections will outline *lease contracts* and *sales contracts.* Discuss the basic types of leases and sales contracts as described in the text.
4. EXAMINE THE METHODS OF PROTECTING YOUR BUSINESS IDEA	
How can business ideas be protected?	Divide the class into small groups. Each group should brainstorm ideas about a new business or product. Choosing their best idea each group should design a *trademark* or *service mark.* As always encourage creativity.

MODEL ASSESSMENT RESPONSES

1. Laws and regulations are an important part of the business world. They are the rules by which all business must operate. Government regulations are issued to promote competition and to protect either selected groups or society as a whole. Some of the more important sources of these business regulations are: the *Federal Trade Commission*, the *Equal Employment Opportunity Commission*, the *Occupational Safety and Health Administration*, and the *Environmental Protection Agency.*

2. Laws that protect and foster fair competition are known as antitrust laws.The three major federal laws passed to protect competition are the *Sherman Act*, the *Clayton Act*, and the *Robinson-Patman Act.* Competition is protected by making it against the law to engage in unfair business practices (e.g., *Price fixing). The Sherman Act relates to restraint of trade and monopolies. The Clayton Act was designed to strengthen the Sherman Act and specifically prohibits four types of unfair business acts: (1) Price discrimination,*

(2) *exclusive and tying contracts*, (3) intercorporate stockholding, and (4) interlocking directorates. The Robinson-Patman Act was again designed to build on and strengthen the Sherman and Clayton Acts in regards to price discrimination.

3. The laws that protect the rights of the employee are the *Occupational Safety and Health Act (OSHA)*, the *Fair Labor Standards Act*, *Workers Compensation*, *Unemployment compensation laws*, the *Social Security Act*, the *Employee Retirement Income Security Act of 1974*, the *Americans with Disabilities Act (ADA)*, the *Age Discrimination Act*, the *Equal Pay Act*, and the *Equal Employment Act*. This of course should only be regarded as a partial list.

4. The purpose of the *Federal Equal Credit Opportunity Act* is to ensure that consumers are not denied credit for reasons of sex, marital status, age, race, religion, or national origin.

5. A *lease* is a special contract that establishes a relationship between a property owner and a tenant. A tenant (lessee) has possession of the real property of the property owner (lessor). The payment given to the lessor by the lessee is called *rent*. The four major types of leases are: (1) tenancy for years, (2) tenancy from month to month, (3) periodic tenancy, and (4) tenancy at will.

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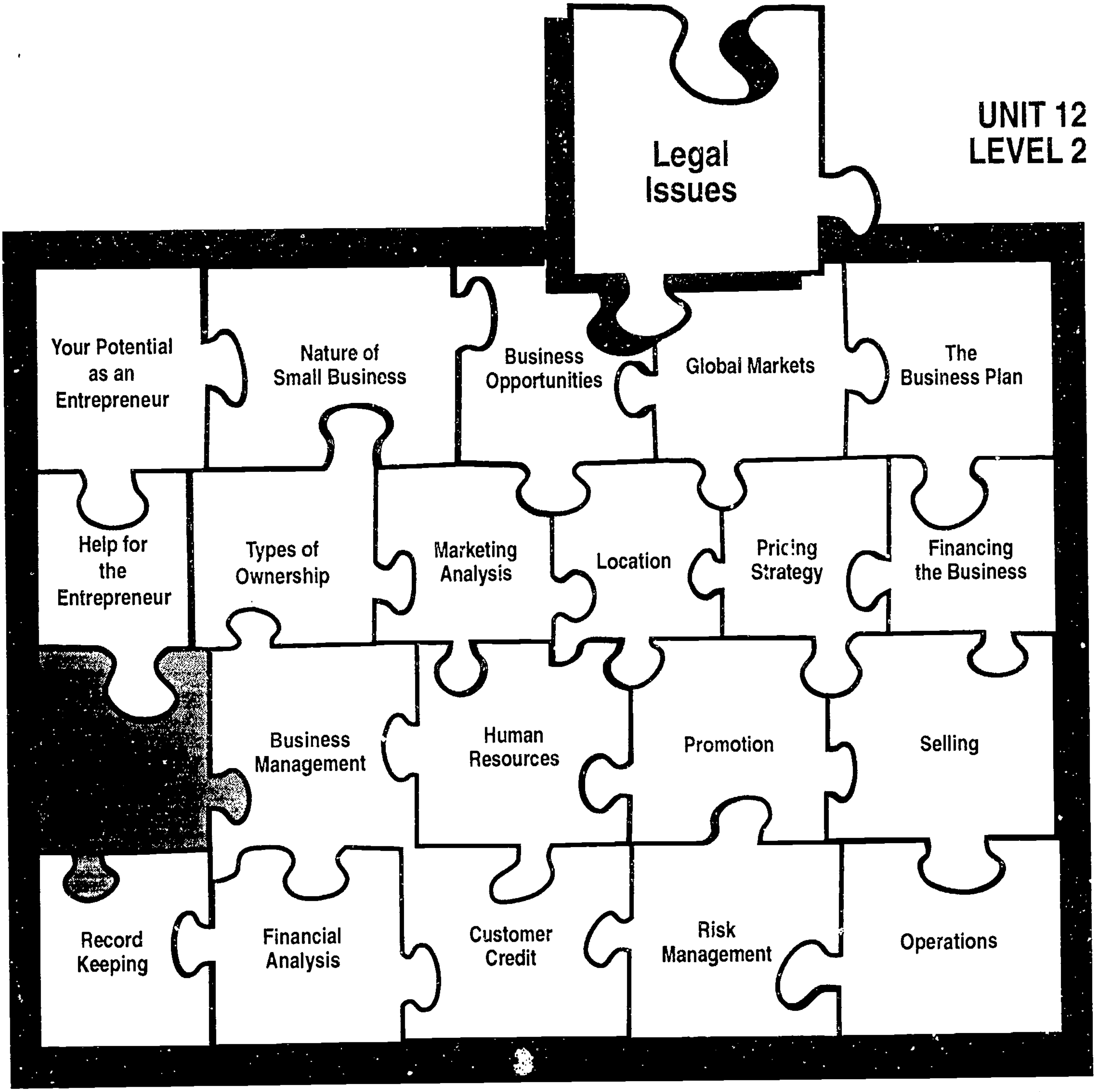
UNIT 12
LEVEL 2



PACE
THIRD EDITION

Program for Acquiring Competence in Entrepreneurship

CENTER ON EDUCATION AND TRAINING FOR EMPLOYMENT
COLLEGE OF EDUCATION
THE OHIO STATE UNIVERSITY

Research & Development Series No. 302-12

LEGAL ISSUES

BEFORE YOU BEGIN . . .

1. Consult the *Resource Guide* for instructions if this is your first PACE unit.

2. Read What are the Objectives for this Unit on the following page. If you think you can meet these objectives now, consult your instructor.

3. These objectives were met at Level 1:

   - Discuss how laws affect the small business operation.
   - Discuss the importance of government rules and regulations.
   - Define the term "contract" and discuss its importance.
   - Identify the components of a contract.
   - Define patents, copyrights, and trademarks.

4. Look for these business terms as you read this unit. If you need help with the meanings, ask your instructor for a copy of the PACE Glossary contained in the *Resource Guide*.

   Bailee
   Bailment Contract
   Bailor
   Commercial paper
   Environmental Protection Agency
   Equal Employment Opportunity Commission
   Exclusive and tying contracts
   Exculpatory clause
   Federal Trade Commission
   Intent to contract
   Intercorporate stockholding
   Interlocking directorate
   Interstate commerce
   Lease
   Legal purpose
   Letter of credit
   Occupational Safety and Health Administration
   Penalty clause
   Preexisting obligation
   Price discrimination
   Price fixing
   Small Business Administration
   Warranty

LEGAL ISSUES

WHAT ARE THE OBJECTIVES FOR THIS UNIT

Upon completion of this unit you will be able to—

- classify government regulations according to whom they are designed to protect,
- identify the regulations that affect your business idea,
- explain the five essential components of a contract,
- identify the major types of contracts used by entrepreneurs, and
- explain the methods of protecting your business idea.

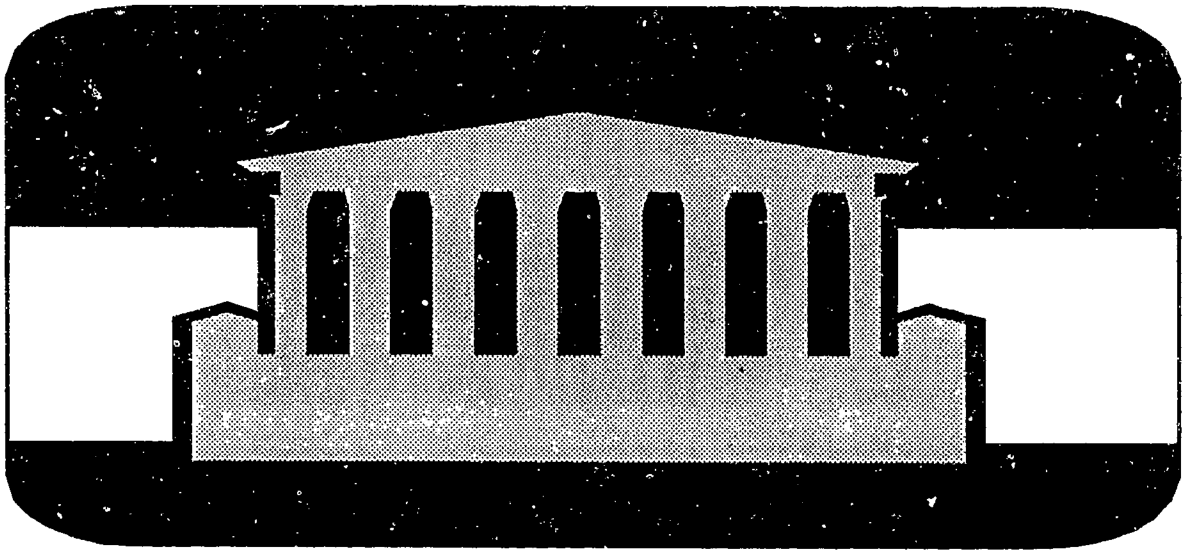
WHAT IS THIS UNIT ABOUT?

Laws and regulations are an important part of the business world. They are the rules by which all businesses must operate. Laws and regulations help make the business world fair and orderly.

Shop owners know that when they accept payment by credit card, they will get paid. Consumers know that if a product has warranties, the manufacturer has to honor those warranties. Employees know that if they work employers will pay them. Why do shop owners, consumers, and employee's know these things? Because there are laws that govern each of these areas.

This unit is designed to help you understand how legal issues affect small businesses. When you complete this unit you will understand how laws affect small business. You will not be a legal expert, but you will know how to identify a legal issue. When you identify a legal issue that affects your business, you should get professional help from lawyers, accountants, or governmental agencies.

Two other PACE units will help you understand and deal with legal issues. They are PACE Unit 7, *Types of Ownership* and PACE Unit 6, *Help for the Entrepreneur.* These units, along with this unit, prepare you to understand and deal with the legal issues faced by small business entrepreneurs.



WHY ARE GOVERNMENT RULES AND REGULATIONS IMPORTANT?

Most business laws were originally passed to protect our economic system and the people who use it. As the business world grew, more laws were passed. In our country today, business laws are always being updated. The growth and complexity of our economy have also encouraged new laws. These laws function to ensure a healthy business environment.

Oftentimes, entrepreneurs feel overwhelmed by these protective laws. However, some basic understanding of them is important. Your firm will be able to comply with the laws if you plan to learn about rules, regulations, and tax laws. Awareness of the regulations with which your business must comply will help you to establish ways to better meet your personal responsibility as an entrepreneur. As you learn more about government rules and regulations, you will discover that certain types of records are very important for your firm. It will be your responsibility to make sure your firm keeps accurate records and complies with the federal, state, and local regulations.

Purpose of Regulations. Even though government laws may increase the work of small business owners, they exist to promote and protect a healthy society. You may often think that the time you spend filling out forms and staying up to date on laws concerning your firm could be better used in operating your business. However, every business depends on a healthy society for its success. Attempts by the government to protect the interest of all citizens also protects you.

Government regulations have been issued to promote competition, and to protect various groups or society as a whole. For example, there are laws that ban business monopolies, establish fair employment practices (especially as they pertain to women, minorities, and handicapped persons), set standards for pure food and drugs, and regulate pollution of the environment.

Source of Regulations. Regulations pertaining to small business operations are made at the federal, state, and local levels. Federal legislation is passed by the U.S. Congress. Agencies are established by the laws to help enforce the regulations. Approximately 90 regulatory agencies exist. Some of the key agencies are:

- the Federal Trade Commission,
- the Equal Employment Opportunity Commission,
- the Occupational Safety and Health Administration, and
- the Environmental Protection Agency.

Impact on Small Business. Government regulations are written to achieve desirable economic and social goals. Preserving fair competition and giving equal opportunity to minorities and disadvantaged persons are important goals of business regulations. Our society as a whole and small business in particular receive benefits from government laws. The *Small Business Administration* is a government agency that provides many valuable services to the owners of small businesses in our nation.

Government regulations also are a source of problems for small businesses. They create a burden of extra paperwork and cost. Many owners of new small businesses are surprised at the large number of government reports and forms they must complete. Many estimates of the costs of government regulations to small businesses have been made and they amount to billions of dollars a year.

Government regulations also affect the plans and daily operations of a small business. The government influences basic management decisions, such as these:

- What lines of business to enter?
- What products can be produced?
- Which investments can be financed?
- Under what conditions can products be produced?
- Where can products be made?
- How can products be marketed?
- What prices can be charged?
- What profit can be kept?

Federal, state, and local laws influence and control certain business practices. Whatever your business is, government officials and other professionals, such as lawyers, accountants, and bankers should be contacted. They can determine the specific effect the many regulations may have on the operations of your business.

HOW CAN FEDERAL REGULATIONS BE CLASSIFIED?

Government regulations can be classified according to the entities they are intended to protect. We will look at five different groups: (1) competition, (2) employees, (3) consumers, (4) the environment, and (5) business people. The federal government regulates business among states. State governments regulate within their own boundaries. Local governments are concerned with business operations within county or municipal boundaries.

HOW DOES THE LAW PROTECT COMPETITION?

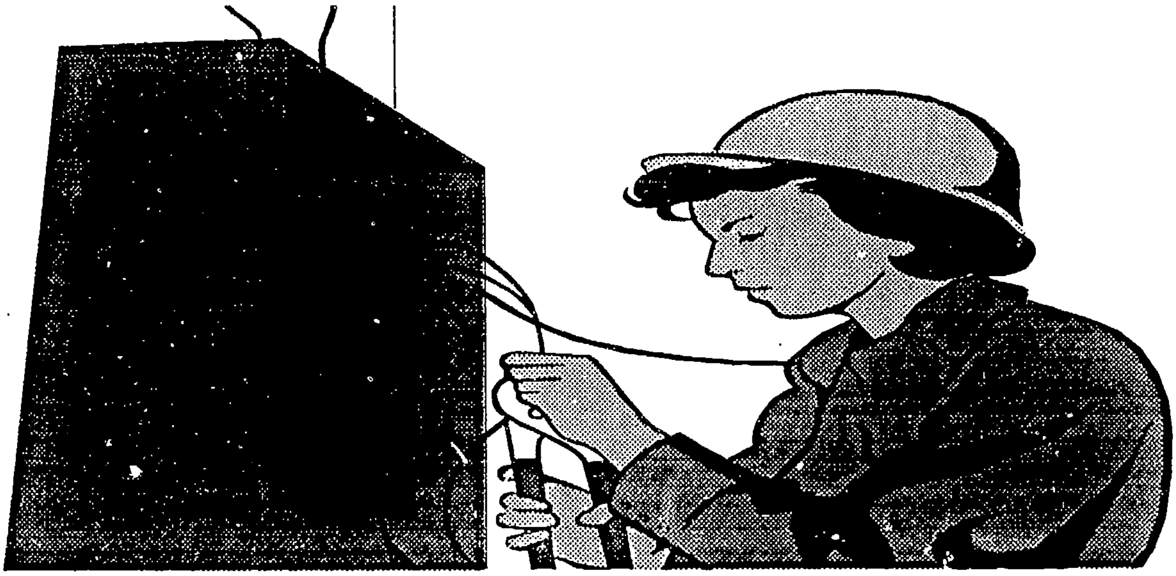
Competition is the cornerstone of the American free enterprise economy. Over the years, laws have been made to maintain the conditions necessary for fair competition. These laws are known as antitrust laws. Three of the major federal laws passed to protect competition among businesses include the *Sherman Act*, the *Clayton Act*, and the *Robinson-Patman Act*. Competition is protected by making it against the law for businesses to use unfair business practices, such as *price fixing*.

A. The **Sherman Act** was passed to prevent businesses from restraining trade and monopolizing markets. The act has two major sections regarding unfair competition. Under section one, every contract, business organization, or conspiracy designed to restrict trade or commerce is illegal. Whereas section one is directed at business organizations or their activities, section two is directed at individuals. This section makes it illegal to monopolize products or industries.

B. The **Clayton Act** was designed to strengthen the Sherman Act. The Clayton Act specifically prohibits four types of business acts, which if practiced, tend to lessen competition or create a monopoly. Firstly, *price discrimination*, whereas states charge different prices for different buyers, is illegal unless the different prices are set to meet competition. Secondly, *exclusive and tying contracts* are illegal. Exclusive contracts require a customer to agree not to sell the products of the supplier's competitors. Tied contracts occur when a customer must sign a contract for two different products to obtain one of the products. A third prohibited practice is *intercorporate stockholding*. A corporation cannot own stock of another corporation if it results in reduced competition. The fourth practice prohibited by the Clayton Act is *interlocking directorates*. A person cannot serve on the board of directors of two or more competing companies if this would reduce competition.

C. The **Robinson-Patman Act** was passed to strengthen the Clayton Act regarding price discrimination. The aim of the Robinson-Patman Act was to equalize prices to all customers if the costs of providing the goods are similar. More specifically, the act prohibits: (1) price discounts unless there are differences in costs, (2) selling private and regular brands of an identical product at different prices, and (3) giving unequal advertising or sales promotion allowances to different buyers. An important aspect of this act is that the burden of proof rests with the seller of the product.

The *Occupational Safety and Health Act* (OSHA) is a federal law. It was written to help ensure that the workplace is safe. Practically every worker, other than domestic and



household workers and miners, is covered by this law. Many states have adopted laws similar to the provisions of OSHA to help protect workers.

HOW DOES THE LAW PROTECT EMPLOYEES?

Many government regulations exist for the purpose of protecting employees. The federal government has enacted many important employee protection laws. State and local governments have enacted additional provisions of their own.

Employees enjoy a great deal of protection. Laws have been passed that deal with everything from workplace safety to minimum wage requirement. Let's look at some of the major laws designed to protect employees.

The *Fair Labor Standards Act* is a federal law. It provides for minimum wages, maximum hours, overtime pay, equal pay and child labor limitations. The law affects almost every business. Specific information on how it may affect your business can be obtained from your nearest office of Wage and Hour Administration, U.S. Department of Labor.

Employees are protected from economic loss by several laws. Every state has *Workers Compensation* laws that protect employees when they suffer a work related injury or illness. These laws vary from state to state. They provide for the payment of an injured workers' medical bills and compensation for wages lost due to a work related injury. The employer *must* pay for workers compensation coverage. This coverage is bought either from the state or private insurance companies. Requirements vary but employers are required to buy coverage.

Unemployment compensation laws help protect employees from financial loss when they are unable to find work. This is a system jointly run by the federal and state governments. Employers must pay unemployment taxes which go to support this program.

The federal *Social Security Act* protects employees and their families when they retire, are disabled, or die. In addition, health care benefits (*Medicare*) are made available to persons 65 and older and to some people under 65 who are disabled. Employers and employees pay a tax to support the Social Security system. It is the employers responsibility to make sure this tax is collected and paid. There are over 1,000 Social Security offices throughout the Unites States that can provide information to small business owners regarding this law.

The *Employee Retirement Income Security Act of 1974* (ERISA) is a federal law. It provides rules that govern pension plans and other benefit plans.

Employees are protected against discrimination on the job due to a handicap by the *Rehabilitation Act of 1973* and the *Americans with Disabilities Act* (ADA). These laws are designed to give people with handicaps a fair chance to get a job. The ADA was passed in 1990. It has a comprehensive set of rules governing employment practices that affect people with handicapping conditions. These rules pertain to employers with 15 or more employees. In addition, the ADA deals with breaking down the barriers these people face in public accommodations, transportation, state and local services and telecommunications. Every small business owner should become familiar with this important law.

Employees are protected against unfair employment practices by a variety of laws. As mentioned above, the ADA prohibits discrimination based on handicap. The *Civil Rights Act of 1964* prohibits discrimination based on race, religion, age, or sex. The *Equal Pay Act*, the *Age Discrimination in Employment Act*, the *Equal Employment Act*, and various state laws—all govern fair employment practices. Small business owners should become familiar with the requirements of these laws if they have employees. State labor offices are a good resource for finding out the exact rules and regulations that apply to your business regarding fair labor practices.

HOW DOES THE LAW PROTECT CONSUMERS?

Some federal laws are aimed at protecting consumers. These include the following:

- Federal Equal Credit Opportunity Act
- Fair Credit Billing Act
- Fair Credit Reporting Act
- Consumer Credit Protection Act

- Pure Food and Drug Act
- Federal Food, Drug, and Cosmetic Act
- Fair Packaging and Labelization Act
- Textile Fiber Products Identification Act
- Magnusen-Moss Warranty Act

A major consumer complaint has been the difficulty of understanding various terms surrounding the borrowing of money. Laws have provided credit protection to customers. The Consumer Credit Protection Act is commonly called the *Truth-in-Lending Act.* If you give credit to your customers, you will be affected by this law. This law is intended to clear up the meaning of credit terms. It requires that lenders provide borrowers with explanations of credit terms. Then the borrower will know exactly what credit will cost. The consumer will be able to compare various credit terms. The law also provides that lenders tell the truth when lending money or extending credit. They must state their credit terms and interest costs in easily understood words.

A second law, the *Federal Equal Credit Opportunity Act*, is designed to ensure that consumers are not denied credit for reasons of sex, marital status, age, race, religion, or national origin. A third law, the *Fair Credit Billing Act* is designed to ensure that a consumer's credit report will contain only accurate, relevant, and recent information. The information must be kept confidential unless requested for an appropriate reason by the proper party. Consumer credit problems have just recently been addressed by government legislation.

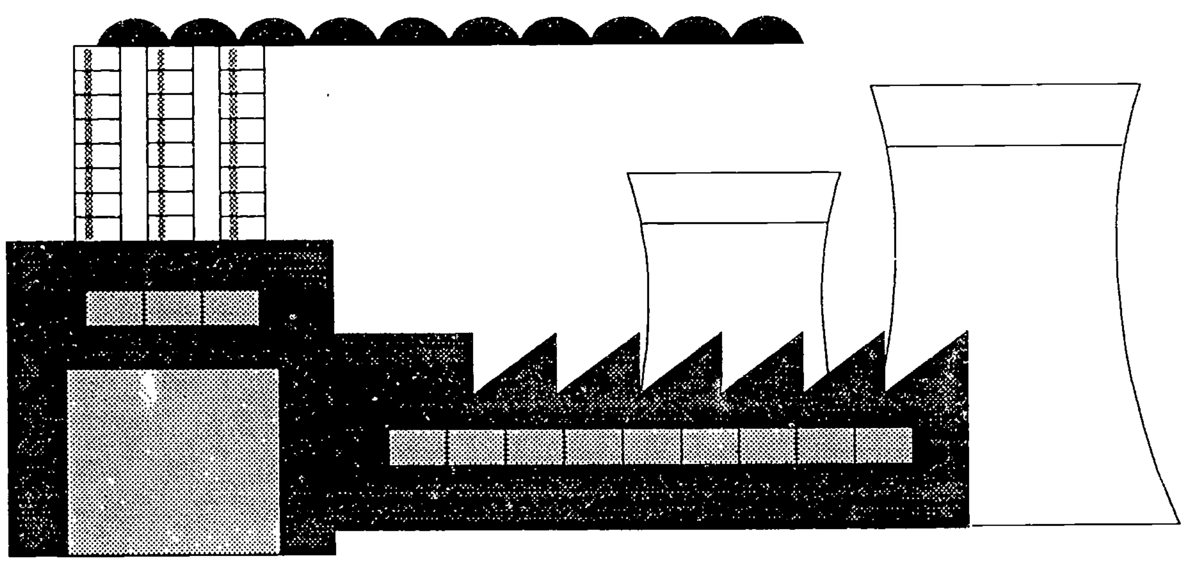
A concern that has had government attention for many years is the mislabeling and sale of hazardous products. The *Food and Drug Administration* (FDA) is a federal agency within the Department of Health and Human Services. It protects consumers by enforcing laws and regulations that prohibit distribution of impure or misbranded foods, drugs, and medical devices. Cosmetics and veterinary products are also covered by this agency.

The *Pure Food and Drug Act* forbids "adulteration and misbranding" of foods and drugs sold in *interstate commerce.* The *Federal Food, Drug, and Cosmetic Act* added cosmetic and therapeutic devices to the FDA's jurisdiction. The Act also changed the definition of misbranded foods. The definition of improper labeling was broadened to include any "false and misleading" label.

The *Fair Packaging and Labelization Act* intends to prevent unfair or deceptive packaging or labeling of certain consumer goods.

Truth-in-Fabric legislation has also been enacted for consumer protection. The *Textile Fiber Products Identification Act* requires information labeling and advertising of textile fiber products. Retailers or wholesalers who sell or advertise textile products share with the manufacturer the responsibility for seeing that the fiber content of goods is properly labeled and advertised. For example, this federal law applies to persons advertising clothing or household fabric products in newspapers having interstate commerce, regardless of whether or not goods are actually marketed across state lines. Therefore, the vast majority of retailers handling textiles have definite responsibilities under this labeling law.

Another area of consumer concern deals with product warranties. The *Magnusen-Moss Warranty Act* sets standards for businesses offering warranties. The basic provision of the Act requires that warranties be written in language that is understandable.



HOW DOES THE LAW PROTECT THE ENVIRONMENT?

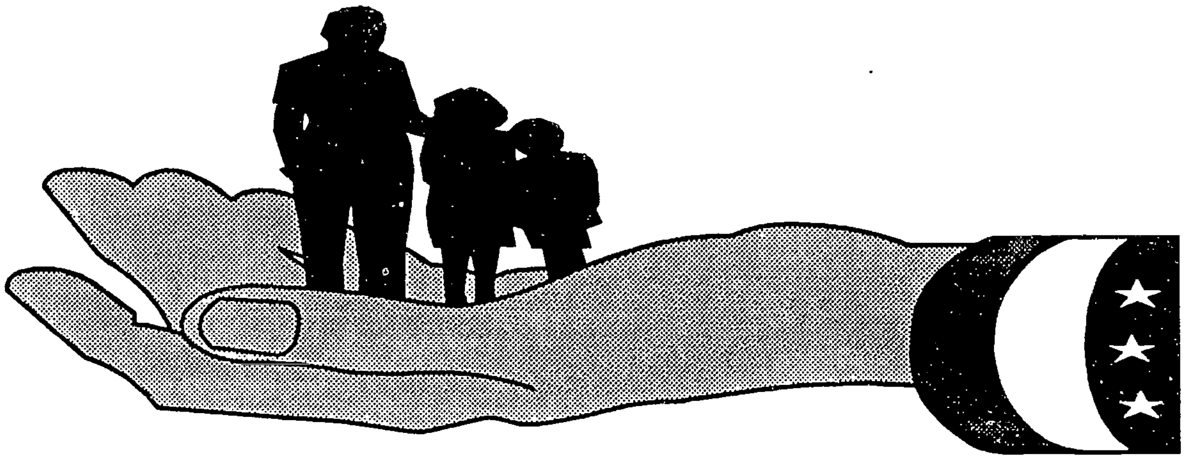
Concern for the environment has resulted in the passing of many anti-pollution laws. These laws are aimed at preventing people, particularly business people, from polluting our natural resources.

There are federal and state laws that prohibit polluting waterways and the air. Noise pollution is regulated. Handling hazardous material and the disposal of hazardous waste such as petroleum based products and toxic substances is highly regulated, at the federal and state levels. More and more communities are regulating what goes into landfills and what must be recycled.

It is very important for every business owner to know and understand the environmental laws that affect their business. Your state environmental protection agency is a good resource for information on complying with environmental laws.

HOW DOES THE LAW PROTECT BUSINESS PEOPLE?

Several laws exist simply to protect the interests of business people. The *Uniform Commercial Code* has been adopted in large part by almost every state. It is the basic law of business. It provides for one set of



rules governing business transactions. Things such as contracts, sales, agencies, bank deposits, sale of accounts, *letters of credit*, *commercial papers*, collections and bank transfers are covered. Having uniform rules allows business people to standardize routine transactions. This makes doing business more efficient and predictable.

Laws governing patents, trademarks and copyrights help business people protect their ideas and inventions. These laws will be discussed in detail later in this unit.

How do you know which laws apply to you?

There are many laws that affect business owners. It may seem like it would be impossible to comply with all these laws. It is challenging, but with the right professional help it is possible.

Many of the laws deal with taxes. Accountants are a good source of help for complying with these laws. Accountants can help you set up your books and keep track of when, how much, and to whom you must pay taxes. Tax laws change so often that it is wise to find a good accountant to help you with tax issues.

A good business lawyer can help you with a variety of legal issues. They are particularly useful for answering questions correctly. They can help you develop business practices that comply with the law.

As noted above, there are many government agencies that help small business owners. **The Small Business Administration** is an excellent resource for entrepreneurs. Agencies such as the **Environmental Protection Agency** can help with specific areas of the law.

Mentors are a good source of advice. They can help you recognize legal issues. Finding a mentor that is familiar with the type of business you are in can be a great help. They are familiar with legal issues from their business. They may also be able to direct you to other sources of help.

You can help yourself by taking a business law course. Doing so will help you to identify legal issues and get help when necessary. Even though you are not a legal expert, you know the most about how you do business. The more knowledge you have, the better you will be at spotting potential legal trouble and taking steps to prevent it.

WHAT IS A CONTRACT?

Almost all of the day-to-day transactions that are done in business involve *contracts*. Selling goods and services, buying goods and services, and using credit—all involve contracts. Making good enforceable contracts is essential for the success of a business enterprise.

A contract is a legally enforceable agreement between two or more people. These people are called *parties to the contract*. If any party to a contract does not do what was promised, he or she can be sued in a court of law for breaking the contract. When small business owners enter into a contract, they have rights and obligations. They have the right to expect the other party to do what was promised. They also have the obligation to fulfill their part of the bargain by doing what they promised to do.

Small business owners are faced with many opportunities to enter into contracts with customers and suppliers. For example, Mary runs a computer repair business. A customer leaves Mary a broken computer. Mary agrees to fix it for $150. The customer agrees to pay Mary $150 to fix it. An *oral contract* has been made between Mary and her customer. Later that day Mary agrees to buy a $10,000 computer tester from a supplier. Mary and the supplier sign a five page *written agreement* that contains all the terms of their contract. Mary has entered into a written contract to purchase the computer tester.

Mary's oral contract and her written contract are both legally *enforceable agreements*. Most contracts do not have to be in writing in order to be enforceable legally. However, putting an agreement into writing makes it easier for the parties to prove what their agreement was if there is a problem. Oral contracts can be enforced but it is harder to prove what the agreement was than if the parties had written it down.

Written contracts and oral contracts both contain five basic elements. These elements are often called *the five essentials of a contract*. Knowing these requirements helps entrepreneurs use this knowledge to make good contracts and avoid contract problems.

WHAT ARE THE FIVE ESSENTIAL COMPONENTS OF A CONTRACT?

The five essential components of a contract are as follows:

- Agreement,
- Consideration,
- Capacity,
- Legality, and
- Mutuality of consent.

In order for a contract to be enforceable it must have all five elements. The next few sections of this unit discuss these items with an emphasis on the key concepts that a small business owner should understand about each item.

WHAT IS AGREEMENT?

The first and most important element of a contract is *agreement*. For agreement to exist, there must be a reasonably definite understanding between the parties. The understanding is sometimes referred to as a meeting of the minds of the parties. Agreement occurs under the following conditions:

1. An *offer* is made. An offer is a proposal that expresses a desire to enter into a *legally binding agreement.*

2. The offer is followed by *acceptance*. Acceptance occurs when the party to whom an offer has been made agrees to the proposal.

3. The offer and the acceptance create a *reasonably definite understanding* between the parties who are involved in the contract.

Some of the most important ingredients for agreement are *intent to contract* and *reasonable definiteness*. Let's take a closer look at these two items.

Intent to contract. Sometimes when people talk business they do so in *exploratory terms*. This involves the parties asking questions and giving answers without promising to do anything. This results in no agreement and no contract. For a contract to exist, the parties involved must intend to contract. This means that all parties must be willing to enter into a contract and to meet the terms of the contract. The following example will help you learn more about intent to contract.

Mary, the owner of the computer repair business we discussed earlier, was shopping for some spare parts to carry in inventory. She called a supplier that she buys most of her parts from. Listen to the telephone conversation between Mary and the supplier.

Mary: "Good morning. I am interested in purchasing memory chips and circuit boards. I would like to know your price for these items. They are items 257 and 695 in your catalog."

Supplier: "The price for a box of 25 memory chips is $1,000 and the price for circuit boards is $50 each."

Mary: "Those prices are too high. They are not worth that much. I would not pay more than $850 for chips and $45 for circuit boards. Also, I would expect good credit terms if I bought 5 boxes of chips and 50 circuit boards."

The supplier laughed and they hung up. The next day the supplier delivers a shipment of merchandise to Mary. Five boxes of 25 memory chips (item 257) and 50 circuit boards (item 695) were included in the shipment. They were priced $850 for the chips and $45 each for the circuit boards. Mary sent them back to the supplier.

Can Mary return the shipment? Yes! In this particular example, Mary and the supplier were talking in exploratory terms. They did not reach an agreement. There was no agreement and no contract.

Reasonable definiteness. In order for an agreement to exist, the offer has to be *reasonably definite*. This means that the terms have to be specific enough to determine when the parties to the contract have lived up to their promises. The following examples will help you understand what is meant by reasonable definiteness.

A supplier offers to sell parts to Mary for $10,000. Credit terms are to be arranged. At first, Mary agrees. Later, she decides to back out.

Can Mary back out? In this particular example, she is able to do this. Why? The supplier's offer lacks *reasonable definiteness*. The statement "with credit terms to be arranged" is too vague. Let's take a look at another example.

A supplier offers to sell merchandise to Mary. The supplier will deliver the merchandise on the first day of the month. Credit terms are 2/10, net 60 (2 percent discount if paid in 10 days; otherwise the net amount due in 60 days). Mary agrees and the merchandise is delivered on the first day of the month.

In this example, the offer was reasonably definite. The terms are specific. A court of law can determine when the parties to the contract have lived up to their promises. There is a contract and Mary cannot back out of it.

Review what you have learned so far. Two items—intent to contract and reasonable definiteness are necessary for agreement. In addition, there must be an offer followed by an acceptance. The offer and the acceptance must create a reasonable definite understanding between the parties involved in the contract.

WHAT IS CONSIDERATION?

Consideration is something of value exchanged between the parties to a contract. Many times consideration is money or goods. However, it can also be as simple as exchanging a promise for a promise. For example, Mary promises to fix Bill's computer and Bill promises to pay Mary $40 per hour for the time she spends working to fix it. The parties' promises are considered valuable consideration.

An area that often causes problems involves *preexisting obligations*. If a person promises to do something that he or she already is required to do, then it is a preexisting obligation. A promise to perform a preexisting obligation is not valuable consideration and does not support the creation of a contract. In order to get a better understanding of preexisting obligations let's review an example.

Mary's business was robbed. Mary offered a $100 reward for information leading to the arrest of the person who robbed her shop.

Two local police detectives later supplied information that lead to the arrest of the robber. Can the detectives collect the $100 reward? Since the detectives were under a preexisting obligation as a paid police officer to catch the robber, they cannot collect a reward. Even though Mary offered a reward and they accepted her offer, there is no consideration and no contract.

WHAT IS CONTRACTUAL CAPACITY?

Contractual capacity is another element of a legally enforceable contract. All parties to a contract must be competent to understand and make legally binding agreement. Persons who are minors, mentally ill or intoxicated by drugs or liquor generally do not have the capacity to enter into a contract. They lack *contractual capacity*.

Generally, the most common capacity issue the small business owner will face involves minors. Minors are defined by most states as anyone under the age of 18. In a few states minors are anyone under the age of 21. Most contracts entered into by a minor are voidable by the minor. In other words, minors can refuse to fulfill their end of the bargain without being in violation of the contract.

This can cause big problems for small business owners. Suppose Mary sells spare computer parts to a minor for $100. The minor gets the parts but decides not to pay the $100. The minor can return the parts even though they are used and worth much less and not pay the $100. The minor has voided the contract. In most states Mary gets back the used parts and no money even though the parts have been used. In fact a minor can even void a contract if they lied about their age in most cases.

Intoxicated and insane persons can also void a contract. They must show that they were unable to understand the terms of the contract when it was made. If they prove that, they can void the contract.

WHAT DOES LEGALITY OF PURPOSE MEAN?

Courts will only enforce contracts that have a *legal purpose*. If the purpose of the contract is illegal or against public policy, the contract is void and unenforceable. If only a portion of a contract involves illegal purposes, then the illegal portion is void and only the remainder of the contract is enforceable.

There are several illegal purposes that small business owners should be aware of. Contracts involving gambling or lotteries are a problem. Many times gambling or lottery-type promotions may be illegal or highly regulated by state law. Before entering into a contract involving gambling, a business attorney should be consulted regarding its legality.

Another area of concern involves contracts that call for interest to be paid. There are state laws that set the maximum interest rate which may be charged when extending credit. Charging more than the allowed rate is called *usury* and is illegal. The portion of any contract which charges an illegal interest rate will not be enforceable.

Exculpatory clauses are another problem area. Exculpatory clauses are provisions in a contract that release a party from liability for its negligent acts. A common example is found on parking lot contracts which say that the owner of the parking lot is not responsible for any damage to your car. If the lot owner is negligent in running her lot, most courts will not enforce the clause stating she is not liable. It is a good idea to seek the advice of a lawyer anytime you want to use a exculpatory clause in a contract. Exculpatory clauses in contracts are generally not legal. In most instances, the courts are unwilling to enforce such provisions.

This is especially true with the *bailment contract*. Courts will not usually enforce an exculpatory clause in a bailment contract. Typically, the bailment contract has two parties: a *bailor* and a *bailee*. The bailor gives the bailee something to hold or protect. For example, a customer enters a restaurant and checks a coat. The customer is a bailor and the restaurant is the bailee. Under general bailment law, the bailee is liable for any damages to, or loss of, property that results from bailee negligence. A bailee may attempt to escape this liability through use of an exculpatory clause. For instance, a restaurant owner might post a sign, "Not responsible for lost or stolen garments." Recently, the courts have not allowed the bailee to escape liability so easily. If the coat is lost, the restaurant owner is responsible if the act was a result of negligence. As long as the bailor can show that the loss occurred through negligence on the party of the bailee, the bailor can recover damages.

Finally, *penalty clauses* in contract are generally against public policy and are unenforceable. Penalty clauses usually call for the party who breaks a contract to pay a very large sum of money as damages. If the amount of the payment is very high and is unreasonable, courts will declare it to be a penalty. They will not enforce the penalty clause.

Anytime a small business owner feels that a contract might involve an illegal purpose, they should seek the advice of an attorney before signing the contract.

WHAT IS MUTUALITY OF CONSENT?

The parties to a contract must have *mutuality of consent*. This means they must have known what deal they were making and freely entered into it. This element is missing if there is fraud, misrepresentation, duress, or mistake involved in the agreement.

Fraud and misrepresentation involve telling someone untrue facts in order to get them to enter into a contract. If the untrue facts are a significant part of the bargain, the contract can be voided by the partv who was misled. In addition, the party who was misled can sue for money damages.

Sometimes a contract can be set aside by the courts when a mistake has been made by one of the parties. This occurs when either or both parties to the contract were mistaken about an important fact. It may occur when one party to the contract was mistaken and can show that the other party knew, or could have known about the mistake at the time the contract was made. It may also occur when both parties are mistaken about an important fact in the contract.

For example, for several days, Mrs. Silver has been admiring an antique vase in Mr. Evans' antique shop. Mrs. Silver phones Mr. Evans and makes arrangements to purchase the vase. The purchase price is $1,000. Mr. Evans agrees to deliver the vase to Mrs. Silver.

When Mr. Evans tries to locate the vase, he finds that it is missing. He asks one of the employees about the vase. The employee informs Mr. Evans that the vase was broken by another employee just yesterday.

In this case, both parties to the contract were mistaken about an important fact. Neither Mrs. Silver or Mr. Evans knew that the vase was broken when they made their agreement. Therefore, the parties are excused from performing the contract.

The examples given in the discussion of the five essentials of contracts demonstrate that each element is very important. All five elements must be present in order to have a good enforceable contract. Failure to include any one of the elements can make a contract unenforceable.

Unenforceable contracts can be very expensive. They often cause expensive lawsuits. They also can result in poor customer service and bad relations with suppliers. Nothing can ruin a business faster than the problems bad contracts can cause. Knowing and understanding the five essential elements of contracts is crucial to running a successful business.

WHAT ARE THE MOST COMMON TYPES OF CONTRACTS?

The two most common types of contracts are *lease contracts* and *sales contracts*.

As you start your business, you will probably lease the site for the business rather than buy it. For this reason, it is important for you to become acquainted with leases and their terms.

WHAT IS A LEASE?

A *lease* is a special contract that establishes a relationship between a property owner and a tenant. A tenant (*lessee*) has possession of the real property of the property owner (*lessor*). Rent is the payment given by the tenant to the property owner. Many states have laws or statutes regarding these leases. In some states, if the leasing period is longer than 1 year, the lease contract must be written to be enforceable.

WHAT TYPE OF LEASES ARE AVAILABLE?

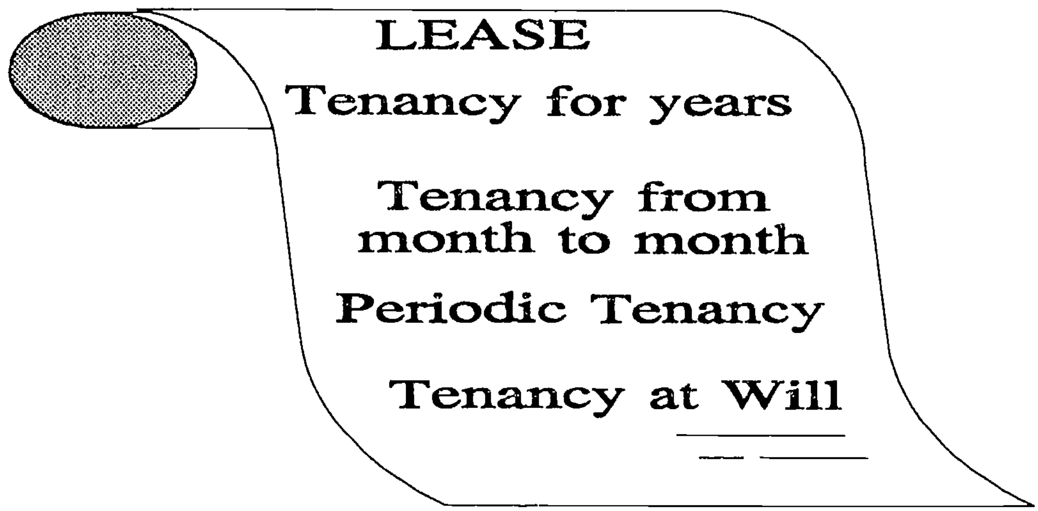
There are various types of leases that a business can sign. Selecting the "right" lease depends on the circumstances, type of business, and common leasing practices within the industry. There are four types of leases.

1. **Tenancy for years.** The site is leased for a definite period of time. The lease can last any fixed amount of time, 6 months, 1 year, 5 years, or more.

2. **Tenancy from month to month.** The site is leased month to month, and rent is due each month.

3. **Periodic tenancy.** The site is leased for an indefinite period of time with rent due at specified intervals.

4. **Tenancy at will.** The site is leased for an indefinite period of time. The lease can be continued or can be terminated on short notice by either party.



WHAT SHOULD A LEASE INCLUDE?

Since a lease is a legal document, it is important that certain precautions be observed before the lease is signed. It is a good idea to have a lawyer review the lease before you sign it. Examine the property thoroughly to make sure that it suits the purpose for which it is used. Make sure that the signatures are properly witnessed. Examine the lease thoroughly to make sure that it contains the following:

- No narrow restrictions on merchandise that may be sold or on services that may be provided.
- Statements of the duration of the lease, the amount of rent, the date on which the rent is to be paid, and the penalty for late and for nonpayment.
- Arrangements for subleasing, subletting, and assignment to another merchant.
- Provisions in case of fire or other damage that makes the premises unusable.
- Provisions regarding obligations concerning major and minor repairs.
- Options and renewal arrangements

WHY LEASE EQUIPMENT?

Often businesses lease more than the firm's premise. Even though leasing rates are usually higher than rates charged for purchasing the equipment on credit, many small firms lease equipment. Manufacturers very often lease machine tools and heavy equipment including trucks. It is not uncommon to find service, wholesale, retail, and manufacturing firms leasing data processing equipment, photocopying equipment, and company cars.

Leasing has some very definite advantages because it—

- does not tie-up capital since there is little down payment required in most cases.
- eliminates the need for some type of insurance protection.
- may provide a tax savings. Lease payments are deductible business expenses under many circumstances.
- eliminates possession of outdated equipment and so forth. (When new models become available, the lease agreement can provide for the lessee to exchange the old equipment for the new models.)
- saves on maintenance costs since these costs are many times included in the terms of the lease.

WHAT ARE SALES CONTRACTS?

As a small business owner, you will deal with a variety of *sales contracts*. These contracts may involve sales to customers or items that you intend to purchase. You may even work with a sales contract in order to purchase your own small business.

If you decide to purchase an existing small business, you will need to develop a sales contract. You may want to have your lawyer draw up the agreement. This will help to ensure that it covers all essential points and that the agreement is understood by all parties.

If you purchase an existing business, you will want to have the following items covered in the agreement:

- A description of what is being sold
- The purchase price
- The method of payment
- A statement of how adjustments (such as inventory sold, rent, payroll, and insurance premiums) will be handled at the time of closing
- Buyer's assumption of contracts and liabilities
- Seller's warranties (such as warranty protection for the buyer against false statements of the seller, inaccurate financial data, or undisclosed liabilities)
- Seller's obligation and assumption of risk pending closing
- The covenant of the seller not to compete with the business
- The time, place, and procedures of closing

The buyer of the business will want to take possession of the business as soon as possible after signing the contract. This will keep the seller from depleting the inventory or from creating ill will for the buyer as the business is taken over.

HOW CAN BUSINESS IDEAS BE PROTECTED?

In the process of doing business, small business owners many times have an opportunity to originate a new idea for a product or process. If so, they may wish to take steps to protect their idea through *patents*, *trademarks*, *service marks*, or *copyrights*. Let's take a closer look at these items and see how they can be used to protect business ideas.

If an item is invented in the process of operating a business, it may qualify for a *patent*. Patents may be obtained on new products, industrial or technical processes, machines, designs, or other items involved in the process of doing business. A patent provides the exclusive rights to the inventor to make, use, or sell the invention for a period of years. On new devices, it is a 17-year period.

In order to qualify for a patent, an invention must be *new* and *unique*. It cannot simply be a reworked version of an existing idea. If entrepreneurs invent a new and unique product or process, they should investigate protecting their invention by getting it patented. The process of getting a patent is very detailed and time consuming. Most inventors find it useful to hire a patent attorney or registered patent agent to help them through the process.

A *trademark* is a word, name, symbol, device (design), or a combination of these items that is used to identify a product. When a trademark is registered, that trademark is protected against use by others for a period of 20 years. The trademark is a device pointing directly to the origin or ownership of merchandise to which it is applied. The trademark is legally reserved to the exclusive use of the owner as maker or seller of the product. The "Golden Arches" symbol used by McDonald's restaurants is a good example of a trademark. No one else is allowed to use the "Golden Arches" because it is a registered trademark of McDonald's.

Like a trademark, a *service mark* is a word (or words), design (or designs), or combinations of word(s) and design(s) used to advertise services. A service mark helps customers to distinguish the services of one firm from those of another. These marks are used to advertise banking, real estate, motel, and other services. Through such advertising, prospective customers become aware of a firms services. When they see the service mark, they associate it with a particular level of quality.

Printed material such as literary and artistic work is protected through *copyrights*. Copyrights are effective for the life of the author plus an additional fifty years. Small business owners may desire to copyright material used in advertising. For example, catalogs, brochures, or instruction sheets regarding products and services can be copyrighted.

ACTIVITIES

The following activities are designed to help you apply what you have learned in this unit.

INDIVIDUAL ACTIVITIES

A.

Test your understanding of the legal terms discussed in this unit. Match terms corresponding to the following definitions:

DEFINITION

a. Legally enforceable agreement between two or more parties.
b. Proposal that expresses a desire to enter into a legally binding agreement.
c. Occurs when the party to whom an offer has been made agrees to the proposal.
d. Involves the parties asking questions and giving answers without promising to do anything.
e. Means that the terms have to be specific to determine when the parties have lived up to their promises.
f. Occurs when a person promises to do something that she/he already is required to do.
g. A party's competency to understand and enter into a legally binding contract.
h. Provision in a contract that releases a party from liability from its negligent contract.
i. Involves providing someone with false information in order to get them to enter into a contract.
j. Legal protection of literary and artistic work.

	TERM
H	Exculpatory Clause
____	Reasonable Definiteness
____	Contract
____	Fraud
____	Offer
____	Preexisting Obligation
____	Copyright
____	Acceptance
____	Contractual Capacity
____	Exploratory Terms

B.

Consult news publications such as *Business Week*, *Wall Street Journal*, *New York Times*, *Fortune*, or *Forbes* which are available at your local library. Identify articles that present business activities associated with legal issues presented in this unit. Develop a written summary of one or two articles to identify the legal issue the article deals with. Try to use the legal terms introduced in this unit.

GROUP ACTIVITIES

A.

Work in teams of four to six. Each team will discuss a legislation presented in this unit and develop an imaginary business situation pertaining to each law or regulation. Each team may use flip charts to record their findings and then share them with the other teams.

B.

Continue working in teams. Each team will consider a legislation regarding protection of employee's rights. The teams should consult the local library to research the assigned legislation. Next, each team will develop a one-page summary on the law or regulation they have researched. Finally, the teams should share their findings in a class discussion.

CASE STUDY

Ralph Zellman wants to start a furniture refinishing business. Several of his friends are antique dealers that need the services of a good furniture refinisher. He thinks he could make a good living doing work for them and the general public.

Ralph has started to develop a business plan for his furniture refinishing business. Ralph is concerned about the chemicals that he uses in the business. Many of the chemicals are toxic. Ralph wonders what type of laws might govern his use of these chemicals.

DISCUSSION QUESTIONS

1. Which government agencies might be involved in regulating hazardous substances?

2. Of the five groups that government regulations are designed to protect, which might be affected by laws dealing with hazardous substances? Why?

3. What should Ralph do to find out what laws he needs to comply with regard to the use of the refinishing chemicals?

ASSESSMENT

Read the following questions to check your knowledge of the topics presented in this unit. When you feel prepared, ask your instructor to assess your competency on them.

1. Explain the purpose of government regulations and laws regarding business. List some of the more important agencies that issue the legislation.

2. List and briefly explain the laws that protect competition.

3. List legislation issued to protect the employee's rights and explain.

4. What is the purpose of the Equal Credit Opportunity Act?

5. Define the concept of lease and list the four types of leases.

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PACE

Units on the above entrepreneurship topics are available at the following levels:

* Level 1 helps you understand the creation and operation of a business
* Level 2 prepares you to plan for a business in your future
* Level 3 guides you in starting and managing your own business