

Quick  Start
YOUR BUSINESS

Business Owner's Guide to the Internet

**How to Build a Strong
Web Presence for
Your Business**

**Your Practical
and Legal Guide**
for Creating an Internet
Presence for Your Business

- ▶ **Develop Your Online Business Plan**
- ▶ **Build and Register Your Website**
- ▶ **How to Sell on the Internet**
- ▶ **Develop Customer Loyalty**
- ▶ **Finance Your Internet Business**
- ▶ **Attract Visitors to Your Site**

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Attorneys At Law

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Introduction

The Internet has changed our world. Gathering information, buying goods and services, finding people, making travel reservations, and more can now be done from the comfort of your own chair. Businesspeople need to be aware of the new ways consumers do business in order to compete in the new economy.

Whether you are starting a new business or just getting around to putting your existing business on the World Wide Web, you will probably have many questions about how to legally and practically reach the consumers who use the Internet to buy or research goods and services, or to find a business's name, address, and phone number.

This book will help you through key issues surrounding the Internet, including:

- what structure to use for your business;
- how to reserve your domain name;
- how to go about setting up a website;
- what should be on your website;
- legal issues of which you should be aware when setting up your website and doing business on the Web;
- and, much, much more.

Checklists, charts, and a glossary are also provided for quick reference.

From the one-page website providing contact information to the complex shopping website, this book will guide you through the legal and practical issues you need to consider when you put your business on the Web. Have fun becoming cyber-savvy!

SECTION I:

**Setting Up and
Maintaining
Your Business**

Chapter

1

Choosing a Form of Entity

- ▶ **The Right Entity for the Original Company**
- ▶ **Corporate Advantages**
- ▶ **Corporate Disadvantages**
- ▶ **The Limited Partnership**
- ▶ **The Limited Liability Company**
- ▶ **The Choice between an S Corporation and an LLC**
- ▶ **Doing Deals through Partners, Subsidiaries, or Affiliates**

The Right Entity for the Original Company

One of the first decisions any entrepreneur must make is the choice of entity for a new business. Should it be a corporation, partnership, limited partnership, limited liability company (LLC), or sole proprietorship?

There are also limited liability partnerships, limited liability limited partnerships, and professional corporations. Professionals, such as architects and doctors, are restricted by state laws to certain types of entities for practicing their professions. They are usually the only ones to use these last three types of business entities.

Limited Liability

The major benefit to forming a corporation or a limited liability company (LLC), as opposed to operating through a partnership or a sole proprietorship, is *limited liability*. That is, if you properly create and maintain a corporation or an LLC to house your business, your personal assets—and your co-owners' personal assets—will not be subject to claims against the company.

Let us say that you start a dog grooming business. You do not organize your business as a corporation, but rather operate as a sole proprietorship, which is not a limited liability entity. A dog attacks a visitor. The visitor sues you. Whether or not you are found liable for the injury, if your business is a sole proprietorship, you may have to exhaust your personal assets—which includes potentially selling your house—to either pay to defend yourself in the lawsuit or to satisfy a judgment if you *default* (fail to defend yourself). If you had set up the business as a corporation and your business is sued, while you may have to exhaust the business's assets to pay for the suit, and perhaps even close up shop, your personal assets should be protected.

Once you put your business out on the Internet, you reach all kinds of people, all over the world. They will be reading your information, perhaps buying things from you, and doing whatever else your website attempts to entice them to do. The mere fact that you are now exposing your business to the whole world is a good reason to conduct your business as a limited liability entity.

So, assuming you want to do business through a limited liability entity, the next issue is to decide which type. The three most common entities used are the *C corporation*, the *S corporation*, and the *LLC*. *Limited part-*

nerships are also still in use, but they do not limit the personal liability of the general partner. If the general partner is a corporation or an LLC, this will not be a concern. *Sole proprietorships* and *partnerships* do not limit the liability of the owners—their assets are subject to the liabilities of the entity.

QUICK Tip

There is no legal requirement that one must use an attorney to form a company. You can just make the decision to form a company and file with the state. That said, there are pros and cons for each type of entity. The best choice can be different based on each person's circumstances, so it is not easy to provide a formulaic answer as to which type of entity you should form.

The Corporation

A *corporation* is an artificial, legal person. That is, a corporation is treated as an independent entity with its own legal identity that allows it to carry on business and also subjects it to legal claims and obligations. The officers and directors of a corporation run the business for the ultimate benefit of its shareholders. In many states, one person may form a corporation and be the sole shareholder and officer.

Each state has its own set of laws governing corporations, including how they must be organized, how they must be governed, how often they must hold shareholders' meetings, how they can be merged or consolidated, how they can be dissolved, and various other matters. In general, the shareholders elect the directors, and the directors elect the officers. The officers have authority to run the day-to-day operations, but they need director approval to do anything out of the ordinary, such as sign a lease for business space, hire an executive employee, or start a new line of business. For even more major decisions—such as the sale of all the assets of the corporation, a merger, reorganization, consolidation, or amendment to the *certificate of incorporation* (in some states, this is called the *articles of organization*)—a shareholders' vote is required.

An amendment to the certificate of incorporation is required in order to increase the number of authorized shares of stock, add another class or series of stock, change the corporation's name (although sometimes a shareholders' vote is not required to do this), and to take various other actions. In most states, a majority shareholder vote is required to take most actions that require a shareholder vote, but for certain matters in certain states, a two-thirds vote or other type of vote is required.

The S Corporation

An *S corporation* is a corporation that has filed IRS Form 2553, choosing to have all profits taxed to the shareholders rather than to the corporation. Not all corporations are eligible for S corporation status. The S corporation can have no more than one hundred shareholders. These shareholders must be individuals or certain types of trusts, estates, or tax-exempt organizations. The company may only have one class of stock, unless the only difference between multiple classes of stock is a voting difference. With certain limited exceptions, all shareholders must be *natural persons*, which means they must be actual human beings, as opposed to a legal person like a corporation. Shareholders cannot be nonresident aliens.

An S corporation files a corporate tax return, but pays no federal tax. The profit shown on the S corporation's tax return is reported on the owners' tax returns. In some states, even an S corporation must pay a corporate excise tax.



Alert!

If an entity begins as an S corporation, but then violates one of the criteria required to remain an S corporation, it converts automatically by operation of law to a C corporation. No filing is required. A corporation can also voluntarily elect to terminate its S corporation status.

The C Corporation

A *C corporation* is any business corporation that has not elected to be taxed as an S corporation. A C corporation pays income tax on its profits, unlike an S corporation, which does not. If a profitable C corporation then pays dividends to its shareholders, the income is taxed an additional time at the shareholder level, thus taxing the same revenues twice.

The Professional Corporation

A *professional corporation* is a corporation formed by a professional such as a doctor or an accountant. State laws have special rules for professional service corporations that differ slightly from those of other corporations. Professional corporations can be either C or S corporations. State laws generally require each shareholder and certain officers and directors of a professional corporation to be licensed practitioners of the profession that the corporation has been organized to practice. When filing the organizational documents, the incorporators of a professional corporation generally have to obtain proof from the appropriate licensing board that the necessary persons are duly licensed. In addition, state law generally prohibits the issuance or transfer of shares to a person who is not professionally licensed. The various licensing boards also often have authority, by statute, to promulgate additional requirements with which professional corporations must comply.

The Nonprofit Corporation

A *nonprofit corporation* is usually used for such organizations as churches and condominium associations. However, with careful planning, some types of businesses can be structured as nonprofit corporations and save a fortune in taxes. While a nonprofit corporation cannot pay dividends, it can pay its officers, directors, and other employees fair salaries that are competitive with those paid by for-profit corporations.

Corporate Advantages

There are many advantages to doing business as a corporation. If a corporation is properly organized and maintained, shareholders have no liability for corporate debts and lawsuits, and officers and directors usually have no personal liability for their corporate acts. The existence of a corporation

may be perpetual, unlike a sole proprietorship or partnership. There are also tax advantages allowed only to corporations.

For example, in a corporation, not all amounts paid out to employees are subject to *self-employment tax*—only salaries are subject to this tax. Other amounts distributed, like dividends, for example, are not subject to self-employment tax, assuming the tax authorities do not exercise their right to recharacterize income. In a sole proprietorship, partnership, or LLC, generally all amounts paid out to employees, whether salary or not, will be subject to self-employment tax.

There may be prestige in owning a corporation—capital may be raised by issuing stock, and it is easy to transfer ownership upon death. A small corporation can be set up as an S corporation to avoid corporate taxes but still retain corporate advantages. Some types of businesses can be created as nonprofit corporations that provide significant tax savings.

Corporate Disadvantages

There are also disadvantages to the corporate structure. There are start-up costs for forming a corporation, and there are certain formal actions that are required, such as annual meetings, maintaining separate bank accounts, and filing tax forms. Unless a corporation registers as an S corporation, it must pay federal income tax separate from the tax paid by the owners, and it may pay more than the minimum state income tax.

The Limited Partnership

A *limited partnership* has characteristics similar to both a corporation and a partnership. There are two types of partners. General partners have the control and liability. Limited partners invest money and have liability limited to what they paid for their share of the partnership (like corporate stock).

The main advantage to a limited partnership over other types of entities is that limited partners who have no control of the business or liability for its debts can contribute capital. However, general partners are personally liable for partnership debts and for the acts of one another. There also may be high start-up costs because a written limited partnership agreement is required. These can be very complicated. If you are considering a limited partnership, contact an attorney to draft this type of agreement.

The Limited Liability Company

The *limited liability company* is quickly gaining in popularity. This entity has characteristics of both a corporation and a partnership. None of the members have liability and all can have some control. The limited liability company offers the tax benefits of a partnership with the protection from liability of a corporation. It offers more tax benefits, in some cases, than an S corporation because it may pass through more depreciation and deductions. This type of corporation may have different classes of ownership, an unlimited number of members, and may have noncitizens and legal entities, such as trusts or corporations, as members. It is also extremely flexible in structure and operational aspects. Tax attributes, such as losses, may be allocated among the members in a manner different than according to their respective ownership interests in the company, with certain restrictions.

Alert!

There are start-up costs associated with forming a limited liability company. It is advisable to have an operating agreement, drafted by an attorney, which can be complex and expensive. However, in many cases the benefits of an LLC will far outweigh the costs.

The Choice between an S Corporation and an LLC

Often the entrepreneur will narrow the choice down to an S corporation versus an LLC. Do not let yourself be talked into forming an LLC just because your attorney or advisor thinks it is the trendy thing to do. An S corporation can be a much simpler, cheaper entity to form, and in many instances can fill the same needs as an LLC with much less cost and complication. If your entity is eligible for S corporation status, ask yourself if it is really preferable to choose an LLC rather than an S corporation.

Tax issues may determine the final decision between the two entities. One tax aspect to consider is that all income of an LLC will be subject to

self-employment tax. This is separate from and in addition to income tax. With an S corporation, only salaries are subject to self-employment tax. If S corporation shareholders receive dividends as well as salaries, the dividends will not be subject to self-employment tax. Note in this regard that the Internal Revenue Service (IRS) has broad authority to recharacterize income as it sees fit.

There is a second tax difference between the two entities that has to do with the distribution of property—not salaries or cash dividends but assets owned by the company—that has increased in value since it went into the company. Distributions of such property out of an LLC to its members will generally be tax-free. The members will have a *carryover basis* in the distributed assets.

The *basis* of property is generally the purchase price. Basis is used, among other things, to determine gain or loss upon the sale or other disposition of property. If a taxpayer has a *carryover basis* in property transferred to him or her from another taxpayer, this means he or she can treat the transferor's cost as his or her own cost for tax purposes, rather than having to use the current fair market value of the property as his or her basis.

EXAMPLE: Assume an LLC buys a painting for \$100. Several years later, the painting is worth \$1,000, and the LLC transfers it to one of its members. The member will not have any taxable event because of the transfer, and he will take the LLC's basis of \$100 as his own basis—if he sells later for \$2,000, his gain will be the difference between the sale price (\$2,000) and his basis (\$100). If the same transaction occurred between an S-corporation and a shareholder, the shareholder would have to take the current fair market value at the time of transfer of the painting (\$1,000) as his basis, and he would also have taxable gain at that time in the amount of the current value of the painting (\$1,000) minus the corporation's basis (\$100).

Talk to your accountant if you think tax issues like the issue of the transaction in the example could possibly come up in your business. With an S corporation, distributed appreciated assets will cause shareholders to have

taxable income. Their basis is current fair market value in the assets. This is the major reason conversion from an S corporation to an LLC creates tax issues, while conversion from an LLC to an S corporation generally does not.

A third tax difference is that in the LLC, as stated earlier, owners can have allocations of tax benefits, such as depreciation and losses, that are different than their pro rata ownership interests. The S corporation cannot make special allocations of these tax items. The allocations are in direct proportion to the percentage of shares held by each individual.

Some tax issues vary by state. For example, there is a major tax problem for a Massachusetts LLC engaged in a business that carries inventory. The personal property tax statutes specifically exempt the personal property of a domestic business corporation but not of an LLC. This means that an LLC with substantial personal property (i.e., inventory, such as automobiles) will be liable for property tax. An S corporation would not owe property taxes in the same circumstances. This legislative omission could be a costly trap for some businesses.

Plenty of people make decisions about their choice of entity and file the necessary paperwork without the assistance of an attorney or accountant. Sometimes it works out, and sometimes it does not. You may save yourself some headaches by consulting with a professional at the outset. As previously noted, state laws differ in their treatment of these different entities, especially the newer LLCs. Making the right choice in the beginning can save you a lot of trouble, time, and money. It is harder to change the form of entity later than it is to spend the time and money to make the right choice now.

Doing Deals through Partners, Subsidiaries, or Affiliates

When you are starting your business, you may have a one-track business plan—make widgets and sell them on your website. You decide to form an S corporation to house your business.

After you have been doing business for a few months, you realize that many of your customers are requesting widgets with built-in modems. You have a friend who is good at modifying your widgets to include built-in

modems, and you think you can both make some money on this new project.

At this point, you need to consider whether your new line of business needs to be separated from your original line of business. You may want to keep the revenue from the two products completely separated. You may want to sell the new product under a different name. You may not want your friend to own any part of the business selling the first product. A major consideration should be whether the liabilities associated with the two different product lines should be segregated.

Does one product have greater inherent product liability risks? The company has a greater risk of being sued if its product is more dangerous. Will it be sold to a different type of market? Do you want the assets being generated by the first product line to be subject to liabilities generated by the second product line? Probably not. You will have to weigh against these issues the costs, in terms of money, time, and hassle, of creating a separate legal entity for the new product line. It will almost always be worth it.

What should the relationship between the two entities be? Perhaps they will both be S corporations. You will be the sole owner of one, and you and your friend will be co-owners of the other. The two corporations could enter into a contract providing for shared office space, a shared website, and shared overhead costs. Or, maybe you and your friend decide that you will both own the original corporation, and you will create a new corporation, which will be owned by the first corporation (this is a *subsidiary*).

You may decide to just try things out temporarily with some type of joint venture agreement between your original corporation and your friend. A *joint venture agreement* is legally a partnership. Your friend may not have any assets to speak of, so he or she may not be concerned about liability issues. You also may not want to spend the resources to set up a new legal entity when you do not know if the new venture will succeed.

In summary, there are many considerations in making the decision about the structure of a new business deal or venture. Tax issues, liability, ownership, length of the venture, physical location issues, and more will all need to be examined. Unfortunately, there is no simple formula for making the correct choice. However, if you know the basic differences among the different structures, you are well on your way to making the best decision for your business.

Chapter

2

Formation and Maintenance of Your New Entity

- ▶ **Creating Structures that Anticipate Change**
- ▶ **Limiting Your Liabilities During (and After) the Life of Your Business**
- ▶ **Avoiding the Piercing of Your Corporate Veil**

Creating Structures that Anticipate Change

When you first set up your entity, try to leave room for new circumstances you do not currently anticipate. For example, if you think you will be the only owner of the business forever, do not make the mistake of authorizing only one hundred shares when you create your corporation with the state if the same filing fee can get you two hundred thousand authorized shares. You do not have to issue all two hundred thousand shares, but at least there will be shares available down the line in the event you want to raise money through selling stock, issuing stock to coworkers, etc. The state will always let you increase the number of authorized shares later, for a fee, but why pay for them if you can get them up front for nothing?

Beware, however, that if your corporation is formed in Delaware, you should keep your number of authorized shares down—not too much greater than your number of issued shares. Otherwise, if your corporation ever has a material amount of assets, your annual franchise taxes may be very high.

You should also think about restrictions on the transfer of your entity's shares or units. Let us say you are going into business with your best friend. You both plan to work at the business full-time. You form an S corporation and you each put in money and get one hundred shares.

Now your best friend's wife gets an unbelievable job offer that she has been wanting for years. The job is in their hometown. Your best friend wants her to take the job, but it will mean they move five hundred miles from where you are now living.

What happens to your friend's stock? Does he stop working with you, but still own 50% of the corporation and thus gets an equal share of any dividends declared? You can put an agreement in place that will give the company, or you, or both, the option to buy a shareholder's shares if the shareholder stops working for the company, becomes incapacitated, or dies.

Do not wait until something happens to put this in place. Once you need it, it may be impossible to agree on the terms. Typically, this document is referred to as a *shareholder's agreement* or a *buy-sell agreement*. It provides a way to create an agreed-upon plan of action in anticipation of several possible eventualities.

An important consideration for the correct choice of structure is the exit strategy contemplated by the business owners. For example, if your idea is to eventually merge with another company or to go public in an *Initial Public Offering of Stock* (IPO), you might choose a structure such as a C corporation, which allows a merger or IPO more readily than an LLC.

Additionally, as previously noted, conversion from an S corporation to an LLC creates tax issues, while conversion from an LLC to an S corporation generally does not. While it is possible to start out with one type of entity and change later, do not delay the effort to determine the right legal structure in the formation of your company. An investment of your time in this effort at the beginning of the enterprise could save you triple the effort to change the structure later.

Limiting Your Liabilities During (and After) the Life of Your Business

You may have heard of *piercing the corporate veil*. This is what a court can do if it thinks that the owners of a corporation should be held personally liable for the corporation's liabilities and obligations. The court may do this if it finds that the owners have misused the corporate entity in some way, or have failed to put the public on notice that their business is being done through a corporate entity.

Avoiding the Piercing of Your Corporate Veil

First, make sure that you put the entity's actual legal name, including the "Inc.," "Corp.," "LLC," or whatever it is, on everything. This means you need your entity's legal name on contracts, stationery, business cards, and especially your website. (These authors come across websites all the time that fail to alert the viewer that the business entity has limited liability.)

Some corporations call their owners *partners*. Legally, partners have unlimited personal liability, even for the acts of the other partners. Do not call yourselves *partners* unless that is your true legal status. A creditor can argue that because your website said you were partners, he or she thought you were personally obligated to pay the bills. The judge may just agree

with him or her. Even if you do not use the word *partners*, simply omitting the use of the real legal name, which includes the "Inc." or the like, makes it look to the world like you are a partnership or sole proprietorship.

If you are one person in business and you do not have limited liability, you are a *sole proprietorship*. If you are more than one person in business and you do not have limited liability, you are by definition a *partnership*. It does not matter that you have no written or verbal partnership agreement, or that you do not call the business a partnership. That is what the law says you are, and that is what a judge or jury may say you are if you do not put the public on notice that you are a limited liability entity.

**Figure 2.1: TIPS TO AVOID GETTING YOUR CORPORATE VEIL
PIERCED**

There are many factors that a court will consider in determining whether to pierce the veil. Following is a list of things you should note carefully in order to avoid placing your personal assets at risk:

- keep your entity's assets separate from other persons' and entities' assets;
- have adequate books and records;
- have sufficient assets to meet your business's reasonably foreseeable needs (this is known as being *adequately capitalized*);
- businesses and operations should be kept separate from other persons' and entities' businesses and operations;
- hold annual meetings, if required by law, and keep appropriate minutes of meetings;
- take formal votes, if required by law, for all major decisions, and keep written records of these votes;
- have required officials, such as officers and directors, who specifically function as required by law;

(continued)

- do not allow the use of your entity's assets for anyone's personal purposes;
- do not allow the use of its assets for anyone's personal purposes;
- do not promise anyone that you will be personally liable for the business's obligations, unless required to complete a transaction (such as a personal guarantee of a bank loan);
- make appropriate tax and other governmental filings in a timely manner; and,
- always use the entity's true legal name, unless it has filed a *fictitious name certificate*.

A *fictitious name certificate* is a document that is filed with the government—town, city, county, or state, depending on where you live—that puts the public on notice that you or your entity is doing business through a *trade name*, or name other than its (or your) true legal name. For example, if you are a sole proprietor and you have set up shop as Bill's Grill, you are legally required to file a fictitious name certificate with the appropriate governmental authority to let the public know who the actual business owner is. This is especially important for any limited liability entity doing business through any name other than its true legal name, as the failure to make this filing can lead to the piercing of the corporate veil.

If your business ceases operations, be sure to notify all parties with whom you have dealt. Put a sign up, put a notice on your website, and send a form letter to everyone with whom you have done business. The most important thing is to make sure that persons and entities that do or have done business with you or your entity are clearly informed that they are not transacting business with you as an individual.

**Alert!**

If you cease to operate, spend the few hundred dollars it takes to dissolve your corporation or other entity. This will put the public on notice that the entity no longer exists and will protect you in the long run.

Chapter

3

Contract Basics

- ▶ **Pros and Cons**
- ▶ **Contract Requirements**

Almost everyone who is in any kind of business will have dealings with some type of contract at some point. This chapter aims to give you a basic understanding of contract law.

A *contract* is an agreement among two or more parties. In most cases, it can be verbal or written. Most states have specific laws regarding which types of contracts must be in writing to be enforceable. In most states, for example, contracts involving the sale of goods for \$500 or more and contracts involving the purchase and sale of real estate must be in writing to be enforceable. There are specific state laws governing other aspects of certain types of contracts as well. Most states have adopted the *Uniform Commercial Code*, which governs contracts for the sale of goods, among other things.

Pros and Cons

There are advantages and disadvantages to putting a contract in writing, rather than just making a verbal contract. The primary advantage to a written contract is that if there is ever a dispute as to the terms or existence of an agreement, the written contract provides ready proof of what the arrangement actually is. It also may assist the parties involved by forcing them to define or specify the various terms of the deal. Sometimes the parties may not even have considered a certain aspect of the deal, until they go to put everything down in writing.

However, this aspect of the written contract can also be a disadvantage. It may be so difficult to put things into writing, or so difficult to agree on the written terms, that a verbal contract may be much easier, quicker, and cheaper to make. But in our experience, in almost every case, except for the smallest, fastest deal, the advantages of putting a contract in writing by far outweigh the disadvantages.

Contract Requirements

In order for a contract to be enforceable—other than the requirement that it be in writing in certain cases—there are several elements that must exist.

Capacity and Authority

Both parties must have the legal *capacity* to enter into a contract. They must not be minors or be mentally incompetent. Corporations and other legal entities are generally presumed to have the capacity to contract. However, the specific officer of the entity who signs the contract must have *authority* to do so—whether it is because of the normal functions of his or her office, or because of specific authority granted by the appropriate person or group (e.g., the board of directors of a corporation). In some cases, even where the person was not duly authorized to sign the contract, the contract may still be enforceable.

Consideration

There must be *consideration* flowing from each party to the other. This means that each party must be giving something to the other. Consideration can consist of mutual promises, money, or property. If you say to Joe, “When I sell my stock, I will give you half the proceeds,” this is not an enforceable contract without more, because Joe has not made any promise to you or given you any other consideration for your promise. Consideration must flow both ways.

Offer and Acceptance

There must be an *offer* and *acceptance*. The parties must come to a mutual agreement about who is going to do what. If you fax Joe a letter saying that you will paint his house for \$3,000, there is no contract until he agrees to the deal. If he faxes you a letter in return, saying you can paint the house but he will only pay you \$2,500, it is a new offer, not an acceptance of your offer. There is not a contract in that case until you accept Joe’s offer, whether verbally or in writing. Again, it is much easier to prove a written contract than a verbal one.

Additionally, a counteroffer, such as Joe’s proposal to pay you \$2,500, serves immediately as a refusal of your original offer. Consequently, you are no longer bound to paint his house for \$3,000 even if he decides later to accept your original deal. The counteroffer has taken your original offer from the table. You are free to come up with another price and start the negotiation over again. (Of course, he may later decide that he does want

you to paint the house for \$3,000—and if you agree at that point, you will have a deal.)

Figure 3.1: WHAT TO INCLUDE IN YOUR CONTRACT

In a written contract, it is very important to be precise and thorough. The obligations of each party should be thoroughly spelled out and defined. Most contracts should cover the following:

- specific time frames for performance;
- specific time frames for payment;
- length of time the contract will be in effect (this is not always applicable—if the arrangement is for one isolated transaction, this provision may be omitted);
- form of payment;
- details of performance—what exactly is to be done, how exactly it is to be done, who is to do it (if you contract with a corporation for consulting services, for example, you may want to specify actual persons who are to do the work);
- who pays for cost of materials and other expenses, and the time frame for this payment;
- whether either party can terminate the contract prior to full performance, and under what circumstances;
- what happens if the contract is terminated;
- what state's law applies;
- in what state legal action or arbitration must be commenced;

(continued)

- arbitration provisions (these can help speed up and lower the cost of resolving disputes, but are not recommended in all cases);
- representations and warranties by each party;
- remedies (some matters lend themselves to the remedy of *specific performance*—this means that the court or arbitrator can force the breaching party to perform his or her obligations under the contract, rather than just pay damages to the nonbreaching party);
- notice and cure provisions for breach (not always appropriate);
- specified damages to be paid in the event of breach (also not always appropriate or enforceable);
- whether the contract is assignable (that is, you or the other party can assign someone else to be responsible for performance called for in the contract);
- how to give notice to the other party and when notice is deemed given (e.g., on the date of mailing by first-class mail or on the date of hand delivery); and,
- whether there are any other agreements that form a part of the deal.

Legal Subject Matter

The subject matter of the contract cannot be against public policy. The courts will not enforce a contract for illegal activities or other matters that are considered against public policy. For example, if Joe says he will pay you \$500 to steal an item from a store, the contract is unenforceable because stealing is illegal.

Some contracts are perfectly understandable by the nonattorney, and you may feel comfortable entering into them without legal assistance. Sometimes if both parties have an attorney it can complicate matters rather than simplify them. If you are confident that you understand all the terms of a contract and are comfortable with them, and that the contract covers

everything, it may be fine to enter into the contract without having an attorney review it. But if you are entering a new area or signing a complex contract, you may do yourself a favor by hiring an attorney.

Chapter

4

Dealing with Employees

- ▶ **Discrimination**
- ▶ **Hiring and Firing**
- ▶ **Employment Agreements**
- ▶ **Internet-Use and Email Policies**

If you are starting a business, you may at some point have employees. Even if you are the only person working at the business, you will probably technically be an employee. You will probably draw a salary, which will be subject to withholding taxes and the like. It is best to have a payroll service handle these tax filings, because the filings can be very cumbersome. The service is usually fairly affordable.

You may wonder what else needs to be in place if you hire other people to work for your company. Issues about hiring and firing, employment agreements, and employee policies may arise. This chapter discusses some of the basics you should consider if you are going to have employees.

Discrimination

There are many federal and state laws that affect employers. Various laws prohibit discrimination in the context of hiring and firing, compensation, promotion, recruitment, use of facilities, fringe benefits, and other aspects of employment. Figure 4.1 lists some of the federal laws with which you may need to comply. If any of these apply to your business, you should investigate the details of how to comply. You can find helpful information regarding these laws at the website of the Equal Employment Opportunity Commission (EEOC):

www.eeoc.gov

In many cases, if a certain law applies to your business, you are required to post notices at your workplace, advising employees of their rights. The EEOC website will help you find out about these requirements as well. You should also check on your state's website for information about state and local laws with which you may need to comply.

Figure 4.1: DISCRIMINATION LAWS AND TO WHOM THEY APPLY

Applies To	Law
All employers	<i>Equal Pay Act of 1963</i> Prohibits sex-based wage discrimination for men and women performing substantially the same work in the same establishment.
Employers with 15 or more employees	<i>Title VII of the Civil Rights Act of 1964</i> Prohibits employment discrimination based on race, color, religion, sex, or national origin.
Employers with 20 or more employees	<i>Title I and Title V of the Americans with Disabilities Act of 1990 (ADA)</i> Prohibits discrimination against qualified individuals with disabilities in the private sector and state and local governments.
	<i>Age Discrimination in Employment Act of 1967 (ADEA)</i> Prohibits discrimination based on age; protects those 40 and older.

Hiring and Firing

In general, an employer is allowed to hire and fire whomever he or she wishes, subject to the types of laws described earlier. If you have not made a specific agreement with someone as to his or her term of employment, you can generally terminate his or her employment at any time for any reason or for no reason at all. However, you should be aware that various

state courts have whittled away at this rule over time. Be careful not to promise employment for any certain length of time, whether verbally or in writing—unless, of course, you intend to make a contract with the employee along those lines—and whether expressly or by implication.

At some point, employees may have to be fired. To avoid charges of discrimination, and to maintain good human resources practices, written records of employee performance should be kept. Annual or semiannual performance reviews should be conducted with each employee, and written evaluations should be shared with the employee and kept on permanent file.

QUICK Tip

If you do have to fire someone, keep written records of the events leading up to the firing. Have a witness present at the exit interview. Be sure to keep the discussion nonpersonal, professional, and short.

Employment Agreements

There is no requirement that an employee have an employment agreement. Contracts are often used with executive-type employees, and often because the employee insists on a contract. There are various reasons why an employee would want a contract—for example, to obligate the employer to employ him or her for a specified length of time, to specify compensation and bonuses, or to specify fringe benefits.

Employment contracts usually are very specific as to the circumstances under which an employee can be terminated and whether the employer has to give the employee advance notice of the problem and an opportunity to fix it. Often a contract will provide that the employer cannot terminate the employment before the end of the stated term, unless there is cause. *Cause* should be carefully and specifically defined. Often the definition will include the employee being indicted or convicted of a crime involving moral turpitude, absence from employment without good reason for a certain length of time, willful failure to perform the duties of employment, and disability. Entering into an employment contract is a serious matter, and you should seek legal counsel before doing so.

A major issue in many Internet-based business employee contracts is a covenant concerning competition with the signing company after the employee leaves the company. On one hand, the signing company does not want the employee to divulge any proprietary techniques to the next employer, and consequently wants to have a strong noncompete provision in the contract. On the other hand, the employee wants to be free to work anywhere and to use his or her full skill set at future positions.

In practice, *noncompete provisions* are usually a compromise between these two extremes. A noncompete that is too strict will not be enforced by the courts. It is a matter of public policy that people should be allowed to earn a living. Reasonable restrictions on employee competition will be enforced.

Reasonable noncompetition clauses include an expiration date on the noncompete—six months to two years are typical time frames—and cannot prevent the employee from using a generic skill set to work in the industry. For example, a programmer cannot be forced to abandon working as a programmer, even if he or she will be working for your competitor. He or she can be stopped from using proprietary programming techniques that have been invented or perfected at your company. He or she can also be restrained from soliciting other employees from your company to work for his or her new employer.

Internet-Use and Email Policies

These days, especially since employees often have access to the Internet, it is important to put written policies in place as to what your employees are allowed to do at the workplace and using the employer's facilities and equipment. In addition to a stated Internet-use policy, filtering and monitoring software may help a business maintain its Internet-use goals.

To formulate an Internet-use policy, you will have to examine your business's goals and objectives. The Internet can be used for many different business purposes—from financial, marketing, purchasing, and shipping to training and project collaboration. Your business's Internet-use policy should encourage positive and constructive use of the Internet, as well as prevent or minimize use of the Internet for personal or inappropriate reasons. Your policy might prohibit employees from visiting adult sites,

participating in chat rooms, shopping for nonbusiness purposes, making personal travel plans, or any other nonwork-related activity. Or, you could limit them to a certain amount of time per day for personal use of the Internet with your equipment.

Once you have your policy in place, consider using Internet-use software that can monitor your employees' use of the Internet, categorize the sites they visit, and keep track of the number of visits and the time they spend there. The software can be used to generate reports that will tell you which employees are adhering to your policy and which are not. These reports may also help you to improve and tailor your policy. You should let your employees know that the software is being used. They should know that they have no expectation of privacy with regard to their Internet use. Just knowing the software is in place may cause them to adhere to your policy.

In addition to monitoring software, you may want to put filtering software in place. You can use filters to completely block your employees' access to specified sites or types of sites (adult sites, for example).

You should also have a policy regarding email. You may want to restrict company email to company business—if so, you need to let your employees know that. They should also know that they have no expectation of privacy with regard to their work email account. If the system has a problem, some technical person may see all of your employees' emails. They should keep the personal information to a minimum for their own benefit.

Policy should also be made concerning using *instant messenger services*. Instant messages are those that pop up on a recipient's screen immediately after being typed and sent by the writer. If both people—or whole groups of people—are all logged on to the same instant messenger account, they can send messages back and forth among the whole group. It has not been unheard of for dozens of employees, who may even sit in the same room, to send instant messages to each other for hours at a time, often joined by friends from outside the company who may also log on to the account. The use of this feature can get totally out of hand.

The Internet, when used appropriately, can help your business prosper. Misuse, however, can cause a lack of productivity, interpersonal issues (if an employee sees personal information about another employee in an email, for example), and worse. Be educated and diligent in making the Internet work for you.

SECTION II:

Financing Your Internet Business

Chapter

5

Financing Options

▶ **What Investors Invest In**

▶ **Equity versus Loans**

This book is not designed to be a guide on the financial and legal details of raising money. There are many sources that can be used that are devoted exclusively to these subjects. Many professionals would be glad to help you through the process for a fee. However, in our experience, Internet businesses often need financing, either as a start-up or an expansion of an already existing business. We therefore include this survey of topics that will familiarize you with the broad outlines of the financing landscape, focusing on subjects most closely related to the Internet entrepreneurial arena.

Depending on your circumstances, you may need to evaluate several options for financing your Internet business. You may be a start-up with no assets but a great idea or a proven management team. Or, you may already have an existing business that can provide funding for your new enterprise. You might have an existing business, but feel that new sources of funding would be a better choice for your start-up. You may be in excellent personal economic condition, but want to raise money in order to leave your other assets intact and to spread the risk. You may even have an Internet-based business on which a parallel venture could be built.

Each of these scenarios (and many others you can think of) presents its own set of strengths and weaknesses to the financing process. Each one has a blend of the three major elements that investors look for in deciding on investment opportunities.

What Investors Invest In

In our experience, investors are willing to invest in three basic things: *management*, *assets*, and *cash flow*. In any money-raising endeavor, the entrepreneur must be prepared to meet all three of these investors, and may meet all three in the same room, each posing questions in their own ways. Of course, everyone's business is unique and you may touch on each of these issues in your own special way. Before meeting with potential investors, however, you should have in mind the ways your business is going to meet the demands posed by each of the following three considerations.

Management

The investors are willing to entrust their money to a certain person or group of persons. The investors have faith that this management team will produce profits and cash. Management may have certain credentials or

expertise that lend viability to a company. The management may simply have established an excellent track record with previous companies.

Some investors are willing to bet on certain managers regardless of the enterprise those managers have become involved in. Other investors see some unique characteristics in the management team that make it a good gamble. For example, they might be the inventors of a new process, or have important relationships in a certain industry or government sector. The investors are investing in the team.

Internet businesses are often started by dynamic management teams or by creative individuals who are enthusiastic about their concepts. Investors certainly want to see a zealous founder, but that is not enough by itself to get the funding you need. Make sure your management team demonstrates competence in key business areas such as marketing, sales, finance, and human resources. It should have the technical expertise to create and manage an Internet environment.

Assets

Investors will invest in a physical device that does something or produces something new or better than existing devices. They will invest in a unique process that produces something, in intellectual property such as a patent or a trademark, or in software that produces a certain result. They may also invest in property, inventory, or other tangible goods.

This does not mean the investors don't care about management—they do. But in this case, investors may see management as stewards whose job is to manage the asset base. If the managers do a poor job, they might be replaced, leaving the asset base to be managed by another team. If needed, the asset can be sold or licensed.

Additionally, computer hardware is not a very bankable asset because it

Alert!

Internet businesses don't necessarily have a lot of assets. Unfortunately, recent experience has demonstrated that Internet software costing millions of dollars cannot be resold at even a small fraction of its original cost, if the underlying business model fails.

rapidly depreciates in value. A useful life of three years is typical before computers become obsolete compared to newer models.

Internet-related businesses may be driven by patented software or be based on a unique process or methodology, but it is often difficult to provide a good valuation of this type of intellectual property. You may have to work hard to demonstrate how and why your assets should be valuable to a potential investor.

Cash Flow

Think of the investor as someone who sees a field as something to be mowed. This investor puts money into a business process that will reap the growth of this field. He or she looks for a circumstance and set of events that will produce reliable *cash flow*. (An example of reliable cash flow for an Internet business would be subscription revenue that is paid for the use of a certain website.) Assets and management may be the key to making this happen, but this investor searches for opportunities in supply, demand, and marketing.

Equity versus Loans

Equity Investments

Someone who invests in your company by buying shares of stock, or a percentage of a limited liability company, is investing in the company itself. This is an *equity investment*. The investor hopes to receive cash at some time in the future, but that date and the amount of cash are uncertain at the time of the investment. The investors will own a part of your company and they will retain certain rights of ownership. Depending on the kind of stock or equity interest they receive, they may vote on decisions and attend meetings.

Some investors might be granted preferred shares or equity interests that command more executive powers. For example, preferred shareholders may have more voting power, or the only voting power, in the company. Preferred shareholders may also have the right to be first in line to be paid if the company declares dividends or is liquidated in case of failure.

Some investors may demand a seat on the board of directors or as a

manager of a limited liability company. The investment may be made through a contract that provides them with additional powers, such as the right to approve expenditures over a certain dollar amount or to approve the start of a new line of business. However, the investors will pretty much sink or swim with you. They make money if you make money and they fail if you fail.

The cash that investors hope to receive may come in a variety of ways. Quite often, they hope the stock or other equity ownership of the company is purchased by another company in a merger, or by the public in an *Initial Public Offering* (IPO). It is true that most often founders' stock or original investors' stock is not bought in an IPO because such stock will be subject to restrictions on sale by the IPO underwriters.

No one wants to see managers and investors selling out of the company the day after the company is made public. However, this lockup of stock usually expires after six months or some other designated time period, after which the investors can put their shares on the market.

QUICK Tip

The receipt of cash in exchange for investments is referred to by a number of names, such as *exit strategy* or *liquidity event*. These expressions boil down to one thing—getting investments out of the company in cash. When approaching investors, it is paramount that you can demonstrate how and when they might be able to realize the value of their ownership in cash. Investors will want to know how they are going to recover their investments, and how long it will take to get there. While you should not guarantee future results, you do need to demonstrate how you think this will be achieved. Be specific—vague hopes for future fortune will not be acceptable.

Loans

Loans are cash that must be paid back to the lender at specific dates and times in amounts predetermined in the loan documents. Loans may be secured or unsecured. *Secured loans* are backed by collateral, which is an

asset of some kind that the lender will obtain in case you fail to pay back the loan. *Unsecured loans* are not backed by collateral and are much riskier for the lender. Unsecured loans usually command a higher interest rate to compensate the lender for taking the risk.

Lenders may insist that certain performance milestones be reached before funding is released. For example, a million-dollar loan may start out with the disbursement of \$100,000. When the company reaches certain milestones, such as a certain revenue target, the next amount of money will be disbursed. Lenders also often demand that the company maintain performance milestones by building in certain covenants that outline financial guidelines that the company must maintain in order to keep the loan active.

An example of this might be the average number of days it takes to collect money. If receivables on average age over sixty days, for example, the lender may not release more cash and may even demand that the loan be repaid immediately. These performance covenants are not dictated by legal standards. They will be as easy or as difficult to comply with as you can manage to negotiate with the lender. Make sure you go over them carefully before borrowing money. Be aggressive in getting the best terms you can.

**Alert!**

If for some reason you fail to repay the loan on time, the lender may be entitled to seize the assets you pledged as collateral. This may be the ownership of a portion of the company itself, or it might be other assets that have been pledged, including personal assets. Again, this is negotiable, and it is worth your time to know exactly what the terms are in order to get the absolute best terms you can manage under the circumstances.

Convertible Notes

An instrument called a *convertible note* is a variation on an ordinary loan. It allows the lender the option of converting all or a part of the loan to equity, based on certain formulas. For example, someone might lend your company

\$50,000, with a payment of \$1,000 plus interest due every month for fifty months, starting six months after the loan is disbursed. This loan is convertible to the company's stock at the rate of one dollar per share—meaning that the lender could decide to forgo receiving a cash payment for the loan and receive stock instead.

This type of loan is desirable to both parties under certain conditions. The lender may be skeptical that your company's stock is ever going to be worth much, and so the lender prefers to get his or her money back in cash. But in the happy event that the lender is wrong, and your company's stock becomes valuable, or its prospects are looking good, the lender can convert whatever remains on the loan to the equivalent dollar amount in shares at the price agreed to in the loan documents.

For example, if the lender has received \$20,000 back in cash, he or she could still choose to receive thirty thousand shares of stock instead of taking the remainder of the loan in cash (ignore interest for this example). The borrower, especially a start-up company strapped for cash, might be glad to trade shares in exchange for the loan to be removed from the company's obligations. The lender gets equity in the company at the point where he or she feels the company is worth the risk.

Chapter

6

Business Plans

- ▶ **Nondisclosure Agreements**
- ▶ **The Right Type of Business Plan for Your Needs**
- ▶ **Business Plan Contents**

Before considering any investments, investors and lenders will want to examine your plans for starting or expanding a business. This calls for a business plan to be written. A written plan demonstrates that you have thought through all aspects of the challenges the business will face, and it lets potential investors review and discuss those items. It also allows you to capture ideas from various readers who may provide valuable insights on tactics and strategies. Equally important, it can serve as an internal tool for planning the future of the company and for making changes to the plan as the business develops.

Nondisclosure Agreements

Written plans can be shared among an investor's colleagues. This is good in that you may interest investors beyond those with whom you have had personal contact. It is also not good in that others may appropriate your ideas before you get a chance to start your own enterprise. Therefore, it is wise to consider having all evaluators of your plan sign a *nondisclosure agreement* (NDA). An NDA stipulates that the readers of the materials will not share the information with anyone else unless you approve it and that the reader acknowledges the ideas are proprietary.

Some investment companies will not sign NDAs as a matter of policy. This is because they may receive dozens or even hundreds of business plans each week. If they signed NDAs for each one, it would be a burdensome legal chore. Additionally, from a practical standpoint, they could never retain all the details of each NDA every time they picked up a plan. Finally, there is a potential for conflict in promising not to disclose almost everything they read without permission of the writer.

You must make up your mind whether or not to provide plans to those who will not sign an NDA. In our experience, investment bankers do not intend to steal anyone's business plans. It would be disastrous for their reputations if they did so. They are not in business as investment bankers in order to start up a new company. Still, this has to be a judgment call on your part. You should research the firms before handing materials over to make sure they are legitimate investors or investment brokers.

Figure 6.1: **SAMPLE NONDISCLOSURE AGREEMENT**

Nondisclosure agreements can run to several pages and outline exactly when the reader can disclose the information. But even a simple one can serve to protect your interests. Something such as the following NDA should be on your plan at a minimum.

Confidentiality Agreement

The undersigned reader acknowledges that the information provided by Company XYZ in this business plan is confidential; therefore, reader agrees not to disclose it without the express written permission of Company XYZ.

It is acknowledged by reader that information to be furnished in this business plan is in all respects confidential in nature, other than information that is in the public domain through other means, and that any disclosure or use of same by reader may cause serious harm or damage to Company XYZ.

Upon request, this document is to be immediately returned to Company XYZ.

Signature

Date

Name (typed or printed)

**This is a business plan.
It does not imply an offering of securities.**

The Right Type of Business Plan for Your Needs

You should try to fit the scope and detail of your plan to fit the size and type of investment you seek.

An entrepreneur who has a positive cash flow and a good track record might get a loan from a bank with a set of financial statements and a brief outline of the new enterprise—a total of ten to fifteen pages. An

entrepreneur with a history of successes might need no more than that if he or she is approaching previous investors or those who know of his or her reputation. A start-up business with no operating history may not need much more than that, particularly if the investment being sought is relatively modest (in the hundreds of thousands). There is nothing to report about the past, and projections into the future are speculative at best.

More detailed plans are called for when the amount of investment being sought gets larger. A five-million-dollar target will certainly require detailed plans about operations, management history, workflow organization, and detailed, multiyear financial projections.

It is much better to decide on the amount of money being sought and to fit the plan to the target than to simply start writing a plan and hope it all works out. Create an outline and delegate responsibilities if there is a team available to work on the project.

Business Plan Contents

The Executive Summary

As previously noted, some investment professionals receive dozens or hundreds of plans every week. They need to sort through these quickly, sometimes to see if a proposed business fits their investment profile, and sometimes to allocate a plan to certain areas within the organization. For example, an Internet group may be designated to review those types of plans, versus other industry segments.

The *executive summary* needs to get the salient ideas into one or two pages. This is sometimes the hardest thing to do in the entire process. Some founders find it almost impossible to summarize their plans into succinct business terms. If you are having difficulty, seek advice and help from someone outside your group. This outside advisor might be able to provide the perspective needed to summarize your plans. (Note: It is not a legitimate option to squeeze five pages of summary into two pages by reducing the type face, expanding the margins, or other tricks. These plans often get thrown in the trash pile within ten seconds of being opened.)

Figure 6.2: ESSENTIAL EXECUTIVE SUMMARY ELEMENTS

The executive summary should make clear:

- what your product, process, or service is;
- your target market and the market's key characteristics;
- the strategy behind the plan;
- a brief description of the management team and why they are suited to the plan (list past successes);
- the amount of money being sought;
- how the money will be used;
- how the investors will get their investment back; and,
- a brief financial history, if appropriate.

Granted, this is a lot of information for a brief summary. It may be helpful to write the summary last, after all other elements are in the plan.

Objectives

This should describe how your process, service, or product would distinguish itself in the marketplace. Make clear what it is and how it works. You must explain the value you bring to the market compared with your competition.

Your objectives should be both short-term and long term. Avoid generalizations. A short-term objective might be "to generate \$100,000 in revenue within six months," not "to increase sales." Measurable goals are better than lofty aspirations. A long-term objective of "capturing 50% of the Internet health care market" is better than "improve the life of all Americans through better health care information."

Your Company

Tell what type of entity the company is (corporation, LLC, etc.), where it is located, and who the owners are (thus far). Provide its history, its current status, and its plans for the future. History can include motivations for starting the company if the company is recently formed. The current status should include a description of any divisions within the company (different lines of business, different markets, etc.) and company affiliates (subsidiaries, joint ventures, etc.).

Market Analysis

Describe the target market and its size. Tell how long it has been identified as a market and what trends exist concerning that market. Describe what you see as its future prospects.

You should also describe how your product or service would benefit that marketplace better than existing competition, what the barriers are to enter the marketplace, and how those barriers are seen by the competition. You must also describe how that marketplace will evolve in the future.

For example, a few years ago, Internet sites that focused on health-related issues had a huge marketplace—health care is a growing part of the world's economy. However, dozens of sites opened up to serve that market; now, only a few are left standing. If you are approaching the health care market using an Internet presence, you need to describe how your services are going to distinguish themselves from existing survivors. You should also describe why you will not repeat the fates of those who closed up before you arrived. Another issue you need to explain is how your services will not be copied by existing health sites or potentially by newly established sites. Also discuss how trends in this marketplace are likely to affect your business.

Market Segmentation

This is an important analysis, but sometimes not a well-understood aspect of the marketing component. This explains the salient behaviors within the market you are targeting. For example, in the health-related services previously described, economic data may show that the bulk of the money is being spent by aging baby boomers, who make up a larger part of the

health care economy. But look a little deeper, and data will show that aging baby boomers may not use the Internet to research health issues as much as young adults. If you are targeting the baby boomer market, you need to describe how you will address this particular issue.

Management Team

A set of brief biographies here is better than full-blown résumés of every team member. You cannot expect investors to plow through everyone's individual life story, no matter how interesting. Be sure to present summarized important accomplishments of each individual on the management team, particularly those elements that will contribute to your plan's success. An appendix can contain the full résumés of all parties concerned, so the investors can review them in detail if desired.

Strategy and Implementation Summary

This section should describe how you are going to execute your plan. It should explain research and development issues, manufacturing or distribution methods, quality controls, and any product regulation issues. It should describe how your organization would be structured to meet the demands of the business. It should cover stages of growth and be tied into the need and timing for cash during each phase. It should also describe the existence of any intellectual property and what protections are in place concerning that property.

Sales and Marketing

This section should cover how your sales efforts will be organized and executed. It should also tell of the plans for marketing—how, to which groups, how frequently, and on what media you will market your product or service. Sales milestones are often presented at this juncture. Good ideas and good products do not sell themselves. Many analysts consider most businesses' successes or failures to be tied directly to their marketing strategies, or lack thereof.

Financial Forecasts

These should include:

- **Profit and loss statements.** Sales – expenses = profit.

(Many investors want to stop here, but the financial picture is not complete without the following two items.)

- **Cash flow statements.** This should include timing and amounts of investments required.
- **Balance sheet.** A list of assets and liabilities of the company at a particular moment in time, usually at the end of a financial reporting period (such as end-of-quarter or end-of-year).

QUICK Tip

Good business plans contain certain key elements. They also contain the personal voice of the founder or founders. Professional business plan writers can be hired to help with this task; however, if you do take that route, make sure your voice comes through the rhetoric.

Chapter

7

Raising Equity

- ▶ **Dog and Pony Shows**
- ▶ **Securities Registration**
- ▶ **Regulation D**
- ▶ **Initial Public Offerings**

Dog and Pony Shows

Finally, you may have to present your plan to potential investors in what are called *dog and pony shows*. This is nothing more than an in-person presentation of your plan to potential investors. You might be asked to put together a slide show or PowerPoint presentation of your plan so that the meeting moves along quickly.

A rule of thumb for presentations: there should be no more than one heading and three bullet-point items per slide. Most audiences dismiss crowded slides within seconds of their being put on the screen. Avoid the temptation to put cute icons or animated figures in the presentation.

Keep the tone professional.

Securities Registration

More than seventy years ago, federal legislation was enacted that put certain controls into place in the securities markets. Every state has also put similar controls into its statutes. Among the goals of these laws was the prevention of the kind of stock market crash that occurred in 1929 and the protection of investors. The laws require, among other things, that specific disclosures must be made to potential investors when selling securities, including audited financial statements and the filing of complex forms with the *Securities and Exchange Commission* (SEC), which, after approval that may take months, allow you to register your securities with the SEC.

Securities registration is a complex process that may take hundreds of hours of professional work from attorneys and accountants and that may cost in the hundreds of thousand of dollars. You may hear references to Form SB-2. This is the SEC form usually used by small businesses (with revenues under \$25 million) to register their securities. In addition, each state has its own set of forms and rules for registering securities.

Regulation D

If your securities are not sold to the general public but instead to a limited number or type of individuals, the offer and sale may be exempt from registration requirements at both the federal and state levels. An offer and sale

of securities that meets exemption requirements is called a *private placement*. If you meet applicable requirements, you do not need to register the securities with federal or state governments. The original federal legislation in the 1930s allowed for private placements, but the rules were not well understood. In 1982, Regulation D was enacted, which made the private placement process better defined and less risky. Since then, private placements have become a common method for raising money in the private equity markets.

Regulation D (Reg D), which is a federal safe harbor from registration provisions, does still provide for certain kinds of controls on the issuance of securities. There are subsections of Regulation D that are each suitable for a different set of objectives and circumstances. If your offering complies with one of the subsections of Reg D, it will be exempt from federal registration. You will also need to make sure your offering is exempt from registration in every state where you offer and sell your securities.

In very brief summary, the various subsections of Reg D are as follows.

Rule 504

The maximum amount of money that may be raised under this provision is \$1 million.

In the other Reg D provisions (described later), there are rules concerning the disclosure that must be made to potential purchasers of securities, as well as other rules concerning who may buy them. However, Rule 504 has no disclosure requirements and no investor standards. In some cases, it can be the easiest rule under which to sell securities and the cheapest with which to comply. Some entrepreneurs refer to this as the *Friends and Family Rule*, because they use this to make sales of securities to those friends and family members who sometimes are the first in line to finance a start-up business.

Despite the friendly nature of Rule 504, it has limits. Not all states have corresponding exemptions. If you are offering and selling in many states, compliance with each state's rules can be extremely burdensome for a 504 offering. (These state rules are sometimes referred to as *Blue Sky Laws*.) Also, as stated earlier, the maximum you can raise in a 504 offering is \$1 million.

The rule does not have specific disclosure requirements; however, note that other securities laws require the disclosure of all material information in connection with the offer or sale of securities. Because of these antifraud

provisions, it is highly advisable that a disclosure document be provided to all potential investors. If one is not issued and an investor levels charges of fraud against you or your company, you and your personal assets may be under siege.

Figure 7.1: REG D OFFERING MEMORANDUM BASICS

Whether an offering is being conducted in accordance with Rule 504, 505, or 506 of Reg D, an *offering memorandum*, sometimes referred to as a *Private Placement Memorandum*, is almost always used to offer the securities for sale. It is the vehicle for listing the various disclosures to potential investors. These disclosures should include:

- a description of the business and its operating history for the last five years;
- a description of the products or services the business provides;
- a description of the directors and officers, plus a summary statement concerning numbers of employees;
- a summary of items that may have an impact on your company's future performance. (This might include pending government regulations, expiration of patents or trademarks, and the like.);
- a summary of risk factors facing the business. (It is critical for your protection that this list be thorough. Potential risks include lack of acceptance of your product in the marketplace, loss of key employees, material downturn in demand for your products or services, unforeseen competitive pressures, catastrophic computer failure, and so on.);
- a list of highly compensated individuals in the company and their compensation;

(continued)

- a thorough description of the securities being offered. (This includes voting rights, trading restrictions, warnings about the lack of liquidity in the present and future, and other technical details such as preemptive rights that could affect the securities' value under certain circumstances.); and,
- a description of the securities themselves, their number and purchase price, and whether there are any commissions given on their sale.

For a detailed description of these and other items you may want to include, see the SEC's form listing all elements of a full disclosure, which can be found at:

www.sec.gov/about/forms/form1-a.pdf

Rule 506

There is no limit to the dollar amount that can be raised under Rule 506.

Any number of accredited investors may buy securities under this rule. The term *accredited investor* is extensively defined in Reg D. With regard to natural persons (not corporations or other entities), an accredited investor is one that has a certain net worth or a certain income and qualifies as a sophisticated investor who guarantees he or she can withstand the loss of his or her investment.

A maximum of thirty-five nonaccredited investors can also purchase securities under this rule, as long as they are, either alone or together with a representative, sophisticated enough to weigh the risks and opportunities of the offering. The offering company usually submits a questionnaire to the potential investors to determine if they meet the guidelines.

Rule 506 is often the easiest rule with which to comply. The federal government has preempted the states from placing any state-level requirements on the offering other than the filing of a *Notice of Sale* (Form D), the payment of a filing fee, and the filing of a *consent to service of process* (meaning you agree to deal with a lawsuit in that state, if someone should sue you). If your offering complies with Rule 506, you can be assured that it can also comply, fairly easily, with a registration exemption in every state.

Alert!

Rule 506 requires detailed disclosure of information to potential investors if you sell to any nonaccredited investors in the offering. If you are selling only to accredited investors, you do not need to comply with specific disclosure rules. However, as stated earlier, all material information must still be disclosed pursuant to other securities laws. An offering memorandum is highly recommended for your own protection.

Rule 505

Rule 505 offerings may not exceed \$5 million. This rule limits the number of nonaccredited investors (maximum of thirty-five), but has no investor sophistication standards. Rule 505 requires disclosure similar to that required for Rule 506 offerings. The problem with Rule 505, and the reason why it is rarely used anymore, is that there is no federal preemption of state level requirements for this type of offering. So, if an issuer is using Rule 505, it must find a corresponding exemption in every state in which it offers and sells securities. Some states may not have an exemption with which the offering can comply. In other cases, compliance with the state's exemption can be overly burdensome.

Initial Public Offerings

Initial Public Offerings (IPOs) are simply another way to raise equity money for your business. Instead of offering equity to a small number of private individuals, as with private placements, the equity is offered to the public, usually by an underwriter. It is then tradable on a stock exchange such as the New York Stock Exchange or NASDAQ.

Stringent standards must be complied with in order to go public. All the previously mentioned rules concerning disclosure apply to public offerings. In addition, the information must first be submitted to the SEC, which will rule on your compliance to these strict standards. Each stock exchange has its own requirements, as well, concerning minimum numbers of

shareholders, the capital asset base of your company, and other financial thresholds your company needs to meet before its equity can be traded on their exchange.

You will need the services of an accounting firm and a legal firm to help you through this process. You will also need an underwriter. This is a company that will actually put your shares into the stock exchange and conduct trades. Underwriters are typically large financial firms who take a percentage of the transaction as a fee.

IPOs are complicated and expensive. They can bring enormous prosperity to a company because they provide large cash inflows. They also put the company into the public arena. Reports must be filed with the SEC at various points. An annual financial statement must be filed, as well as quarterly statements. Changes in control, acquisition, or disposition of significant amounts in assets and various other events must be reported as well. The company's officers, directors, and major shareholders also have reporting obligations.

Anyone can browse through publicly reporting companies' information. The Internet has a variety of pathways into this database. An excellent one is provided by the SEC itself, and can be found at www.sec.gov/edgar.shtml. Choose a company that you are familiar with and look through the various reports that have been filed in the last year or so. This will give you a good idea of the reporting requirements with which public companies must comply.

SECTION III:

Setting Up Your Website

Chapter

8

Your Website Name

- ▶ **Choosing and Registering Your Domain Name**
- ▶ **Cybersquatting**

Choosing and Registering Your Domain Name

The first step in establishing a website is to choose and register a domain name. A domain name is the name by which people identify and locate your website, such as www.sphinxlegal.com. A company often uses the main part of its name as its domain name. You also might consider a domain name that describes what you are selling, how you are selling it, or something along those lines. If you are selling only widgets, think about www.widget.com (which is taken by Widget UK Ltd.).

To check on whether a domain name is available, go to www.internic.net/whois.html or www.networksolutions.com/whois/index.jsp and follow the directions. There are scores of registrars through which you can register a domain name; for a list of accredited domain name registrars, go to www.internic.net/regist.html.

Once you choose a domain name and determine that it is not already taken, you are ready to register the name. You do not need to have a website created or hosted in order to register the name. Just call or go to the website of an accredited domain name registrar and follow the directions. Be sure to print out any necessary instructions and remember your password.

QUICK Tip

When you register your domain name you will need to give contact and technical information. If you do not have a host yet for your website or you do not know the information for your host, the registrar will provide some temporary host information that you will need to change later.

Cybersquatting

You may come up with a great domain name that may be owned by a cybersquatter. You may be able to take the name away from that owner under the *Uniform Dispute Resolution Policy* (UDRP) of *Internet Corporation for Assigned*

Names and Numbers (ICANN). This is a nonprofit corporation that manages the Internet domain name system. (Madonna was successful in taking the domain name **www.madonna.com** away from a cybersquatter under the UDRP.) You can read the policy at:

www.icann.org/udrp/udrp-policy-24oct99.htm

Arbitration is required to commence a dispute and the cost is primarily the complainant's. To succeed in a dispute under the UDRP, the complainant must show three things:

1. that the domain name is identical or confusingly similar to a trademark or service mark in which the complainant has rights;
2. that the domain name registrant has no rights or legitimate interests in respect to the domain name; and,
3. that the domain name has been registered and is being used in bad faith.

The first element is self-explanatory. As for the second, the policy sets forth some factors that are considered in determining whether a registrant has rights or legitimate interests in a domain name. General factors include:

- use of the name in a bona fide offering of goods or services;
- whether the registrant has been commonly known by the domain name; and,
- whether the registrant is making a legitimate noncommercial or fair use of the domain name without intent to obtain commercial gain by misleadingly diverting consumers or tarnishing the mark in question.

Other factors may also be considered in determining whether the second element exists.

The third element, the question of bad faith, is probably the most controversial and complicated. The UDRP provides for four nonexclusive circumstances that, if shown, will prove bad faith. These include:

1. if the domain name was registered or acquired primarily for the purpose of selling, renting, or otherwise transferring the domain name registration to the trademark owner or its competitor for valuable consideration in excess of the costs directly related to registering or acquiring the domain name;
2. if the domain name was registered in order to prevent the trademark owner from using it as a domain name, provided that the domain name registrant has engaged in a pattern of such conduct;
3. if the domain name was registered for the purpose of disrupting the business of a competitor; or,
4. if the domain name registrant has used the domain name to intentionally attempt to attract, for commercial gain, Internet users to its website, by creating a likelihood of confusion with the trademark as to the source, sponsorship, affiliation, or endorsement of the website or of a product or service on the website.

The UDRP provides that the arbitrators may order the cancellation of the domain name or transfer it to the complainant. An appeals process is also provided.

There is a corresponding federal law, the *Anti-Cybersquatting Consumer Protection Act*, that provides for liability of a cybersquatter to a trademark owner if the person acts in bad faith to profit from the trademark and registers, traffics in, or abuses a domain name that is either identical to or confusingly similar to a distinctive mark, or is identical to, confusingly similar to, or dilutive of a famous mark.

The act provides for proceedings where an action can be filed against the domain name in the district where the domain name registrar is located, when the defendant cannot be located. The remedy to be obtained in this

type of proceeding is limited to the transfer of the domain name or forfeiture or cancellation of the trademark. In a proceeding where a trademark owner personally sues the domain name owner, money damages can be obtained as well.

Chapter

9

The Internet Website and Related Software and Hardware

- ▶ **Waterfall Method—Defining Your System Specifications**
- ▶ **Waterfall Method—Writing the Request for Proposal**
- ▶ **Agile Method**
- ▶ **Decisions Common to All Developmental Practices**

The purpose of the next three chapters is to provide guidance in securing technical services to create, expand, and maintain an Internet presence. Uses of the Internet can vary in scale. You may simply wish to start small by creating a *brochure* site, intended to display a modest amount of information and have relatively simple functionality. (Perhaps you will consider expanding later on.) Others may see their website as a major factor in their enterprise, having a complex structure, sophisticated functions, large amounts of data, and connections with other systems, such as financial record keeping and inventory management systems.

The topics covered as follows are intended to provide a comprehensive description of important elements in the technical procurement process. Those who are contemplating a more modest site may not need to consider all the items listed in depth.

There are several different possible approaches to development. If you are going to hire someone, be sure to understand how the developer intends to proceed. Two different styles that you are likely to encounter are called the *waterfall method* and the *agile method*. The *waterfall method* is a more traditional approach to systems development. As its name implies, it is a linear process in which one set of events follows another—and in which it is not easy to reverse direction. The *agile method* consists of much less predefined work, shorter development cycles, a lot of meetings and interaction with the user during development, not too much documentation, and is much more flexible in terms of changing direction during development.

Figure 9.1: THE SIX STEPS IN THE WATERFALL METHOD

The basic steps in utilizing the waterfall method are:

1. Define needs
2. Examine and modify existing process
3. Document requirements

(continued)

4. Interview and select vendors for
 - (a) software development and
 - (b) hosting, or, alternatively, decide to build and host the website in house
5. Test functionality and response time
6. Train users and implement system

Waterfall Method—Defining Your System Specifications

The creation of a set of system specifications can help bring all or most of the technology issues out for discussion, both inside the company and with potential suppliers. This exercise can serve to identify and resolve potential misalignments in goals or aspirations for the system among the company's participants. Additionally, good specifications will lay the groundwork for good technical design by identifying in advance all the major components. They also serve to ensure that a complete list of requirements is given to the technical supplier, so that the scope and costs of the project can be correctly estimated. A supplier may also be able to separate core functionality from less important "wish list" items and separately identify the costs associated with each component.

These specifications are often gathered together and sent to various suppliers in the form of a request for proposal (RFP). This document becomes the basis for comparing costs and deliverables from various suppliers of technology. Often it becomes a part of the final agreement with the supplier and is attached as an appendix to the contract, if a written agreement is drawn up.

QUICK Tip

Defining and refining your system requirements in advance may drastically reduce the cost of the technical supplier. If you do not define the specifications in advance, the supplier will have to do it with you—probably charging by the hour to do so. A good set of specifications may save thousands of dollars in such fees.

Waterfall Method—Writing the Request for Proposal

It is likely that your RFP, describing what the supplier is going to deliver, will become part of the contract. Before you embark on defining your goals in writing, review the following concepts.

Process Review before Automation

Some people have a belief that computerizing a process will provide improvements in and of itself. However, automating a process that should not exist in the first place just doubles the disaster.

In a recent real-life example, an existing company designed a web-based system that mimics existing workflows. Certain reports were demanded of the web-based software that were complex and required laborious data input. However, an investigation was performed that showed that none of the recipients of the existing report actually used it for anything. It was a relic of an old process that everybody thought somebody needed. The report was eliminated and a large detour in the project was avoided.

Is Automation Necessary to Achieve Desired Objectives?

However happy the outcome in the previous example, it points out the need for a process review before the specification and design of a system begins. There may be more efficient ways to organize workflow in or between departments that would bring savings and efficiencies. The cost/benefit of the system needs to be evaluated *after* the process changes—perhaps the system's payback was mostly related to improved workflow that actually requires no system to achieve. The extraneous report in the example could have been identified and eliminated with no automation project!

A manager at a large company demanded a certain process be added to the company website. In listening to the rationale, the real problem was a poorly performing employee who the manager thought he could eliminate after the system was put in. This is a poor reason to seek out automation—it is an expensive way for the manager to avoid managing.



Alert!

Be wary of using the Internet as an excuse to reorganize workflow or eliminate poor performers.

Know the Cost of Wish List Features before Demanding Them

Designers of systems can get carried away with the enthusiasm generated by a new Internet project. Be sure to identify and isolate wish list items that are being put into the specifications. Cool features that are of minor importance can influence fundamental system design and cost disproportionate amounts of money. Beware of sentences that begin with “Can’t you just...,” e.g., “Can’t you just put that in six colors?” or “Can’t we just ‘link’ the inventory system to the shipping lists?” Ideas that are easy to conceptualize may be monstrously difficult to automate.

Buy Functionality and Performance, Not Systems

It is a mistake to attempt to specify hardware or software by name or brand, unless the equipment needs to integrate very specifically into a certain hardware environment. Let the supplier recommend the correct environment. Make that recommendation part of the vendor evaluation.

Why? The user (and the company) should be buying functionality and performance—the ability to do certain tasks, within a certain time. Suppliers, unlike buyers, are more dedicated to keeping up with trends in the software and hardware industries. You are buying their expertise, and that includes recommendations on system components.

Tests should be done against the ability to perform functions—therefore the specifications need to be expressed as functions.

Notwithstanding all of the aforementioned topics, maintenance and compatibility *are* important issues. Software components should not be so customized or so far from the mainstream that only a specific supplier could ever maintain the software. Expandability and spare parts should not be limiting factors in hardware selection.

**Alert!**

Specifying certain brand names is by definition self-limiting. That may preclude the best options.

Agile Method

The *agile method* was developed by a group of programmers in 2001 who wrote “The Agile Manifesto.” Their goals included: rapid development, quick turnaround (weeks rather than months), heavy user interaction to define needs and react to software deliveries, milestones defined by software deliveries, projects built around motivated individuals who define their own methods, simplicity in design, and frequent team meetings.

The agile method is suitable for smaller teams and smaller projects that are not carrying mission-critical functions. It might not be suitable to use the agile method to build a banking system or an airport radar system. However, for users who are willing to work in close association with the developers, defining and reacting to software deliveries in short-burst time frames, especially if the requirements are likely to evolve quickly, the agile method might be preferable.

QUICK Tip

The agile method may seem to be the opposite of the waterfall method and it does call for less written documentation and group decision-making up front. However, it does not imply a free-for-all, with no planning or methodology (*cowboy coding*). Make sure your potential developer is not using the agile method to mask poor programming practices. That means paying careful attention to the software deliveries as they are made and working closely and carefully with the developer to make sure your requirements are correctly defined as you go.

Decisions Common to All Developmental Practices

You should be asking yourself these questions no matter which development method you choose.

Build or Buy

Building or expanding a website poses a number of important questions concerning technology.

The following elements need to be considered when deciding whether to build the website yourself or to outsource all or some of the work to a third party. There are two basic issues to consider for each subject: *capability* and *cost*. Even if you determine that you can build your own site more cheaply and better than you could buy it from a technical supplier, you then need to ask if you want this to be the focus of your attention. The most precious resource you have may be your time. If overseeing technical development takes your attention away from building your business, make sure it is worth the trade.

Required technical skill The entrepreneur may have a level of technical skill required to build a site him- or herself. Even so, he or she should weigh the following considerations:

•Even if I have the technical skill now, will I be able to keep it up-to-date while I run my business?

- Will I be able to keep my skill set current at the same time I am turning my attention to starting a new business?
- Should I be devoting the bulk of my time to technical tasks, or does the new business demand that other tasks—such as sales, staffing, marketing, and the like—take priority?

•Does my skill set fit current industry norms, so that I can bring in outside help later on and expand my site without starting over from scratch or otherwise interrupting my business?

- If I participate or take a lead in the technical development, will I be able to smoothly hand that responsibility to others later on?
- Will new programmers understand what I have done, and be able to build upon that foundation?

•Do I adequately understand the complexity of the system and website I envision?

Some functions seem simple to the user, but a lot goes on behind the scenes. That simple-looking “buy” button on a website can trigger a cascade of processing and calculation, from inventory checking to pick-and-pack shipping calculations.

Hiring technical skill The business owner or manager may consider hiring staff to build, maintain, and otherwise care for the Web technology. In doing so, he or she should weigh the following considerations:

•Do I know how to hire technically skilled staff?

- What criteria will I use to make certain the person's skill set fits my requirements?

- Will I know how to weed out false or exaggerated claims of technical skill?
- Can I balance the load of skill sets required for the task at hand (programmers, designers, communications, maintenance, etc.)?

• **Am I willing to manage technical staff turnover?**

- Will the absence of on-site staff damage my business?
- If someone leaves my firm, how will I find time to interview new candidates?

• **How will I maintain continuity in the programming in the face of staff turnover?**

- Can I establish and enforce programming standards and maintain detailed documentation on programs?
- Can I supervise programming staff to ensure rules are understood and complied with?

• **Will my technology involve proprietary programming techniques, trade secrets, or private information concerning clients?**

- Do I have policies and procedures in place to protect those items both while staff is employed, as well as after they leave the company? (See the “Employment Agreements” section in Chapter 4.)
- Do I need to develop special contracts with my employees because of this proprietary nature?

Hosting: In-house or Outsourced

Once your website has been designed and coded, the software needs to reside on a computer system—often a device called a *file server*—in order

to actually work. Just as programs such as word processing or computer games need to be installed on a system—such as a personal computer—so a website needs a *host* system in order to function. Additionally, this host system needs to be connected to the Internet through communications lines so that users can access your website and so your site can send information to the users.

As part of the planning for an active Web presence, you need to consider whether to host the site yourself, on your own systems, or to hire a service to provide the hosting. Usually the service would provide the file server and all the related services needed to keep your site available to users. You should consider the following:

•Can I provide the physical environment suitable for housing equipment?

- Do I have power supply reliability for brownouts, surges, etc.?
- Do I have access to air temperature and humidity controls in my building?
- Am I allowed access to the building on off hours, weekends, and holidays?
- Can I take care of the building—for example, can I keep the wiring neat?
- Is there room to grow?

•Can I provide an environment suitable for programmers to work on complex problems?

- Have I supplied ample desk space, personal storage areas, computer systems, local area networks with email and shared printers, and dust-free and glare-free environments where they are expected to be available?
- Are there quiet work areas?

- Are there meeting or common areas that include large tables, white boards, conference call speaker phones, and computers with TV monitors with access to the local area network for programmers to get together to plan or hash out problems?
- Are meeting areas suitable for clients to meet with programmers or other staff members?
- Should I allow late-night, weekend, and holiday access—especially if *hosting* is part of the task?

• **Are communications facilities in place to handle expected traffic?**

- Will traffic exceed my system's capacity and cause slowdowns in response time or influence users' satisfaction?
- Do I have the incoming and outgoing capacity needed to handle short-term peaks?
- Am I aware of factors that influence traffic?
- Will my website see a high volume of importation and exportation of files, especially graphics files?
- Have I considered the frequency of users' requests for new pages or new data while they are browsing through my site?

• **Can I provide reliable, offsite data backup?**

- Do I back up my system periodically in case of a failure in the main system?
- Is my backup stored off-site in a different physical location from the main system to guard against business interruption in case of fire or

some hazardous condition?

- Is the backup copy easy to get to in case I need it?
- Does my professional hosting facility provide backup options as part of my monthly fees?

• Do I need redundant systems, so that my website is always available?

- Should I have off-site hardware backup, as well as data backup?
- How do I plan for a system to keep the website running in case of hardware, software, or power failure?
- Can I provide communications lines, a duplicate set of software and data, and a means to switch to the backup system?

• Can I plan adequately for future telecommunications traffic and data storage requirements?

- How do I meet peak customer demands with hardware, computation power, telecommunication capacity, and networking?
- How do I anticipate spikes in demand around certain events, like holiday shopping?
- How can I monitor and analyze traffic patterns in order to allow for adequate lead time for planning increases to communications capacity?
- Is there software available to monitor traffic and to test the system's ability to handle future volume?

Figure 9.2: EVALUATING THE TECHNOLOGY SUPPLIER

Unless you are satisfied with your ability to deal successfully with the issues previously discussed, you will need to find, and negotiate with, a technology supplier. In effect, the technology supplier should have the ability to deal with all the elements discussed earlier.

In summary, the supplier should be expected to:

- keep current with new developments in areas such as software, graphics, hardware, telecommunications, and networking;
- provide top-notch programming and design talent;
- provide current versions of all development and operating software;
- provide adequate hardware and communications systems for programming, development, and operations;
- handle the hiring and turnover of staff without interruption or damage to your project;
- guide you to effective use of technology—lively, interactive, intuitive websites with good command of design issues;
- have strong programming skills: no dead ends, no mistakes, fast response times, and elegant results;
- bring good design to the screen area;
- create a sense of continuity in the way that web pages interact with the user and with other web pages—the architecture of the site and an understanding of users' psychology as it applies to the Internet. Information organization and navigation has a dramatic effect on the usefulness of the material;

(continued)

- understand and advise on marketing issues—how to attract and keep users;
- provide advice and solutions on having your site interact with other systems (inventory, financial, customer service, etc.);
- create a site with scalable solutions, so that your business can grow.
- provide security safeguards for the preservation of data integrity, protection against hackers, etc.;
- be able to provide *beta test systems* for evaluating functionality;
- plan for data storage requirements, processing power requirements, communications throughput, and other capacity constraints for peak load conditions;
- provide maintenance; and,
- be capable of providing the next phases of growth in your system.

Chapter

10

Business Decisions Regarding Your Software and Hardware

- ▶ **Negotiation of Hardware and Software Contracts**
- ▶ **Payment Schedules**
- ▶ **Comparing Suppliers**
- ▶ **Contracts**
- ▶ **Your Responsibilities**

Negotiation of Hardware and Software Contracts

In order to justify the project, return must be weighed against all the system's costs over the system's life span, which are called *full-life cycle costs*. Following are some of the specific costs that comprise the full-life cycle costs.

Purchase cost This is the initial cost of hardware and software, or *implementation cost*. Examples of purchase cost include the cost for the supplier to install the system, plus an assessment of internal costs—rent, power, fire code changes (if any), hours of internal systems personnel to install, training courses required, etc.

Maintenance costs (software, content, transactions, communications, upgrades, backups, disaster recovery) These can easily add up, over three or more years, to more than the purchase cost. Typical maintenance costs for custom-installed systems are 15–20% of the purchase price per year. Depending on the nature of the system, there are additional costs for transmitting data, for installation and use of communications lines, and for periodic backups. In mission-critical installations there are also additional costs for online backups, including *Unstoppable Power Supply* (UPS) and even a separate facility. Often there is a requirement to keep step with software upgrades, and so annual upgrade costs should be calculated.

Support costs (users, customers) There might be internal users who need phone support or on-site support. Therefore, overtime, sick days, coverage during staff turnover, etc., need to be included in the overall cost of maintaining the system and its users.

Systems that interact with an outside customer base (for example, e-commerce websites) may need phone support customer service for outside users. This could be internal or outsourced.

Infrastructure costs Installation of communications lines, rental of “cages” for equipment at off-site computer environment rental agencies, air filtration and air conditioning, fire extinguishers, power lines, special security

arrangements such as door locks or card entry systems, wiring for connections of terminals, wiring for local area networks, new furniture, cubicles and walls, and other requirements need to be considered.

Cost of integration of legacy systems, legacy data Some websites and the systems behind them may need to contain data on customers, such as customer loyalty, buying patterns, website negotiation patterns, and so forth. In some cases the website will represent a fresh start, and the system can begin tracking information from the beginning of its existence.

In some cases, however, this data has already been compiled for the past. This data may be critical to the ongoing task at hand. For example, information on customers and their purchases must be maintained for marketing purposes.

Not all data is critical, however. One possible choice that may be too bold for developers to consider is to abandon the data that existed in a legacy system, except at a summary level. The cost of capturing the old detail, reformatting it, and porting it over to the new database should be weighed against the intended use of the information.

This may take courage. For example, a company may have years of tradition, in which every nickel spent was compared to spending in previous years and previous quarters. The real value of such comparisons needs to be questioned. It may be nice to have, true, but is it worth the cost to have that information in the database? Manual retrieval (e.g. printed pages in three-ring binders) may be sufficient if there is only occasional need for the information.

Staff costs New hires may be required to run the new system. Conversely, there may be savings in reduced staff requirements.

Training costs Changes to the system could involve the need for training for the users and others in the company.

Project management costs The need for the sophistication of the tools must be weighed in context of the complexity of the project. If specific project management tools are used, entering data on the completion level of various tasks can easily become a full-time job in itself.

Payment Schedules

The project timetable should include well-defined milestones for completing critical achievements. The payments to the supplier should be tied to these milestones. This ensures that the project will not wander too far off track before corrections are made. It is also an incentive to the supplier.

Testing must be carefully planned so that each milestone can be accepted or rejected with some certainty that the tests reflect the viability of the system.

QUICK Tip

Planning for the transition, including a fall-back plan in case the transition is not successful, is a mini-project that deserves separate planning. In most cases, there cannot be a cessation of business just to accommodate the transition to a new system. Therefore, planning must take into account the requirements of the business first, and the system second.

Comparing Suppliers

The creation of a simple chart can help organize your thinking when comparing the services of potential suppliers. In Figure 10.1 on page 84, each vendor's capabilities, as judged by the business owner, are weighted by the importance of that capability.

The total score should give an indication of a clearly outstanding performer, or one who falls short in critical areas. This exercise is best used as an internal company tool. It is not so much a scientific exercise as it is a vehicle to make explicit the criteria that are important to the system, and that offers a way to map the vendors' strengths and weaknesses against those criteria in a deliberate, structured way. The benefits of creating a weighted chart include the following.

- By soliciting each person's response to where each vendor falls in each category, a full discussion can be brought about in which all issues are discussed.
- Often a vendor can be chosen with the consensus of all interested parties.
- Everyone's voice is heard.
- The best choice is easier to make.
- Agreement is achieved at all levels of the organization, helping to foster collaboration.
- A second-best supplier that has full internal commitment will provide a better outcome than the first-choice supplier if that supplier is met with suspicion, resistance, or sabotage-though-indifference.
- If no choice can be made, it provides an indication that more data is needed or the system needs to be reassessed.

Figure 10.1: WEIGHTED SCORE CHART

Column 1: The items you wish to include in your evaluation criteria.

Column 2: The weight, on a scale of 1 to 10, given to each criterion.

Column 3: Evaluation for the first supplier, also on a scale of 1 to 10.

Column 4: Evaluation multiplied by the weight of each item.

Column 5: Evaluation for another potential supplier, and onward.

Criteria	Weight	Vendor 1	Vendor 1 score	Vendor 2	Vendor 2 score
Design	7	8	56	2	14
Programming	8	8	64	6	48
Maintenance	5	2	10	4	20
Project management	5	9	45	7	35
Integration with legacy systems	2	5	10	8	16
Etc.					
Etc.					
Etc.					
Total Score			185		133

Contracts

Some businesspeople demand written agreements for any major transaction. Some reject the idea of spending time and money on a contract when they could just get to work instead. Others do not want to get pinned down on specifying technology because they are not really sure of what they want. They want to fashion the technology as it goes. Others think contracts are the first step toward litigation. One

entrepreneur remarked, “The only time I’ve ever been sued has been when I’ve had a contract.”

Ideally, you know just what your website should look like, what the software behind the screens should accomplish, and how users should be able to navigate around the site. Ideally, your supplier knows how to deliver those things exactly the way you have them in mind. Verbal agreements can work, and fashioning the technology as you go can also work, as described in the “Agile Method” section on page 70. It is usually safest, however, to allow this unstructured approach only after the parties have demonstrated a successful history of clear communication and understanding, coupled with prompt and excellent execution. When both parties are new to each other, however, it is probably best to define expectations, on both sides, as clearly as possible from the beginning, a more formal approach that is discussed in the “Waterfall Method—Defining Your System Specifications” on page 67.

A contract can range from a general agreement to a document that incorporates detailed specifications on design, functionality, and performance of software and hardware. There are some dangers in either approach. The more you specify, the less input your supplier will have in doing things in imaginative, and perhaps better, ways.

On the other hand, you may not know exactly the best way to build the site. You may very much want suggestions from the technology supplier on how to accomplish certain tasks. You may have an imperfect idea of the final product. If the technology supplier is confident he or she can provide you with what you want, the supplier will be willing to go ahead with incomplete specifications. However, the more you leave in the hands of your supplier, the more you leave yourself open to surprise.

QUICK Tip

The best approach to avoid the dangers previously described (being too rigid or too vague) is to build an agreement that allows for frequent, step-by-step delivery and testing of components, with feedback loops and team-oriented organization.

Your Responsibilities

You, as the buyer, should be aware of, and plan for, certain responsibilities in the development cycle. Even if you have done a great job describing your requirements in the request for proposal (RFP) or during the design phase of the project, you must still take primary responsibility for making sure that what is delivered is what you have defined.

This means you need to have:

- a timely review of deliverables and feedback to the designers and technicians (you may want to work out the timetable for these reviews with the supplier, so that neither one of you is wasting time waiting for the other to respond) and
- a thorough testing of components.

Figure 10.2: CONTRACTUAL ELEMENTS

Your contract with the supplier should cover, at a minimum, the following elements:

- system goals;
- system functions;
- performance, such as (a) the time it takes to perform certain functions; (b) the speed at which users receive a response from the system; (c) communications rates; and, (d) other issues related to processing ability and data storage and retrieval, such as production of reports, system backups, and the like;
- deliverable components and a timetable for each delivery;
- cost of each component and conditions under which payments will be made (a payment cycle that allows time for testing, etc.);
- testing procedures for acceptance and related payments for accepted components;

(continued)

- final testing of integrated components in one system;
- communications issues: specifically, capacity and reliability (guarantees on uptime and ability to connect to the website);
- planning for peak load capacity (X number of simultaneous users or transactions);
- compatibility with other systems;
- interaction with other systems (input produced for other systems, such as inventory or financial systems, and output to be accepted from other systems, such as credit card authorization);
- future upgrades;
- maintenance issues such as data backups, telephone support, and on-site support, including response times and the scope of ongoing responsibilities;
- data storage and retrieval; and,
- other critical matters, as defined in the specification process.

A set of poorly defined goals will not be rescued by a legal contract, but will instead likely be written into the contract. The lawyers will take their lead from the developers during the definition phase.

Chapter

11

Implementing Your Software and Hardware

- ▶ **Users**
- ▶ **Training, Error Control, and Feedback**
- ▶ **Functionality Creep**

A successful development plan should include a defined method of introducing the system and training those who will be involved in the processes that interact with the system.

Users

There are a few different types of users.

- Some users will actually put their hands on the system, do data entry of some sort, create the queries for the database, or somehow manipulate the contents. Examples include purchasing systems, analytical modeling systems, and hotel or airline reservation systems.
- Some users will be managers who need reports on traffic, volume, service levels, and the like.
- Some users will use other systems or will be in departments that take the output of this system as input for their system or area.
- Some users will serve as testers. Software and hardware need to work together according to specifications. This includes functionality and speed. Testing for acceptance needs to be well-defined and designated as a separate task.
- There may be clients involved who interact with the system or use it directly for purchases. For example, online banking and brokerages, or e-commerce on the Internet.
- Programmers are users, too.

All these persons, and perhaps more, will need to understand the system. They will be the ones judging its success.

Introduction of System to User Community

Are the end users the same people who participated in specifications? Has the staff or key player(s) changed? It is not unheard of for a system to be handed over, upon completion of development, to people different from those who justified and specified it. This can easily happen if the project takes more than six months to complete.

Be aware that these new people may not have the same desire for the system or may have confusion about its priority or their role in the new situation. Some may be worried about their jobs or their ability to perform their jobs, or about how their job definitions may change. Newcomers need to be integrated into the project.

These issues should be addressed, and not only technically. A human resources professional may need to be consulted and may wish to orient the new people on the team.

Training, Error Control, and Feedback

A mechanism needs to be established to capture user feedback. Testing can never be 100% foolproof. Some problems may come up. This should be anticipated in the plan to avoid potential panic by the users.

Data Integrity Testing

A new system may demand new types of data. In many practical instances, acquiring error-free data is the single most difficult task in system implementation. This is of particular importance if data is to be entered by the website users. For example, ordering information, shipping information, credit card numbers, and personal information can easily be entered incorrectly.

Systems that integrate orders with inventory systems and generate traditional data streams such as shipping manifests, part numbers, or other mundane information may depend on many small details in order to work correctly. Make sure that your system does not demand perfect data, and do not expect perfect users.

QUICK Tip

Entirely new procedures may have to be implemented by suppliers who have been successfully doing business with you for years. Make sure you weigh the costs of this task—not only the burden on the suppliers' side, but also the burden on your system and staff as they work through these new procedures.

Functionality Creep

During the development cycle, particularly when using the waterfall method, it would be almost impossible for people on the team not to generate new ideas for the system. A hallmark of system development failure is the addition of features and functions during the development phase. Changing specifications on the fly must be resisted. The reworking of the functionality to include new components is almost never worth the addition of an element that was not part of the original list.

However, it would be a mistake to ignore these new ideas. Some may very well contribute to a better website. A mechanism should be established to capture the new ideas as they are generated, so that good ideas are not lost and people know their voices are being heard. These new ideas, improvements, and changes can be implemented in *Phase II*.

Phase II is to take place after the current project is complete. Then all the ideas gathered during development can be considered and weighed against the costs and benefits.

Figure 11.1: CRITERIA FOR SUCCESS

Finally, determine how success will be measured. Many possibilities are available. Below are some specific questions that may be used to assess various measures of success.

- How well does the process work?
- What is the amount of improvement to the existing process?
- Will the criteria be based on user satisfaction, sales, or customer retention?
- How will dollars be tracked?
- How do you determine if the new system has lived up to its expectations?
- Are there accounting procedures to identify dollars saved as new dollars earned?

This information provides needed feedback to the development process, provides rewards for those who deserve it, and sets the stage for further development.

Chapter

12

Website Content

- ▶ **Quality of Information**
- ▶ **Copyright Protection**
- ▶ **Defamation of Character**
- ▶ **Access to Content by Minors**

The Internet has been heralded as a revolutionary phenomenon. It has the ability to bring information across physical borders and into the homes of billions of individuals. It is readily available using a variety of modestly priced, standard technologies. Although it is comprised of many individual inventions, no one group or individual invented it.

The Internet is fairly reliable and naturally robust due to its decentralized components, yet no one individual, group, or agency is responsible for keeping it running. And a lot, if not most, of the content available on it is available free to the Internet user. Pictures of stellar explosions taken by the Hubble telescope, details of decoded DNA, stock prices, poetry, and email are available in your living room, for free, almost instantly.

Anyone who has the ability to receive data from the Internet is not far from being able to create and publish content on the Internet, therefore contributing to the vast and expanding Internet storehouse of information. However, there is an undesirable side to free content. Everyone can be a publisher, but there are few safeguards about what might appear on your screen. The information can be of dubious quality, can be oriented toward someone's personal agenda or politics, and can be old or out-of-date.

In the United States, as in many other countries, there are certain laws that ensure that you are allowed to publish content (laws concerning freedom of speech), but also restrain certain types of content usage (e.g., usage of copyrighted material without permission).

As discussed later in Chapter 15, your trademark or service mark can identify you as the author (or publisher) of the content that appears in association with your mark. Your domain name, as a unique identifier associated with your business, is another sort of marker that identifies you as someone responsible for content.

QUICK Tip

Your website will interact with the laws of copyright in two ways. Copyright laws protect original content that goes into your site. Conversely, you are not permitted to publish someone else's material without his or her permission—he or she enjoys the same protections that you do.

Quality of Information

Keeping Content Up-to-Date

Out-of-date information is a recurring frustration for Web users. If you pick up an old magazine or newspaper, or last year's college catalogue, you would not expect the information to be current. Very often on Internet sites, however, there is no such obvious correlation with the original publication date. Search engines may not land the user on the home page. The user may not take the path you expect, and so dates may be bypassed or simply not noticed, even if the website has them there in the first place.

If you display information that is date sensitive, make sure that it is kept current. Almost every Web user has encountered this problem. Tremendous ill will can be created when your potential customers make plans based on invalid information.

If you are starting a new business, then an obvious consideration should be the development of a process that will keep your website current. If you are going onto the Web with an existing business, it is imperative to include your website in the list of tasks that you currently use to keep other elements in your business current.

Do not let your website be an afterthought. If you offer material for sale on the Web and neglect to update your prices when you should, you may be offering unintentional discounts to Web customers. When you update prices on the bar code scanners, menus, or advertising flyers, be sure to add your site to that checklist. If you change your hours of operation, decide to close on the day after Thanksgiving, or remove a product line from your inventory, do not forget to update the information on your site. Carloads of clients who relied on your site to know your operating hours, now circling your store and staring at the closed doors, are soon to be ex-clients, and will no doubt tell all their friends about their disappointment.

The Data Quality Act

Some of the frustrations with the quality of information available on the Web have resulted in a recent law called the *Data Quality Act*. This act requires the U.S. government to set standards for the accuracy of scientific data used by federal agencies. Under this law, systems must be put into

place that allow anyone to point out errors in the data. If confirmed, the faulty information must be removed from all government websites and any printed publications.

While this law applies to government websites only, it is not a bad practice to provide a feature that allows your users to provide feedback and report any possible problems, such as dead-end hyperlinks. It not only provides an outlet for clients' frustrations, but enlisting the user community will help you to keep your site functional.

A black starburst shape with a white border, containing the word "Alert!" in white, bold, sans-serif font.

Alert!

A common frustration is a link to a dead end. You should periodically check to see that all of your links connect to sites or pages that are still functional. More than that, you may want to browse through those sites and make sure they still contain the sort of content with which you wish to be associated. Websites can change.

FDA and FTC Regulations about Content

Certain agencies of the U.S. government, such as the *Food and Drug Administration* (FDA) and the *Federal Trade Commission* (FTC), regulate information given to consumers to protect them from false or facetious claims. FDA and FTC regulations and policies concerning marketing claims are described in various acts. Some examples of these are the *Federal Food, Drug and Cosmetic Act* (www.fda.gov/opacom/laws/fdcact/fdctoc.htm) and the *Public Health Service Act* (www.fda.gov/opacom/laws/phsvact/phsvact.htm). Other important professional organizations, such as the *American Medical Association*, have also issued guidelines concerning marketing claims. The FDA defines standards for labeling and advertising for prescription drugs, over-the-counter drugs, food, and promotional materials to health professionals and to the general public through advertising or direct mail campaigns, as well as for medical devices and materials for veterinarians.

Alert!

Being out of compliance with these regulations can bring on expensive enforcement sanctions. If your website has anything to do with marketing, promotion, or sales of materials that concern any government agencies, make sure you investigate the policies governing the claims that may be legally made about your products.

Copyright Protection

Like trademarks and service marks, copyright arises immediately when one creates a *work*, such as a play, a book, a poem, or any other artistic or literary work. Copyright applies to many different things, including software, manuals, text on a website, recipes, and more. The official categories of copyrightable matter are as follows:

- literary works;
- musical works, including any accompanying words;
- dramatic works, including any accompanying music;
- pantomimes and choreographic works;
- pictorial, graphic, and sculptural works;
- motion pictures and other audiovisual works;
- sound recordings; and,
- architectural works.

These categories are very broad. For example, *literary work* includes computer software programs.

Copyright does not protect the following:

- works that have not been fixed in a tangible form of expression (for example, choreographic works that have not been notated or recorded, or improvisational speeches or performances that have not been written or recorded);
- titles, names, short phrases, and slogans; familiar symbols or designs; mere variations of typographic ornamentation, lettering, or coloring; or, mere listings of ingredients or contents;
- ideas, procedures, methods, systems, processes, concepts, principles, discoveries, or devices, as distinguished from a description, explanation, or illustration; and,
- works consisting entirely of information that is common property and containing no original authorship (for example, standard calendars, height and weight charts, tape measures and rulers, and lists or tables taken from public documents or other common sources).

How Copyright Arises

Once you create something that is protectable by copyright, you own the copyright, even if you have not registered the copyright with the federal government. Owning the copyright to something means that you have the exclusive right to make copies of the work, distribute copies, perform the work publicly, display the work publicly, and prepare derivative works based on the original work. You also have the exclusive right to authorize others to do those things.

A copyright generally lasts for the term of the author's life plus seventy years. In the case of a work by more than one author, the copyright lasts for the term of the last surviving author's death plus seventy years.

In the case of works made for hire, or works made by an employee in the course of his or her employment, where the employer is the copyright owner, the copyright lasts ninety-five years from publication or 120 years from creation, whichever is shorter. For certain other works, specifically those cases of

anonymous and pseudonymous works, the copyright also lasts 95 years from publication.

Benefits of Registering a Copyright

There are certain advantages to the copyright owner who has registered his or her copyright with the Copyright Office of the Library of Congress. First, the registration puts the copyright claim into the public records. Second, it is necessary to register the copyright for works of U.S. origin before one can file a copyright infringement suit in court. Third, if the copyright is registered within five years of publication, the copyright owner will have *prima facie* evidence of the validity of the copyright and of the facts stated in the registration certificate. This means that in a legal action, those facts will be considered proven until someone proves otherwise.

Fourth, if registration is made within three months after publication or prior to an infringement of the work, in an infringement action the copyright owner may be able to win *statutory damages* (a monetary award provided by law against the infringer, without having to prove actual money damages) and attorney's fees. Finally, registration allows the copyright owner to record the registration with the Customs Service to protect against the importation of infringing copies.

Registration Procedure

Registration of copyright is cheaper, simpler, and quicker than registration of a trademark. There is no substantive review process by the Library of Congress. The copyright owner simply fills out the copyright registration form, pays the fee—at this writing, \$45 on paper and \$35 online—and files the application with a copy of the work.

There are different deposit requirements for different types of works. If the work has confidential or proprietary information, in some circumstances portions can be blacked out or omitted. If the filing meets the procedural requirements, the copyright is registered, and the owner receives a certificate of registration back from the copyright office. The copyright office's website provides information regarding the registration procedure. It can be found at www.copyright.gov.

Publication

If a work is published, the law generally requires the owner to deposit the work with the Library of Congress within three months of publication. In copyright law, *publication* means:

The distribution of copies or phonorecords of a work to the public by sale or other transfer of ownership, or by rental, lease, or lending. The offering to distribute copies or phonorecords to a group of persons for purposes of further distribution, public performance, or public display constitutes publication. A public performance or display of a work does not of itself constitute publication.

Whether a work has been published may affect the duration of copyright protection, the deposit requirements, and limitations on the exclusive rights of the copyright owner.

Copyright Notice

Regardless of whether a work has been published or the copyright registered with the Library of Congress, the copyright owner has the right to, and should for his or her own protection, use a copyright notice on the work. For visually perceptible works, the copyright notice should show the symbol ©, the word "Copyright," or the abbreviation "Copr.," the year of the first publication of the work; and, the name of the owner of the copyright. If the work has not been published, the notice should say "Unpublished work" and state the year of the work's creation.

Registering the Copyright to Your Website

Most websites have some level of content that is copyright protected. The website owner should give serious consideration to registering the copyright to the text and other content of his or her site. The procedure is simple and cheap, and can give the owner a substantial advantage in protecting his or her copyright. In addition, whenever you make revisions, file a separate registration. It may help you in the long run.

You may want to avoid using the U.S. mail to file your registration, as it is not always completely reliable. It is best to use an overnight courier or hand-delivery service instead.

Trademark registration can give the owner of the trademark various advantages in protecting the mark. (See Chapter 15 for more detailed

information.) In addition to registering the trademark or service mark that identifies your goods or services, you may be able to register your domain name as a trademark or service mark. The registration will be allowed only if the domain name is determined by the Trademark Office to be an identifier or source of goods or services. The addition of the “.com,” “.biz,” or other top-level Internet domain name to an otherwise unregistrable mark will not render it registrable. Whether or not you register your domain name as a trademark or service mark, the most important protection of your domain name is to be sure you keep the payments up-to-date on the domain name registration. As long as you have the rights to the name and have paid the necessary fees, no one else can use your domain name as a domain name.

Site Content to Which the Website Owner Does Not Own the Copyright

Let us say you publish a printed (paper) newsletter and sell it to your friends and neighbors. It contains articles and essays from various writers. They have all given you appropriate permission to use their work in your printed newsletter. Do you have the right to take the text of two of the pieces in your last newsletter and now put them up on your website, accessible for a small fee, without getting additional permission from the writers?

The Supreme Court says no. In the 2001 case *New York Times Co. v. Tasini*, 121 S.Ct. 2381, the Court ruled that where an author's work is removed from the context of the original publication and presented to readers outside of that original context, the publisher infringes the author's copyright unless specific permission is granted by the author for that use.

QUICK Tip

Be sure to get specific written permission from the creator of every work that you put on your website for every particular use you plan to make of that work.

Figure 12.1: **SOME POINTS ABOUT
THE NATURE OF COPYRIGHT**

In the practice of law, we have received some questions from clients concerning the nature of copyrighted works. The clients often wish to borrow an expression from a book, an article, a poem, or an advertisement. Their line of reasoning is that because the expression just has ordinary words from the English language, they should be able to use them. Some think it would be okay to use the expression if they gave the authors a footnote, citing their authorship. However, here are the basic rules to follow.

- You cannot just use others' words, even if they are words in the English language. If you want to express the same concept, do so using different words. A person can only copyright ideas if the ideas are in a form of expression. If you absolutely must use those words in that order, then the author of that expression has created something that is better than anything else and it is considered stealing to use those words without permission.
- As far as simple words of the English language are concerned, consider this expression: "To be or not to be, that is the question." These are simple words in the English language, and yet most people know that Shakespeare created that line over four hundred years ago. (The reason it can be used in this book is that the copyright has expired.) A string of simple words can express a complex idea in a way that is difficult to improve upon. It can be tempting to borrow, but do not.
- Finally, do not be fooled. A footnote or a citation to the author does not protect you. It incriminates you, if you do not have the author's permission to use the work. Perhaps you wrote research papers in high school or college that allowed you to quote from authors if you gave references to the original text. That is permissible under the *education exception* to the copyright laws. By putting such a citation in a commercial publication when you do not have the author's consent, you simply prove that you knew in advance you were using copyrighted material without permission.

Copyright of the Look and Feel of a Website

Code behind website pages is protected by copyright under the literary works umbrella. If you think that another website has an identical look and feel to your site, you may want to investigate if a copyright violation has taken place. Likewise, you want to avoid being charged with that violation yourself.

Copyright protects against copying, so the code behind the web pages must be copied from your code in order to make your claim. You may not simply point to the color schemes or other elements as evidence of copyright violation. In addition, the copying of the copyrighted work must be of protected expression, and not just ideas, or elements that fall below the threshold of copyright protection. Items that fall below copyright protection, such as generic short phrases, are not distinguishable as being associated with a particular product or company (examples include “Open seven days a week,” and “Special savings for Internet users”). Basic color schemes (blue background, white type, etc.) are not protected unless they are so distinct that users are likely to mistake your particular color palette and typeface with another company’s scheme. Some colors, such as the blue that Tiffany’s uses for its boxes, are copyrighted in and of themselves.

You will need to prove that someone has copied your code. You may find quirks in the code behind another website that might provide evidence of copying. Programming code is a skill that can leave patterns indicative of the programmer. However, if the exact code is not shown to have been copied outright, courts may use other tests to determine if a violation has taken place.

The *subtractive test* analyzes the copyrighted work, throws out the non-copyrightable elements, and compares only the copyrightable elements of the copyrighted work to the allegedly infringing work. (*Universal Athletic Sales Co. v. Salkeld*, 511 F.2d 904, 908–09 (3d Cir.), cert. denied, 423 U.S. 863.)

The *totality test* compares works using a total concept and feel standard to determine whether they are substantially similar. The *extrinsic/intrinsic test* uses a combination of objective and subjective perspectives, but both of these have largely given way to variations of the subtractive test. (*Computer Associates International, Inc., v. Altai, Inc.*, 982 F.2d 693 (2d Cir. 1992).)

An important element in the proceeding can be the determination of the *intended audience*. Should the tests be done from the perspective of an

ordinary user, or from the perspective of the *intended audience*? That, in turn, may depend on how narrowly the focus of the site seems to be aimed. Is it directed toward a very specific audience (art connoisseurs) or a wider audience (video game players)? (*Atari, Inc., v. North American Philips Consumer Electronics Corp.*, 672 F.2d 607, 619 (7th Cir.), cert. denied, 459 U.S. 880 (1982) “[v]ideo games, unlike an artist’s painting, . . . appeal to an audience that is fairly indiscriminating insofar as [its] concern about more subtle differences in artistic expression.”) Narrowly focused sites that look exactly like their competition will be suspect.

Defamation of Character

Defamation involves damage to some person’s or organization’s reputation. Writers of fiction and nonfiction, as well as photographers, run some risk of being charged with defamation if they portray other people or discuss organizations. *Libel* is written defamation. *Slander* is spoken defamation.

The Supreme Court reasoned, “The legitimate state interest underlying the law of libel is the compensation of individuals for the harm inflicted on them by defamatory falsehoods. The individual’s right to the protection of his good name reflects no more than our basic concept of the essential dignity and worth of every human being—a concept at the root of any decent system of ordered liberty.” (*Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 341 (1974).)

Balancing this need to preserve reputation is the concept of freedom of speech. It is possible to curtail speech too much under the guise of protection against defamation. It is easier to defame a private person than a public one, because public people trade off their right to privacy for their fame.

Other famous people get less protection than ordinary private citizens, even if the person is famous against his or her will, for example, by being accidentally involved in a newsworthy event. The courts will attempt to balance the need for reputation against free speech rights.

Showing Someone in a False Light

Another item to be aware of as a publisher of material on your site is the showing of someone in a *false light*. You may say nothing directly defamatory about a person or an organization. However, if in association with other

written statements or other media, such as photographs, the published material presents a negative picture of someone through suggestion, it is possible for a defamation suit to be brought against you.

For example, someone might post an article about teenage drinking juxtaposed with a picture of rowdy teens emerging from a football game. The teens in the photos may have simply been exuberant over their team's victory, but the implication is that alcohol has caused them to lose their composure. Make sure that your website does not inadvertently place a person or an organization in a questionable position.

Figure 12.2: REQUIREMENTS FOR PROVING DEFAMATION

There are several basic elements that are required for a person to prove defamation.

1. The statement made must be *defamatory*, that is, intending to harm the person's reputation, holding the person up to shame or ridicule, damaging his or her business dealings, or making others not wish to associate with him or her.
2. The statement must be false. (Truth of the statement is a complete defense.)
3. It must be about ("of and concerning") a living person or group of persons, and only these people can bring the claim.
4. It must be published, and without the person's permission. The publication must be in a form that is not ephemeral—writings in the sand at the sea shore would not qualify. Publishing the statements with the defamed person's permission is also a complete defense.
5. If the person alleging defamation is a *public figure*, the statement must be published knowing that the statement was false, or the statement must have been made with a reckless disregard for the truth.
6. It must cause damage to the defamed party. If the defamation is about an organization, the statement must be explicit enough to identify the specific organization.
7. The remedy for defamation is usually money damages to the injured party.

SLAPP Suits

SLAPP stands for *Strategic Lawsuits Against Public Participation*. Some of these cases have arisen when disgruntled groups have posted unflattering material about a company on a website. They might be ex-employees or others who are dissatisfied with the company in some way.

The company in question, in seeking to stop them from publishing this material, may file a defamation lawsuit. Courts have rejected these efforts to stifle public complaints as being restrictive of free speech. If the court finds this particular suit to have no basis (the remarks do not fit the qualifications for defamation), the company could face anti-SLAPP sanctions issued by the court, which would result in the company paying the attorney's fees for the defendant Internet speakers. (*Global Telemedia International, Inc., v. Doe, 1*, 132 F.Supp.2d 1261 (C.D. Cal. 2001). Attorney's fees awarded were in excess of \$50,000.)

Currently, different states have different anti-SLAPP provisions with varying levels of protection for companies or groups who are having unpleasant things said about them. In New York, for example, anti-SLAPP protections apply only to citizens posting information about public figures. In other words, the New York laws only protect citizens who post information about people such as politicians. The companies involved can sue those people who publish derogatory material for libel.

California's statutes, on the other hand, provide more protection for those who post the unpleasant messages. As in the case previously cited, a company in California who attempts to silence criticism may not only lose the case but also be forced to pay the defendant's legal fees as a punishment for attempting to stifle the commentary.

Access to Content by Minors

The Communications Decency Act

In February of 1996, the *Communications Decency Act* (CDA) was enacted as part of the *Telecommunications Act of 1996*. The CDA made Internet transmission of indecent materials to minors a criminal offense. In 1997, the Supreme Court ruled unanimously that the CDA was an unconstitutional

restriction on the Internet, a “unique and wholly new medium of worldwide human communication.” The Court ruled that the regulations would reduce the constitutionally protected material available to adults “to only what is fit for children.”

Responding to precedents prohibiting obscene material or talk on the radio or other media, the Court said that, unlike radio, which may be playing and dispensing content to all within listening range without warning, Internet access takes a deliberate act. Also, due to the nature of the Internet, it is possible to warn viewers about indecent content. In addition, the restrictions on the nature of the forbidden material were too vaguely defined. For those and other reasons, the CDA was rejected by the Court.

Children’s Online Privacy Protection Act (COPPA)

The *Children’s Online Privacy Protection Act* (COPPA) was signed into law in 1998.

If you have a website aimed at children in particular, or even if your site would simply tend to attract children, COPPA requires you:

- to post prominent links on your website to a notice of how you collect, use, and/or disclose personal information from children;
- to notify parents that you wish to collect information from their children and to obtain parental consent prior to collecting, using, or disclosing such information, with certain exceptions;
- not to condition a child’s participation in online activities on the provision of more personal information than is reasonably necessary to participate in the activity;
- to allow parents the opportunity to review and/or to have their child’s information deleted from your database and to prohibit further collection from the child; and,
- to establish procedures to protect the confidentiality, security, and integrity of personal information you collect from children.

To determine whether a website is directed toward children, who are defined as being 13 years old and younger, the Federal Trade Commission, the governmental body in charge of enforcing this law, looks at several factors regarding the site, including:

- subject matter;
- visual or audio content;
- age of models on the site;
- language;
- whether advertising on the site is directed toward children;
- information regarding the age of the actual or intended audience; and,
- whether a site uses animated characters or other child-oriented features.

Child Online Protection Act (COPA)

Congress and many individual states have passed various laws trying to regulate Internet content that may be offensive or harmful to minors. Most of these laws are being challenged on the theory that they violate the constitutional right to freedom of speech. One of these laws, called the *Child Online Protection Act* (COPA) (different from the COPPA statute discussed in the previous section) makes it a federal crime to use the Web to communicate for commercial purposes material considered harmful to minors without attempts to prevent access to minors under 17, such as through an age verification device. It imposes severe monetary penalties and also possible jail time on violators. COPA is currently the subject of a challenge as to its constitutionality.

If you do have questionable content on your site, you should, at a minimum, require the user to take a positive action to warrant that he or she is age 18, or 21 if that is the applicable standard where he or she lives. It would also be smart to consider requiring the user to actively agree that

he or she will not redistribute the material to any minors or other persons who might find it offensive, that he or she believes in freedom of expression, and that he or she will not hold the publisher responsible for the material on the site or any material reached through links on the site.

Will this protect you from prosecution under one of the harmful content laws if a minor enters your site? At this point in the history of Internet law, it is not possible to predict the outcome.

SECTION IV:

Doing Business on Your Website

Development and Practice of Business on the Internet

- ▶ **E-Commerce**
- ▶ **The Retail Model**
- ▶ **Using the Internet to Share Information**
- ▶ **Auctions, Reverse Auctions, and Matchmaking**
- ▶ **Selling on the Internet**

Since its very earliest developmental phase, the Internet has been designed to facilitate the sharing of information. Two major architects behind the initial development—the U.S. military and a group of universities—used networks of data lines and transmission protocols to share research and other information among their own constituents. The Internet grew out of these networks, designed to be used for communication.

Before examining some of the basic elements needed to do business on the Internet, it may be helpful to review some perspectives on the landscape of e-commerce.

E-Commerce

In the late 1990s, there was a frenzy of website development. Investment capital poured into technical infrastructure and software development. There are some interesting historical parallels to the e-commerce explosion. The chronicles of two other technologies—the telegraph and the personal computer—can provide some perspectives on recent events.

The telegraph in its day shrank the boundaries of the world like nothing before. Businessmen in California could learn of prices in New York in a matter of hours. Telegraph companies sprang up by the dozens. Laying the infrastructure—thousands of miles of wire, with main lines branching into individual telegraph offices, at risk to the elements, floods, and roaming buffalo—was a Herculean task, and an expensive one. Many start-up telegraph companies ran through their initial investments and then went out of business. After the initial wave subsided, a group of entrepreneurs bought up several defunct telegraph companies, taking advantage of the initial investment in infrastructure. That group eventually became known as Western Union.

In the early 1980s, central processing units of computers had shrunk in size and cost to the point where they could provide computing power to individual, self-contained units at a reasonable price. The dawn of the personal computer was characterized by the development of many brands, each jockeying for position. Adherents touted the features of the PCs they liked best. When bigger companies saw that consumers were accepting the personal computer, they stepped in and soon dominated the fragmented market.

The boom-and-bust period for Internet development went through an exciting beginning. The 1990s were the first phase of development, with a lot of experimentation, some of which was very successful, some of which is still rolling along, and some of which is on Internet Boot Hill. Second and third waves of sophisticated online commercial ventures followed. The Internet is now a common and often necessary business tool.

The Retail Model

To many businesses that operated stores or market brands during the Internet's developmental period, Internet *traffic* was irresistible. The Internet seemed to offer nonstop, worldwide traffic forever walking past the door, and e-commerce seemed to be the method to gain access to this rich market. Websites with cool functionality and displays tailored to psychological profiles would entice the users, who were ready day and night with credit cards to shop at home or wherever they might be.

Some have failed to import the retail model, in its entirety, into the land of Internet traffic. A store is a separate entity from any of its neighbors. Outside the store, signage announces the store's name. Inside, a collection of brands has been gathered by a buyer, who picks offerings to sell based on the store's market position, target audience, location, and other factors. Advertising is done to help draw traffic and build brand recognition.

Virtual retail establishments, when plopped down into the Internet, did not always work according to the standard model. Traditional advertising was not effective; some types of products did not take well to the Internet, and selling directly to the consumer online was more like using a catalog than selling through a store—tasks like processing thousands of small payments, tax collection, warehousing, inventory tracking, order preparation, customer service, special orders, fulfillment, back orders, returns, packing materials, and shipping labels became major considerations where they were once on the sideline.

Using the Internet to Share Information

The retail model did take advantage of Internet traffic. However, the Internet's original strength was the *sharing* of information. The traditional

retail enterprise, in part to protect its sales but also to distinguish itself from other businesses, sets itself apart. Are these two concepts incompatible? Perhaps not. Yet the one-to-one or the one-to-many relationships typical of retail transactions do not bring into play the many-to-many capabilities that the Internet makes available.

Auctions, Reverse Auctions, and Matchmaking

Other models used the Internet to take advantage of its ability to link many-to-many. These people saw that the Internet was a way to bring together buyers and sellers, much as auctions did, but without the need to use a physical space to house the participants. Auctions were developed for the buyers and sellers of a wide variety of items, from commodities such as bulk minerals to specialized objects such as Ferris wheels.

The auction functions did expand on information linking made possible by the Internet. Pure price and delivery comparisons were adequate in some situations—for example, when the product was relatively inexpensive, well-understood by the buyer, and did not vary in quality from supplier to supplier. Items such as books and airline tickets could often be obtained from one supplier or another, based on price and delivery only.

Auction sites have expanded and diversified as people have become more familiar with Internet technology. Some people are willing to bid on bigger items such as automobiles if they have the opportunity to examine the item beforehand and then use the auction site simply for bidding. Real estate auctions can work if someone is familiar with the property or the neighborhood. Many estate sales take place via the Internet, often as a supplement to a *live auction*. Collectibles and antiques are very often posted on the Internet. Individual items are often sold via a *timed auction*. In this type of auction, bidders have up to a certain deadline to post their bids. At the end of this defined period, the items goes to the highest bidder. A threshold minimum price may be set in advance by the seller.

Developing Relationships with the Customer

The successful sites backed their offerings with good inventory and distribution channels, or sold items, such as tickets, that did not suffer from an impersonal relationship and that did not need physical delivery (like the airline e-ticket, which requires only that an identification number be brought to the airport). They worked hard to get the buyers of their goods to change traditional buying habits and develop trust in Internet-based transactions. Traditional strengths in inventory management, marketing, fulfillment, and other basic business tactics were just as important as ever. Software tracked customer preferences, either through online forms that customers filled out in order to freely give their preferences to the sellers, or through traditional marketing tools such as lists, home zip codes, and ongoing purchase patterns. Systems that manage these functions sometimes go under the rubric of *Electronic Customer Relationship Management* (ECRM) systems. Sites that ask you to create an identity and to sign on are most likely using ECRM systems. Your home address, shipping information, purchase history, and other data are used for marketing and for customizing your visit to your purported needs. When you sign in on an Internet site and are welcomed with “Hi, [your name],” you know this type of software is at work behind the scenes. Some analytical tools can examine your browsing history by tracking what you click on as you surf. These systems can track your preferences and offer up information, advertising, and choices that are more likely to fit your profile. In theory, this makes customers more satisfied with what a seller is offering, and makes customers, in turn, more loyal.

Virtual Communities

Some *virtual communities* seem to have self-generated, but others were planned to a greater or lesser degree. This many-to-many communication conglomerate can bring together disparate individuals who share some common interest, way of thinking, beliefs, goals, or all of the above. The virtual community may be a way for others to discover those things, even if they do not want to join the community. Virtual communities can, of course, engage in e-commerce, along with the sharing of ideas.

QUICK Tip

Virtual communities, and theories about how they grow, are the subject of scholarly papers and serious research. Each community has rules for behavior, provides various perceived benefits to its members, and is managed according to different rules. Communities formed in colleges through popular sites such as Facebook became hugely popular methods of posting personal information. A generation of people who were comfortable with computer technology had few qualms about privacy issues.

Selling on the Internet

Many of the considerations about setting up a website are addressed in the chapter on contract negotiation for website development. There are some issues that relate specifically to e-commerce on the Web; however, they can be referred to separately.

Selling items on the Internet demands the same sort of business sense that selling items in a store would demand. Some of the basic considerations are listed as follows.

Know What You Are Selling

Every item can be considered part of some group. Are you selling the whole group of items or individual items? Are you selling cake or desserts? Baseball equipment or sporting goods? This decision will affect your marketing plans, your inventory, your advertising, and your customers' perception of what you are and whether to shop at your site—and is critical to effectively managing your business.

Know Your Customers

Whom are you targeting? Where are they located? Do they have certain characteristics that will help you serve their needs? Do they change over time? Will they stick with you as they get older, or are they replaced by new arrivals?

Know How to Reach Your Customers

Will you advertise on traditional media? How do you know when you reach your target audience? How can you tell if the audience is satisfied with your goods?

Web tracking software can help analyze who visits your site and what they do while they are there. (see page 119.) There are also methods to help drive traffic to your site. (see Chapter 14.)

Know How to Provide Good Customer Service

If you are starting small with only yourself or a few others, are you prepared to field questions from customers? Will you provide a phone number for customers to call? Many business leaders recommend providing a method for customer feedback. Will you provide an email address for them to use for questions? How will you monitor the quality of the responses given to your customers? Might your business grow to the point where you need full-time customer service functions?

If the answer to the last question is yes, you should note that customer service telephone response services are available. This might be more cost-effective than trying to put together a dedicated customer service center on your own.

Know How to Set the Correct Price

This is one of those basic questions that has many complicated answers. Are you bidding for contracts? Are you trying to charge the maximum amount of money possible, to make the most profit per sale, even if it means losing sales to competition? Are you thinking of charging lower prices to increase your market share? Will prices need constant adjustment to stay in tune with market conditions? How will you adjust pricing on your site? Is it a manual task, or will you be provided with a catalog of goods and services from another database? If so, will you accept that pricing, or will you mark it up (or down)?

Know How to Identify What the Customer Wishes to Purchase

Providing shopping cart holding areas in your site for customers to gather their purchases, check what they have bought, change their minds, and finalize their purchases has become routine in many websites. The processing that occurs after these choices are made can vary in complexity, depending on what you offer for sale and how it is delivered.

Do you need to check if items are in inventory? If so, and if not all items are available, can you process back orders? Should you check with the customer if back orders are okay with them, before completing the transaction? (This is recommended.) Must you compute shipping charges and add them to the invoice? Are you offering different types of shipping (regular, expedited, overnight, etc.)? If you ship in more than one shipment, are there multiple shipping charges? Are your sales final? If not, how will customers return goods? Don't forget sales tax.

Know How to Collect Payment from Your Customers

By check Many websites allow you the option of sending in a check for a purchase. Usually the items being purchased will not be shipped until the check has been received, deposited, and given time to clear through the bank. There are some services that will provide *check verification* if you want to reduce this time delay. The services use sophisticated algorithms to test the checking account number and the check writer's personal information against data banks of account information to determine if the check is good or not. These services are not foolproof but can have a high degree of reliability and may make sense in your business.

The credit card processing system If you are selling items on the Internet, you will almost certainly have to set up a system that allows you to receive money through credit cards. You may build this process into your own system if you choose. The transactions are well-defined and should not pose a technical problem to your developers. However, services are available that can offer an entire package of services, including credit card verification and money transfers.

Paypal Whether or not you take credit cards on your site, you should take Paypal. Millions of people use Paypal rather than credit cards to shop online—often because they would prefer not to expose their credit card account numbers directly to merchants. It is simple to set up an account as a seller of goods—just go to **www.paypal.com** and the site will walk you through it. Paypal is a much quicker function to set up than directly taking credit card payments on your site.

Understand Internet Credit Card Authorization

For the following illustration, it is assumed you have signed on with a credit card processing service.

EXAMPLE: An Internet customer decides to buy something using your website. (It is assumed that you have a shopping cart or other method of identifying the items for sale that the customer has chosen.) Typically, you would provide a form in which the customer can fill out information about himself or herself, including name, address, and other personal information, along with the credit card type and the card number. Any transmission of this personal information should only be sent in encrypted form for security purposes. Additionally, the area of your site that houses this information must be secure against intruders.

Your site's credit card processing software sends the encrypted transaction to the appropriate credit card association. (The software may be in your own site, or it may be in a credit card processing service location.) The credit card association will send the request for credit card authorization to the issuing bank. The issuing bank either accepts or declines the credit card transaction. The bank's system sends this message to the card association. The card association transmits the acceptance or denial to your credit card software. If the software is housed in the file server of a credit card processing service, the acceptance or denial will be sent to that service first, which in turn will pass the information to your site.

Assuming the transaction is authorized, your site will send the credit card processing company *fulfillment notification to permit settlement*, meaning that the goods and services have been delivered or are ready to be shipped. This means that you must in good faith actually be ready to ship the goods you are charging for in a reasonably short period of time. Each credit card issuer and credit card association will have its own rules and policies, but authorizations to charge goods or services are only valid for several days. If the order cannot be fulfilled within that time frame, you may need to secure another authorization. In general, card issuers require that only after an order has been fulfilled are charges to be posted to the card. Check with the credit card company and merchant bank to determine what their policies are in this matter. Assuming you supply a valid *fulfillment notification*, the consumer's credit card is charged for the order. All the above transactions are usually completed within half a minute.

When you decide to close out the current series of transactions, the processing software will notify the issuing bank and the bank transfers the money into your bank. Note that credit card companies charge a fee for each transaction, usually a percentage of the dollar amount. You will be subject to higher or lower fees depending on your history. For example, if you provide many credit card numbers that are expired, fraudulent, or over their credit limits, and consequently are declined, your history will probably subject you to paying higher fees than if most of your credit card charges are accepted. In addition, other factors, such as the size and volume of transactions (many small dollar amounts versus a few large dollar amounts, etc.), will affect your fee structure with the card issuers. Determine what the fee structure is

with the cards you plan to process, and try to get the best deal for your circumstances.

Beware of credit card setup offers you receive by email. It is best to use a service offered by a trusted source or recommended by friends or colleagues.

Figure 13.1: PARTIES INVOLVED IN CREDIT CARD TRANSACTIONS

There are several parties involved in a credit card transaction:

- the consumer
- the credit card issuing bank
- the merchant
- the merchant's bank
- the acquiring bank

The process used to authorize a credit card transaction is fundamentally the same for the different methods used to make the charge. That is, whether you swipe the credit card through a credit card terminal, type in the card number after receiving it over the telephone, or take the card number over the Internet using credit card processing software. However, a different level of security usually accompanies each one of these methods. The most trusted transactions are usually those in which the credit card holder shows up personally at a store with the credit card. When credit cards are taken over the phone or on the Internet, there is a higher chance that the card number is false or stolen, or that the card itself has expired.

Understand Internet Taxation

State and local governments have various sales and use tax schemes. Sales made on the Internet are subject to these same regulations. Generally, states tax the sale price or rental charge of tangible personal property and certain

telecommunications services sold or rented within the state. A typical state sales and use tax scheme will require a seller to collect sales tax on behalf of the state under the following circumstances: if the seller regularly sells, rents, or leases within the state; buys tangible personal property or telecommunications services for resale within the state; acquires parts to manufacture goods for sale or resale within the state; has a business location within the state; has representatives soliciting orders for tangible personal property or telecommunications services within the state; or, sells to in-state residents or businesses and delivers, repairs, or installs goods or telecommunications services within the state.

Out-of-state vendors that take or have taken any of the previously mentioned actions will also be required to collect sales tax on behalf of the state.

The typical state sales tax scheme exempts sales where the purchaser takes possession of the goods outside the state. If the seller delivers to an out-of-state purchaser's address or to an interstate carrier for out-of-state delivery, the sale will be exempt.

States and localities each have their own schemes, and anyone selling or renting goods or services must thoroughly understand which laws and regulations apply to him or her. The U.S. Treasury Department estimates that there are thirty thousand local taxing jurisdictions in the United States, so you must take stock of your own situation and determine which of those authorities apply to you.

Many localities have attempted to liken Internet access to telephone or telecommunications services and thus to include Internet access in the list of things that are subject to sales tax. There is a national movement to bar this type of taxation, for various reasons. First, utilities, unlike Internet Service Providers (ISPs), are guaranteed profits. Second, regulated telephone companies, unlike ISPs, buy their access lines at wholesale prices. Third, ISPs already pay telecommunications taxes on the lines they use to deliver Internet access, so to tax ISPs like phone companies would be double taxation.

In addition, some localities have attempted to enforce overly broad sales tax schemes on Internet sellers. For example, Vermont has attempted to require any out-of-state company running an *electronic mall* to collect taxes on all sales

made to Vermont residents, even if the computer server hosting the electronic mall is not physically located in Vermont.

To keep localities from taxing Internet access and from attempting to broaden their sales and use tax schemes to unfairly target Internet sales, Congress enacted the *Internet Tax Freedom Act* in 1998. The act prohibited state and local governments from taxing Internet access fees, except for those states that had been doing so prior to October of 1998. Those states could continue to do so only if they could show that the taxes had been generally imposed and actually enforced on Internet access providers before October 1, 1998. Some states voluntarily agreed to abide by the national moratorium even though their tax schemes could meet this exception. In November 2007, the *Internet Tax Freedom Act Amendment Acts of 2007* was signed into law, which continues to prohibit multiple and discriminatory taxes on electronic commerce until 2014.

As previously explained, state sales taxes are levied on sales only when the buyer and seller are in the same state, or the seller has a sufficient *nexus*, or connection, with the state in which the buyer resides. Sales at a retail store to a local purchaser are clearly subject to the sales tax scheme. Sales made by phone or mail order are more difficult to determine. Usually, the law requires that the seller must have some sort of physical presence in a state for there to be a sufficient nexus to collect sales taxes. This might mean a branch office, salesperson, warehouse, or the like.

Logically, taxation of Internet sales should follow the same rule as taxation of sales made by phone or mail order. And, in most places, it does, thanks to the Internet Tax Freedom Act Amendment Acts.

QUICK Tip

Be sure to check and comply with your local sales and use tax rules and regulations before you start selling goods or services on the Internet.

Chapter

14

How to Attract Visitors to Your Website

▶ **Search Engines**

If you are reading this, you probably do not need to be convinced that a lot of people use the Web and that access and usage are increasing daily. It is probably safe to assume that hundreds of millions of people use the Web and that most of them have at least a moderate amount of education and means.

Some people use the Web for very limited purposes, such as to look at stock prices. Others use it to get information about anything and everything. You can research the best camera for the money you have to spend. You can find out about resorts and what they offer. You can make plane, train, and hotel reservations. You can compare prices. You can read books, do all kinds of research, and buy almost anything. Many people start their searches for goods and services on the Web.

The number of registered Internet domain names is growing. There were fewer than twenty thousand registered domains in 1992. As of this writing, the number of registered domains is about 150 million and rising. It is now considered a normal part of business practice to have a website, no matter how mundane the business may be. That implies two things:

1. there will be more sites for your site to compete with; and,
2. there will be more people ready to look for you and use your site when they find it.

Search Engines

Some people may look at your website because of a word-of-mouth (or word-of-email) referral or a direct email campaign you may undertake. But most people will get to your website through a search engine. *Google* has become an accepted verb in our vocabulary; “Just Google it” is synonymous with “Go look it up.”

Getting Your Website Listed on Search Engines

Search engines crawl the Web and pick up your website information whether you want them to or not. These Web-crawling robots—*bots* for

short—constantly scan the Web for new sites and changes to existing sites. The closer to the top of the list your site appears after a search, the more likely it will be accessed by a user. Therefore, many webmasters have a high ranking as a goal when designing websites. If you do a search for “webmaster” on www.google.com, you can find a good set of descriptions about how Google and other search engines find and rank your site.

There have been instances where site designers engaged in certain unethical practices to trick search engines into ranking their sites. One well-known trick was to put key words in a color that matched the background, effectively making the words invisible (e.g., blue letters on a matching blue background). These hidden words were used to lure searchers to sites that might not have been the real objective of their search. A used-car dealer, for example, might put in every single make and model description in this hidden text in order to draw traffic to the site, even if he or she never carries certain auto inventory, hoping that someone tricked into going on to his or her site will buy something anyway.

Most search engines are well aware of these tricks and do not think highly of misleading practices, dooming such sites to low rankings or skipping them altogether. Better rankings can be achieved through good site architecture, clear descriptions, and *site maps* that offer an unambiguous table of contents for your site. There are various ways to structure your website for optimum placement in search engines. Every page of your site should be reachable through an individual link rather than buried in a complex pathway. Try to use key words and phrases that your prospective customers would use in conducting their searches for goods and services. Also try to get related sites to add links to your site—some search engines count the number of links that point to your site and use that number in determining how high you place on their resulting lists of sites that were found. More detailed information on these strategies is readily available on the Internet. Just go to any search engine and look for “search engine placement.”

QUICK Tip

You should submit your site to various search engines. Most registrations are free.

Google also has a paid *listing* (advertisement) option. The paid listings appear above and beside the regular search results.

Submitting to the search engines is an ongoing task, not a one-time activity. You must set aside time or money, or both, if you want to get the most traffic to your website. It is wise to check your listings and resubmit if necessary at least once every few months. You should treat the cost of submitting to search engines as a necessary start-up cost for your business, like stationery and phone lines.

A black starburst shape with a white border, containing the word "Alert!" in white, bold, sans-serif font.

Alert!

You can do the work of submitting your site on a regular basis to search engines yourself, or you can hire one of the myriad consultants and companies offering this service. Beware of email offers, however. Email appears to be the breeding ground for a whole new collection of scammers. It is best to get personal recommendations for these services from friends and colleagues.

One way of improving your marketing efforts is to track the traffic to your website. Tracking mechanisms can be built into your website by the developer, or you can often get traffic reports from your hosting service. The reports can tell you things such as the site your visitors jumped from to get on to your site, the site they went to afterward, and how long they stayed at your site. These reports can also tell you what path your visitors chose as they went through your site and how long they stayed on each individual page. These elements can be critical in evaluating the effectiveness of your site's information architecture. Different trackers will provide different information. You can use this information to pinpoint your marketing efforts.

A deeper look at traffic can be found by analyzing exactly what people do once they have found their way to your website. Each click of the mouse that brings up a new page or graphic is actually a command being given to a computer program that instructs it on what information to present next to the user. The accumulation of these click commands is called *clickstream data*, and each visitor leaves digital footprints whenever your site is

accessed. Understanding where people are going, how long they spend on each page, what sections are popular, and what sections are ignored can provide marketing information only dreamed about in the past. These behavioral profiles can be used to expand or tailor product lines, can be used in conjunction with email and regular mail advertising campaigns, and can supplement point-of-sale information traditionally collected. Well-visited sites can develop billions of clicks, however, so this sort of analysis can demand high-powered marketing programs.

SECTION V:

Intellectual Property Basics for Your Website

Chapter

15

Trademarks and Service Marks

- ▶ **Trademarks**
- ▶ **Service Marks**

Trademarks and service marks help to protect you and your company when doing business on the Internet. If you think of a catchy name for your product or service, you will want the consumer who remembers that name and looks for it later to come to you, not to your competitor. The trademark laws are designed to protect the consumer from purchasing *knock-off* or *copycat* goods or services. If a jacket says "L.L. Bean" on it, the consumer should be confident that it was actually made by (or for) L.L. Bean.

Trademarks

A *trademark* is a unique identifier for your product. A trademark can be a word or several words, or it can be a logo or symbol. The symbol can stand by itself or be used in conjunction with words. In special cases, colors and even sounds have been held to be valid trademarks. The government keeps a list of trademarks that are registered and approved by it as being acceptable, but in theory and in practice, trademarks exist the moment you start to use them in commerce.

Service Marks

A *service mark* serves the same purpose as a trademark, but denotes a service rather than a physical product. Consulting is a service, for example, as opposed to dishwashers or cars. So, consulting firms would have service marks, while product manufacturers use trademarks. (For the balance of this discussion, we will address trademarks, but the concepts apply equally to service marks.)

Trademarks and Service Marks versus Patents and Copyrights

Trademarks and service marks protect the names, identifying symbols, or logos of goods and services. Patents and copyrights should not be confused with each other or with trademarks and service marks. *Patents* protect inventions. If you think you have an invention that could be the subject of a patent, you should get a book on patents. You should also consider consulting a patent lawyer. Patent law is very complex and is usually only undertaken by specialists in that area. *Copyrights* protect original creative works, such as

artistic, literary, or musical works. Copyrights are addressed in Chapter 12 of this book.

The Purpose of Trademark Protection

It may come as a surprise to many business owners that the purpose behind the government sanction and protection of trademarks is to protect the consumer, not the business owner. The touchstone of trademark law is consumer confusion. Legitimate marks help consumers distinguish one product from another. That this protection also extends to the owner of the mark is secondary to the goal of preventing consumer confusion.

Misunderstandings about the fundamental nature of trademarks have caused business owners to miscalculate their abilities to protect their trademarks. Often, in fact, the trademark may not be held as valid or protectable by the owner because it fails the *consumer confusion test*.

Two of the bases on which the United States Patent and Trademark Office (USPTO) may refuse registration are if the mark is *generic* or *merely descriptive*. An illustration may help explain the meaning of these terms.

EXAMPLE: You could not register a trademark for the word “pumpkin” when you are selling pumpkins at a pumpkin stand. This identification does not help the consumer distinguish your pumpkins from anyone else’s, because the word is the generic, or common, name for the item you are selling.

However, if you decided to name a brand of shoes “Pumpkin Shoes,” then most likely you will be granted the trademark registration, because as of yet no one else has used the word to name their line of shoes. Also, the phrase is neither generic nor merely descriptive. Therefore, the consumer will find that trademark helpful in identifying your shoes from any other shoes. A brand name for shoes such as “Brown Leather Shoes” would not be registrable, because it is merely descriptive of the product and not distinctive.

This rule applies to services as well. If you run a design studio, you will not be granted a registration for the service mark “The Design Studio,” even

if you have those words on letterheads and business cards. You could probably get a registered service mark for “Pumpkin Design Studios,” if you wished, because it will alert the buyers of those services that the origin of the work is from your studio alone.



Alert!

You may start using the TM trademark symbol (or SM for service mark) from the very first day you start using the mark in commerce as a claim to the public that you own the mark. You may not use the ® symbol until your registration is granted by the USPTO.

Benefits of Registering a Trademark

It is not necessary to register your trademark with the federal government in order for you to be able to protect it legally, because rights in a trademark arise simply from use in commerce. However, federal registration does give various benefits to the owner of the mark.

First, it provides constructive notice nationwide of the trademark owner's claim. If the owner has to initiate legal action to protect the mark, the federal registration will provide clear evidence of ownership of the trademark—although ownership of the mark is not exempt from challenge simply because of registration. In addition, the owner may bring legal action in federal court, rather than state court, which can be advantageous. Registration can also be used as a basis for obtaining registration in foreign countries. And, registration may be filed with the United States Customs Service to prevent importation of infringing foreign goods. So, although registration is not necessary, it can assist the owner of the mark in various ways in protecting his or her rights in a mark. You can contact the Trademark Office at:

Commissioner for Trademarks

P.O. Box 1451

Alexandria, VA 22313

www.uspto.gov

States also have their own registration processes, for those owners who do not see the need to register federally. This would be the case if your business will always remain completely local and you will never sell anything outside of your state, something that is very difficult to guarantee if you are selling things on the Internet.

The Federal Trademark Application Process

The United States Patent and Trademark Office (USPTO) reviews trademark applications to see if they meet the standards for registration into a national system of trademarks. Only after a trademark is registered may you use the registration symbol ®.

If your application does not meet the requirements listed in Figure 15.1, the USPTO will return the application papers and refund any fees submitted. Depending on whether you are filing on an *intent to use* basis or are already using the mark in commerce, you may also need a specimen of use of the mark on the goods, or describing the services. A *specimen* is something evidencing the mark as used in commerce, such as a photograph of a jar of jelly with your label and trademark on it.

Figure 15.1: TRADEMARK APPLICATION REQUIREMENTS

An application must include the following elements before the USPTO will accept it:

- name of the applicant;
- name and address for correspondence;
- clear drawing of the mark;
- listing of the goods or services; and,
- filing fee for at least one class of goods or services.

The USPTO classifies the mark into certain categories based on the goods or services you are selling. Therefore, you must specify the product or service

category in which you are using the mark or in which you plan to use the mark. If one trademark is used to identify, for example, a type of dishwashing liquid, the same mark might be registered in another product category, such as tools, without causing consumer confusion. Therefore, product categories define market limits for registration of the mark.

The USPTO also decides whether your trademark application adequately describes, in plain English, what it is you are selling and what the mark is intended to identify. If your claim is too broad or not specific enough—for example, if you want to register a certain mark for use on “all products manufactured in this facility”—it will be rejected. If your claim is too narrow, it may be found acceptable by the USPTO, but it may be very limited in the products for which it will be registered. For example, a clothing trademark might be specified for use on trousers, which is fine, but if you had claimed the mark as one to be used on other specific clothing items such as shirts, then your use of the mark on those other items would be registered as well.

**Alert!**

The USPTO is not a trademark police force. It does not guarantee that you have the right to use the mark. It will not search the world for other marks that may come along that look like your mark in order to protect your interests. It is up to the owner of a mark to enforce his or her trademark rights. A letter to the alleged infringer may initiate enforcement of rights. It may progress to a full-blown lawsuit, but in any event, it is the owner of the mark who must be vigilant in making sure the mark is not copied or misused.

Registration Process

You do not need an attorney to file a trademark application. The application process is specific in its demands and you must follow the rules in order to register your mark successfully. The USPTO will provide friendly advice but will not act as your representative in the filing process. It is up to you to get it right. There are several books that can guide you through this process. You may also apply for registration using the Internet. The Trademark Electronic Application System (TEAS) is available at:

Trademark law can be confusing. An example of what types of marks may or may not be registrable might help you understand this area of the law.

EXAMPLE: Let us say two people, Tammy and Susan, manufacture apple juice. Tammy's juice comes from her orchard and is tart. Susan has another sort of apple orchard and her juice is sweet. Both come to market in big barrels. Consumers who wish to purchase apple juice at the market would not be able to tell which type of juice they were getting without opening a barrel and tasting it, because both barrels look the same.

Tammy now starts labeling her juice barrels with the word "Juice." She likes the idea, and decides to apply for trademark registration for her product. It is her product, after all, and it is juice, so why not register that trademark before someone else does?

Her trademark application would be denied. She has merely used the generic name of the product. The labeling of the barrel with the word "Juice" does not help an otherwise unknowing consumer identify the juice as Tammy's juice. The trademark office would reject the trademark as being generic.

Susan decides that she would sell more juice if people could distinguish her juice from anyone else's juice. She decides that "Sweet Orchard Apple Juice" would be a good name, and starts stamping those words on her barrels. She, too, wants trademark registration for her label.

Susan's application would also most likely be denied by the USPTO because the words are merely descriptive of the item she is selling. Someone else may start making sweet apple juice, and he or she should not be precluded from using those descriptive words on his or her label.

Susan might propose using "Susan's Sweet Apple Juice." This is the type of mark that has a good chance of

registration. It is neither generic nor merely descriptive. First, the USPTO would check that no one else has registered the phrase "Susan's Sweet Apple Juice," and if no one has, she could have her mark registered in the category of "light beverages." The basis for the registration is to assist Susan in preventing imitators from fooling the consumer. However, the mark can also hurt Susan's business. For those who do not like sweet apple juice, the mark helps them avoid a product they do not want. If Susan has a bad crop one year, people may avoid her juice from then on.

Suppose someone else named Susan starts making apple juice. Could she register her own name for her own apple juice? The answer is no, because it would be the basis of consumer confusion. The second Susan is out of luck. The only way the second Susan could register the mark is if she could prove that her trademark was in use in interstate commerce before the first Susan's mark, "Susan's Sweet Apple Juice," was in use.

Rights in a trademark begin the moment the mark is used in commerce, whether it is registered or not. Registration does give the owner of the mark certain legal benefits, as previously described. In the previous example, could the Susan who first used her name on the apple juice stop the second Susan from using her registered mark? Possibly, if they were competing in the same markets, such as the same city or geographical area.

Chapter

16

Publishing Law, Copyright, and Electronic Media

- ▶ **Trademarks as Identifiers of Internet Speakers**
- ▶ **Infringement of Copyright**
- ▶ **Using the Publisher Model**

Trademarks as Identifiers of Internet Speakers

Many companies are establishing a presence on the World Wide Web, with the company's trade name prominently displayed on the website's home page. The company may be surprised to learn that it has just ventured into the publishing business and that mass media law governs some of its activities.

The Supreme Court has denoted different categories of speech. *Trademarks* may be characterized as a certain kind of speech, and may also identify a particular speaker as the source of speech on the Internet. Both points are important in determining:

- what degree of protection the speech has;
- what causes of action may be brought against the speaker; and,
- what defenses are available to the speaker.

Different Types of Speech Receive Different Protections

Editorial content is one type of speech, and it demands full protection from the First Amendment. (*Miami Herald Publishing Co. v. Tornillo*, 418 U.S. 241 (1974).)

Advertising is classified as commercial speech, and the Supreme Court says that the Constitution accords a lesser protection to commercial speech than to editorial speech. (*Central Hudson Gas & Electric Corp. v. Public Service Commission of New York*, 447 U.S. 557 (1980).) Nevertheless, the Constitution affords some sort of protection to commercial speech, even if it is a lesser degree of protection.

Fully protected commercial speech does exist. Speech does not lose its First Amendment protection merely because money is spent to announce it, as in a paid advertisement of one form or another. (*Virginia Pharmacy Bd. v. Virginia Citizens Consumer Counsel, Inc.*, 425 U.S. 748, 761 (1976).) The Supreme Court said in 1977, "The listener's interest [in commercial speech] is substantial: the consumer's concern for the free flow of commercial speech often may be far keener than his concern for urgent political dialogue. Moreover, significant societal interests are served by such speech." (*Bates v. State Bar of Arizona*, 433 U.S.

350 1977).) The Court recognized that people are interested in reading advertising and that the freedom of speech applies to commercial speech.

The Court has said, however, that there is a lesser degree of protection available when the expression relates solely to “the economic interests of the speaker and its audience.” (*Central Hudson Gas & Electric Corp. v. Public Service Commission of New York*, 447 U.S. 557 (1980).)

Figure 16.1: TYPES OF SPEECH AND THEIR DEGREES OF PROTECTION

The following is a summary of the different types of speech and the degree of protection given to them:

- editorial speech that is fully protected, within the limits proscribed by the Supreme Court (e.g., obscenity is not protected);
- commercial speech that is fully protected; and,
- commercial speech that is less protected.

As will be seen in examples to follow, courts have used some basic models to characterize the speaker in various situations involving printed or spoken words.

The Publisher The *publisher* owns the original contents and is responsible for controlling the content. The publisher also exercises control over areas in the publication that are rented to others for advertising purposes. The publisher may choose who is allowed to advertise and may also refuse to carry advertising. In most cases, the publisher is the company that owns the Internet site. The more control one has over what goes on to the site, the more likely that person is to be held legally liable for claims regarding those contents.

The Distributor The *distributor* (or common carrier) is one that acts as a mere conduit between publishers and the public. It does not review content or necessarily know what the contents of the publications are. The

distributor might be the group that provides hosting for your site and also the telephone line or communications supplier. The distributor is least likely to be held liable for the published contents on a site because it has no control over those contents.

The Individual Anyone may exercise First Amendment rights by printing information. (*City of Ladue v. Gilleo*, 114 S.Ct. 2038 2d 36 (1994).) Exercising those rights subjects one to the possibility of liability.

The Anonymous Individual Sometimes, you do not know who is speaking. The First Amendment does protect anonymous speech. The Supreme Court upheld the right to write, print, and distribute leaflets with no identification of source. (*Talley v. California*, 362 U.S. 60 (1960).)

However, magazines must, by law, file the name of the publisher with the United States Postal Service, and if an advertisement's trademark is not obvious, the publication must mark all paid reading matter "Advertisement." If there is no trademark identifier, magazines, in effect, have to substitute a generic trademark.

Advertisements Have Their Own Type of Speech

Advertising as a term is constantly changing as new media and marketing techniques emerge. It may be said that anything carried by media with a trademark is presumed to be advertising. The Food and Drug Administration (FDA) defined advertising in 1995 to include "all commercial uses of the brand name of a product (along with or in conjunction with other words), logo, symbol, motto, selling message, or any other indicia of product identification..." (60 Federal Register 41314.) Trademarks imply advertising, which implies commercial speech, the type of speech that may receive less constitutional protection.

Commercial Speech on the Internet

There is ordinarily no question in the reader's mind whether a given page of a magazine, or a section of a given page, contains editorial content or advertising content. A trademark usually identifies the area as advertising and therefore as commercial speech. However, there can be difficulty discerning between the two when moving from page to page on the

Internet due to lack of context. A magazine's pages are physically bound together, which implies that all pages contained therein come from the same publisher. In addition, to state the obvious, one knows from experience and through the design of the magazine that one page is distinct from another.

None of these conclusions necessarily follow for a website's contents. It may be hard to know when you are moving from one page to a new page or using a hyperlink to go to an entirely different website. In both instances, the user/reader clicks on icons or text, but the resulting page can be from an entirely different source than the previous one.

Imagine if you were looking at a printed magazine, and the act of turning a page could transform the publication in your hands into an entirely different printed product made by a different publisher and even printed in another country, and whose contents may be a few minutes, or a few years, old. This can happen to a reader on the Internet.

This lack of context intensifies when geography-based trademarks encounter the global network. (Kenneth Sutherland Dueker, *Trademark Law Lost in Cyberspace: Trademark Protection for Internet Addresses*, 9 Harv. J.L. & Tech. 483 (1996).)

A U.S. court convicted an Italian publisher of trademark infringement when it published a magazine similar to an existing U.S. magazine (the Italian *Playmen Magazine* versus the U.S. *Playboy Magazine*). Italian courts did not agree, and allowed the magazine to be published in Italy, which it did for several years. Later, a website in Italy was found to have violated a U.S. court's injunction when the Italian website made the magazine's contents available.

However, the magazine's mere presence on the Internet was not the focus of the court's reasoning. Rather, the court found that the fact that the Italian website allowed entry only if it received a subscription payment and then issued a password to the user implied that the Italian publisher was reaching out to sell the enjoined publication to U.S. readers. (The Italian publisher had unsuccessfully maintained that visiting the website was comparable to getting on a plane and flying to Italy.) (*Playboy Enterprises, Inc., v. Chuckleberry Publishing, Inc.*, 79 Civ. 3525 (SAS) (1996 U.S. Dist. LEXIS 8435).)

Identifying the Speaker on the Net

Creation and maintenance of registered domains on the Internet is a way of grouping and identifying the type of contents to be found on successive pages. In addition, a domain is useful in identifying the *speaker*, who is responsible for the content contained within the domain. In the real world, different organizations in different lines of business may use the same trademark as long as the mark is distinguishable by lines of business. An example of this might be Sphinx Publishing and Sphinx Jewelry. On the Internet, the domain name **www.Sphinx.com** would be available to only one of these product-makers—the first one to register. An Internet user would need some other clues to know which one, if either, of the companies the site represented.

Figure 16.2: RESPONSIBILITY OF THE DOMAIN OWNER

The owner of a domain may be held responsible for its contents even if the owner did not enter the contents (for example, if chat rooms or bulletin boards allow users to enter content).

Two likely causes of action for contents published on a website are:

- infringement of copyright and
- *libel* or character *defamation* (writing something untrue that is damaging to someone's reputation).

The domain owner must be wary of publishing content that may subject him or her to these types of claims.

Infringement of Copyright

Briefly, copyright protects someone's creative work and can be used to protect writings, music, and paintings. You may not use someone else's words, music, art, or other creative work without first obtaining his or her permission. Even if you attribute the work to the correct author, if you publish work on your site without the author's permission, you may be held liable for copyright infringement.

The distinct combination of color palette, typefaces, and other graphic elements of a site are often referred to as the *look and feel* of a website. The look and feel of a website has been held as copyrightable, which means you must not use a combination of elements that would make a user mistake your site for some other site. A good analogy would be to think of the cover of a magazine—each magazine strives to create a look and feel for its covers, and the covers are usually quite distinctive. If one magazine makes its covers so similar to another magazine’s cover that it would be mistaken for the original publication, it is an infringement of copyright. This same idea applies to websites.

Figure 16.3: COURT DECISIONS REGARDING COPYRIGHT INFRINGEMENT

A few decisions by the courts on these matters can give you an idea of the issues in this area:

- A subscription bulletin board service infringed a magazine’s copyrights by distributing copyrighted photographs, even though the bulletin board operator did not know that the photographs had been uploaded by subscribers onto the bulletin board. (*Uploading* is the transfer of a file from one user’s computer to a host computer through telecommunications lines) (*Playboy Enterprises, Inc., v. Frena*, 839 F.Supp. 1552 (M.D. Fla. 1993).)
- A bulletin board operator was found liable when users uploaded the plaintiff’s computer game programs onto the service so that other users could copy the games instead of buying them from the plaintiff’s company. (*Sega Enterprises, Ltd., v. Maphia*, 30 U.S.P.Q.2d (BNA) 1921 (N.D. Cal. 1994).)
- An online service that had numerous bulletin boards available to over two million subscribers was held to be similar to a newspaper and liable for statements made by a bulletin board subscriber because it held itself out as exercising limited editorial control over the contents of its bulletin boards. It was held to be analogous to a newspaper and therefore a publisher of its contents, even though a subscriber had written the defaming statement. (*Stratton Oakmont, Inc., v. Prodigy Services Company*, 1995WL 323710 (N.Y. Sup.) (1995).)

(continued)

- Another bulletin board operator was found not to be liable for defaming statements found on its service. The rationale behind the decision was the lack of editorial control. The court was explicit: “[The provider] has no more editorial control over such a publication than does a public library, book store, or newsstand, and it would be no more feasible for [it] to examine every publication it carries for potentially defamatory statements than it would be for any other distributor to do so. . . .” (*Cubby Inc. v. CompuServe Inc.*, 776 F.Supp. 135 (S.D.N.Y. 1991).)

Using the Publisher Model

Courts have likened domains and websites to printed periodicals. (*U.S. v. Baker*, 890 F.Supp. 1375 (1995).)) In the past, printed materials have received the strongest protection of the First Amendment, and safeguards have been weaker where the broadcast media are concerned. Thus broadcasters have been held responsible for identifying the speaker when airing political campaign endorsements. (*Loveday v. Federal Communications Commission*, 707 F.2d 1443.) However, the restraints on broadcasting have relied on the *scarcity of bandwidth* rationale that cannot be said to apply to the Internet. (*Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367 (1969).)

The endorsement by a publisher (e.g., “Good Housekeeping Seal”) of an advertising claim in the publisher’s magazine makes the publisher liable for negligence when the product advertised injures a reader. (*Hanberry v. Hearst Corp.*, 81 Cal. Rptr. 519 (Cal. Ct. App. (1969).) Not all advertising in a magazine is treated as being endorsed by the publisher. However, advertising has been held to make the publisher liable for injury when the publisher should have known the product being advertised was dangerous, even though the publisher did not create the contents. This means that you must beware of advertising you accept for publication on your site.

Implication for Internet Hyperlinks

Hyperlinks are elements that serve to bring a user to another web page or to other web resources. Hyperlinks can be text links, images, buttons, or other elements in a website. The *buy button* that brings a user to the checkout portion of an e-commerce site is a typical example of a hyperlink. Often text links are underlined to distinguish them from ordinary text. Depending

on the settings of your computer, your mouse pointer on the screen may change shape when it points to a hyperlink—for example, the pointer may change from an arrow to the image of a hand, indicating that the user may click on the link to be taken to a new destination.

Hyperlinks can be and are commonly established without reference to the domain name of the linked-to site. (*Intermatic Incorporated v. Dennis Toeppen*, 1996 U.S. Dist. LEXIS 14878.) A hyperlink for a map of Greenwich Village might lie behind the words “Greenwich Village.” A hyperlink to a catalog of products might simply have a representation of the catalog, which when clicked will activate a hyperlink.

The fact that you may have a hyperlink to another website does not mean that your contents and the linked contents are considered to be one and the same. If your website contains nothing but e-commerce catalogs, but has references to another website that has political speeches, the information on the website with the trademark does not become a political speech, too.

However, the U.S. Supreme Court has also stated the reverse proposition—informational literature does not turn into commercial speech simply because the published piece contains advertising for related products, even if the publisher was economically motivated for producing the piece. (*Bolger v. Youngs Drug Products Corp.*, 463 U.S. 60 (1983). The Supreme Court concluded, nonetheless, that the material in question in this case—informational flyers promoting prophylactics—were commercial speech because other evidence, including the concession of the publisher, supported that conclusion.) Consequently, it is most likely that your own content will speak for itself. It will neither be tainted nor can it borrow the characteristics of linked contents.

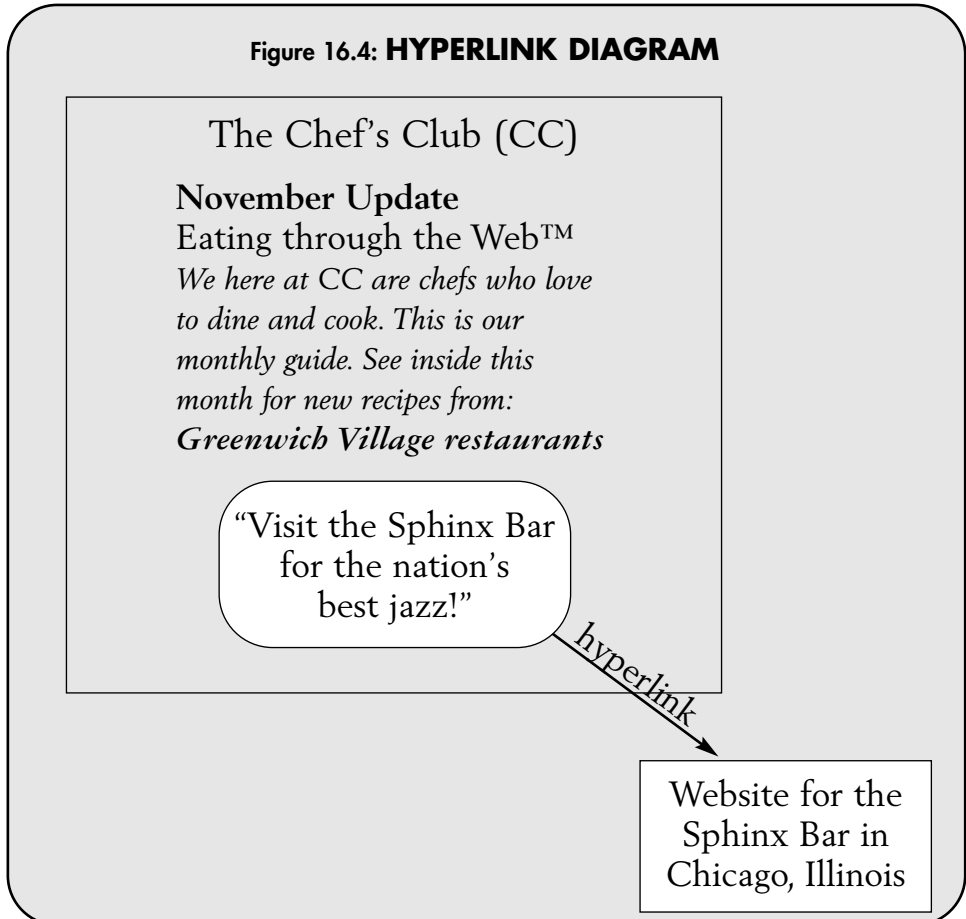
Summary

Trademarks on the Internet, either in domain names or website pages, identify a person or a group as responsible for creating or delivering the contents. Different models used to characterize the owner of the domain or web page—publisher, distributor, individual, anonymous individual—imply differing amounts of responsibility for the contents. The applicability of these different models to the Internet remains uncertain in the courts because the cases to date have almost all involved other media.

A website's contents may be classified as commercial or noncommercial speech. If the trademark implies the content is commercial speech, the contents receive a certain type of protection, usually less than the full First Amendment protection afforded to noncommercial speech. Trademarks usually identify commercial speech, but organizations may associate their mark or name with noncommercial speech. However, linking commercial speech in an indirect way to a current news topic does not by itself transform commercial speech into editorial speech.

The use of trademarks on the Internet, therefore, has important implications for the owners of those marks. The entrepreneur who develops a Web presence must be mindful that the use of trademarks and service marks, and the publication of content on a website, all carry potential liabilities.

Figure 16.4: HYPERLINK DIAGRAM



The Publisher Model in Action

The various regulations and responsibilities in media law can present a complex set of variables to the publisher. The following example, given in conjunction with Figure 16.4, will highlight some of these variables and demonstrate how a well-meaning Internet publisher can invoke several aspects of mass media law in the ordinary course of business.

EXAMPLE: CC, a club for dues-paying members organized in Wisconsin, decides to put up a website guide offering monthly updates on where and where not to eat. To help defer costs, CC decides to rent out some of the space on its popular site to restaurants and nightclubs, offering hyperlinks to those that also have websites. The consultant that CC hires to design the site also takes the ads over the telephone, and takes an ad from, and enters the Internet Protocol Address for, the Sphinx Bar in Chicago, Illinois. The Sphinx Bar in New York's Greenwich Village sues CC for trademark infringement.

Defenses for CC include positioning itself as the publisher of a periodical. In the case of *It's in the Cards, Inc. v. Fuschetto* (23 Media L.Rptr. 2082 (Wis. App. 1995)), a posting of private information on an Internet bulletin board organized in Wisconsin invoked a state law requiring that libel claims against newspapers and periodicals be brought to the attention of the periodical, and the periodical be given an opportunity to retract the statement prior to commencing a lawsuit.

The court determined that the plain meaning of *periodical* meant a publication that is published at regular intervals. Because the bulletin board service in this case posts messages at irregular intervals, it did not qualify as a periodical, according to the court. However, in CC's case, since CC's Internet offering is published monthly, it should be qualified as a periodical under Wisconsin law. Therefore, by law, The Sphinx should be required to offer CC a chance to retract before bringing suit.

A second line of defense for CC is to move to dismiss for lack of personal jurisdiction. In *Bensusan Restaurant Corporation v. King*, (96 Civ. 3992 (SHS) (1996 U.S. Dist. LEXIS 13035), the owner of the New York City Blue Note nightclub sued a Columbia, Missouri nightclub of the same name for trademark infringement, but only after the Missouri club created a “Blue Note” website. The court dismissed the case, saying that the New York club’s allegations were insufficient to support a finding of *long-arm jurisdiction*, which would give the party with the grievance the right to sue someone from out of state on the aggrieved party’s home turf.

The court reasoned that even though a New York resident could find the site and gain access to it:

- the user would have to own a computer, have Internet access, and take affirmative steps to access the site;
- the person would have to call the Missouri box office in order to reserve tickets to the club; and, finally,
- the user would have to go to Missouri to get the tickets and see the show.

Even if the person was still confused, the confusion would be occurring in Missouri, not New York.

However, the court maintained that “the mere fact that a person can gain information on the allegedly infringing product is not the equivalent of a person advertising, promoting, or otherwise making an effort to target its product in New York.” This implies that the inclusion of the hyperlink in an article about Greenwich Village might be construed to have been intentional advertising in New York.

This brings us to CC’s third line of defense—although the referenced hyperlink appeared in its periodical, it was a paid advertisement and therefore, as long as CC was not aware of any falsity or implied falsity, the plaintiff must look to the advertiser for relief, if any. In *Yuhas v. Mudge*, (322 A.2d 824 (N.J. Super. Ct. App. Div. 1974)), the court concluded that a magazine had no legal duty to the public unless the magazine guarantees, warrants, or

endorses the product. “To impose the suggested broad legal duty [to investigate advertisements] upon publishers of national circulated magazines, newspapers and other publications, would not only be impractical and unrealistic, but would have a staggering adverse effect on the commercial world and our economic system.” (Id. at 825.) Also, in *Hernandez v. Underwood* (7 Media L. Rptr. 1535 (N.Y. Sup. Ct. 1981)), the court held that Newsday had no duty to investigate each of the advertisers that purchased space in its papers. Requiring media to investigate every ad is unrealistic and impractical, said the court.

The weak spot in this line of argument is the lack of notice that the hyperlink was an advertisement. There was no notice that the hyperlink was part of a paid notice. The publishers were free to disown the ad’s contents, but the website visitor does not realize that the contents were not put forth by the publisher, which may be misleading. It may be held to imply endorsement, in which case, as in *Hanberry v. Hearst*, (81 Cal. Rptr. 519 (Cal. Ct. App. 1969)) the publisher does assume some liability.

Finally, Section 43(a) of the Lanham Act 15 U.S.C. Section 1125(a) explicitly provides that publishers and broadcasters of advertisements that violate Section 43(a) will not be liable for damages provided that they are “innocent violators.” (15 U.S.C. Section 1114(2)(B).) If CC can maintain its position as publisher, this should exonerate it.

A black starburst shape with a white border, containing the word "Alert!" in white, bold, sans-serif font.

Alert!

Beware what you put on your site. It is best to consult an attorney if you are sued or threatened with suit because of content or links on your site.

Conclusion

- ▶ **The Future Prospects**
- ▶ **Standard Business Tool**
- ▶ **Marketing**
- ▶ **Opening Up International Possibilities**
- ▶ **This Is Only the Beginning**

Over the last few centuries, legislatures and courts have developed specific rules for dealing with every sort of business situation. One example relates to the mailing of letters by ordinary mail—complicated rules govern the time at which offers are deemed to have been made or responded to, by outlining every possible sequence of mail-and-reply combinations that can happen through standard mail, using postmarks as a guide for the sequence. As use of communications over the Internet becomes standard, rules will develop that will govern all the new Internet parameters. Authentication of email contents, mailing times, and receipt times will be called for as a means of self-protection.

Business on the Internet can be rooted in the same legal and financial basics as any traditional brick-and-mortar enterprise. At the same time, certain features of the Internet can bring you face-to-face with legal aspects of the business world that some companies never have to face, and some only face when they are well-established. These issues, such as mass media law, computer law, and intellectual property law, can be a lot to handle in addition to forming the right kind of company, getting financing, and dealing with sales, marketing, inventory, contracts, and human resource issues. Done correctly, dealing with each of these areas can put real strength behind your new company. We see these laws continuing to evolve to embrace Internet-based transactions. As a business owner, you need to keep current on the nature of the rules governing your Internet transactions.

The Future Prospects

We see a few basic things happening in the near future:

- the Internet becomes standard business tool—e-commerce will be accepted in all commercial transactions;
- the Internet used as an adjunct to existing businesses;
- the Internet changes business, but does not displace traditional businesses;
- the international use generates new possibilities;

- the increase in the numbers of websites and users; and,
- the novelty of the Internet decreasing, and the reliability increasing.

Standard Business Tool

Your clients, investors, and suppliers will come to expect a website for every business, and many already do. Your employees will rely on Internet access and email in the ordinary course of their workday. Email letters and their attachments will carry business information, contracts, orders, specifications, and every other facet of business.

Marketing

Increased numbers of websites and increased numbers of users who expect a Web presence and ecommerce facilities have already made an impact on the business community. Usefulness will become the key parameter in potential customers' choice of where to go to get the services they need. You will need to maintain your Internet presence and constantly be vigilant about competition and your user community.

Opening Up International Possibilities

The Internet is comprised of many individual inventions, but no one group or individual invented it, and no one group controls it. It is fairly reliable and naturally robust due to its shared components, yet no one individual, group, or agency is responsible for keeping it running. We will not speculate as to the Internet's ability to change the world, but it is going to be added to the forces of social change, for good or ill. Because of the Internet's decentralized nature, traditional political boundaries are relatively small barriers to Internet information.

In business terms, in the future the Internet will bring widening access to international markets. Traditional boundaries may not stop the retrieval of information, but they can stop goods and services from flowing. Care has to be taken when entering the international arena. Tariffs, duties, international shipping charges, and monetary exchange rates may all need to be added to your profitability equation.

Different laws govern other countries. You will be subject to those laws in your efforts to collect money and to guard your intellectual property. International standards and agreements are being developed in some of those areas—for example, the World Intellectual Property Organization (WIPO) presents a forum for trademark and patent protection in over 100 member countries worldwide. However, not every country in the world is a member. Additionally, policing the use of your intellectual property rights and enforcing violations of those rights is still up to you.

Once you are on the Internet, you are part of and subject to worldwide access, automatically. That means you should make yourself aware, periodically, of developments in international business relations and their implications for your business.

This Is Only the Beginning

The Internet has engendered a lot of discussion as to its future. We believe the Internet has just begun to have its impact felt on our society and the world at large. Children born today may find it hard to imagine a world without it, just as we can sometimes today take telephones and radios for granted. Understanding the Internet's evolution and potential while conducting a profitable business will take initiative, money, patience, dedication, mental energy, and common sense. We hope that you find our guide helpful in clearing your path to success.

Glossary

A

accredited investor. A person or entity that meets certain net worth or income requirements such that they can withstand the loss of an entire investment. Defined in Reg D.

Anti-Cybersquatting Consumer Protection Act. A federal law that provides for the liability of a cybersquatter to a trademark owner if the person acts in bad faith to profit from the trademark.

articles of organization. *See* certificate of organization.

assignable contract. A contract under which one or more parties to the contract may assign their rights and obligations to another party.

auctions, reverse auctions. Online auctions use the same concepts that apply to real-life auctions—offering something for sale and receiving bids on the item, with the item going to the highest bidder. Reverse auctions allow a potential buyer to name a price that buyer is willing to pay. That price is made available to potential suppliers through the website. If one of them is willing to sell the item for the named price, the sale is made.

authorized shares. When a corporation is formed, it is divided into parts called shares. The number of shares that comprise 100% of the company can vary. In theory, there could be only one share, owned by one person, which would comprise 100% of the company. More often, the corporation is formed with multiple shares, which can range from a small number (often two hundred shares) to a large number (fifty million shares or more). After the number of shares is decided upon, that number is noted in the company formation documents. The maximum possible shares described in those documents are the authorized shares.

B

B-2-B. *See* business-to-business transactions.

B-2-C. *See* business-to-consumer.

bulletin board service. A website that allows third parties to post information on the site. Some bulletin board services monitor, and may edit, the submitted material, sometimes by screening out offensive words. Others simply provide the website as a medium of exchange among contributors and do not have any control over the content.

business-to-business. Transactions in which one company sells products directly to another company, for resale sometime later on, possibly after additional work is performed.

business-to-consumer. When a retailer sells individual items to a customer, such as in a department store or a grocery store.

buy-sell agreement. *See* shareholders' agreement.

C

capitalized, adequately. The corporation has a sufficient amount of assets to meet its reasonably foreseeable needs without placing one's personal assets at risk.

C corporation. One of the types of entities under which you may do business and achieve the protections of limited liability. That is, the liabilities incurred by that business would be in most cases limited to those assets owned by the company. In other words, someone who wins a lawsuit against the corporation cannot take the owner's personal assets.

certificate of organization. The document that creates a corporation and is filed with the state.

Child Online Protection Act (COPA). The *Child Online Protection Act* or COPA, makes it a federal crime to use the Web to communicate for commercial purposes material considered harmful to minors with severe monetary penalties and also possible jail time.

Children's Online Privacy Protection Act (COPPA). If you have a website aimed at children in particular, or even if your site would simply tend to attract children, the *Children's Online Privacy Protection Act* (COPPA) requires you to post information on how you plan to use information you gather. It also requires you to notify parents of your plan to collect the information. The act has several other requirements intended to safeguard children 13 years of age or younger.

Communications Decency Act (CDA). The *Communications Decency Act* (CDA) was enacted as part of the *Telecommunications Act of 1996*. CDA

made Internet transmission of “indecent” materials to minors a criminal offense. In 1997, the Supreme Court ruled unanimously that the CDA was an unconstitutional restriction on the Internet.

convertible note. A variation on an ordinary loan, this note allows the lender the option of converting all or part of the loan to equity based on certain formulas.

copyright. The legal right granted to an author, composer, playwright, publisher, or distributor to exclusive publication, production, sale, or distribution of a literary, musical, dramatic, or artistic work. This allows the copyright's owner to prevent a copier from using the copy or copies, and compensatory damages under certain conditions.

corporation. A body that is granted a charter recognizing it as a separate legal entity having its own rights, privileges, and liabilities distinct from those of its members. Corporations are entities created by the state in which they are formed.

cybersquatting. The registration and use, in bad faith and for profit, of someone else's trademarked name as a domain name. The intention is often to sell the domain name to the trademark holder at exorbitant prices.

D

defamation. The act of maliciously injuring the good name of another. The information must be false and must injure the person to whom it refers. The injury could be nonspecific, that is, it could injure the person's reputation generally.

domain name. A series of letters used to name organizations, computers, and addresses on the Internet. Every computer on the Internet has an address that is a series of numbers much like a telephone number. (In technical jargon that address is called the *Internet Protocol* or *IP address*.)

E

Electronic Customer Relationship Management (ECRM) Systems. The name given to computer software that is used to track a company's relationships with its customers. Names of customers are linked to information about such basic things as the customer's address and phone number, and also to information on the company's products and sales. ECRMs may also provide automatic responses to email questions, allow for online, real-time customer service chat sessions in lieu of telephone conversations, and have other features that reduce and manage customer call volume. These systems also may house information about existing contracts with various clients, display pricing options for clients, and prompt the company at certain times.

encrypted transaction. For certain transactions a computer program scrambles (*encrypts*) the message into a code that is unscrambled (*decrypts*) by the receiving computer, which by prearrangement has the key to the encryption code used to send the message. If a website has a provision for credit card sales, most often encryption is used to protect the information.

equity investment. This occurs when someone invests in your company by buying shares of stock or other type of equity.

F

fair use. Copyrighted material is protected against those who would make copies for their own use without payment to the copyright owner. However, there are certain exceptions called fair use exceptions. One example of fair use is for education. A teacher is permitted to make copies of material for use in the classroom. Generally, there is no fair use exception available to the typical website owner that allows him or her to use someone else's material.

fictitious name certificate. A document that is filed with the local government (town, city, county, or state, depending on where you live) that puts

the public on notice that you are an entity doing business through a trade name.

fulfillment notification to permit settlement. This is part of the sequence of transactions that occurs when someone makes a purchase on a website using a credit card. After authorization for the purchase is given by the credit card issuing bank, the seller informs the bank that he or she is ready to actually fulfill the order, that the goods are in stock and can be shipped, or that services being purchased are about to be delivered or have been delivered to the buyer. Credit card issuing companies usually have their own individual sets of rules governing the time frames involved.

H

host system. The computer where the webpages and content of a website reside. This can range from a single personal computer to a large complex network of computers.

html. Hypertext Markup Language. A language used to structure text and multimedia documents and to set up hypertext links between documents used only on the World Wide Web.

hyperlinks. Strings of letters (and possibly, numbers) that lead you automatically to a webpage when you click on the link with your keyboard or mouse. The webpage may be another page in your own website or may be in a different website.

I

infringement of copyright. Making copies of copyrighted material without permission of the holder of the copyright. Gaining permission may involve the payment of royalties to the copyright owner, or the owner may freely grant it.

Initial Public Offering (IPO). The first time a corporation offers its stock to the public, or “goes public.”

Internet Corporation for Assigned Names and Numbers (ICANN). The nonprofit corporation that has responsibility for the IP address space allocation, protocol parameter assignment, domain name system management, and root server system management functions previously performed under U.S. government contract by IANA (Internet Assigned Numbers Authority) and other entities.

Internet Service Provider (ISP). A company that provides other entities and individuals with access to, or presence on, the Internet. Most ISPs are also Internet access providers; extra services include help with design, creation and administration of World Wide Websites, training, and administration of intranets.

Internet Tax Freedom Act of 1998. This act prohibits state and local governments from taxing Internet access fees, except for those states that have been doing so prior to October of 1998.

intranet. A privately maintained computer network that can be accessed only by authorized persons, usually members or employees of the organization that owns it.

J

joint venture. A partnership, usually one formed for a specific project.

judgment. A determination of a court of law; a judicial decision.

L

libel. A false publication, as in writing, print, signs, or pictures, that damages a person's reputation. Libel is a type of defamation.

limited liability company (LLC). A legal entity with characteristics of both a corporation and a partnership. The tax treatment of an LLC is similar to that of a partnership. That is, the income is not taxed at the entity level, but at the equity owner level. But the LLC also has the benefit of limited liability, meaning that the owners are not personally liable for the business's debts and obligations. Its limited liability protection is similar to that of a corporation.

limited liability entity. An entity whose equity owners are not personally liable for the entity's debts and obligations, such as a corporation, LLC, limited liability partnership, or limited liability limited partnership.

limited partnership. In a limited partnership, there are one or more general partner(s), who do not enjoy limited liability status, and one or more limited partners, who do. The limited partners cannot participate in the running of the entity's business, or their limited liability status will be jeopardized.

M

meta. An element, with the tag name of *META*, expressing certain key information about a given HTML document. The *META* element can be used to identify properties of a document (e.g., author, expiration date, a list of key words, etc.) and assign values to those properties. It is used by search engines to help categorize web pages.

N

non-compete provisions. Provisions of a contract which restrict a person's ability to compete with his former employer.

nonprofit corporation. An entity recognized as a legal person that is set up so that none of its income can be distributed to its members, officers, or directors.

P

parent company. A company that owns and controls one or more other companies, which are called subsidiaries.

partnership. An arrangement between two or more persons who agree to pool talent and money and share profits or losses for the purpose of undertaking some sort of business.

pay-per-click search engines. This is one way to pay for advertising through a search engine in order to get targeted traffic. Sites vary in how they set up account balances or the way they charge. Basically, you set up key words that are important for your site and pay the search engine when a user searches the word that you have selected. The more you pay, the higher up on the search results your site will be listed.

piercing the corporate veil. Holding the equity owners of a corporation or limited liability company personally liable for the company's debts and liabilities. This is a legal remedy that can be used to obtain the assets of a company's shareholders or equity owners to satisfy a judgment against the company. A court will only allow the piercing of the veil in limited circumstances. Some of the factors that may lead a court to pierce the veil are the commingling of personal and company assets; failure to observe company formalities; failing to hold oneself out to the public as a limited liability entity; undercapitalization; use of company assets for personal purposes; and, failure to make legally required filings.

private placement. An offer and sale of securities by an entity to a limited number or category of persons.

professional corporation. A corporation owned and run by certain professionals such as accountants, lawyers, or doctors. Most states allow certain

professionals to incorporate only as a professional corporation. Although the corporation does have limited liability status, it does not protect the professionals from malpractice liability nor does it alter professional responsibility or privilege.

Project Evaluation and Review Technique (PERT). A method, using diagrams, where flowcharts work responsibilities in a complex project so that all tasks stay coordinated and bottlenecks can be foreseen and avoided. In addition, the effects of changes in the project plan can be readily evaluated.

R

request for proposal (RFP). This is a document that is sent to various suppliers in order to develop a basis for computing costs relating to specific items, services, concepts, etc. that a supplier will provide.

S

scalable. Capable of being expanded in size or function without having to alter the existing structure or mechanisms.

S corporation. A corporation that has made an official election under federal law to be treated similarly to a partnership for purposes of tax law. The tax attributes of the corporation flow through to its equity owners and are taxed only at the owner level. This is called *flow through taxation*.

secured loan. These are loans that are backed by collateral, which are assets of some kind that the lender will obtain if a loan is not paid back.

service mark. Any word, name, symbol, device, or any combination used, or intended to be used, in commerce to identify and distinguish the services of one provider from services provided by others, and to indicate the source of the services.

shareholders' agreement. An agreement among shareholders governing the sale or other transfer of shares, and usually including what happens if a shareholder working for the corporation leaves the job, is fired, dies, or becomes disabled.

shares. When a corporation is formed, it is divided into parts called shares. The number of shares that comprise 100% of the company can vary. In theory, there could be only one share, owned by one person, which would comprise 100% of the company. More often, the corporation is formed with multiple shares, which can range from a small number (often two hundred shares) to a large number (fifty million shares or more).

shopping cart. On a retail website, a function that holds the items you have selected for purchase until you are ready to complete the order.

slander. A false statement, not in writing, that damages a person's reputation. Slander is a type of defamation.

sole proprietorship. A business owned and managed by one individual, not incorporated, and not having limited liability status. The owner of a sole proprietorship is personally liable for the business's obligations.

Strategic Lawsuits Against Public Participation (SLAPP). Civil complaints or counterclaims against either an individual or an organization in which the alleged injury was the result of petitioning or free speech activities protected by the First Amendment of the United States Constitution. SLAPPs are often brought by corporations, real estate developers, or government officials and entities against individuals who oppose them on public issues. Typically, SLAPPs are based on ordinary civil tort claims such as defamation, conspiracy, and interference with prospective economic advantage.

subsidiary. A company that is managed and owned by another company, the parent.

subtractive test. A legal test that is used to analyze a copyrighted work by eliminating the non-copyrightable elements and comparing only the copyrightable elements of the copyrighted work to the allegedly infringing work.

T

totality test. A legal test that compares two works using a *total concept and feel standard* to determine whether they are substantially similar.

trademark. Any word, name, symbol, device, or any combination used, or intended to be used, in commerce to identify and distinguish the goods of one manufacturer or seller from goods manufactured or sold by others, and to indicate the source of the goods. A brand name.

trademark dilution. Use of a trademark by one other than its owner, in a context where there is not a likelihood of confusion to the public, but where the use of the trademark by the subsequent user will lessen the uniqueness of the prior user's mark and thus weaken the mark.

U

underwriter. One who participates in the distribution of securities, often in an initial public offering.

Uniform Dispute Resolution Policy (UDRP). This is the policy that governs the resolution of disputes over domain names. unsecured loan. Loans that are not backed by collateral and are much riskier for the lender.

The United States Patent and Trademark Office (USPTO). An agency of the U.S. Department of Commerce that grants patents for the protection of inventions and registers trademarks and service marks. Its website has additional information and can be found at www.uspto.gov.

unsecured loan. A loan that is not backed by collateral and is much riskier for the lender.

V

virtual community. A website, or collection of sites, that is used or visited by people or entities sharing similar beliefs, values, interests, disabilities, etc.

W

website architecture. The infrastructure of a website, how it looks and functions, how the user interacts with it, and all the components that go into its structure and how it works.

Appendix

A

Basic Legal Concepts with Business Implications

This list serves as a quick reference for important legal concepts that might affect your Internet business. Through this list, you can easily locate information on the ownership of your software, the *Uniform Computer Information Transactions Act* (UCITA), and contracts used in your business. The legal concept regarding each is listed first, followed by the impact it may have on your business. There is also information that you can quickly reference on lawsuits that might arise from your business contracts, including the basic legal procedure involved and the major issues that might arise.

Ownership of Software

Legal Note

- Copyright belongs to the creator, unless the creator is an employee, or the work is otherwise done as a *work for hire*.

Business Implications

- If the creator is an employee of the company (or other employer) and does work within the scope of his or her employment, the work is a work for hire and the copyright belongs to the company (or other employer).
- If the company buys the time of the creator as work for hire, for example by contract with the programmer as a consultant, the company owns the copyright to the software.
- The company may use, sell, or license the software.

Legal Note

- Work for hire other than by an employee is ALWAYS through a written agreement, never implied or assumed.

Business Implication

- You should have a work-for-hire contract ready to use with contract programmers.

Legal Note

- Even if the company develops the software from scratch, if the process is patented by a different entity, the company cannot use or sell it. (Example: The one-click checkout process patented by Amazon.com)

cannot be used by others even if they write similar one-click checkout software themselves.)

Contracts

Legal Note

- Verbal and written contracts are both valid.

Business Implication

- Even if there is no signed contract, a contract may exist by way of the parties' oral statements, or even by their behavior (e.g., performance and payment).

Legal Note

- Contract law

Business Implications

- If there is no signed contract, the agreement between the parties is governed by state or federal law, depending on the subject matter. Many general contract principles are outlined in the Uniform Commercial Code (UCC) adopted by many states.
- There is an extension of the UCC called "UCITA" which specifically applies to electronic commerce (see below).

Legal Note

- Contract law model (Performance – Cost of Performance = Profit)

Business Implication

- In the majority of computer-related contracts, the buyer is entitled to “performance” done in a “workmanlike” manner according to “industry standards.”

Legal Note

- Buyer protection

Business Implication

- If performance is lacking, substandard, or late, the buyer may recover damages because of the provider's failure to perform. Damages may be limited in whole or in part by your contract language.

Legal Note

- Seller protection

Business Implication

- If the buyer fails to pay, or cancels midway through the project, ordinarily the contractor/performer is entitled to the profit he would have made, minus any savings due to the cancellation, unless unusual or offsetting circumstances exist.

Uniform Computer Information Transactions Act (UCITA)

Legal Note

- Proposed guidelines for e-commerce transactions, which have been adopted by many states

Business Implications

- Primarily defines the buyer/seller relationship in an e-commerce transaction.
- Some attorneys specialize in UCITA and related concepts.

Contract Lawsuits

Legal Steps

- Prove existence of agreement.
- Prove breach of agreement (failure of one side to perform or pay).
- Prove damages due to breach (loss of profit, damage to business).

Legal Process

- Complainant files suit with the court (unless an arbitration or mediation provision applies).
- Defendant answers the charges to the court, and perhaps makes counterclaims against the other party.
- Period of *discovery* (oral and /or written questions from the each side to the other, which must by law be answered truthfully). These discovery interviews are called *depositions*.
- Legal *briefs* are submitted to the court by each party. *Briefs* are legal arguments explaining why a party should prevail.
- Trial
- Expense

- Timeframe for this process: 1–5 years
- \$5,000–\$10,000 retainer common
- \$20,000–\$100,000 legal fees not unusual
- Time and attention of management

Legal Alternatives

- Mediation—Nonbinding attempt to compromise.
- Arbitration—Binding (usually; depends on arrangement between parties) ruling given by arbitrator, but no explanation of reasoning is given. If binding, no appeal is possible, and the decision will be enforced by courts.

Legal Problems

- Determine breadth of problem
- Estimate damages
- Estimate costs
- Identify business implications
- Legal fees
- Time away from business
- Reputation in industry
- Get legal opinion
- Determine course of action

Appendix

B

Sample Business Worksheets

Use these sample worksheets to start and run your business. Feel free to copy all or parts of these worksheets, or modify them to fit your individual needs. We hope that they give you valuable ideas and will serve as a way for you to get started in finding what methods work best for your own financial, technical and business needs.

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Financial Worksheet

page 1

Monthly P&L	Year 1 Month 1	Year 1 Month 2	Year 1 Month 3	Year 1 Month 4	Year 1 Month 5	Year 1 Month 6
Revenue						
Item or Service 1						
Item or Service 2						
Item or Service 3						
Item or Service 4						
Item or Service 5						
Total Revenue						
Cost of Sales						
Parts, components						
Sales commissions						
Inventory						
Shipping						
Other						
Other						
Total Cost of Sales						
Detailed Expenses						
Compensation						
Bonuses						
Benefits						
Total Salaries and Benefits						

Financial Worksheet

page 2

Monthly P&L	Year 1 Month 1	Year 1 Month 2	Year 1 Month 3	Year 1 Month 4	Year 1 Month 5	Year 1 Month 6
<i>Marketing and Advertising</i>						
Advertising Expense						
Direct Mail Campaigns						
Conventions & Shows						
Research Material						
Travel						
Customer Service						
Total Marketing & Advertising						
<i>Monthly Infrastructure</i>						
Rent						
Electric, other utilities						
Website Communications						
Website Hosting						
Phone (local and long distance)						
Cell Phone/Pagers						
Office Supplies & Misc.						
Stationery & Business Cards						
Postage and delivery						
Insurance						
Total Monthly Infrastructure						
<i>Professional Services</i>						
Legal Fees						
Accounting Fees						
Consultants						
Total Professional Services						

Financial Worksheet

page 3

Monthly P&L	Year 1 Month 1	Year 1 Month 2	Year 1 Month 3	Year 1 Month 4	Year 1 Month 5	Year 1 Month 6
P&L Summary						
Total Revenue						
<i>Subtract:</i>						
Cost of Sales						
Gross Profit						
<i>Subtract:</i>						
Salaries & Benefits						
Marketing & Advertising						
Monthly Infrastructure						
Professional Services						
Total Expenses						
Corporate Reinvestment						
Debt Payments						
Net Profit						
Basic Cash Flow						
Net Profit						
<i>Subtract:</i>						
Capital Expenditures						
Office Build-Out						

Financial Worksheet

page 4

Monthly P&L	Year 1 Month 1	Year 1 Month 2	Year 1 Month 3	Year 1 Month 4	Year 1 Month 5	Year 1 Month 6
Office Equipment						
Office Furniture						
Computer Hardware						
Communications Devices						
Software						
Phone System						
Other Capital Expenses						
Capital Expenditures						
Cash after Capital Expense						
<i>Add:</i>						
Investments/Loans						
Cash Balance						

Technical Budget Worksheet

page 1

Staffing
In-House Technical Staff

Year 1
1st Qtr

Year 1
2nd Qtr

Year 1
3rd Qtr

Year 1
4th Qtr

Year 2
1st Qtr

Department/Position	Annual						
	Salary						
Customer Service							
Director							
Phone Support Rep							
Technical Support Rep							
Marketing							
Director							
Research							
Technical Operations							
Programming							
Hardware							
Graphic Designer							
Content Management							
Editor							
Editor							
Advertising Management							
Director, Advertising							
Ad sales							
Advertising Analyst							

Technical Budget Worksheet

Staffing
In-House Technical Staff

Year 1 1st Qtr	Year 1 2nd Qtr	Year 1 3rd Qtr	Year 1 4th Qtr	Year 2 1st Qtr
---------------------------------	---------------------------------	---------------------------------	---------------------------------	---------------------------------

Department/Position	Annual	Year 1 1st Qtr	Year 1 2nd Qtr	Year 1 3rd Qtr	Year 1 4th Qtr	Year 2 1st Qtr
Salary						
Technology and Operations [8]						
Director, Internet Technology						
Director, Internet Operations						
Manager, Technical Administration						
Operations Technical Administration						
Operations Technical Team Lead						
Technology and Operations Support						
Director, Information Services						
LAN/PC Support						
Manager, Quality Assurance						
Quality Assurance Engineer						
Office						
Office Manager						
Receptionist						
Total Salary Expense						
Benefits @ 25%						
Bonuses						
Recruiting fees@25%						

Technical Budget Worksheet

page 3

Staffing	Year 1	Year 1	Year 1	Year 1	Year 2
Outsourced Developmental Costs	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr

	Hourly	#
	\$	Hours
Project Mgr/Senior Dev	150-250	200
Senior Developer	150-200	175
Database Developer	125-175	150
Database Admin	125-175	150
Developers/Programmers	120-175	135
Operations Staff	115-135	125
System Admin	115-150	125
Firewall Admin	115-150	125
Networking	115-150	125
Total		

(Amounts listed in above worksheet represent only a *possible range* that could be used.)

Vendor Chart

page 1

		Vendor 1 Score	Vendor 1 Weighted Score	Vendor 2 Score	Vendor 2 Weighted Score	Vendor 3 Score	Vendor 3 Weighted Score
Criteria	Weight	Col B	A X B	Col C	A X C	Col D	A X D
Design	Col A						
Programming skills							
Maintenance required on system							
Project management abilities of vendor							
Integration with legacy systems							
Performs system functions defined in specifications							
Performance related issues:							
Time it takes to perform defined functions							
Speed at which users receive a response from the system							
Communications rates							
Data storage and retrieval							
Production and reports							
System backups							
Other							
Other							

Vendor Chart

page 2

	Weight	Vendor 1 Score	Vendor 1 Weighted Score	Vendor 2 Score	Vendor 2 Weighted Score	Vendor 2 Score	Vendor 2 Weighted Score
Criteria							
	Col A	Col B	A X B	Col C	A X C	Col D	A X D
Vendor Plan shows deliverable components and a timetable for each delivery							
Plan shows cost of each component and conditions under which payments will be made (payment cycle allows time for testing, etc.)							
Plan shows testing procedures for acceptance and related payments for accepted components							
Plan shows final testing of integrated components in one system							
Communications issues—specifically, capacity and reliability (guarantees on uptime and ability to connect to the website)							
Planning for peak load capacity (X number of simultaneous users)							
Compatibility with other systems							

Vendor Chart

	Weight	Vendor 1 Score	Vendor 1 Weighted Score	Vendor 2 Score	Vendor 2 Weighted Score	Vendor 3 Score	Vendor 3 Weighted Score
Criteria							
	Col A	Col B	A X B	Col C	A X C	Col D	A X D
Interaction with other systems (input produced for other systems, such as inventory or financial systems, and output to be accepted from other systems, such as credit card authorization)							
Future upgrades							
Maintenance issues such as data backups, phone support and onsite support, including response times and the scope of ongoing responsibilities							
Other:							

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