

4th edition

# **Nolo's Encyclopedia of Everyday Law**

**Answers to Your Most Frequently  
Asked Legal Questions**

edited by Attorneys Shae Irving,  
Kathleen Michon and Beth McKenna



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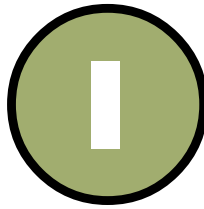
### Glossary

# Houses



*Home is heaven for beginners.*

—CHARLES H. PARKHURST



- 1.2 *Buying a House*
- 1.9 *Selling Your House*
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**B**uying or selling a house is a major undertaking. To do it right, you need to understand how houses are priced, financed and inspected; how to find and work with a real estate agent; how to protect your interests when negotiating a contract; and how legal transfer of ownership takes place. This chapter covers many of the basic issues that buyers, sellers and owners need to know.

# Buying a House

Before you look for a house, it's essential to determine how much you can afford to pay and what your financing options are. You'll also need to decide whether you want to work with a real estate agent or broker, and finally, even if you think you've found your dream home, you'll need to master the ins and outs of house inspections. This section will help you find your way through the house-buying maze—and to your new front door.

**I'm a first-time home buyer. Is there any easy way to determine how much house I can afford?**

As a broad generalization, most people can afford to purchase a house worth about three times their total (gross) annual income, assuming a 20% down payment and a moderate amount of other long-term debts, such as car or student loan payments. With no other debts, you can probably afford a house worth up to four or even five times your annual income.

The most accurate way to determine whether you can afford a particular house is to total up the estimated monthly principal and interest payments plus one-twelfth of the yearly bill for property and homeowner's insurance. Now compare that to your gross monthly income. Lenders normally want you to make

all monthly housing payments with 28%-38% of your monthly income—the percentage depends on the amount of your down payment, the interest rate on the type of mortgage you want, your credit history, the level of your long-term debts and other factors. A bank or other lender can help you determine how much house you can afford.

Or you can run the numbers yourself, using an online mortgage calculator such as those on the websites listed at the end of this chapter.

Once you've done the basic calculations, you can ask a lender or loan broker for a prequalification letter saying that loan approval for a specified amount is likely based on your income and credit history. Prequalifying lets you determine exactly how much you'll be able to borrow and how much you'll need for a down payment and closing costs.

Unless you're in a very slow market, with lots more sellers than buyers, you will want to do more than prequalify for a loan—you will want to be guaranteed for a specific loan amount. This means that the lender actually evaluates your financial situation, runs a credit check and preapproves you for a loan—rather than giving a general prequalification based on your own statement about your income and debts. Having lender preapproval for a loan makes you more attractive financially to sellers than simple loan prequalification and is crucial in competitive markets. Without it, you stand very little chance of your offer being accepted.

## How important is my credit history in getting loan approval?

Your credit history has an important effect on the type and amount of loan lenders offer you. When reviewing loan applications and making financing decisions, lenders typically request your credit risk score from the credit bureaus. This score is a statistical summary of the information in your credit report and includes:

- your history of paying bills on time
- the level of your outstanding debts
- how long you've had credit
- your credit limit
- the number of inquiries for your credit report (too many can lower your score), and
- the types of credit you have.

The higher your credit score, the easier it will be to get a loan. If you routinely pay your bills late, you can expect a lower score, in which case a lender may either reject your loan application altogether or insist on a very large down payment or high interest rate to lower the lender's risk.

To avoid problems, always check your credit report and clean up your file if necessary—before, not after, you apply for a mortgage. For information on how to order your credit report, what to do if you find mistakes in your report and how to rebuild good credit, see *Rebuilding Credit* in Chapter 9, *Your Money*.

## How can I find the best home loan or mortgage?

Many entities, including banks, credit unions, savings and loans, insurance

companies and mortgage bankers make home loans. Lenders and terms change frequently as new companies appear, old ones merge and market conditions fluctuate. To get the best deal, compare loans and fees with at least a half-dozen lenders. Fortunately, mortgage rates and fees are usually published in the real estate sections of metropolitan newspapers and are widely available on the Internet.

Because many types of home loans are standardized to comply with rules established by the Federal National Mortgage Association (Fannie Mae) and other quasi-governmental corporations that purchase loans from lenders, comparison shopping is not difficult, especially if you go online.

Mortgage rate websites come in two basic flavors: those sites that don't offer loans (called "no-loan" sites) and those that do. No-loan sites don't broker or lend mortgage money, but are a great place to examine mortgage programs, learn mortgage lingo, understand underwriting, get questions answered about the loan qualification process, crunch numbers with online mortgage calculators and check your credit.

Many online mortgage sites also offer direct access to loans from one or more lenders. With multi-lender shopping sites, you simply enter the loan amount, property details and other information and you'll get current rates, APR, points, even settlement costs for each loan from dozens of lenders. If you choose to complete



an application, mortgage shopping sites review your application, process the required documentation and ship your loan to the lender for further review and underwriting.

See the list of recommended websites at the end of this chapter for more information on mortgage websites.

If you don't want to shop for mortgages on your own, you can also work with a loan broker, someone who specializes in matching house buyers with an appropriate mortgage lender. Loan brokers usually collect their fee from the lender.

### What are my other options for home loans?

You may also be eligible for a government-guaranteed loan, offered by:

- the Federal Housing Administration (FHA), an agency of the Department of Housing and Urban Development (HUD) (see <http://www.hud.gov/mortprog.html>)
- the U.S. Department of Veterans Affairs (see <http://www.homeloans.va.gov>), or
- a state or local housing agency.

Government loans usually have low down payment requirements and sometimes offer better-than-market interest rates as well.

Also, ask banks and other private lenders about any “first-time buyer programs” that offer low down payment plans and flexible qualifying guidelines to low and moderate income buyers with good credit.

Finally, don't forget private sources of mortgage money—parents, other relatives, friends or even the seller of the house you want to buy. Borrowing money privately is usually the most cost-efficient mortgage of all.

### What's the difference between a fixed and an adjustable rate mortgage?

With a fixed rate mortgage, the interest rate and the amount you pay each month remain the same over the entire mortgage term, traditionally 15, 20 or 30 years. A number of variables are available, including five- and seven-year fixed rate loans with balloon payments at the end.

With an adjustable rate mortgage (ARM), the interest rate fluctuates as the interest rates in the economy fluctuate. Initial interest rates of ARMs are usually offered at a discounted (“teaser”) rate which is lower than those for fixed rate mortgages. Over time, however, initial discounts are filtered out and ARM rates fluctuate as general interest rates go up or down. To avoid constant and drastic changes, ARMs typically regulate (cap) how much and how often the interest rate and/or payments can change in a year and over the life of the loan. A number of variations are available for adjustable rate mortgages, including hybrids that change from a fixed to an adjustable rate after a period of years.

A good loan officer or loan broker will walk you through all mortgage options and tradeoffs such as higher fees (or points) for a lower interest rate.

### How do I decide whether to choose a fixed or an adjustable rate mortgage?

Because interest rates and mortgage options change often, your choice of a fixed or an adjustable rate mortgage should depend on the interest rates and mortgage options available when you're buying, how much you can afford in the short term, your view of the future (generally, high inflation will mean that ARM rates will go up and lower inflation means that they will fall), and how willing you are to take a risk. Very risk-averse people usually prefer the certainty of a fixed rate mortgage, rather than take a chance that an ARM might be cheaper in the long run. However, some people can't afford the relatively higher interest rates at which fixed rate mortgages usually begin.

Keep in mind that lenders not only lend money to purchase homes; they also lend money to refinance homes. If you take out a loan now, and several years from now interest rates have dropped, refinancing may be an option.

### What's the best way to find and work with a real estate agent or broker?

Get recommendations from people who have purchased a house in the past few years and whose judgment you trust. Don't work with an agent you meet at an open house or find in the Yellow Pages or on the Internet unless and until you call references and thoroughly check the person out. The agent or broker you choose should be in the full-time business of selling

real estate and should have the following five traits: integrity, business sophistication, experience with the type of services you need, knowledge of the area where you want to live and sensitivity to your tastes and needs.

All states regulate and license real estate agents and brokers. You may have different options as to the type of legal relationship you have with an agent or broker; typically, the seller pays the commission of the real estate salesperson who helps the buyer locate the seller's house. The commission is a percentage (usually 5% to 7%) of the sales price of the house. What this means is that your agent or broker has a built-in conflict of interest: Unless you've agreed to pay her separately, she won't get paid until you buy a home, and the more you pay for a house, the bigger her cut.

In short, when you evaluate the suitability of a house, it's not wise to rely principally on the advice of a person with a significant financial stake in your buying it. You need to be knowledgeable about the house-buying process, your ideal affordable house and neighborhood, your financing needs and options, your legal rights and how to evaluate comparable prices.

### What's the best way to get information on homes for sale and details about the neighborhood?

Thanks to the Internet, you no longer have to rely solely on a real estate agent for information about homes for sale. You can scan online listings to see which homes are worth a visit,

how much they cost and what amenities they offer. Virtual visits to new homes often include floor plans and photographs.

Once you identify a house you like, you can email the address or identification number to your agent, the listing agent or the owner (if it's a listing by a FSBO—For Sale By Owner) to obtain additional information or to set up an appointment to see the home in person.

The list of websites at the end of this chapter has some of the major national real estate listing sites. Your state or regional realty association or multiple listing service (MLS) may also have a website listing homes for sale. Major real estate companies, including ERA, RE/MAX, Coldwell Banker, Prudential and others often offer lists on their websites.

Finally, virtually all online editions of newspapers offer a homes-for-sale classifieds section that works much like an online listing site. On most newspaper sites, you can browse all the listings, or customize your search by typing in your criteria, such as price range, location and number of bedrooms and baths. Some of the best sites also include useful information on mortgage rates, schools and other community resources, financial calculators, links to sales data on comparable houses, home inspection services, real estate agents and other information of interest to local buyers. Check the Newspaper Association of America (<http://www.naa.org>) for a link to your newspaper. (Click on "Newspaper Links.")

Advice on relocation decisions and details about your new community and its services are also readily available online. For valuable information about cities, communities and neighborhoods, including schools, housing costs, demographics, crime rates and jobs, see the websites listed at the end of this chapter. Finally, keep in mind that the Internet is no substitute for your own legwork. Ask your friends and colleagues, walk and drive around neighborhoods, talk to local residents, read local newspapers, visit the local library and planning department and do whatever it takes to help you get a better sense of a neighborhood or city.

**My spouse and I want to buy a \$350,000 house. We have good incomes and can make high monthly payments, but we don't have \$70,000 to make a 20% down payment. Are there other options?**

Assuming you can afford (and qualify for) high monthly mortgage payments and have an excellent credit history, you should be able to find a low (10% to 15%) down payment loan for a \$350,000 house. However, you may have to pay a higher interest rate and loan fees (points) than someone making a higher down payment. In addition, a buyer who puts less than 20% down should be prepared to purchase private mortgage insurance (PMI), which is designed to reimburse a mortgage lender up to a certain amount if a buyer defaults and the foreclosure sale price is less than the amount owed the

lender (the mortgage plus the costs of the foreclosure sale).

PMI premiums are usually paid monthly and typically cost less than one-half of one percent of the mortgage loan. With the exception of some government and older loans, you can drop PMI once your equity in the house reaches 22% and you've made timely mortgage payments.

### I want to buy a newly built house. Is there anything special I need to know?

The most important factor in buying a newly built house is not what you buy (that is, the particular model), but rather from whom you buy. New is not always better, especially if the house is slapped together in a hurry. Shop for an excellent builder—someone who builds quality houses, delivers on time and stands behind his or her work. To check out a particular builder, talk to existing owners in the development you're considering, or ask an experienced contractor to look at other houses the developer is building.

Many developers of new housing will help you arrange financing; some will also pay a portion of your monthly mortgage or subsidize your interest payments for a short period of time (called a "buydown" of the mortgage). As with any loan, be sure you comparison shop before arranging financing through a builder.

Also, be sure to negotiate the prices of any add-ons and upgrades, such as a spa or higher quality carpet. These can add substantially to the cost of a new home.

### Is there anything else I need to know before buying a home in a development run by a homeowners' association?

When you buy a home in a new subdivision or planned unit development, chances are good that you also automatically become a member of an exclusive club—the homeowners' association, whose members are the people who own homes in the same development. The homeowners' association will probably exercise a lot of control over how you use and what you do to your property.

Deeds to houses in new developments almost always include restrictions—from the colors you can paint your house to the type of front yard landscaping you can do to where (and what types of vehicles) you can park in your driveway. Usually, these restrictions, called covenants, conditions and restrictions (CC&Rs), put decision-making rights in the hands of a homeowners' association. Before buying, study the CC&Rs carefully to see if they're compatible with your lifestyle. If you don't understand something, ask for more information and seek legal advice if necessary.

Usually, getting relief from overly restrictive CC&Rs after you move in isn't easy. You'll likely have to submit an application (with fee) for a variance, get your neighbors' permission and possibly go through a formal hearing. And if you want to make a structural change, such as building a fence or adding a room, you'll probably need formal permission from the association in addition to complying with city zoning rules.

## How can I make sure that the house I'm buying is in good shape?

In some states, you may have the advantage of a law that requires sellers to disclose considerable information about the condition of the house. (See *Selling Your House*, below.) Regardless of whether the seller provides disclosures, however, you should have the property inspected for defects or malfunctions in the building's structure.

Start by conducting your own inspection. There are several useful do-it-yourself inspection books available to help you learn what to look for. Ideally, you should inspect a house before you make a formal written offer to buy it so that you can save yourself the trouble should you find serious problems.

If a house passes your inspection, hire a general contractor to check all major house systems from top to bottom, including the roof, plumbing, electrical and heating systems and drainage. This will take two or three hours and cost you anywhere from \$200 to \$500 depending on the location, size, age and type of home. You should accompany the inspector during the examination so that you can learn more about the maintenance and preservation of the house and get answers to any questions you may have, including which problems are important and which are relatively minor. Depending on the property, you may want to arrange specialized inspections for pest damage, hazards from floods, earthquakes and other natural disasters

and environmental health hazards such as asbestos, mold and lead.

Professional inspections should be done after your written purchase offer has been accepted by the seller. (Your offer should be contingent upon the house passing one or more inspections.) To avoid confusion and disputes, be sure you get a written report of each inspection.

If the house is in good shape, you can proceed, knowing that you're getting what you paid for. If an inspector discovers problems—such as an antiquated plumbing system or a major termite infestation—you can negotiate with the seller to have him pay for necessary repairs and provide a home warranty (see *Selling Your House*, below). Finally, you can back out of the deal if an inspection turns up problems, assuming your contract is properly written to allow you to do so.

## I'm making an offer to buy a house, but I don't want to lock myself into a deal that might not work out. How can I protect myself?

Real estate offers almost always contain contingencies—events that must happen within a certain amount of time (such as 30 days) in order to finalize the deal. For example, you may want to make your offer contingent on your ability to qualify for financing, the house passing certain physical inspections or even your ability to sell your existing house first. Be aware, however, that the more contingencies you place in an offer, the less likely the seller is to accept it. See *Selling Your House*, below, for more on real estate offers.

## Strategies for Buying an Affordable House

To find a good house at a comparatively reasonable price, you must learn about the housing market and what you can afford, make some sensible compromises as to size and amenities and, above all, be patient. Here are some proven strategies to meet these goals:

- 1 Buy a fixer-upper cheap.
- 2 Buy a small house (with remodeling potential) and add on later.
- 3 Buy a house at an estate or probate sale.
- 4 Buy a house subject to foreclosure (when a homeowner defaults on his mortgage).
- 5 Buy a shared-equity house, pooling resources with someone other than a spouse or partner.
- 6 Rent out a room or two in the house.
- 7 Buy a duplex, triplex or house with an in-law unit.
- 8 Lease a house you can't afford now with an option to buy later.
- 9 Buy a limited-equity house built by a nonprofit organization.
- 10 Buy a house at an auction.



### More Information About Buying a Home

*100 Questions Every First-Time Home Buyer Should Ask*, by Ilyce R. Glink (Times Books), is a substantial book designed to help first-time buyers through the maze of buying a house.

*Your New House: The Alert Consumer's Guide to Buying and Building a Quality Home*, by Alan & Denise Fields (Windsor Peak Press), offers valuable advice for those who want to buy or build a new home.

*Inspecting a House*, by Rex Cauldwell (Taunton Press), shows how to inspect a house in order to discover major problems such as a bad foundation, leaky roof or malfunctioning fireplace.

*How to Buy a House in California*, by Ralph Warner, Ira Serkes and George Devine (Nolo), explains all the details of the California house-buying process and contains tear-out contracts and disclosure forms.

## Selling Your House

If you're selling a home, you need to time the sale properly, price the home accurately and understand the laws, such as disclosure requirements, that cover house transactions. These questions and answers will get you started.

## I'm trying to decide whether to put my house on the market or wait a while. What are the best and worst times to sell?

Too many people rush to sell their houses and lose money because of it. Ideally, you should put your house on the market when there's a large pool of buyers—causing prices to go up. This may occur in the following situations:

- Your area is considered especially attractive—for example, because of the schools, low crime rate, employment opportunities, weather or proximity to a major city.
- Mortgage interest rates are low.
- The economic climate of your region is healthy and people feel confident about the future.
- There's a jump in house buying activity, as often occurs in spring.

Of course, if you have to sell immediately—because of financial reasons, a divorce, a job move or an imperative health concern—and you don't have any of the advantages listed above, you may have to settle for a lower price, or help the buyer with financing, in order to make a quick sale.

## I want to save on the real estate commission. Can I sell my house myself without a real estate broker or agent?

Usually, yes. This is called a FSBO (pronounced “fizzbo”)—For Sale By Owner. You must be aware, however, of the legal rules that govern real estate transfers in your state, such as who must sign the papers, who can conduct the actual transaction and

what to do if and when any problems arise that slow down the transfer of ownership. You also need to be aware of any state-mandated disclosures as to the physical condition of your house. (See the discussion below.)

If you want to go it alone, be sure you have the time, energy and ability to handle all the details—from setting a realistic price to negotiating offers and closing the deal. Also, be aware that FSBOs are usually more feasible in hot or sellers' markets where there's more competition for homes, or when you're not in a hurry to sell. For more advice on FSBOs, including the involvement of attorneys and other professionals in the house transaction, contact your state department of real estate. Also, check online at <http://www.owners.com> for useful advice on selling a home without an agent.

If you're in California, check out *For Sale by Owner* by George Devine (Nolo). This book provides step-by-step advice on handling your own sale in California, from putting the house on the market to negotiating offers to transferring title.

## Is there some middle ground where I can use a broker on a more limited (and less expensive) basis?

You might consider doing most of the work yourself—such as showing the house—and using a real estate broker's help with such crucial tasks as:

- setting the price of your house
- advertising your home in the local multiple listing service (MLS) of



homes for sale in the area, published by local boards of realtors, and

- handling some of the more complicated paperwork when the sale closes.

If you work with a broker in a limited way, you may be able to negotiate a reduction of the typical 5%-7% broker's commission, or you may be able to find a real estate agent who charges by the hour for specified services such as reviewing the sales contract.

### How much should I ask for my house?

The key is to determine how much your property is actually worth on the market—called “appraising” a house’s value. The most important factors used to determine a house’s value are recent sales prices of similar properties in the neighborhood (called “comps”).

Real estate agents have access to sales data for the area (“comp books”) and can give you a good estimate of what your house should sell for. Many real estate agents will offer this service free, hoping that you will list your house with them. You can also hire a professional real estate appraiser to give you a documented opinion as to your house’s value. Public record offices, such as the county clerk or recorder’s office, may also have information on recent house sales. A few private companies offer detailed comparable sales prices online for many areas of the country, based on information from County Recorder’s Offices and property assessors. See the list of recommended websites at the end of this chapter.

Finally, asking prices of houses still on the market can also provide guidance (adjusting for the fact that asking prices are typically 10% or more above the usual sales price). To find out asking prices, go to open houses and check newspaper real estate classified ads and online listings of homes for sale.



### *Preparing Your House for Sale*

Making your house look as attractive as possible may put several thousand dollars in your pocket. Sweep the sidewalk; mow the lawn; put some pots of blooming flowers by the front door; clean the windows; fix chipped or flaking paint. Clean and tidy up all rooms; be sure the house smells good—hide the kitty litter box and bake some cookies. Check for loose steps, slick areas or unsafe fixtures, and deal with everything that might cause injury to a prospective buyer. Take care of real eyesores, such as a cracked window or overgrown front yard. Don’t overlook small but obvious problems, such as a leaking faucet or loose door-



knob. Find ways to improve the look of your house without spending much money—a new shower curtain and towels might really spruce up your bathroom.

### Do I need to take the first offer that comes in?

Offers, even very attractive ones, are rarely accepted as written. More typically, you will respond with a written counteroffer accepting some, maybe even most, of the offer terms, but proposing certain changes. Most counteroffers correspond to these provisions of an offer:

- price—you want more money
- financing—you want a larger down payment
- occupancy—you need more time to move out
- buyer's sale of current house—you don't want to wait for this to occur
- inspections—you want the buyer to schedule them more quickly.

A contract is formed when either you or the buyer accept all of the terms of the other's offer or counteroffer in writing within the time allowed.

### What are my obligations to disclose problems about my house, such as a basement that floods in heavy rains?

In most states, it is illegal to fraudulently conceal major physical defects in your property, such as your troublesome basement. And states are increasingly requiring sellers to take a pro-active role by making written disclosures on the condition of the property. California, for example, has stringent disclosure requirements.

California sellers must give buyers a mandatory disclosure form listing such defects as a leaky roof, faulty plumbing, deaths that occurred within the last three years on the property, even the presence of neighborhood nuisances, such as a dog that barks every night. In addition, California sellers must disclose potential hazards from floods, earthquakes, fires, environmental hazards and other problems in a Natural Hazard Disclosure Statement. California sellers must also alert buyers to the availability of a database maintained by law enforcement authorities on the location of registered sex offenders.

Generally, you are responsible for disclosing only information within your personal knowledge. While it's not usually required, many sellers hire a general contractor to inspect the property. The information will help you determine which items need repair or replacement and will assist you in preparing any required disclosures. An inspection report is also useful in pricing your house and negotiating with prospective buyers.

Full disclosure of any property defects will also help protect you from legal problems from a buyer who seeks to rescind the sale or sues you for damages suffered because you carelessly or intentionally withheld important information about your property.

Check with your real estate broker or attorney, or your state department of real estate, for disclosures required in your state and any special forms you must use. Also, be aware that real

estate brokers are increasingly requiring that sellers complete disclosure forms, regardless of whether it's legally required.

## *Sellers Must Disclose Lead-Based Paint and Hazards*

If you are selling a house built before 1978, you must comply with the federal Residential Lead-Based Paint Hazard Reduction Act of 1992 (42 U.S.Code § 4852d), also known as Title X (Ten). You must:

- disclose all known lead-based paint and hazards in the house
- give buyers a pamphlet prepared by the U.S. Environmental Protection Agency (EPA) called *Protect Your Family From Lead in Your Home*
- include certain warning language in the contract, as well as signed statements from all parties verifying that all disclosures (including giving the pamphlet) were made
- keep signed acknowledgments for three years as proof of compliance, and
- give buyers a ten-day opportunity to test the housing for lead.

If you fail to comply with Title X, the buyer can sue you for triple the amount of damages suffered—for example, three times the cost of repainting a house previously painted with lead-based paint.

For more information, contact the National Lead Information Center, 800-424-LEAD (phone) or <http://www.epa.gov/lead/nlic.htm>.

## *What are home warranties, and should I buy one?*

Home warranties are service contracts that cover major housing systems—electrical wiring, built-in appliances, heating, plumbing and the like—for one year from the date the house is sold. Most warranties cost \$300-\$500 and are renewable. If something goes wrong with any of the covered systems after escrow closes, the repairs are paid for (minus a modest service fee)—and the new buyer saves money. Many sellers find that home warranties make their house more attractive and easier to sell.

Before buying a home warranty, be sure you don't duplicate coverage. You don't need a warranty for the heating system, for example, if your furnace is just six months old and still covered by the manufacturer's three-year warranty.

Your real estate agent or broker can provide more information on home warranties.

## *What is the "house closing"?*

The house closing is the final transfer of the ownership of the house from the seller to the buyer. It occurs after both you and the buyer have met all the terms of the contract and the deed is recorded. (See *Deeds*, below). Closing also refers to the time when the transfer will occur, such as "The closing on my house will happen on January 27 at 10:00 a.m."

## Do I need an attorney for the house closing?

This varies depending on state law and local custom. In some states, attorneys are not typically involved in residential property sales, and an escrow or title company handles the entire closing process. In many other states, particularly in the eastern part of the country, attorneys (for both buyer and seller) have a more active role in all parts of the house transaction; they handle all the details of offer contracts and house closings. Check with your state department of real estate or your real estate broker for advice.

## I'm selling my house and buying another. What are some of the most important tax considerations?

The 1997 Taxpayer Relief Act contained a big break for homeowners. If you sell your home, you may exclude up to \$250,000 of your profit (capital gain) from tax. For married couples filing jointly, the exclusion is \$500,000.

The law applies to sales after May 6, 1997. To claim the whole exclusion, you must have owned and lived in your residence an aggregate of at least two of five years before the sale. You can claim the exclusion once every two years.

Even if you haven't lived in your home a total of two years out of the last five, you are still eligible for a partial exclusion of capital gains if you sold because of a change in employment, health or unforeseen circumstances. You get a portion of the exclusion, based on the percentage of the two-year period you lived in the house. To calculate it, take the number of months you lived there before the sale and divide it by 24.

For example, if you're an unmarried taxpayer who's lived in your home for 12 months, and you sell it for a \$100,000 profit, the entire amount would be excluded from capital gains. Because you lived in the house for half of the two-year period, you could claim half the exclusion, or \$125,000. ( $12/24 \times \$250,000 = \$125,000$ .) That's enough to exclude your entire \$100,000 gain.

For more information on current tax laws involving real estate transactions, contact the IRS at 800-829-1040 or check their website at <http://www.irs.gov>. Ask for Publication 523, *Selling Your Home*, and the general instructions for Form 2119, *Sale of Your Home*. If you're claiming the exclusion, you must file Form 2119 with your tax return.

# Deeds

*Castles in the air are the only property you can own without the intervention of lawyers. Unfortunately, there are no title deeds to them.*

—J. FEIDOR REES

Remember playing Monopoly as a kid, where amassing deeds to property—those little color-coded cards—was all-important? Real-life deeds aren't nearly so colorful, but they're still very, very important. Here are some questions commonly asked about deeds.

## What is a deed?

A deed is the document that transfers ownership of real estate. It contains the names of the old and new owners and a legal description of the property, and is signed by the person transferring the property.

## Do I need a deed to transfer property?

Almost always. You can't transfer real estate without having something in writing. In some situations, a document other than a deed is used—for example, in a divorce, a court order may transfer real estate from the couple to just one of them.

I'm confused by all the different kinds of deeds—quitclaim deed, grant deed, warranty deed. Does it matter which kind of deed I use?

Probably not. Usually, what's most important is the substance of the deed: the description of the property being transferred and the names of the old and new owners. Here's a brief rundown of the most common types of deeds:

A *quitclaim* deed transfers whatever ownership interest you have in the property. It makes no guarantees about the extent of your interest. Quitclaim deeds are commonly used by divorcing couples; one spouse signs over all his rights in the couple's real estate to the other. This can be especially useful if it isn't clear how much of an interest, if any, one spouse has in property that's held in another spouse's name.

A *grant deed* transfers your ownership and implies certain promises—that the title hasn't already been transferred to someone else or been encumbered, except as set out in the deed. This is the most commonly used kind of deed, in most states.

A *warranty deed* transfers your ownership and explicitly promises the buyer that you have good title to the property. It may make other promises as well, to address particular problems with the transaction.

## Does a deed have to be notarized?

Yes. The person who signs the deed (the person who is transferring the property) should take the deed to a notary public, who will sign and stamp it. The notarization means that a notary public has verified that the signature on the deed is genuine. The signature must be notarized before the deed will be accepted for recording (see the next question).

## After a deed is signed and notarized, do I have to put it on file anywhere?

Yes. You should “record” (file) the deed in the land records office in the county where the property is located. This office goes by different names in different states; it’s usually called the County Recorder’s Office, Land Registry Office or Register of Deeds. In most counties, you’ll find it in the courthouse.

Recording a deed is simple. Just take the signed, original deed to the land records office. The clerk will take the deed, stamp it with the date and some numbers, make a copy and give the original back to you. The numbers are usually book and page numbers, which show where the deed will be found in the county’s filing system. There will be a small fee, probably about \$5 a page, for recording.

## What’s a trust deed?

A trust deed (also called a deed of trust) isn’t like the other types of deeds; it’s not used to transfer property. It’s really just a version of a mortgage, commonly used in some states.

A trust deed transfers title to land to a “trustee,” usually a trust or title company, which holds the land as security for a loan. When the loan is paid off, title is transferred to the borrower. The trustee has no powers unless the borrower defaults on the loan; then the trustee can sell the property and pay the lender back from the proceeds, without first going to court.

### *More Information About Deeds*

*Deeds for California Real Estate,*

by Mary Randolph (Nolo),  
contains tear-out deed forms and  
instructions for transferring  
California real estate.

For information about deeds  
in other states, check your  
local law library.



### <http://www.nolo.com>

*Nolo offers self-help information on a wide variety of legal topics, including real estate matters. The website also has several real estate calculators, including a Home Affordability calculator.*

### <http://www.homefair.com/home>

*Homefair offers lots of information and calculators that will help you move and make relocation decisions. It's especially useful if you're deciding where to live based on home prices, schools, crime, salaries and other factors.*

### <http://www.homeadvisor.com>

*Microsoft's Home Advisor helps with all aspects of buying or selling a home—from listings and financing to home improvements.*

### <http://www.ashi.com>

*The American Society of Home Inspectors offers information on buying a home in good shape, including referrals to local home inspectors.*

### <http://www.inman.com>

*Real estate columnist Brad Inman provides the latest real estate news. Also, see <http://deadlinenews.com> by real estate writer Brouderick Perkins.*

### <http://www.realtylocator.com>

*Realty Locator provides over 100,000 real estate links nationwide, including property listings, agents, lenders, neighborhood data, real estate news and resources on everything from home improvement to mortgage calculators.*

### <http://www.homepath.com>

*Fannie Mae, the nation's largest source of home mortgage loans, offers several useful home affordability mortgage calculators. It also provides a wide range of consumer information.*

### <http://www.iOwn.com>

*iOwn allows you to compare rates from various lenders, prequalify and apply for a home loan. It includes detailed advice on choosing the best type of mortgage, determining how much house you can afford, selecting a real estate broker and evaluating the value of a house. Similar online mortgage sites are available at <http://www.e-loan.com> and <http://www.homeadvisor.com>.*

### <http://www.hsh.com>

*HSH Associates publishes detailed information on mortgage loans available from lenders across the U.S.*

### <http://www.realtor.com>

*The official website of the National Association of Realtors lists over one and a half million homes for sale throughout the United States and provides links to real estate broker websites and a host of related realty services.*

**<http://www.homebuilder.com>**

*The National Association of Homebuilders' website lists new homes and developments in major metropolitan areas.*

**<http://www.owners.com>**

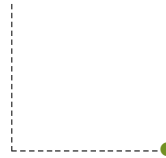
*This site lists homes sold without a broker, also known as FSBOs (for sale by owner). It also provides useful information for anyone considering selling their home without a real estate agent.*

**<http://www.homegain.com>**

*HomeGain is geared toward home sellers. It provides an Agent Evaluator service to help you find a real estate agent, a Home Valuation tool to help price your home, calculators for a wide variety of tasks and other resources.*

**<http://www.dataquick.com/consumer>**

*For a modest fee, Dataquick.com (click on the "Neighborhood Report Center") provides details on houses—including purchase price, sales date, address, number of bedrooms and baths, square footage and property tax information.*





# N

## eighbors

2.2 *Boundaries*

2.3 *Fences*

2.4 *Trees*

2.6 *Views*

2.8 *Noise*

*People have discovered that they can fool  
the devil, but they can't fool the neighbors.*

—EDGAR WATSON HOWE

**Y**ears ago, problems between neighbors were resolved informally, perhaps with the help of a third person respected by both sides. These days, neighbors—who may not know each other well, if at all—are quicker to head for court. Usually, of course, lawsuits only exacerbate bad feelings and cost everyone money, and the courthouse should be the place of last, not first, resort. But knowing the legal ground rules is important; you may prevent small disputes from turning into big ones.



# Boundaries

Most of us don't know, or care, exactly where our property boundaries are located. But if you or your neighbor wants to fence the property, build a structure or cut down a tree close to the line, you need to know where it actually runs.

## How can I find the exact boundaries of my property?

You can hire a licensed land surveyor to survey the property and place official markers on the boundary lines. A simple survey usually costs about \$500; if no survey has been done for a long time, or if the maps are unreliable and conflicting, be prepared to spend up to \$1,000.

## My neighbor and I don't want to pay a surveyor. Can't we just make an agreement about where we want the boundary to be?

You and the neighbor can decide where you want the line to be, and then make it so by signing deeds that describe the boundary. If you have a mortgage on the property, consult an attorney for help in drawing up the deeds. You may need to get the permission of the mortgage holder before you give your neighbor even a tiny piece of the land.

Once you have signed a deed, you should record (file) it at the county land records office, usually called the County Recorder's Office, Land Registry Office or something similar.

Deeds are discussed in more detail in Chapter 1.

## What can I do if a neighbor starts using my property?

If a neighbor starts to build on what you think is your property, do something immediately. If the encroachment is minor—for instance, a small fence in the wrong place—you may think you shouldn't worry. But you're wrong. When you try to sell your house, a title company might refuse to issue insurance because the neighbor is on your land.

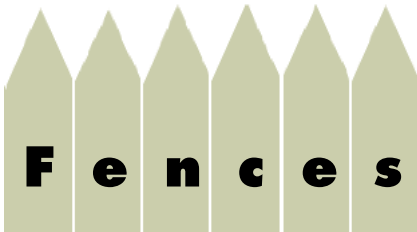
Also, if you don't act promptly, you could lose part of your property. When one person uses another's land for a long enough time, he can gain a legal right to continue to do so and, in some circumstances, gain ownership of the property.

Talk to your neighbor right away. Most likely, a mistake has been made because of a conflicting description in the neighbor's deed or just a mistaken assumption about the boundary line. If your neighbor is hostile and insists on proceeding, state that you will sue if necessary. Then send a firm letter—or have a lawyer send one on his or her letterhead. If the building doesn't stop, waste no time in having a lawyer get a judge's order to temporarily stop the neighbor until you can bring a civil lawsuit for trespass before the judge.

## *A Little Common Sense*

If you are having no trouble with your property and your neighbors, yet you feel inclined to rush out to determine your exact boundaries just to know where they are, please ask yourself a question. Have you been satisfied with the amount of space that you occupy? If the answer is yes, then consider the time, money and hostility that might be involved if you pursue the subject.

If a problem exists on your border, keep the lines of communication open with the neighbor, if possible. Learn the law and try to work out an agreement. Boundary lines simply don't matter that much to us most of the time; relationships with our neighbors matter a great deal.



Local fence ordinances are usually strict and detailed. Most regulate height and location, and some control the material used and even appearance. Residents of planned unit developments and subdivisions are often subject to even pickier rules. On top of all this, many cities require you to obtain a building permit before you begin construction.

Fence regulations apply to any structure used as an enclosure or a partition. Usually, they include hedges and trees.

## How high can I build a fence on my property?

In residential areas, local rules commonly restrict artificial (constructed) backyard fences to a height of six feet. In front yards, the limit is often four feet.

Height restrictions may also apply to natural fences—fences of bushes or trees—if they meet the ordinance's general definition of fences. Trees that are planted in a row and grow together to form a barrier are usually considered a fence. When natural fences are specifically mentioned in the laws, the height restrictions commonly range from five to eight feet.

If, however, you have a good reason (for example, you need to screen your house from a noisy or unsightly neighboring use, such as a gas station), you can ask the city for a one-time exception to the fence law, called a variance. Talk to the neighbors before you make your request, to explain your problem and get them on your side.

## My neighbor is building a fence that violates the local fence law, but nothing's happening. How can I get the law enforced?

Cities are not in the business of sending around fence inspection teams, and as long as no one complains, a non-conforming fence may stand forever.

Tell the neighbor about the law as soon as possible. She probably doesn't know what the law is, and if the fence is still being built, may be able to modify it at a low cost. If she suggests that you mind your own business, alert the city. All it takes in most cir-

cumstances is a phone call to the planning or zoning department or the city attorney's office. The neighbor will be ordered to conform; if she doesn't, the city can fine her and even sue.

### My neighbor's fence is hideous. Can I do anything about it?

As long as a fence doesn't pose a threat of harm to neighbors or those passing by, it probably doesn't violate any law just because it's ugly. Occasionally, however, a town or subdivision allows only certain types of new fences—such as board fences—in an attempt to create a harmonious architectural look. Some towns also prohibit certain materials—for example, electrically charged or barbed wire fences.

Even without such a specific law, if a fence is so poorly constructed that it is an eyesore or a danger, it may be prohibited by another law, such as a blighted property ordinance. And if the fence was erected just for meanness—it's high, ugly and has no reasonable use to the owner—it may be a "spite fence," and you can sue the neighbor to get it torn down.

### The fence on the line between my land and my neighbor's is in bad shape. Can I fix it or tear it down?

Unless the property owners agree otherwise, fences on a boundary line belong to both owners when both are using the fence. Both owners are responsible for keeping the fence in good repair, and neither may remove it without the other's permission.

A few states have harsh penalties for refusing to chip in for maintenance after a reasonable request from the other owner. Connecticut, for example, allows one neighbor to go ahead and repair, and then sue the other owner for double the cost.

Of course, it's rare that a landowner needs to resort to a lawsuit. Your first step should be to talk to the neighbor about how to tackle the problem. Your neighbor will probably be delighted that you're taking the initiative to fix a fence that's already an eyesore and might deteriorate into a real danger.

## Trees

WOODMAN, SPARE THAT TREE.

TOUCH NOT A SINGLE BOUGH:

IN YOUTH IT SHELTERED ME,

AND I'LL PROTECT IT NOW.

—GEORGE POPE MORRIS

We human beings exhibit some complicated, often conflicting, emotions over our trees. This is especially true when it comes to the trees in our own yards. We take ownership of our trees and their protection very seriously in this country, and this is reflected in the law.

**Can I trim the branches of the neighbor's tree that hang over my yard?**

You have the legal right to trim tree branches up to the property line. But you may not go onto the neighbor's property or destroy the tree itself.

### *Deliberately Harming a Tree*

In almost every state, a person who intentionally injures someone else's tree is liable to the owner for two or three times the amount of actual monetary loss. These penalties protect tree owners by providing harsh deterrents to would-be loggers.

**Most of a big oak tree hangs over my yard, but the trunk is on the neighbor's property. Who owns the tree?**

Your neighbor. It is accepted law in all states that a tree whose trunk stands wholly on the land of one person belongs to that person.

If the trunk stands partly on the land of two or more people, it is called

a boundary tree, and in most cases it belongs to all the property owners. All the owners are responsible for caring for the tree, and one co-owner may not remove a healthy tree without the other owners' permission.

**My neighbor dug up his yard, and in the process killed a tree that's just on my side of the property line. Am I entitled to compensation for the tree?**

Yes. The basic rule is that someone who cuts down, removes or hurts a tree without permission owes the tree's owner money to compensate for the harm done. You can sue to enforce that right—but you probably won't have to, once you tell your neighbor what the law is.

**My neighbor's tree looks like it's going to fall on my house any day now. What should I do?**

You can trim back branches to your property line, but that may not solve the problem if you're worried about the whole tree coming down.

City governments often step in to take care of, or make the owner take care of, dangerous trees. Some cities have ordinances that prohibit maintaining any dangerous condition—including a hazardous tree—on private property. To enforce such an ordinance, the city can demand that the owner remove the tree or pay a fine. Some cities will even remove such a tree for the owner. To check on your city's laws and policies, call the city attorney's office.

You might also get help from a utility company, if the tree threatens its equipment. For example, a phone company will trim a tree that hangs menacingly over its lines.

If you don't get help from these sources, and the neighbor refuses to take action, you can sue. The legal theory is that the dangerous tree is a "nuisance" because it is unreasonable for the owner to keep it and it interferes with your use and enjoyment of your property. You can ask the court to order the owner to prune or remove the tree. You'll have to sue in regular court (not small claims court) and have proof that the tree really does pose a danger to you.

## V i e w s



The privilege of sitting in one's home and gazing at the scenery is a highly prized commodity. And it can be a very expensive one. Potential buyers, sometimes overwhelmed by a stunning landscape, commit their life savings to properties, assuming that the view is permanent. Sometimes it is not.

### If a neighbor's addition or growing tree blocks my view, what rights do I have?

Unfortunately, you have no right to light, air or view, unless it has been granted in writing by a law or subdivision rule. The exception to this general rule is that someone may not deliberately and maliciously block another's view with a structure that has no reasonable use to the owner.

This rule encourages building and expansion, but the consequences can be harsh. If a view becomes blocked, the law will help only if:

- a local law protects views
- the obstruction violates private subdivision rules, or
- the obstruction violates some other specific law.

### How can a view ordinance help?

A few cities that overlook the ocean or other desirable vistas have adopted view ordinances. These laws protect a property owner from having his view (usually, the view that he had when he bought the property) obstructed by growing trees. They don't cover buildings or other structures that block views.

The ordinances allow someone who has lost a view to sue the tree owner for a court order requiring him to restore the view. A neighbor who wants to sue must first approach the tree owner and request that the tree be cut back. The complaining person usually bears the cost of trimming or topping, unless the tree was planted

after the law became effective, or the owner refuses to cooperate.

Some view ordinances contain extensive limitations that take most of the teeth out of them. Some examples:

- Certain species of trees may be exempt, especially if they grew naturally.
- A neighbor may be allowed to complain only if the tree is within a certain distance from his or her property.
- Trees on city property may be exempt.

## Cities Without View Ordinances

If, like most cities, your city doesn't have a view ordinance, you might find help from other local laws. Here are some laws that may help restore your view:

**Fence Height Limits.** If a fence is blocking your view, it may be in violation of a local law. Commonly, local laws limit artificial (constructed) fences in back yards to six feet high and in front yards to three or four feet. Height restrictions may also apply to natural fences, such as hedges.

**Tree Laws.** Certain species of trees may be prohibited—for example, trees that cause allergies or tend to harm other plants. Laws may also forbid trees that are too close to a street (especially an intersection), to power lines or even to an airport.

**Zoning Laws.** Local zoning regulations control the size, location and uses of buildings. In a single-family area, buildings are usually limited to 30 or 35 feet. Zoning laws also usually require a certain setback, or distance between a structure and the boundary lines. They also limit how much of a lot can be occupied by a structure. For instance, many suburban cities limit a dwelling to 40% to 60% of the property.

## I live in a subdivision with a homeowners' association. Will that help me in a view dispute?

Often, residents of subdivisions and planned unit developments are subject to a detailed set of rules called Covenants, Conditions and Restrictions (CC&Rs). They regulate most matters that could concern a neighbor, including views. For example, a rule may state that trees can't obstruct the view from another lot, or simply limit tree height to 15 feet.

If someone violates the restrictions, the homeowners' association may apply pressure (for example, removing the privilege of using a swimming pool) or even sue. A lawsuit is costly and time-consuming, however, and the association may not want to sue except for serious violations of the rules.

If the association won't help, you can take the neighbor to court yourself, but be prepared for a lengthy and expensive experience.

I want to buy a house with a great view. Is there anything I can do to make sure I won't ever lose the view—and much of my investment?

First, ask the property owner or the city planning and zoning office if the property is protected by a view ordinance. Then check with the real estate agent to see if neighbors are subject to restrictions that would protect your view. Also, if the property is in a planned unit development, find out whether a homeowners' association actively enforces the restrictions.

Check local zoning laws for any property that might affect you. Could the neighbor down the hill add a second-story addition?

Finally, look very closely from the property to see which trees might later obstruct your view. Then go introduce yourself to their owners and explain your concerns. A neighbor who also has a view will probably understand your concern. If someone is unfriendly and uncooperative, you stand warned.

## *How to Approach a View Problem*

Before you approach the owner of a tree that has grown to block your view, answer these questions:

- Does the tree affect the view of other neighbors? If it does, get them to approach the tree owner with you. Trimming costs may be divided among you.

- Which part of the tree is causing view problems for you—one limb, the top, one side of it?
- What is the least destructive action that could be taken to restore your view? Maybe the owner will agree to a limited and careful pruning.
- How much will the trimming cost? Be ready to pay for it. Remember that every day you wait and grumble is a day for the trees to grow and for the job to become more expensive. The loss of your personal enjoyment is probably worth more than the trimming cost, not to mention the devaluation of your property (which can be thousands of dollars).



**N o i s e**

*Nothing so needs re-forming as other people's habits.*

—MARK TWAIN

If you are a reasonable person and your neighbor is driving you wiggy



with noise, the neighbor is probably violating a noise law.

### Do I have any legal recourse against a noisy neighbor?

You bet. The most effective weapon you have to maintain your peace and quiet is your local noise ordinance. Almost every community prohibits excessive, unnecessary and unreasonable noise, and police enforce these laws.

Most laws designate certain “quiet hours”—for example, from 10 p.m. to 7 a.m. on weekdays, and until 8 or 9 a.m. on weekends. So running a power mower may be perfectly acceptable at 10 a.m. on Saturday, but not at 7 a.m. Many towns also have decibel level noise limits. When a neighbor complains, they measure the noise with electronic equipment. To find out what your town’s noise ordinance says, ask at the public library or the city attorney’s office.

If your neighbor keeps disturbing you, you can also sue, and ask the court for money damages or to order the neighbor to stop the noise (“abate the nuisance,” in legal terms). For money damages alone, you can use small claims court. For a court order telling somebody to stop doing something, you’ll have to sue in regular court.

Of course, what you really want is for the nuisance to stop. But getting a small claims court to order your neighbor to pay you money can be

amazingly effective. And suing in small claims court is easy and inexpensive, and it doesn’t require a lawyer.

Noise that is excessive and deliberate may also be in violation of state criminal laws against disturbing the peace or disorderly conduct. This means that, in very extreme circumstances, the police can arrest your neighbor. Usually, these offenses are punishable by fines or short jail sentences.

### The neighbor in the apartment next to mine is very noisy. Isn’t the landlord supposed to keep tenants quiet?

In addition to the other remedies all neighbors have, you have another arrow in your quiver: You can lean on the landlord to quiet the neighbor. Standard rental and lease agreements contain a clause entitled “Quiet Enjoyment.” This clause gives tenants the right to occupy their apartments in peace, and also imposes upon them the responsibility not to disturb their neighbors. It’s the landlord’s job to enforce both sides of this bargain.

If the neighbor’s stereo is keeping you up every night, the tenants are probably violating the rental agreement, and could be evicted. Especially if several neighbors complain, the landlord will probably order the tenant to comply with the lease or face eviction. For more information about your rights as a tenant, see Chapter 3.



## Tips for Handling a Noise Problem

- Know the law and stay within it.
- Be reasonably tolerant of your neighbors.
- Assert your rights.
- Communicate with your neighbors—both the one causing the problem and others affected by it.
- Ask the police for help when it is appropriate.
- Use the courts when necessary.

### My neighbor's dog barks all the time, and it's driving me crazy. What can I do?

Usually, problems with barking dogs can be resolved without resorting to police or courts. If you do eventually wind up in court, however, a judge will be more sympathetic if you made at least some effort to work things out first. Here are the steps to take when you're losing patience (or sleep) over a neighbor's noisy dog:

*1. Ask your neighbor to keep the dog quiet.* Sometimes owners are blissfully unaware that there's a problem. If the dog barks for hours every day—but only when it's left alone—the owner may not know that you're being driven crazy.

If you can establish some rapport with the neighbor, try to agree on specific actions to alleviate the problem: for example, that your neighbor will take the dog to obedience school or consult with an animal behavior

specialist, or that the dog will be kept inside after 10 p.m. After you agree on a plan, set a date to talk again in a couple of weeks.

*2. Try mediation.* Mediators, both professional and volunteers, are trained to listen to both sides, identify problems, keep everyone focused on the real issues and suggest compromises. A mediator won't make a decision for you, but will help you and your neighbor agree on a resolution.

Many cities have community mediation groups which train volunteers to mediate disputes in their own neighborhoods. Or ask for a referral from:

- the small claims court clerk's office
- the local district attorney's office—the consumer complaint division, if there is one
- radio or television stations that offer help with consumer problems, or
- a state or local bar association.

For more information on mediation, see Chapter 17, *Courts and Mediation*.

*3. Look up the law.* In some places, barking dogs are covered by a specific state or local ordinance. If there's no law aimed specifically at dogs, a general nuisance or noise ordinance makes the owner responsible. Local law may forbid loud noise after 10 p.m., for example, or prohibit any "unreasonable" noise. And someone who allows a dog to bark after numerous warnings from police may be arrested for disturbing the peace.

To find out what the law is where you live, go to a law library and check

the state statutes and city or county ordinances yourself. Look in the index under “noise,” “dogs,” “animals” or “nuisance.” For more information on how to do this, see the Legal Research Appendix. Or call the local animal control agency or city attorney.

4. *Ask animal control authorities to enforce local noise laws.* Be persistent. Some cities have special programs to handle dog complaints.

5. *Call the police, if you think a criminal law is being violated.* Generally, police aren’t too interested in barking dog problems. And summoning a police cruiser to a neighbor’s house obviously will not improve your already-strained relations. But if nothing else works, and the relationship with your neighbor is shot anyway, give the police a try.



### *More Information About Neighbor Law*

*Neighbor Law: Fences, Trees, Boundaries & Noise*, by Cora Jordan (Nolo), explains laws that affect neighbors and shows how to resolve common disputes without lawsuits.

*Dog Law*, by Mary Randolph (Nolo), is a guide to the laws that affect dog owners and their neighbors.



<http://www.nolo.com>

*Nolo offers self-help information about a wide variety of legal topics, including neighbor law.*

# 3

## Landlords and Tenants

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*Property has its duties as well  
as its rights.*

—THOMAS DRUMMOND

**T**hirty years ago, custom, not law, controlled how most landlords and tenants interacted with each other. This is no longer true. Today, whether you focus on leases and rental agreements; habitability; discrimination; the amount, use and return of security deposits; how and when a landlord may enter a rental unit or a dozen other issues, both landlord and tenant must understand their legal rights and responsibilities.

Because landlord-tenant laws vary significantly depending on where you live, remember to check your state and local laws for specifics. A list of state landlord-tenant statutes is included at the end of this chapter. You can find and read the state statutes online. (See “Finding Statutes and Regulations Online” in the Legal Research Appendix.)

## Leases and Rental Agreements

It's important to carefully read—and fully understand—the terms of your lease or rental agreement. This piece of paper is the contract that forms the legal basis for the landlord-tenant relationship.

### Why is it important to sign a lease or rental agreement?

The lease or rental agreement is the

key document of the tenancy. A thorough lease or rental agreement will set out important issues such as:

- the length of the tenancy
- the amount of rent and deposits the tenant must pay
- the number of people who can live on the rental property
- who pays for utilities
- whether the tenant may have pets
- whether the tenant may sublet the property
- the landlord's access to the rental property, and
- who pays attorney fees if there is a lawsuit.

Leases and rental agreements should always be in writing, even though oral agreements for less than a year are enforceable in most states. While oral agreements may seem easy and informal, they often lead to disputes. If a tenant and landlord later disagree about key agreements, such as whether the tenant can sublet, the result is all too likely to be a court argument over who said what to whom, when and in what context.

### What's the difference between a rental agreement and a lease?

The biggest difference is the length of occupancy. A written rental agreement provides for a tenancy of a short period (often 30 days). The tenancy is automatically renewed at the end of this period unless the tenant or landlord ends it by giving written notice, typically 30 days. For these month-to-month rentals, the landlord can change the terms of the agreement with proper written notice, subject to

any rent control laws. This notice is usually 30 days, but can be shorter in some states if the rent is paid weekly or bi-weekly or if the landlord and tenant agree. In some states, the notice period is longer.

A written lease, on the other hand, gives a tenant the right to occupy a rental unit for a set term—most often for six months or a year, but sometimes longer—as long as the tenant pays the rent and complies with other lease provisions. Unlike a rental agreement, when a lease expires it does not usually automatically renew itself. A tenant who stays on with the landlord's consent will generally be considered a month-to-month tenant (with the same terms and conditions that were present in the lease).

In addition, with a fixed-term lease, the landlord cannot raise the rent or change other terms of the tenancy during the lease, unless the changes are specifically provided for in the lease or the tenant agrees.

### What happens if a tenant breaks a long-term lease?

As a general rule, a tenant may not legally break a lease unless the landlord significantly violates its terms—for example, by failing to make necessary repairs, or by failing to comply with an important law concerning health or safety. A few states have laws that allow tenants to break a lease because health problems or a job relocation require a permanent move. A tenant who begins active military service may break a lease after giving 30 day's notice.

A tenant who breaks a lease without a legally recognized cause will be responsible for the remainder of the rent due under the lease term. In most states, however, a landlord has a legal duty to try to find a new tenant as soon as possible—no matter what the tenant's reason for leaving—rather than charge the tenant for the total remaining rent due under the lease. At that point, the old tenants' responsibility for the rent will stop.

### When can a landlord legally break a lease and end a tenancy?

Usually, a landlord may legally break a lease if a tenant significantly violates its terms or the law—for example, by paying the rent late, keeping a dog in violation of a no-pets clause in the lease, substantially damaging the property or participating in illegal activities on or near the premises, such as selling drugs.

Usually a landlord must first send the tenant a notice stating that the tenancy has been terminated. State laws set out very detailed requirements as to how a landlord must write and deliver (serve) a termination notice, depending on what the tenant has done wrong. The termination notice may state that the tenancy is over and warn the tenant that he or she must vacate the premises or face an eviction lawsuit. Or, the notice may give the tenant a few days to clean up his or her act—for example, pay the rent or find a new home for the dog. (If the tenant fixes the problem or leaves as directed, no one goes to court.) If a

tenant doesn't comply with the termination notice, the landlord can file a lawsuit to evict the tenant.

## Tenant Selection

Choosing tenants is the most important decision any landlord makes. To do it well, landlords need a reliable system that helps weed out tenants who will pay their rent late, damage the rental unit or cause legal or practical problems later.

### What's the best way for landlords to screen tenants?

Savvy landlords should ask all prospective tenants to fill out a written rental application that asks for the following information:

- employment, income and credit history
- Social Security and driver's license numbers
- details on past evictions or bankruptcies, and
- references.

Before choosing tenants, landlords should check with previous landlords and other references; verify income, employment and bank account information; and obtain a credit report. The credit report is especially important because it will indicate whether a particular person has a history of paying rent or bills late, has gone through bankruptcy, has been convicted of a crime or has ever been evicted.

### How can a landlord avoid discrimination lawsuits when choosing a tenant?

Fair housing laws specify clearly illegal reasons to refuse to rent to a tenant. (For details, see *Housing Discrimination*, below.) Landlords are legally free to choose among prospective tenants as long as their decisions comply with these laws and are based on legitimate business criteria. For example, a landlord is entitled to reject someone with a poor credit history, insufficient income to pay the rent or past behavior—such as damaging property—that makes the person a bad risk. A legally recognized occupancy policy limiting the number of people per rental unit—one that is clearly tied to health and safety—can also be a legal basis for refusing tenants.

## Housing Discrimination

Not so long ago, a landlord could refuse to rent to an applicant, or could evict a tenant, for almost any reason. If a landlord didn't like your race or religion, or the fact that you had children, you might find yourself out on the street. But times have changed. To protect every American's right to be treated fairly and to help people find adequate housing, Congress and state legislatures passed laws prohibiting discrimination, most notably the federal Fair Housing Acts.



### What types of housing discrimination are illegal?

The federal Fair Housing Act and Fair Housing Amendments Act prohibit landlords from choosing tenants on the basis of a group characteristic such as:

- race
- religion
- ethnic background or national origin
- sex
- age
- the fact that the prospective tenant has children (except in certain designated senior housing), or
- a mental or physical disability.

In addition, some state and local laws prohibit discrimination based on a person's marital status or sexual orientation. And some cities and counties have added other criteria, such as one's personal appearance.

On the other hand, landlords are allowed to select tenants using criteria that are based on valid business reasons, such as requiring a minimum income or positive references from previous landlords, as long as these standards are applied equally to all tenants.

### *Examples of Housing Discrimination*

The Fair Housing Act and Amendments prohibit landlords from taking any of the following actions based on race, religion or any other protected category:

- advertising or making any statement that indicates a preference based on group characteristic, such as skin color
- falsely denying that a rental unit is available
- setting more restrictive standards, such as higher income, for certain tenants
- refusing to rent to members of certain groups
- refusing to accommodate the needs of disabled tenants, such as allowing a guide dog, hearing dog or service dog
- setting different terms for some tenants, such as adopting an inconsistent policy of responding to late rent payments, or
- terminating a tenancy for a discriminatory reason.

### How does a tenant file a discrimination complaint?

A tenant who thinks that a landlord has broken a federal fair housing law should contact the U.S. Department of Housing and Urban Development (HUD), the agency which enforces the Fair Housing Act. To find the nearest office, call HUD's Fair Housing Information Clearinghouse at 800-343-3442, or check the HUD Website at <http://www.hud.gov>. HUD will provide a complaint form and will investigate and decide the merits of the

claim. A tenant must file his or her complaint within one year of the alleged discriminatory act. HUD will typically appoint a mediator to negotiate with the landlord and reach a settlement (called a “conciliation”). If a settlement can’t be reached, the fair housing agency will hold an administrative hearing to determine whether discrimination has occurred.

If the discrimination is a violation of a state fair housing law, the tenant may file a complaint with the state agency in charge of enforcing the law. In California, the Department of Fair Employment and Housing enforces the state’s two fair housing laws.

Also, instead of filing a complaint with HUD or a state agency, tenants may file lawsuits directly in federal or state court. If a state or federal court or housing agency finds that discrimination has taken place, a tenant may be awarded damages, including any higher rent he or she had to pay as a result of being turned down, and damages for humiliation or emotional distress.

## Rent and Security Deposits

Landlords may charge any dollar amount for rent, except in certain areas covered by rent control. Many states do, however, have rules as to

when and how rent must be paid and how it may be increased.

Security deposits are more strictly regulated by state law. Most states dictate how much money a landlord can require, how the funds can be used—for example, to cover unpaid rent—and when and how the deposit must be returned.

### What laws cover rent due dates, late rent and rent increases?

By custom, leases and rental agreements usually require rent to be paid monthly, in advance. Often rent is due on the first day of the month. However, it is legal for a landlord to require rent to be paid at different intervals or on a different day of the month. Unless the lease or rental agreement specifies otherwise, there is no legally recognized grace period—in other words, if a tenant hasn’t paid the rent on time, the landlord can usually terminate the tenancy the day after it is due. Some landlords charge fees for late payment of rent or for bounced checks; these fees are usually legal if they are reasonable. The laws on late fees can be found in your state’s landlord-tenant statutes, listed at the end of this chapter.

For month-to-month rentals, the landlord can raise the rent (subject to any rent control laws) with proper written notice, typically 30 days. With a fixed-term lease, the landlord may not raise the rent during the lease, unless the increase is specifically called for in the lease or the tenant agrees.



## *How Rent Control Works*

Communities in only five states—California, the District of Columbia, Maryland, New Jersey and New York—have laws that limit the amount of rent landlords may charge. Rent control ordinances (also called rent stabilization, maximum rent regulation or a similar term) limit the circumstances and times rent may be increased. Many rent control laws require landlords to have a legal or just cause (that is, a good reason) to terminate a tenancy—for example, if the tenant doesn't pay rent or if the landlord wants to move a family member into the rental unit. Landlords and tenants in New York City, Newark, San Francisco and other cities with rent control should get a current copy of the ordinance and any regulations interpreting it. Check the phone book for the address and phone number of the local rent control board, or contact the mayor or city manager's office.

### How much security deposit can a landlord charge?

All states allow landlords to collect a security deposit when the tenant moves in; the general purpose is to assure that the tenant pays rent when due and keeps the rental unit in good condition. Half the states limit the amount landlords can charge, usually not more than a month or two worth of rent—the exact amount depends on the state.

Many states require landlords to put deposits in a separate account, and some require landlords to pay tenants the interest on deposits.

### What are the rules for returning security deposits?

The rules vary from state to state, but landlords usually have a set amount of time in which to return deposits, usually 14 to 30 days after the tenant moves out—either voluntarily or by eviction.

Landlords may normally make certain deductions from a tenant's security deposit, provided they do it correctly and for an allowable reason. Many states require landlords to provide a written itemized accounting of deductions for unpaid rent and for repairs for damages that go beyond normal wear and tear, together with payment for any deposit balance.

A tenant may sue a landlord who fails to return his or her deposit when and how required, or who violates other provisions of security deposit laws such as interest requirements. Often these lawsuits are brought in small claims court. If the landlord has intentionally and flagrantly violated the ordinance, in some states a tenant may recover the entire deposit—sometimes even two or three times this amount—plus attorney fees and other damages.

The rules for the keeping and return of security deposits can be found in state landlord-tenant statutes, listed at the end of this chapter.

# Tenants' Privacy Rights

In most states, the tenant's duty to pay rent is conditioned on the landlord's proper repair and maintenance of the premises. This means that landlords have a legal responsibility to keep fairly close tabs on the condition of the property. To balance landlords' responsibilities with tenants' rights to privacy in their homes, laws in many states set rules about when and how landlords may legally enter rented premises.

## Under what circumstances may a landlord enter rental property?

Typically, a landlord has the right to legally enter rented premises in cases of emergency, in order to make needed repairs (in some states, just to determine whether repairs are necessary) or to show the property to prospective new tenants or purchasers.

Several states allow landlords the right of entry during a tenant's extended absence (often defined as seven days or more) to maintain the property as necessary and to inspect for damage and needed repairs. In most cases, a landlord may not enter just to check up on the tenant and the rental property.

## Must landlords provide notice of entry?

States typically require landlords to provide advance notice (usually 24 hours) before entering a rental unit. Without advance notice, a landlord or manager may enter rented premises while a tenant is living there only in an emergency, such as a fire or serious water leak, or when the tenant gives permission.

To find out how much notice a landlord must give a tenant before entering, check your state's landlord-tenant statutes, listed at the end of this chapter.

## Is it legal for a landlord to answer questions about a tenant's credit?

Creditors, banks and prospective landlords may ask a landlord to provide credit or other information about a current or former tenant. A landlord who sticks to the facts that are relevant to the tenant's creditworthiness (such as whether the tenant paid rent on time) may respond to these inquiries without fear of legal difficulties initiated by the tenant. To be extra careful, some landlords insist that tenants sign a release giving the landlord permission to respond to such requests.



## Repairs and Maintenance

In 1863, an English judge wrote that “Fraud apart, there is no law against letting [leasing] a tumble-down house.” But in 20th century America, it’s no longer legal to be a slumlord. Landlords must repair and maintain their rental property or face financial losses and legal problems from tenants—who may withhold rent and pursue other legal remedies—and from government agencies that enforce housing codes.

### What are the landlord’s repair and maintenance responsibilities?

Under most state and local laws, rental property owners must offer and maintain housing that satisfies basic habitability requirements, such as adequate weatherproofing; available heat, water and electricity; and clean, sanitary and structurally safe premises. Local building or housing codes typically set specific standards, such as the minimum requirements for light, ventilation and electrical

wiring. Many cities require the installation of smoke detectors in residential units and specify security measures involving locks and keys.

To find out more about state laws on repair and maintenance responsibilities, check your state’s landlord-tenant statutes listed at the end of this chapter. Your local building or housing authority and health or fire department can provide information on local housing codes and penalties for violations.

### What are a tenant’s rights if the landlord refuses to maintain the property?

If a landlord doesn’t meet his or her legal responsibilities, a tenant usually has several options, depending on the state. These options include:

- paying less rent
- withholding the entire rent until the problem is fixed
- making necessary repairs or hiring someone to make them and deducting the cost from the next month’s rent
- calling the local building inspector, who can usually order the landlord to make repairs, or
- moving out, even in the middle of a lease.

A tenant who has lived under substandard conditions can also sue the landlord for a partial refund of rent paid during that time, and in some circumstances can sue for the discomfort, annoyance and emotional distress caused by the substandard conditions.

Tenants should check state and local laws and understand remedies available before taking any action, especially withholding rent.

### What must tenants do to keep the rental property in good shape?

All tenants have the responsibility to keep their own living quarters clean and sanitary. A landlord can usually delegate his repair and maintenance tasks to the tenant in exchange for a reduction in rent. If the tenant fails to do the job well, however, the landlord is not excused from his responsibility to maintain habitability. In addition, tenants must carefully use common areas and facilities, such as lobbies, garages and pools.

### Is a landlord liable if a tenant or visitor is injured on the rental property?

A landlord may be liable to the tenant—or others—for injuries caused by dangerous or defective conditions on the rental property. In order to hold the landlord responsible, the tenant must prove that the landlord was negligent and that the landlord's negligence caused an injury. To do this, the tenant must show that:

- the landlord had control over the problem that caused the injury
- the accident was foreseeable
- fixing the problem (or at least giving adequate warnings) would not have been unreasonably expensive or difficult
- a serious injury was the probable consequence of not fixing the problem

- the landlord failed to take reasonable steps to avert the accident
- the landlord's failure—his negligence—caused the tenant's accident, and
- the tenant was genuinely hurt.

For example, if a tenant falls and breaks his ankle on a broken front door step, the landlord will be liable if the tenant can show that:

- It was the landlord's responsibility to maintain the steps (this would usually be the case, because the steps are part of the common area, which is the landlord's responsibility).
- An accident of this type was foreseeable (falling on a broken step is highly likely).
- A repair would have been easy or inexpensive (fixing a broken step is a minor job).
- The probable result of a broken step is a serious injury (a fall certainly qualifies).
- The landlord failed to take reasonable measures to maintain the steps (this will be easy to prove if the step was broken for weeks, or even days, but less so if the step broke five minutes earlier and showed no previous signs of weakening).
- The broken step caused the injury (this is easy to prove if the tenant has a witness to the fall, but might be hard if there are no witnesses and the landlord claims that the tenant really injured himself somewhere else and is attempting to pin the blame on the landlord), and
- He is really hurt (in the case of a broken bone, this is easy to establish).

A tenant can file a personal injury lawsuit for medical bills, lost earnings, pain and other physical suffering, permanent physical disability and disfigurement and emotional distress. A tenant can also sue for property damage that results from faulty maintenance or unsafe conditions.



### *More Information on Personal Injury Lawsuits*

*How to Win Your Personal Injury Claim*, by Joseph L. Matthews (Nolo), provides step-by-step details on how to understand what a claim is worth, prepare a claim for compensation, negotiate a fair settlement and manage a case even if a lawyer is not involved.

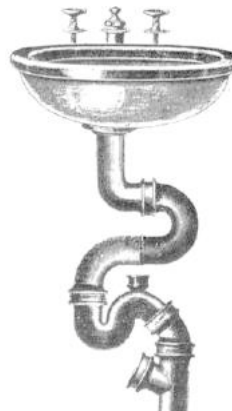
### How can property owners minimize financial losses and legal problems related to repairs and maintenance?

Landlords who offer and maintain housing in excellent condition can avoid many problems. Here's how:

- Clearly set out responsibilities for repair and maintenance in the lease or rental agreement.
- Use a written checklist to inspect the premises and fix any problems before new tenants move in.
- Encourage tenants to immediately report plumbing, heating, weatherproofing or other defects or safety or

security problems—whether in the tenant's unit or in common areas such as hallways and parking garages.

- Keep a written log of all tenant complaints and repair requests with details as to how and when problems were addressed.
- Handle urgent repairs as soon as possible. Take care of major inconveniences, such as a plumbing or heating problem, within 24 hours. For minor problems, respond in 48 hours. Always keep tenants informed as to when and how the repairs will be made and the reasons for any delays.
- Twice a year, give tenants a checklist on which to report potential safety hazards or maintenance problems that might have been overlooked. Use the same checklist to inspect all rental units once a year.



# Landlord Liability for Criminal Acts and Activities

Can a law-abiding citizen end up financially responsible for the criminal acts of a total stranger? Yes—if it's a landlord who owns rental property where an assault or other crime occurred. Rental property owners are being sued with increasing frequency by tenants injured by criminals, with settlements and jury awards typically ranging from \$100,000 to \$1 million. What are the landlord's responsibilities for tenant safety and security?

Property owners are responsible for keeping their premises reasonably safe for tenants and guests. Landlords in most states now have at least some degree of legal responsibility to protect their tenants from would-be assailants and thieves and from the criminal acts of fellow tenants. Landlords must also protect the neighborhood from their tenants' illegal activities, such as drug dealing. These legal duties stem from building codes, ordinances, statutes and, most frequently, court decisions.

## How can a landlord limit responsibility for crime committed by strangers on the rental property?

Effective preventive measures are the best response to possible liabilities

from criminal acts and activities. The following steps will not only limit the likelihood of crime, but also reduce the risk that the property owner will be found responsible if a criminal assault or robbery does occur. A landlord should:

- Meet or exceed all state and local security laws that apply to the rental property, such as requirements for deadbolt locks on doors, good lighting and window locks.
- Realistically assess the crime situation in and around the rental property and neighborhood and design a security system that provides reasonable protection for the tenants—both in individual rental units and common areas such as parking garages and elevators. Local police departments, the landlord's insurance company and private security professionals can all provide useful advice on security measures. If additional security requires a rent hike, the landlord should discuss the situation with his or her tenants. Many tenants will pay more for a safer place to live.
- Educate tenants about crime problems in the neighborhood and describe the security measures provided and their limitations.
- Maintain the rental property and conduct regular inspections to spot and fix any security problems, such as broken locks or burned out exterior flood lights. Asking tenants for their suggestions as part of an ongoing repair and maintenance system is also a good idea.

- Handle tenant complaints about dangerous situations, suspicious activities or broken security items immediately. Failing to do this may saddle a landlord with a higher level of legal liability should a tenant be injured by a criminal act after a complaint is made.

## *The Costs of Crime*

The money a landlord spends today on effective crime-prevention measures will pale in comparison to the costs that may result from crime on the premises. The average settlement paid by landlords' insurance companies for horrific crimes such as rape and assault is \$600,000, and the average jury award (when cases go to trial) is \$1.2 million.

### What kind of legal trouble do landlords face from tenants who deal drugs on the property?

Drug-dealing tenants can cause landlords all kinds of practical and legal problems:

- It will be difficult to find and keep good tenants and the value of the rental property will plummet.
- Anyone who is injured or annoyed by drug dealers—be it other tenants or people in the neighborhood—may sue the landlord on the grounds that the property is a public nuisance that seriously threatens public safety or morals.
- Local, state or federal authorities may levy stiff fines against the landlord for allowing the illegal activity to continue.
- Law enforcement authorities may seek criminal penalties against the landlord for knowingly allowing drug dealing on the rental property.
- In extreme cases, the presence of drug dealers may result in the government confiscating the rental property.

### How can a property owner avoid legal problems from tenants who deal drugs or otherwise break the law?

There are several practical steps landlords can take to avoid trouble from tenants and limit their exposure to any lawsuits that are filed:

- Screen tenants carefully and choose tenants who are likely to be law-abiding and peaceful citizens. Weed out violent or dangerous individuals to the extent allowable under privacy and anti-discrimination laws that may limit questions about a tenant's past criminal activity, drug use or mental illness.
- Keep the results of background checks that show that the tenants' rent appeared to come from legitimate sources (jobs and bank accounts).
- Don't accept a cash deposit or rental payments.
- Do not tolerate tenants' disruptive behavior. Include an explicit provision in the lease or rental agreement prohibiting drug dealing and other illegal activity by tenants or guests and promptly evict tenants who violate the clause.

- Be aware of suspicious activity, such as heavy traffic in and out of the rental premises.
- Respond to tenant and neighbor complaints about drug dealing on the rental property. Get advice from police immediately upon learning of a problem.
- Consult with security experts to do everything reasonable to discover and prevent illegal activity on the rental property.

### *Protecting Tenants From the Manager*

Rental property owners should be particularly careful when hiring a property manager—the person who interacts with all tenants and has access to master keys. Landlords should scrupulously check a manager's background to the fullest extent allowed by law, and closely supervise his or her job performance. A tenant who gets hurt or has property stolen or damaged by a manager could sue the property owner for failing to screen the manager properly. If tenants complain about illegal acts by a manager, landlords should pay attention. Finally, property owners should make sure their insurance covers illegal acts of their employees.

## **Landlord Liability for Lead Poisoning**

Landlords are increasingly likely to be held liable for tenant health problems resulting from exposure to lead and other environmental toxins, even if the landlord didn't cause—or even know about—the danger.

### **What are a landlord's legal responsibilities regarding lead in rental property?**

Because of the health problems caused by lead poisoning, the Residential Lead-Based Paint Hazard Reduction Act was enacted in 1992. This law is commonly known as Title X (ten). Environmental Protection Agency (EPA) regulations implementing Title X apply to rental property built before 1978.

Under Title X, before signing or renewing a lease or rental agreement, and before undertaking any renovation, a landlord must give every tenant the EPA pamphlet, *Protect Your Family From Lead in Your Home*, or a state-approved version of this pamphlet. At the start of the tenancy, both the landlord and tenant must sign an EPA-approved disclosure form



to prove that the landlord told the tenants about any known lead-based paint or hazards on the premises. Property owners must keep this disclosure form as part of their records for three years from the date that the tenancy begins.

A landlord who fails to comply with EPA regulations faces penalties of up to \$10,000 for each violation. And a landlord who is found liable for tenant injuries from lead may have to pay three times what the tenant suffered in damages.



#### *More Information on Lead Hazard Resources*

Information on the evaluation and control of lead dust, and copies of *Protect Your Family From Lead in Your Home* may be obtained by calling the National Lead Information Center at 800-424-LEAD, or checking its website at <http://www.epa.gov/opptintr/lead/nlic.htm>. In addition, state housing departments have information on state laws and regulations governing the evaluation and control of lead hazards.

#### *Are there any rental properties exempt from Title X regulations?*

These properties are not covered by Title X:

- housing for which a construction permit was obtained, or on which construction was started, after January 1, 1978
- housing certified as lead-free by a state-accredited lead inspector
- lofts, efficiencies and studio apartments
- short-term vacation rentals of 100 days or less
- a single room rented in a residential dwelling
- housing designed for persons with disabilities, unless any child less than six years old lives there or is expected to live there
- retirement communities (housing designed for seniors, where one or more tenants is at least 62 years old), unless children under the age of six are present or expected to live there.

## **Landlord's Liability for Exposure to Asbestos and Mold**

In addition to lead, property owners may be liable for tenant health problems caused by exposure to other environmental hazards, such as asbestos and mold.

Regulations concerning asbestos are issued by the Occupational Safety and Health Administration (OSHA). They

set strict standards for the testing, maintenance and disclosure of asbestos in buildings constructed before 1981. For information call the nearest OSHA office or check OSHA's website at <http://www.osha.gov>.

Mold is the newest environmental hazard fueling lawsuits against rental property owners. Across the country, tenants have won multi-million-dollar cases against landlords for significant health problems—such as rashes, chronic fatigue, nausea, cognitive losses, hemorrhaging and asthma—allegedly caused by exposure to “toxic molds” in their building. In a typical case, the Delaware Supreme Court in May 2001 upheld a \$1.4 million award to two tenants who suffered asthma and other health problems caused by mold that grew when the landlord refused to fix leaks in their apartment.

There are no federal or state laws or regulations covering permissible exposure to mold, though California has directed its Department of Health Services to study the issue. New York City's Department of Health has developed guidelines for indoor air quality, which landlords in New York City should follow. In fact, any landlord would be wise to consult them. You can read them online at <http://www.ci.nyc.ny.us>. San Francisco has added mold to its list of nuisances, thereby allowing tenants to sue landlords under private and public nuisance laws if they fail to clean up serious outbreaks (San Francisco Health Code §581).

## Insurance

Both tenants and landlords need insurance to protect their property and bank accounts. Without adequate insurance, landlords risk losing hundreds of thousands of dollars of property from fire or other hazards. While tenants may not have as much at stake financially, they also need insurance—especially tenants with expensive personal belongings. Tenant losses from fire or theft are not covered by the landlord's insurance.

### How can insurance help protect a rental property business?

A well-designed insurance policy can protect rental property from losses caused by many perils, including fire, storms, burglary and vandalism. (Earthquake and flood insurance are typically separate and, in some areas, mold may soon join the list.) A comprehensive policy will also include liability insurance, covering injuries or losses suffered by others as the result of defective conditions on the property.

Equally important, liability insurance covers the cost (mostly lawyer's bills) of defending personal injury lawsuits.

Here are some tips on choosing insurance:

- Purchase enough coverage to protect the value of the property and assets.
- Be sure the policy covers not only physical injury but also libel, slander, discrimination, unlawful and retaliatory

tory eviction and invasion of privacy suffered by tenants and guests.

- Carry liability insurance on all vehicles used for business purposes, including the manager's car or truck if he or she will use it on the job.
- Make sure your policy is "occurrence based," not "claims based." Here's the difference: under a claims-based policy, your policy must be in effect on the date you make the claim—even if it was in place when the incident leading to the claim occurred. Under an occurrence-based arrangement, you can make the claim after the policy has ended—which is obviously to your advantage.

If you need more information, *The Legal Guide for Starting & Running a Small Business*, by Fred S. Steingold (Nolo), contains a detailed discussion of small business law, including how to insure your rental property.

### What does renter's insurance cover?

The average renter's policy covers tenants against losses to their belongings occurring as a result of fire and theft, up to the amount stated on the face of the policy, such as \$25,000 or \$50,000.

Most renter policies include deductible amounts of \$250 or \$500. This means that if a tenant's apartment is burglarized, the insurance company will pay only for the amount of the loss over and above the deductible amount.

In addition to fire and theft, most renter's policies include personal li-

ability coverage (\$100,000 is a typical amount) for injuries or damage caused by the tenant—for example, if a tenant's garden hose floods the neighbor's cactus garden, or a tenant's guest is injured on the rental property due to the tenant's negligence.

Renter's insurance is a package of several types of insurance designed to cover tenants for more than one risk. Each insurance company's package will be slightly different—types of coverage offered, exclusions, the dollar amounts specified and the deductible will vary. Tenants who live in a flood or earthquake-prone area will need to pay extra for coverage. Policies covering flood and earthquake damage can be hard to find; tenants should shop around until they find the type of coverage that they need. There's lots of information on the Web—type "renters' insurance" into your favorite search engine to learn more.

## Resolving Disputes

Legal disputes—actual and potential—come in all shapes and sizes for landlords and tenants. Whether it's a disagreement over a rent increase, responsibility for repairs or return of a security deposit, rarely should lawyers and litigation be the first choice for resolving a landlord-tenant dispute.

## How can landlords and tenants avoid disputes?

Both landlords and tenants should follow these tips to avoid legal problems:

- Know your rights and responsibilities under federal, state and local law.
- Make sure the terms of your lease or rental agreement are clear and unambiguous.
- Keep communication open. If there's a problem—for example, a disagreement about the landlord's right to enter a tenant's apartment—see if you can resolve the issue by talking it over, without running to a lawyer.
- Keep copies of any correspondence and make notes of conversations about any problems. For example, a tenant should ask for repairs in writing and keep a copy of the letter. The landlord should keep a copy of the repair request and note when and how the problem was repaired.

## We've talked about the problem and still don't agree. What should we do next?

If you can't work out an agreement on your own, but want to continue the rental relationship, consider mediation by a neutral, third party. Unlike a judge, the mediator has no power to impose a decision but will simply work to help find a mutually acceptable solution to the dispute. Mediation is often available at little or no cost from a publicly funded program.



### *More Information About Mediation*

For information on local mediation programs, call your mayor's or city manager's office, and ask for the staff member who handles "landlord-tenant mediation matters" or "housing disputes." That person should refer you to the public office, business or community group that handles landlord-tenant mediations. You can learn more about mediation by reading Chapter 17 of this book, *Courts and Mediation*.

## If mediation doesn't work, is there a last step before going to a lawyer?

If you decide not to mediate your dispute, or mediation fails, it's time to pursue other legal remedies. If the disagreement involves money, such as return of the security deposit, you can take the case to small claims court. A few states use different names for this type of court (such as "Landlord-Tenant Court"), but traditionally the purpose has been the same: to provide a speedy, inexpensive resolution of disputes that involve relatively small amounts of money.

Keep in mind that your remedy in small claims court may be limited to an award of money damages. The maximum amount you can sue for varies from \$3,000 to \$7,500, depending on your state.

You can find more information about small claims court in Chapter 17, *Courts and Mediation*.

## Landlord-Tenant Statutory Codes

Here are some of the key statutes pertaining to landlord-tenant law in each state.

### ALABAMA

Ala. Code §§ 35-9-1 to 35-9-100

### ALASKA

Alaska Stat. §§ 34.03.010 to 34.03.380

### ARIZONA

Ariz. Rev. Stat. Ann. §§ 12-1171 to 12-1183, §§ 33-1301 to 33-1381

### ARKANSAS

Ark. Code Ann. §§ 18-16-101 to 18-16-306

### CALIFORNIA

Cal. Civ. Code §§ 1925 to 1954, 1961 to 1962.7, 1995.010 to 1997.270

### COLORADO

Colo. Rev. Stat. §§ 38-12-101 to 38-12-104, 38-12-301 to 38-12-302

### CONNECTICUT

Conn. Gen. Stat. Ann. §§ 47a-1 to 47a-51

### DELAWARE

Del. Code Ann. tit. 25, §§ 5101 to 7013

### DIST. OF COLUMBIA

D.C. Code Ann. §§ 45-1401 to 45-1597, 45-2501 to 45-2593

### FLORIDA

Fla. Stat. Ann. §§ 83.40 to 83.66

### GEORGIA

Ga. Code Ann. §§ 44-7-1 to 44-7-81

### HAWAII

Haw. Rev. Stat. §§ 521-1 to 521-78

### IDAHO

Idaho Code §§ 6-301 to 6-324, §§ 55-201 to 55-313

### ILLINOIS

765 Ill. Comp. Stat. §§ 705/0.01 to 740/5

### INDIANA

Ind. Code Ann. §§ 32-7-1-1 to 37-7-9-10

### IOWA

Iowa Code Ann. §§ 562A.1 to 562A.36

### KANSAS

Kan. Stat. Ann. §§ 58-2501 to 58-2573

### KENTUCKY

Ky. Rev. Stat. Ann. §§ 383.010 to 383.715

### LOUISIANA

La. Rev. Stat. Ann. §§ 9:3201 to 9:3259; La. Civ. Code Ann. art. 2669 to 2742

### MAINE

Me. Rev. Stat. Ann. tit. 14, §§ 6001 to 6046

### MARYLAND

Md. Code Ann. [Real Prop.] §§ 8-101 to 8-604

### MASSACHUSETTS

Mass. Gen. Laws Ann. ch. 186, §§ 1 to 21

### MICHIGAN

Mich. Comp. Laws §§ 554.601 to 554.640

### MINNESOTA

Minn. Stat. Ann. §§ 504B.001 to 504B.471

### MISSISSIPPI

Miss. Code Ann. §§ 89-8-1 to 89-8-27

### MISSOURI

Mo. Rev. Stat. §§ 441.005 to 441.880, §§ 535.150 to 535.300

### MONTANA

Mont. Code Ann. §§ 70-24-101 to 70-25-206

### NEBRASKA

Neb. Rev. Stat. §§ 76-1401 to 76-1449

### NEVADA

Nev. Rev. Stat. Ann. §§ 118A.010 to 118A.520

### NEW HAMPSHIRE

N.H. Rev. Stat. Ann. §§ 540:1 to 540:29, 540-A:1 to 540-A:8

**NEW JERSEY**

N.J. Stat. Ann. §§ 46:8-1 to 46:8-49

**NEW MEXICO**

N.M. Stat. Ann. §§ 47-8-1 to 47-8-51

**NEW YORK**

N.Y. Real Prop. Law §§ 220 to 238, Real Prop. Acts. §§ 701 to 853, Mult. Dwelling Law (all), Mult. Res. Law (all), Gen. Oblig. Law §§ 7-103 to 7-108

**NORTH CAROLINA**

N.C. Gen. Stat. §§ 42-1 to 42-14.2, 42-25.6 to 42-76

**NORTH DAKOTA**

N.D. Cent. Code §§ 47-16-01 to 47-16-41

**OHIO**

Ohio Rev. Code Ann. §§ 5321.01 to 5321.19

**OKLAHOMA**

Okla. Stat. Ann. tit. 41, §§ 1 to 136

**OREGON**

Or. Rev. Stat. §§ 90.100 to 90.450

**PENNSYLVANIA**

68 Pa. Cons. Stat. Ann. §§ 250.101 to 250.510-B

**RHODE ISLAND**

R.I. Gen. Laws §§ 34-18-1 to 34-18-57

**SOUTH CAROLINA**

S.C. Code Ann. §§ 27-40-10 to 27-40-910

**SOUTH DAKOTA**

S.D. Codified Laws Ann. §§ 43-32-1 to 43-32-29

**TENNESSEE**

Tenn. Code Ann. §§ 66-28-101 to 66-28-520

**TEXAS**

Tex. Prop. Code Ann. §§ 91.001 to 92.354

**UTAH**

Utah Code Ann. §§ 57-17-1 to 57-17-5, 57-22-1 to 57-22-6

**VERMONT**

Vt. Stat. Ann. tit. 9, §§ 4451 to 4468

**VIRGINIA**

Va. Code Ann. §§ 55-218.1 to 55-248.40

**WASHINGTON**

Wash. Rev. Code Ann. §§ 59.04.010 to 59.04.900, 59.18.010 to 59.18.911

**WEST VIRGINIA**

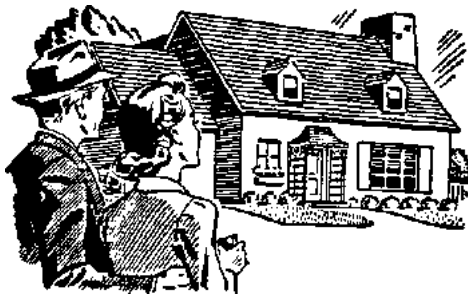
W. Va. Code §§ 37-6-1 to 37-6-30

**WISCONSIN**

Wis. Stat. Ann. §§ 704.01 to 704.45

**WYOMING**

Wyo. Stat. §§ 1-21-1201 to 1-21-1211, §§ 34-2-128 to 34-2-129





### *More Information About Landlord-Tenant Law*

#### **From the landlord's point of view:**

*Every Landlord's Legal Guide*, by Marcia Stewart, Ralph Warner and Janet Portman (Nolo). This 50-state book provides extensive legal and practical information on leases, tenant screening, rent, security deposits, privacy, repairs, property managers, discrimination, roommates, liability, tenancy termination and much more. It includes more than 25 legal forms and agreements as tear-outs and on disk.

*LeaseWriter* (Nolo)(CD-ROM for Windows/Macintosh). This software program generates a customized legal residential lease or rental agreement, plus more than a dozen key documents and forms every landlord and property manager needs. It includes a database to track tenants and rental properties, and a log for rental payments, repairs and problems. The program gives you instant access to state-specific landlord-tenant information, and extensive online legal help.

#### **From the tenant's point of view:**

*Every Tenant's Legal Guide*, by Janet Portman and Marcia Stewart (Nolo). This book gives tenants in all 50 states the legal and practical information they need to deal with their landlords and protect their rights when things go wrong. It covers all important issues of renting, including signing a lease, getting a landlord to make needed repairs, fighting illegal discrimination, protecting privacy rights, dealing with roommates, getting the security deposit returned fairly, moving out and much more.

*Renters' Rights*, by Janet Portman and Marcia Stewart (Nolo). A concise, highly accessible guide for tenants in every state, loaded with tips and strategies.

#### **For both landlords and tenants:**

*Everybody's Guide to Small Claims Court*, by Attorney Ralph Warner (National and California Editions)(Nolo). The book explains how to evaluate your case, prepare for court and convince a judge you're right. It also tells you what remedies (money only, or enforcement of the lease) are available in your state.

*How to Mediate Your Dispute*, by Peter Lovenheim (Nolo), explains how to choose a mediator, prepare a case and navigate the mediation process.

Additionally, tenants' unions and rental property owners' associations are good sources of advice. Look in your telephone book's white pages for names of these organizations.

## For tenants renting commercial property:

*Leasing Space for Your Small Business*, by Janet Portman and Fred. S. Steingold (Nolo). Gives commercial tenants the information they need to understand and negotiate a commercial lease, plus tips on finding suitable space, choosing and working with brokers and lawyers and bargaining effectively for the best terms and conditions.



**<http://www.nolo.com>**

*Nolo offers self-help information about a wide variety of legal topics, including landlord-tenant law and provides links to federal and state statutes.*

**<http://tenant.net>**

*TenantNet provides information about landlord-tenant law, with a focus on tenants' rights. TenantNet is designed primarily for tenants in New York City, but the site offers information about the law in many other states. The site also provides the text of the federal fair housing law.*

**<http://www.spl.org>**

*The Seattle Public Library has links to many cities that have posted their ordinances (and often their rent control laws) online.*



# 4

## Workplace Rights

- 4.2 *Fair Pay and Time Off*
- 4.9 *Workplace Health and Safety*
- 4.12 *Workers' Compensation*
- 4.17 *Age Discrimination*
- 4.21 *Sexual Harassment*
- 4.25 *Disability Discrimination*
- 4.29 *Losing or Leaving Your Job*

I LIKE WORK; IT FASCINATES ME.

I CAN SIT AND LOOK AT IT FOR HOURS.

—JEROME K. JEROME

If you're like most workers, you have experienced occasional job-related problems or have questions about whether you are being fairly and legally treated on the job. Here are several common problems:

- You were not hired for a job and you have good reason to suspect it was because of your race, age, sex, sexual orientation or because you are disabled.
- Your employer promoted a less-qualified person—perhaps someone who is younger than you are—to fill a position you were promised.
- You are regularly forced to work overtime but are not given extra pay. Or, you are paid for working extra hours, but you do not receive a premium rate, such as time-and-a-half.
- You need to take a leave of absence from your job to care for a sick parent, but you are concerned that this will jeopardize your job or your eligibility for a promotion.
- You have been called to serve on a jury and wonder if your employer must pay you for this time.
- You have just been laid off and you want to know whether, if business at your company picks up in the future, you have any right to get your job back. You also want to know whether you're entitled to unemployment payments, or whether your employer owes you severance pay.

It is reassuring for many workers to learn that they do not face these issues alone. In recent years, a number of laws have been passed to protect your rights in the workplace. Federal laws now establish some basic guarantees for most workers—such as the right to be paid fairly and on time and to work free from discrimination. And state laws may place their own twists

on your workplace rights—giving more protection than federal law, for example, or regulating whether or not you are entitled to time off work to vote.

## Fair Pay and Time Off

*I do not like work*

*even when someone else does it.*

—MARK TWAIN

These days, most of us spend at least half of our waking hours working. Ideally, this time will be spent on jobs that are fulfilling. But whether or not we enjoy our work, the bottom line for almost all of us is to be paid fairly and on time. Fortunately, both state and federal laws protect this right.

**I suspect my employer is bending some of the rules on paying employees. What are the legal controls on pay for work?**

The most important and far-reaching law guaranteeing a worker's right to be paid fairly is the federal Fair Labor Standards Act or FLSA. The FLSA:

- defines the 40-hour workweek
- covers the federal minimum wage (currently \$5.15 per hour)
- sets requirements for overtime, and
- places restrictions on child labor.

The FLSA is the single law most often violated by employers. But em-

employers must also comply with other local, state or federal workplace laws that sometimes set higher standards on wages and hours. If a state law sets a higher—or more worker-friendly—standard, then your employer must follow it. So in addition to determining whether you are being paid properly under the FLSA, you may need to check other laws that apply to your situation. For example, many states have a higher minimum wage than mandated by federal law. Your employer must comply with whichever minimum wage is higher.

To learn about state and local labor laws that might apply to you, contact the local office of your state department of labor, which should be able to supply you with written materials setting forth your legal rights.

### What is the current minimum wage?

The federal minimum wage is currently \$5.15 per hour. But many states have their own minimum wage laws that require a higher rate of pay. For example, Rhode Island's minimum wage is \$6.15 per hour. Employers must pay whichever minimum wage rate—federal or state—is higher. To find out the minimum wage rates in the 50 states, the District of Columbia, Puerto Rico and Guam, visit the U.S. Department of Labor's website at <http://www.dol.gov/dol/esa/public/minwage/america.htm>. You can also contact your state labor department for information.

In addition, some cities and counties have enacted so-called “living



wage” ordinances. These can set the minimum wage that your employer must pay even higher. To find out if your area has a living wage ordinance, contact your local government offices.

**My boss says that because I’m a supervisor, I am not legally entitled to overtime pay. Is this true?**

It may be. Some employees are exempt from the overtime requirements of the FLSA—and the biggest and most abused exemption is for executive, administrative and professional workers. To qualify as an exempt executive, the employee must, among other things, supervise two full-time employees (or the equivalent). The definitions of administrative and professional employees have their own quirks. For example, employees categorized as professionals must perform work that is primarily intellectual. The definitions also change with the employee’s salary level. For example, if the weekly salary of the executive, administrative or professional employee exceeds a certain minimum, fewer factors are required to qualify for the exemption.

Determining whether you truly are exempt from overtime requirements becomes even more complex when you factor in state law requirements. If you have a question about whether your particular job is exempt, it may be worth your while to go to the nearest law library and carefully read the Fair Labor Standards Act, 29 U.S.C. §§ 201 and following. You can also read this law online by visiting the U.S. Department of Labor site at <http://www.dol.gov>.

To learn about overtime laws in your state, contact your state department of labor.

**I put in more than forty hours on the job each week, without overtime pay. Am I entitled to time off to compensate for this?**

Most workers are familiar with compensatory or comp time—the practice of offering employees time off from work in place of cash payments for overtime. What comes as a shock to many is that the practice is illegal in most situations. Under the FLSA, only state or government agencies may legally allow their employees time off in place of wages (29 U.S.C. § 207(o)). Even then, comp time may be awarded only:

- according to the terms of an agreement arranged by union representatives, or
- if the employer and employee agree to the arrangement before work begins.

When compensatory time is allowed, it must be awarded at the rate of one and one-half times the overtime hours worked—and comp time must be taken during the same pay period that the overtime hours were worked.

Some states do allow private employers to give employees comp time instead of cash. But there are complex, often conflicting laws controlling how and when it may be given. A common control, for example, is that employees must voluntarily request in writing that comp time be given instead of overtime pay—before the extra hours are worked. Check with your state's labor department for special laws on comp time in your area.

Many employers and employees routinely violate the rules governing the use of compensatory time in place of cash overtime wages. However, such violations are risky. Employees can find themselves unable to collect money due them if a company goes out of business or they are fired. And employers can end up owing large amounts of overtime pay to employees as the result of a labor department prosecution of compensatory time violations.

**Can my boss force me to work overtime?**

Under the FLSA (which, you'll recall, is a federal law) your employer can force you to work overtime and can even fire you if you refuse to do so.

The FLSA does not limit the number of hours in a day or days in a week that an employer can schedule an employee to work. It only requires em-

employers to pay non-exempt employees overtime (time and a half the worker's regular rate of pay) for any hours over 40 that the employee works in a week.

However, your state law may provide additional rights. Contact your state labor department to learn more.

### Does my employer have to pay me overtime if I work more than eight hours in a day?

Under the FLSA, your employer does not have to pay you overtime if you work more than eight hours in any given day. The federal law is interested only in weeks, not days, so as long as you work less than 40 hours in a week, you aren't entitled to overtime.

In this area, however, it's definitely worth checking to see what your state law has to say on the subject. Some states, such as California, do require employers to pay overtime to employees who work more than eight hours in a day. Your employer must comply with whichever law—federal or state—is most beneficial to you.

### I work as a waitress and make good tips. My boss says that because I get this extra money at work, he can pay me a wage that is lower than the hourly minimum wage. Is this true?

It depends on how much money you make in tips. Employers must pay all employees not less than the minimum wage.

But the matter of minimum wage becomes tricky when an employee routinely receives at least \$30 per

month in tips. Under federal law, employers are allowed to credit half of those tips against the minimum wage requirement, which, under federal law, is currently \$5.15 per hour. So, they can credit up to \$2.12 an hour of the tips received toward their wage obligation and actually pay you only \$2.13 an hour. However, the employer's offset must not exceed the tips the employee actually receives.

#### EXAMPLE

*Alphonse is employed as a waiter and earns more than \$10 per hour in tips. Denis, the restaurant's owner, is required to pay Alphonse at least \$2.13 per hour on top of his tips for the first 40 hours worked in each week.*

*If business slows and Alphonse's tips dip to, say, \$1 an hour, Denis may credit the tip amount toward Alphonse's hourly minimum wage. Denis must pay the additional salary required to make up the full amount of minimum wage Alphonse is owed: \$5.15 an hour.*



I am required to carry a beeper 24 hours a day, every day of the week for my job. I am occasionally called on my vacation, holidays and other days off. Am I entitled to be paid anything for on-call time?

Under federal law, vacation days, holidays and other paid days off work should be just that—days off work—and you are entitled to enjoy them free from the reins of your beeper.

When your employer requires you to be on-call but does not require you to stay on the company's premises, the following two rules generally apply:

- On-call time that you control and use for your own enjoyment or benefit is not counted as payable time.
- On-call time over which you have little or no control and which you cannot use for your own enjoyment or benefit is payable time.

Disputes usually boil down to the slipperiness in the definition of control and use of time. If the occasional beep beckons you only to call in to give advice, but you are otherwise free to spend your time any way you want, your employer need only pay for the time you spend answering the beeper. However, if your employer insists that you be available to return to work on demand and puts constraints on your behavior between beeper calls—you cannot consume alcohol, or you must stay within a certain radius of work, for example—you may be entitled to compensation for your on-call time.

Similarly, if you receive five or six beeper calls on every day off, and if each of those beeps require you to come into the office or be in a specific place, then a court will likely see that your time isn't your own and will require that your employer compensate you.

And—as always—be sure to check with your state labor department to see if your state has different rules.

## *Independent Contractors Are Exempt*

The Fair Labor Standards Act covers only employees, not independent contractors, who are considered independent business people. Whether a person is an employee for purposes of the FLSA, however, generally turns on whether that worker is employed by a single employer, and not on the sometimes more lax Internal Revenue Service definition of an independent contractor.

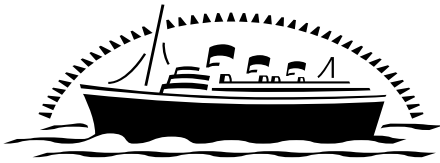
If nearly all of your income comes from one company, a court would probably rule that you are an employee of that company for purposes of the FLSA, regardless of whether other details of your worklife would appear to make you an independent contractor.

The FLSA was passed to clamp down on employers who cheated workers of their fair wages. As a result, employee status is broadly interpreted so that as many workers as possible come within the protections of the law. In recent cases determining close questions of employment status, growing numbers of courts

have found workers to be employees rather than independent contractors.

Courts are more likely to find that workers are employees when:

- the relationship appears to be permanent
- the worker lacks bargaining power with regard to the terms of his or her employment, and
- the individual worker is economically dependent upon the business to which he or she gives service.



### What laws ensure my right to take vacations?

Here's a surprising legal truth that most workers would rather not learn: No law requires employers to pay you for time off, such as vacation or holidays. This means that if you receive a paid vacation, it's because of custom, not law.

And just as vacation benefits are discretionary with each employer, so is the policy of how and when they accrue. For example, it is perfectly legal for an employer to require a certain length of employment—six months or a year are common—before an employee is entitled to any vacation time. It is also legal for employers to prorate vacations for part-time employees, or to deny them the benefit completely. Employers are also free to set limits on how much paid

time off employees may store up before it must be taken or is lost.

If your employer does have a policy of offering employees paid time off, however, it cannot discriminate in offering it—all employees must be subject to the same rules.

### If I lose or leave my job, when will I receive my final paycheck?

Unfortunately, there is no easy answer to this question. Many state laws, but not all, mandate that a worker who is fired must be paid all accrued wages and promised vacation pay immediately. Furthermore, state laws often set short limits—generally 72 hours—as the time in which this payment must be made if an employee quits. But you'll need to check with your state's department of labor to learn the details of the law that applies to you.

### Am I entitled to take time off from work if I get sick?

No law requires an employer to offer paid time off for illness. As with paid vacation time, however, an employer who offers paid sick time to some workers cannot discriminate by denying it to others.

Though you may not be entitled to paid time off, the Family and Medical Leave Act (FMLA), a federal law passed in 1993, gives workers some rights to unpaid leave for medical reasons. Under the FMLA, you may be eligible for up to 12 weeks of unpaid sick leave during any 12-month period. Your employer can count your

accrued paid benefits—vacation, sick leave and personal leave days—toward the 12 weeks of leave allowed under the law. But many employers give employees the option of deciding whether or not to include paid leave time as part of their 12 weeks of sick leave.

The FMLA applies to all private and public employers with 50 or more employees—an estimated one-half of the workforce. To be covered under the law, you must have:

- been employed at the same workplace for a year or more, and
- worked at least 1,250 hours (about 24 hours a week) during the year preceding the leave.

There are a number of loopholes in the FMLA. Companies with fewer than 50 employees working at offices within a 75-mile radius are exempt from the FMLA—this means that small regional companies or even the largest corporations may not need to comply with the Act. The law also allows companies to exempt the highest paid 10% of employees. And finally, schoolteachers and instructors who work for educational agencies and private elementary or secondary schools may have restrictions on their FMLA leave.

Note, however, that a number of states have passed their own versions of family leave laws—and most of them give workers more liberal leave rights. A number of laws apply, for example, to smaller workplaces and

extend to workers who have been on the job only a short time. Check with your state's department of labor for more information.

### What if a member of my family gets sick—can I take time off to care for him or her?

Possibly. Workers' rights under the Family and Medical Leave Act (FMLA)—or under your state's version of it—also apply if a member of your close family gets sick, or if you give birth to or adopt a child. The rights for new parents apply to both mothers and fathers in all situations—birth or adoption.

### My employer refused to grant me the time off for sick leave guaranteed by the FMLA. What can I do?

The FMLA is enforced by the U.S. Department of Labor. If you have specific questions about this law, including how to file a claim against your employer for failing to comply, contact your local Department of Labor office. You should be able to find a listing under U.S. Government, Department of Labor, in the phone book. You can also find a list of local offices of the U.S. Department of Labor by visiting the agency's website at <http://www.dol.gov>.

You generally must file a claim under the FMLA within two years of an employer's violation. If the violation was willful (intentional), you'll have up to three years to file.





*More Information About  
Wages, Hours and Time Off*

You can check into your employer's wage and payment policies by calling the local U.S. Labor Department, Wage and Hour Division office, listed in the federal government section of your telephone directory.

Most of the exemptions to FLSA coverage are listed in federal statute, 29 U.S.C. §213. The most direct way to become familiar with these exemptions is to read about them in an annotated edition of the U.S. Code, which is what your local law library (or even a large public library) is most likely to have. You can also find this law through Nolo's Legal Research Center at <http://www.nolo.com/research/index.html>.

Also, the United States Department of Labor, 200 Constitution Avenue, NW, Washington, DC 20210, 202-219-7316, offers pamphlets describing federal wage and hours laws and the Family Medical Leave Act. Or, visit the agency's website at <http://www.dol.gov>.



## Workplace Health and Safety

Over the past 20 years, workers have pushed strongly for laws to protect their health and safety on the job. And they have been somewhat successful. Several laws now establish basic safety standards aimed at reducing the number of illnesses, injuries and deaths in workplaces. Because most workplace safety laws rely for their effectiveness on employees who are willing to report job hazards, most laws also prevent employers from firing or discriminating against employees who report unsafe conditions to proper authorities.

### Do I have any legal rights if I feel that my workplace is unsafe or unhealthy?

The main federal law covering threats to workplace safety is the Occupational Safety and Health Act of 1970 (OSHA). OSHA requires employers to provide a workplace that is free of dangers that could physically harm employees.

The law quite simply requires that your employer protect you from "recognized hazards" in the workplace. It does not specify or limit the types of dangers covered. Instead, it includes everything from equipment that might cause a serious cut or bruise to the unhealthy effects of long-term exposure to radiation, chemicals or airborne pollutants.

Most states now have their own OSHA laws, most of which offer protections similar to the federal law. A few states, including California, require all employers to fashion workplace safety plans. And Texas, big in its approach to most everything, has instituted a 24-hour hotline to receive complaints; the state prohibits employers from discriminating against those who call in.

### How do I assert my rights to a safe workplace?

If you feel that your workplace is unsafe, your first action should be to make your supervisor aware of the danger. If your employer doesn't take prompt action, follow up in writing. Then, if you are still unsuccessful in getting your company to correct the safety hazard, you can file a complaint at the nearest OSHA office. Look under the U.S. Labor Department in the federal government section of your local telephone directory. You can also file a complaint online at <http://www.osha.gov/as/opa/worker/index.html>.

If you feel that a workplace hazard poses an imminent danger (which is a danger that could immediately cause death or serious physical harm), you should act immediately and call the agency's hotline at 800-321-OSHA.



## Preventing Additional Injuries

Workplace hazards often become obvious only after they cause an injury. For example, an unguarded machine part that spins at high speed may not seem dangerous until someone's clothing or hair becomes caught in it. But even after a worker has been injured, employers sometimes fail—or even refuse—to recognize that something that hurt one person is likely to hurt another.

If you have been injured at work by a hazard that should be eliminated before it injures someone else, take the following steps as quickly as possible after obtaining the proper medical treatment:

- Immediately file a claim for workers' compensation benefits so that your medical bills will be paid and you will be compensated for your lost wages and injury. In some states, the amount you receive from a workers' comp claim will be larger if a violation of a state workplace safety law contributed to your injury. (For more information about workers' compensation, see the next series of questions in this chapter.)
- Point out to your employer that a continuing hazard or dangerous condition exists. As with most workplace safety complaints, the odds of getting action will be greater if other employees join in your complaint.
- If your employer does not eliminate the hazard promptly, file a complaint with OSHA and any state or local agency that you think may be able to help.

You can obtain a list of state health and safety agencies on the OSHA website at <http://www.osha.gov>. For example, if your complaint is about hazardous waste disposal, you may be able to track down a specific local group that has been successful in investigating similar complaints in the past.

### Does OSHA protect against the harmful effects of tobacco smoke in the workplace?

OSHA rules apply to tobacco smoke only in rare and extreme circumstances, such as when contaminants created by a manufacturing process combine with tobacco smoke to create a dangerous workplace air supply that fails OSHA standards. Workplace air quality standards and measurement techniques are so technical that typically only OSHA agents or consultants who specialize in environmental testing are able to determine when the air quality falls below allowable limits.

### If OSHA won't protect me from secondhand tobacco smoke at work, is there anything I can do to limit or avoid exposure?

If your health problems are severely aggravated by co-workers' smoking, there are a number of steps you can take.

*Check local and state laws.* A growing number of local and state laws prohibit smoking in the workplace. Most of them also set out specific procedures for pursuing complaints. Your

state's labor department should have up-to-date information about these. If you can't find local laws that prohibit smoking in workplaces, check with a national nonsmokers' rights group, such as Americans for Nonsmokers Rights, 2530 San Pablo Avenue, Suite J, Berkeley, CA 94702, 510-841-3032, <http://www.no-smoke.org>.

*Ask your employer for an accommodation.* Successful accommodations to smoke-sensitive workers have included installing additional ventilation systems, restricting smoking areas to outside or special rooms and segregating smokers and nonsmokers.

*Consider income replacement programs.* If you are unable to work out a plan to resolve a serious problem with workplace smoke, you may be forced to leave the workplace. But you may qualify for workers' compensation or unemployment insurance benefits. See *Losing or Leaving Your Job*, below.



### More Information About Workplace Health and Safety

The Occupational Safety and Health Administration, 200 Constitution Avenue, NW, Washington, DC 20210, 202-693-1999, publishes pamphlets about workplace safety laws. You can also visit OSHA online at <http://www.osha.gov>.

# Workers' Compensation

If you are injured on the job—or suffer a work-related illness or disease that prevents you from working—you may be eligible to receive benefits from your state workers' compensation program. You also may be entitled to free medical care. If your disability is classified as permanent or results in death, additional benefits may be available to you and your family. If you receive workers' compensation benefits, you lose your right to sue your employer for the injury.

## Who pays workers' compensation benefits?

In most states, employers are required to purchase insurance for their employees from a workers' compensation insurance company—also called an insurance carrier. In some states, larger employers who are clearly solvent are allowed to self-insure or act as their own insurance companies, while smaller companies (with fewer than three or four employees) are not required to carry workers' compensation insurance at all. When a worker is injured, her claim is filed with the insurance company—or self-insuring employer—who pays medical and disability benefits according to a state-approved formula.

## Are all on-the-job injuries covered by workers' compensation?

Most are. The workers' compensation system is designed to provide benefits

to injured workers no matter whether an injury is caused by the employer's or employee's negligence. But there are some limits. Generally, injuries caused because an employee is intoxicated or using illegal drugs are not covered by workers' compensation. Coverage may also be denied in situations involving:

- self-inflicted injuries (including those caused by a person who starts a fight)
- injuries suffered while a worker was committing a serious crime
- injuries suffered while an employee was not on the job, and
- injuries suffered when an employee's conduct violated company policy.

If your employer's conduct is especially egregious (for example, your employer did something intentional or reckless that injured you), you may be allowed to bypass the workers' compensation system and sue your employer in court—for much larger amounts of money than you could cover through workers' compensation.

## Does an injury have to have a definite date of onset in order to be covered?

Not necessarily. Your injury does not need to be caused by an accident—such as a fall from a ladder. Many workers, for example, receive compensation for repetitive stress injuries, including carpal tunnel syndrome and back problems, that are caused by

overuse or misuse over a long period of time. You may also be compensated for some illnesses and diseases that are the gradual result of work conditions—for example, heart conditions, lung disease and stress-related digestive problems.

## *Are You Covered by Workers' Compensation?*

Most workers are eligible for workers' compensation coverage, but every state excludes some workers. Exclusions often include:

- business owners
- independent contractors
- casual workers
- domestic employees in private homes
- farm workers
- maritime workers
- railroad employees, and
- unpaid volunteers.

Check the workers' compensation law of your state to see whether these exclusions affect you.

Federal government employees are also excluded from state workers' compensation coverage, but they receive workers' compensation benefits under a separate federal law.

Employees who aren't covered by workers' compensation usually must sue the employer for damages or, in some cases, they can sue the maker of a faulty piece of equipment.

## *Do I have to be injured at my workplace to be covered by workers' compensation?*

No. As long as your injury is job-related, it's covered. For example, you'll be covered if you are injured while traveling on business, doing a work-related errand or even attending a required, business-related social function.

## *How do I claim workers' compensation benefits?*

First, promptly report the work-related injury or sickness to your employer. Most states require that this be done within two to 30 days following an injury. If an injury occurs over time (for example, a breathing problem or carpal tunnel syndrome), you must report your condition soon after you discover it and realize that it is caused by your work.

Next, get the medical treatment you need and follow the doctor's instructions exactly. (This may include an "off-work order" or a "limited-duties work order.") Finally, file a claim with your workers' compensation carrier. Necessary forms must be provided by your employer. Ask someone in the personnel or benefits department.

Finally, make sure you save copies of all correspondence with your employer, its insurance carrier and your doctor concerning your workers' compensation claim.

## What kind of benefits will I receive?

The workers' compensation system provides replacement income, medical expenses and sometimes vocational rehabilitation benefits—that is, on the job training, schooling or job placement assistance. The benefits paid through workers' compensation, however, are almost always limited to relatively modest amounts.

If you become temporarily unable to work, you'll usually receive two-thirds of your average wage up to a fixed ceiling. But because these payments are tax-free, if you received decent wages prior to your injury, you'll fare reasonably well in most states. You will be eligible for these wage-loss replacement benefits as soon as you've lost a few days of work because of an injury or illness that is covered by workers' compensation.

If you become permanently unable to do the work you were doing prior to the injury, or unable to do any work at all, you may be eligible to receive long-term or lump-sum benefits. The amount of the payment you may be entitled to receive varies greatly with the nature and extent of your injuries. If you anticipate a permanent work disability, contact your local workers' compensation office as soon as possible; these benefits are rather complex and may take a while to process.

## *Social Security Benefits for the Permanently Disabled*

If you're permanently unable to return to work, you may qualify for Social Security Disability benefits. Social Security will, over the long run, provide more benefits than workers' compensation—but be forewarned that these benefits are hard to get. They are reserved for seriously injured workers. To qualify, your injury or illness:

- must prevent you from doing any "substantial gainful work," and
- must be expected to last at least twelve months, or to result in death.

If you think you may meet the above requirements, contact your local Social Security office. For more information about Social Security benefits, see Chapter 14.

## Can I be treated by my own doctor and, if not, can I trust a doctor provided by my employer?

In some states, you have a right to see your own doctor if you make this request in writing before the injury occurs. More typically, however, injured workers are referred to a doctor or health plan recruited and paid for by their employer.

Your doctor's report will have a big impact upon the benefits you receive. While it's crucial that you tell the doctor the truth about both your injury and your medical history (your benefits may be denied based on fraud if you don't), be sure to clearly identify all possible job-related medical problems and sources of pain. In short, this is no time to downplay or gloss over the presence of a pain.

Keep in mind that a doctor paid for by your employer's insurance company is not your friend. The desire to get future business may motivate a doctor to minimize the seriousness of your injury or to identify it as a pre-existing condition.

**If I am initially treated by an insurance company doctor, do I have a right to see my own doctor at some point?**

State workers' compensation systems establish technical and often tricky rules in this area. Often, you have the right to ask for another doctor at the insurance company's expense if you clearly state you don't like the one the insurance company provides, although there is sometimes a waiting period before you can get a second doctor. Also, if your injury is serious, you usually have the right to a second opinion. And in some states, after you are treated by an insurance company's doctor for a certain period (90 days is typical), you may have the automatic right to transfer your treatment to your own doctor or health plan—with the cost being paid for by the workers' comp insurance company.

To understand your rights, contact your state worker's compensation office (also called industrial relations office). You can also get copy of your state's rules—or, if necessary, research your state workers' compensation laws and regulations in the law library. The Appendix contains information about how to do your own legal research.

**Suppose I suffer an injury to a part of my body that had been injured previously—will I still be covered?**

If the previous injury was also work-related, workers' compensation should provide full coverage. If it wasn't, you may receive lower-level benefits.

If your earlier injury occurred at a former job, it's generally up to your current employer's insurance company and your former employer to sort out who's responsible for paying your benefits—sometimes they will split the costs between them.

**How do I find a good workers' compensation lawyer—and how much will it cost?**

You usually don't need a lawyer unless you suffer a permanent disability, or all or part of your workers' compensation claim is denied. If one of these situations occurs, you'll probably want to do some research to familiarize yourself with your rights and duties. For example, many claims are denied based on a doctor's report claiming that you are not injured. If you dispute this, you may have a right to obtain a second

doctor's opinion paid for by the workers' compensation insurer.

If your claim is denied, consider hiring an experienced workers' compensation lawyer to help you navigate the appeals process. The best way to find a good lawyer is often through word of mouth—talk to other injured workers or check with a local union or other workers' organization.

In most states, fees for legal representation in workers' compensation cases are limited to between 10% and 15% of any eventual award. Because these fees are relatively modest, workers' compensation lawyers customarily take on many clients and, as a result, do not have time to provide much individual attention. Most of your contacts with your attorney's office will be with paralegals and other support personnel. This is not a bad thing in itself, if the office is well run by support staff. Be sure that the office is able to stay on top of paperwork and filing deadlines, and that a knowledgeable person is available to answer your questions clearly and promptly.

## *What to Do When the Insurance Company Won't Pay*

Some workers' compensation carriers take an aggressive stance and deny legitimate claims for workers' compensation. When this happens, it's often because the insurer claims you haven't been injured or, if you have, that it's not serious enough to qualify you for temporary or total disability. Commonly,

this is done after a private investigator hired by the insurance company follows you and obtains photographs showing you engaging in fairly strenuous physical activity, such as lifting a box or mowing the lawn, despite claiming a back injury.

If your legitimate benefits are denied, you should immediately file an appeal with your state appeals agency—called the industrial accidents board, the workers' compensation appeals board or something similar. You may also want to hire an attorney to help you press your claim.

## *If I receive workers' compensation, can I also sue my employer in court?*

Generally, no. The workers' compensation system was established as part of a legal trade-off. In exchange for giving up the right to sue an employer in court, you get workers' compensation benefits no matter who was at fault. Before the workers' compensation system was passed, if you went to court, you stood to recover a large amount of money, but only if you could prove the injury was caused by your employer.

Today, you may be able to sue in court if your injury was caused by someone other than your employer (a visitor or outside contractor, for example) or if it was caused by a defective product (such as a flaw in the construction of the equipment you were working with).

You might even be able to sue your employer in court if your injury was caused by intentional, reckless or illegal conduct on your employer's part.



What if my employer tells me not to file a workers' compensation claim or threatens to fire me if I do?

In most states, it is a violation of the workers' compensation laws to retaliate against an employee for filing a workers' compensation claim. If this happens, immediately report it to your local workers' compensation office.



### *More Information About Workers' Compensation*

*How to Handle Your Workers' Compensation Claim*, by Christopher Ball (Nolo), includes all forms and instructions for filing a workers' compensation claim in California. The book is also useful for people who live elsewhere, given the absence of self-help resources for other states; it provides a good overview of how the system works.



## Age Discrimination

*Young men think old men are fools, but old men know young men are fools.*

—GEORGE CHAPMAN

Unfortunately, rather than value older workers' intelligence, experience and work ethic, some employers assume that older workers are "out of touch" or set in their ways. And, because older workers often earn higher salaries and have higher healthcare premiums than younger workers, some employers think they are too "expensive." For these reasons, some employers try to get rid of their more seasoned workers and are reluctant to hire older workers.

Fortunately, federal and state laws afford some protection to older workers who face discrimination in the workplace—and also help protect their pension rights when they leave.

**My employer has just cut the workforce in half, singling out older workers. Is there any legal protection for us?**

Possibly. The federal Age Discrimination in Employment Act (ADEA) provides that workers over the age of 40 cannot be arbitrarily discriminated against because of age in any employment decision. Perhaps the single most important rule under the ADEA

is that no worker can be forced to retire.

Under the ADEA, there has to be a valid reason—not related to age—for all employment decisions, especially lay-offs. Examples of valid reasons would be poor job performance by the employee or an employer's economic trouble. If lay-offs have been announced or are in the wind, talk with other affected workers. If most people who are laid off are 40 or older, and the majority of workers kept on are younger, you may have the basis for an ADEA complaint or lawsuit. This is especially likely if the employer has hired younger workers to take the places of workers over 40.

Many states also have laws that prohibit age discrimination. To find out if your state has such a law, contact your state labor department or fair employment office.

### Does the ADEA protect all workers from age discrimination?

Unfortunately not; there are limits on both the employees and the employers who are covered. The ADEA applies only to employees age 40 and older—and only to workplaces with 20 or more employees. The ADEA applies to federal employees, private sector employees and labor union employees. It does not, however, cover state employees.

There are several other exceptions to the broad protection of the ADEA:

- Executives or people “in high policy-making positions” can be forced to retire at age 65 if they

would receive annual retirement pension benefits worth \$44,000 or more.

- There are special exceptions for police and fire personnel, tenured university faculty and certain federal employees having to do with law enforcement and air traffic control. If you are in one of these categories, check with your personnel office or benefits plan office for details.
- An additional exception to the federal age discrimination law is made when age is an essential part of a particular job—referred to by the legal jargon of a “bona fide occupational qualification” (BFOQ). For example, if an employer who sets age limits on a particular job can prove that the limit is necessary because a worker's ability to adequately perform the particular job does, in fact, diminish after the age limit is reached, it's okay to discriminate. However, it has become more difficult for employers to prove a BFOQ because the law protects workers as young as age 40.

### If I'm not protected by the ADEA, is an employer free to discriminate against me because of my age?

That depends on where you live. All states except Alabama and South Dakota have laws against age discrimination in employment, and those state laws often provide greater protection than the federal law. For example, several states provide age discrimination protection to workers before they reach age 40, and other states protect

against the actions of employers with fewer than 20 employees. In addition, state laws against age discrimination do protect state employees, unlike the federal ADEA.

To find out more about the laws of your own state, contact your state labor department.

**I've noticed a pattern where I work: Older workers tend to be laid off just before their pension rights lock in or vest. Is that legal?**

Using various ploys like this one to cheat workers out of their promised pensions is a technique some employers use to save money. But it's not legal. The federal Older Workers Benefit Protection Act forbids

- using an employee's age as the basis for discrimination in benefits, and
- targeting older workers for their staff cutting programs.



**Can my employer force me to take early retirement?**

No employer can require you to retire because of your age. An early retirement plan is legal only if it gives you a choice between two options: keeping things as they are or choosing to retire under a plan that leaves you better off than you previously were. This choice must be a genuine one; you must be free to reject the offer. In addition, if either choice leaves you worse off, the offer violates the Older Workers Benefit Protection Act.

**How can I enforce my rights under the laws that protect against age discrimination?**

If you believe that an employer has discriminated against you because of your age, you can file a complaint with the federal Equal Employment Opportunity Commission (EEOC) just as you would against any other workplace discrimination. Call 800-669-4000 to find the EEOC office nearest you. You can also find a list of EEOC regional offices on the agency's website at <http://www.eeoc.gov>. If the EEOC does not resolve your complaint to your satisfaction, you can consult an attorney for advice about filing a lawsuit.

In addition, you can file a complaint under your state age discrimination law, if your state has one. Contact your state labor department or fair employment office for details.

Like all fair employment laws, age discrimination laws require you to file a complaint within a specified amount

of time, usually 180 days. Therefore, it is important for you to act as soon as you realize that you might be the victim of age discrimination. If you wait too long, you might lose your rights.

## *Out From Under the Golden Parachute*

A growing number of employers ask older workers to sign waivers—also called releases or agreements not to sue. In return for signing the waivers, the employer offers the employee an incentive to leave the job voluntarily, such as a significant amount of severance pay. The Older Workers Benefit Protection Act places a number of restrictions on such waivers:

- Your employer must make the waiver understandable to the people who are likely to use it.
- The waiver may not cover any rights or claims that you discover are available after you sign it, and it must specify that it covers your rights under the ADEA.
- Your employer must offer you something of value (such as severance pay)—over and above what is already owed to you—in exchange for your signature on the waiver.
- Your employer must advise you, in writing, that you have the right to consult an attorney before you sign the waiver.

- If the offer is being made to a group or class of employees, your employer must inform you in writing how the class of employees is defined; the job titles and ages of all the individuals to whom the offer is being made; and the ages of all the employees in the same job classification or unit of the company to whom the offer is not being made.
- You must be given a fixed time in which to make a decision on whether or not to sign the waiver.

### **More Information About Age Discrimination**

Several organizations offer help and information on age discrimination in employment. Among the most helpful are:

American Association of Retired Persons  
601 E Street, NW  
Washington, DC 20049  
800-424-3410  
<http://www.aarp.org>

AARP is a nonprofit membership organization of older Americans open to anyone age 50 or older. It offers a wide range of publications on retirement planning, age discrimination and employment-related topics. Networking and direct services are available through local chapters.

Older Women's League  
666 Eleventh Street, NW, Suite 700  
Washington, DC 20001  
202-783-6686

The Older Women's League provides advice on discrimination and other issues facing elderly men and women.

# Sexual Harassment

Sexual harassment on the job took a dramatic leap into public awareness in October 1991, when Professor Anita Hill made known her charges against Judge Clarence Thomas after his nomination to the U.S. Supreme Court. Many other incidents have erupted since then, including investigations into the Navy after the Tailhook incident and into government officials after Senator Bob Packwood was accused of harassing several female staffers. Paula Jones dominated headlines for months with her claim that President Clinton harassed her while a conventioning governor. And more recently, Mitsubishi Motors agreed to pay a record \$34 million settlement to hundreds of women harassed at its auto assembly plant.

Enforcement of the laws prohibiting sexual harassment has been stepped up in the last few years. But in workplaces across America, the issue is far from settled. Sexual harassment is still a daily problem for many workers, especially women.

## What is sexual harassment?

In legal terms, sexual harassment is any unwelcome sexual advance or conduct on the job that creates an intimidating, hostile or offensive working environment. In real life, sexually harassing behavior ranges from repeated offensive or belittling

jokes to a workplace full of offensive pornography to an outright sexual assault.

## Are there laws that protect against sexual harassment on the job?

Yes. But surprisingly, those laws are fairly new. In 1980, the Equal Employment Opportunity Commission (EEOC) issued regulations defining sexual harassment and stating it was a form of sex discrimination prohibited by the Civil Rights Act, which had been originally passed in 1964. In 1986, the U.S. Supreme Court first ruled that sexual harassment was a form of job discrimination—and held it to be illegal.

Today, there is greater understanding that the Civil Rights Act prohibits sexual harassment at work. In addition, most states have their own fair employment practices laws that prohibit sexual harassment—many of them more strict than the federal law. To find out more about the federal prohibition against sexual harassment, contact the EEOC office nearest you. For a list of EEOC regional offices, call the main EEOC office at 800-669-4000 or refer to the agency's website at <http://www.eeoc.gov>.

To learn more about state laws prohibiting sexual harassment, contact your state labor department or state fair employment office. In addition, your local EEOC office should be able to give you information about the laws in your state.

## Can a man be sexually harassed?

Yes, a man can be sexually harassed. The laws prohibiting sexual harassment on the job protect all workers, male and female, from being harassed on the basis of their gender.

But in the overwhelming majority of cases of sexual harassment, it's a male co-worker or supervisor who is harassing a female worker. No one is sure why this is so. Socialization probably plays a part: Men are more likely than women to find sexual advances flattering, women more likely to be perceived as the gatekeepers of sexual conduct. Economics probably enter, too. There are simply more women in the workforce than ever before—and at least some male workers feel the influx as a threat to their own livelihoods. Finally, sexual harassment is usually a power ploy, a way to keep some workers in lower-paid, less respected positions—or force them out of the workplace altogether.

## Are gays and lesbians protected by the laws against sexual harassment?

Whether federal civil rights laws protect gays and lesbians is a hot question these days. The U.S. Supreme Court has not addressed the issue, so there is no definitive word on whether gays and lesbians can find shelter under the federal prohibition against sexual harassment in the workplace. A number of lower federal courts have considered the issue, however, and

they have proven to be quite hostile to the protection of gays and lesbians.

If you are gay or lesbian, you might find protection under a state law or a local ordinance. In addition, you might live in an area where the federal courts are more receptive to granting protection. To find out about what laws might protect you in your geographical area, contact the Lambda Legal Defense and Education Fund at 202-809-8585 or <http://www.lambdalegal.org>.

## I'm being sexually harassed at work. What is the first thing I should do?

Tell the harasser to stop. Surprisingly often—some experts say up to 90% of the time—this works.

When confronted directly, harassment is especially likely to end if it is at a fairly low level: off-color jokes, inappropriate comments about your appearance, tacky cartoons tacked onto the office refrigerator or repeated requests for dates after you have said no.

But clearly saying you want the offensive behavior to stop does more than let the harasser know that the behavior is unwelcome. It is also a crucial first step if you later decide to take more formal action against the harasser, whether through your company's complaint procedure or through the legal system. And be sure to document what's going on by keeping a diary or journal; your case will be stronger if you can later prove that the harassment continued after you confronted the harasser.

## What if the harassment doesn't stop even after I've confronted the harasser?

If confronting the harasser doesn't work, complain, complain, complain. Talk to your supervisor. Talk to the harasser's supervisor. If that doesn't work, talk to their supervisors, and so on. If your company has a complaint procedure in place, follow it. If your company has a human resources department, talk to someone there. And every step of the way, document your complaints. Save copies of all letters and e-mails. Take notes of all conversations. You have a right to a work environment free of sexual harassment, and you must be assertive about making that right work for you.

Of course, there will be times when you are afraid to complain about harassment, perhaps because the harasser is your supervisor or because the harasser has made threats against you. The laws against sexual harassment prohibit your employer from retaliating against you for complaining about sexual harassment. Although this fact might be cold comfort if you fear for your job or your safety, the fact is that the law can protect you only if you let someone with power at your workplace know about your problem. Be creative. If your supervisor is the one harassing you, go to his supervisor or go to a supervisor in another department.

Collect as much detailed evidence as possible about the harassment. Be

sure to save any offensive letters, photographs, cards or notes you receive. And if you were made to feel uncomfortable because of jokes, pin-ups or cartoons posted at work, confiscate them—or at least make copies. An anonymous, obnoxious photo or joke posted on a bulletin board is not anyone else's personal property, so you are free to take it down and keep it as evidence. If that's not possible, photograph the workplace walls. Note the dates the offensive material was posted—and whether there were hostile reactions when you took it down or asked another person to do so.

Also, keep a detailed journal. Write down the specifics of everything that feels like harassment. Include the names of everyone involved, what happened, and where and when it took place. If anyone else saw or heard the harassment, note that as well. Be as specific as possible about what was said and done—and how it affected you, your health or your job performance.

If your employer has conducted periodic evaluations of your work, make sure you have copies. In fact, you may want to ask for a copy of your entire personnel file—before you tip your hand that you are considering taking action against a harassing coworker. Your records will be particularly persuasive evidence if your evaluations have been good but after you complain, your employer retaliates by trying to transfer or fire you, claiming poor job performance.



## *If You're Afraid of Offending*

The super-cautious advice—don't talk with co-workers about anything but business—is surely overkill. The better approach is to use common sense. There is plenty of room to be friendly and personable without behaving in a way that is likely to offend workers of either gender.

Some rough guides for evaluating your own workplace behavior:

- If you wouldn't say or do something in front of your spouse or parents, it's probably a poor idea to say or do it at work.
- Would you say or do it in front of a colleague of the same gender?
- How would you feel if your mother, wife, sister or daughter were subjected to the same words or behavior?
- How would you feel if a co-worker said or did the same things to you?
- Does it need to be said or done at all?

If you are truly concerned that your words or conduct may be offensive to a co-worker, there is one surefire way to find out: ask.

### **If the harassment still doesn't stop, what are my options short of filing a lawsuit or a complaint with a government agency?**

If the harasser has ignored your oral requests to stop, or you are uncomfortable making the request, write a succinct letter demanding an end to the behavior. If that doesn't end the harassment, you may want to take more forceful action. Consider giving

a copy of your letter to the harasser's supervisor—along with a memo explaining that the behavior has become more outrageous.

If the harassment still does not abate—or if you believe the supervisor is sympathetic to the harassment or the harasser—send the letter to the next-ranked worker or official at your workplace. Include a cover letter in which you offer your own remedy for the situation—something realistic that might help end the discomfort, such as transferring the harasser to a more distant worksite. If it's your own supervisor who has been harassing you, consider asking to be assigned a different supervisor.

These days, most workplaces have specific written policies prohibiting sexual harassment. If you have followed the steps that seem reasonable to you but the harassment continues, your next option is to pursue any procedure your company has established for handling harassment.

### **What legal steps can I take to end the harassment?**

If all investigation and settlement attempts fail to produce satisfactory results, one option is to file a civil lawsuit for damages either under the federal Civil Rights Act or under a state fair employment practices statute.

Even if you intend right from the beginning to file such a lawsuit, you sometimes must first file a claim with a government agency. For example, an employee pursuing a claim under the Civil Rights Act must first file a claim with the federal EEOC, and a



similar complaint procedure is required under some state laws. The EEOC or state agency may decide to prosecute your case on its own, but that happens only occasionally.

More commonly, at some point, the agency will issue you a document referred to as a “right-to-sue” letter that allows you to take your case to court. When filing an action for sexual harassment, you will almost always need to hire a lawyer for help.



### *More Information About Sexual Harassment*

*Sexual Harassment on the Job*, by William Petrocelli and Barbara Kate Repa (Nolo), explains what sexual harassment is and how to stop it.

9to5, National Association  
of Working Women  
614 Superior Avenue, NW  
Cleveland, OH 44113  
216-566-9308 (general information)  
800-522-0925 (hotline)  
<http://www.9to5.org>

9to5 is a national nonprofit membership organization for working women. It provides counseling, information and referrals for problems on the job, including family leave, pregnancy disability, termination, compensation and sexual harassment. 9to5 also offers a newsletter and publications. There are local chapters throughout the country.

## Disability Discrimination

Many individuals fortunate enough to be healthy in mind and body—and to be employed—lament the difficulties a workplace can impose. But for those with physical or mental disabilities, many workplaces can be truly daunting. Fortunately, the federal Americans with Disabilities Act (ADA), has helped to level the playing field a bit.

### What laws protect disabled workers from workplace discrimination?

The Americans with Disabilities Act (ADA) prohibits employment discrimination on the basis of workers’ disabilities. Generally, the ADA prohibits employers from:

- discriminating on the basis of virtually any physical or mental disability
- asking job applicants questions about their past or current medical conditions
- requiring job applicants to take medical exams, and
- creating or maintaining worksites that include substantial physical barriers to the movement of people with physical disabilities.

The ADA covers companies with 15 or more employees. Its coverage broadly extends to private employers, employment agencies and labor organizations. A precursor of the ADA, the Vocational Rehabilitation Act, prohibits discrimination against dis-

abled workers in state and federal government.

In addition, many state laws protect against discrimination based on physical or mental disability.

### Exactly whom does the ADA protect?

The ADA's protections extend to disabled workers—defined as people who:

- have a physical or mental impairment that substantially limits a major life activity
- have a record of impairment, or
- are regarded as having an impairment.

An impairment includes physical disorders, such as cosmetic disfigurement or loss of a limb, as well as mental and psychological disorders.

The ADA protects job applicants and employees who, although disabled as defined above, are still qualified for a particular job. In other words, they would be able to perform the essential functions of a job with some form of accommodation, such as wheelchair access, a voice-activated computer or a customized workspace. As with other workers, whether a disabled worker is deemed qualified for a given job depends on whether he or she has appropriate skill, experience, training or education for the position.

### If I am disabled, how do I get my employer to accommodate my disability?

The first step is simple, but often skipped: Ask. The ADA places the burden on you, the employee, to in-

form the employer that you have a disability and that you need an accommodation for it. Indeed, the ADA forbids employers from asking employees whether they have a disability.

When you ask for an accommodation, you do not need to use formal legal language or even do it in writing (though it's always a good idea to document your request). Just tell your employer what your disability is and why you need an accommodation. If you aren't comfortable going to your employer and making this request yourself, you can ask a friend, family member, or representative to do it for you.

Once you request the accommodation, your employer should engage in an informal process of determining whether it can accommodate you and, if so, how. Remember that your employer may be concerned about cost or worried that other employees may incorrectly view you as getting "special treatment." The more helpful and understanding you can be during this process, the more likely it is that your employer will find a way to accommodate you.

As part of this process, your employer is allowed to ask you for documentation, or proof, of your disability. It is important that you comply with this request to the best of your ability; if you don't, then you will lose your right to an accommodation.

If an accommodation is not "reasonable" (see below for more explanation), your employer does not have to provide it. Nor does your employer have to provide you with the accom-

modation that you want, as long as it provides another one that is effective.

You don't have to accept a particular accommodation, but be prepared to defend your choice on the grounds that the accommodation isn't effective. If a court decides that the offered accommodation was reasonable, you may no longer be qualified for the job, and your employer can terminate you.

## *Accommodations Don't Need to Cost a Bundle*

According to ergonomic and job accommodation experts, the cost of accommodating a particular worker's disability is often surprisingly low.

- 31% of accommodations cost nothing.
- 50% cost less than \$50.
- 69% cost less than \$500.
- 88% cost less than \$1,000.

The Job Accommodation Network (JAN), which provides information about how to accommodate people with disabilities, gives the following examples of inexpensive accommodations:

- Glare on a computer screen caused an employee with an eye disorder to get eye fatigue. The problem was solved with a \$39 antiglare screen.
- A deaf medical technician couldn't hear the buzz of a timer, which was necessary for laboratory tests. The problem was solved with an indicator light at a cost of \$26.95.

To contact JAN, call 1-800-526-7234 or visit its website at <http://janweb.icdi.wvu.edu>.

## *How can I tell if a particular accommodation offered by my employer is reasonable?*

The ADA points to several specific accommodations that are likely to be deemed reasonable—some of them changes to the physical set-up of the workplace, some of them changes to how or when work is done. They include:

- making existing facilities usable by disabled employees—for example, by modifying the height of desks and equipment, installing computer screen magnifiers or installing telecommunications devices for the deaf
- restructuring jobs—for example, allowing a ten-hour/four-day workweek so that a worker can receive weekly medical treatments
- modifying exams and training materials—for example, allowing more time for taking an exam, or allowing it to be taken orally instead of in writing
- providing a reasonable amount of additional unpaid leave for medical treatment
- hiring readers or interpreters to assist an employee, and
- providing temporary workplace specialists to assist in training.

These are just a few possible accommodations. The possibilities are limited only by an employee's and employer's imaginations—and the reality that might make one or more of these accommodations financially impossible in a particular workplace.

## When can an employer legally claim that a particular accommodation is simply not feasible?

The ADA does not require employers to make accommodations that would cause them an undue hardship—a weighty concept defined in the ADA only as “an action requiring significant difficulty or expense.”

The Equal Employment Opportunity Commission (EEOC), the federal agency responsible for enforcing the ADA, has set out some of the factors that will determine whether a particular accommodation presents an undue hardship on a particular employer:

- the nature and cost of the accommodation
- the financial resources of the employer (a large employer may be expected to foot a larger bill than a mom-and-pop business)
- the nature of the business (including size, composition and structure of the workforce), and
- accommodation costs already incurred in the workplace.

It is not easy for employers to prove that an accommodation is an undue hardship, as financial difficulty alone is not usually sufficient. Courts will look at other sources of money, including tax credits and deductions available for making some accommodations, as well as the disabled employee's willingness to pay for all or part of the costs.

## *Taking Action Under the ADA*

The ADA is enforced by the Equal Employment Opportunity Commission (EEOC). To start an investigation of your claim, file a complaint at the local EEOC office. Call 800-669-4000 to find the office nearest you. Or refer to the agency's website at <http://www.eeoc.gov>.

If you live in a state with laws that protect workers against discrimination based on physical or mental disability, you can choose to file a complaint under your state's law, the ADA or both. To find out about state laws, contact your state labor department or fair employment office.

For additional information on the ADA, contact:

Office of the Americans  
with Disabilities Act  
Civil Rights Division  
U.S. Department of Justice  
P.O. Box 66118  
Washington, DC 20035-6118  
Hotline:  
800-514-0301 (voice)  
800-514-0383 (TTY)  
[http://www.usdoj.gov/  
crt/ada/adahom1.htm](http://www.usdoj.gov/crt/ada/adahom1.htm)

# Losing or Leaving Your Job

*Nothing is really work  
unless you would rather be  
doing something else.*

—SIR JAMES A. BARRIE

The possibility of being laid off or fired looms large in the list of fears of most workers. Employers have traditionally had a free hand to hire and fire, but a number of recent laws and legal rulings restrict these rights.

## For what reasons can I be fired?

Unfortunately, the answer to this question is: “It depends.” Generally, the reasons for which you can be fired depend in large part on whether you have a contract for employment.

Determining whether you have an employment contract can be tricky. A contract can be oral or written, express or implied. Sometimes, a contract is a document labeled “Contract for Employment” that has a number of provisions and that is signed by you and your employer. Other times, it is an oral promise that your employer makes to you when you are hired that you will only be fired if you perform your job incompetently. Still other times, it is something that is implied from the peculiar circumstances of

your employment, such as the amount of time you have worked for your employer, the way that your employer has treated other employees and provisions in your employee handbook.

If you do have a contract for employment, that generally (but not always) means that you can be fired only for “good cause,” a legal concept that includes such things as incompetence, excessive absences and violation of work rules.

If you don’t have a contract for employment (which is likely since the majority of employees in this country do not have employment contracts), then your employer can terminate you for any reason that isn’t illegal (see below). For example, your employer can terminate you simply because she doesn’t like you or because your work style does not fit in with the company or because you and your supervisor disagree too much on how your job should be done. Be aware, however, that sometimes these sorts of superficial reasons, such as “I just didn’t like her” or “She didn’t fit in with the rest of the office,” can mask the real reason behind the termination, which is an illegal one.

Whether or not you have an employment contract, the law does place limits on your employer’s ability to fire you. For example, employers do not have the right to discriminate against you illegally or to violate state or federal laws, such as those controlling wages and hours. Most state discrimination laws are quite broad. In addition to protecting against the traditional forms of discrimination

based on race, color, religion, national origin and age, many also protect against discrimination based on sexual orientation, physical and mental disability, marital status and receiving public funds.

Separate state laws protect workers from being fired or demoted for taking advantage of laws protecting them from discrimination and unsafe workplace practices. And there are a number of other more complex reasons that may make it illegal for an employer to fire you—all boiling down to the fact that an employer must deal with you fairly and honestly.

### I've just received a warning from my employer, and I suspect I will be fired soon. What should I do?

If you find yourself on the receiving end of a disciplinary notice you consider to be unfair, there are several steps you should take to avoid losing your job.

First, be sure you understand exactly what work behavior is being challenged. Check your company handbook to see if there is a clear policy against what you've done. If you are unclear, ask for a meeting with your supervisor or human resources staff to discuss the issue more thoroughly.

If you think that there might be some truth to what you are told, find out what you can do to improve the situation. Arrange a meeting with your supervisor and ask her what you can do to improve. Or you can make your own suggestions. For example, if your employer is unhappy with your

performance, consider requesting training or educational materials. If your employer thinks that you talk too much on company time, ask to move your workstation to a place where you won't be quite so tempted to talk. Make sure you document any meeting or communication with your supervisor regarding the discipline, your performance and strategies you can pursue to improve.

If you disagree with allegations that your work performance or behavior is poor, you may want to ask for the assessment in writing. You can then write a clarification and ask that it be inserted in your personnel file. But do this only if you feel your employer's assessment is clearly inaccurate; otherwise you may risk escalating a minor verbal reprimand into a more major incident that will be permanently recorded in your file. Before you sit down to write, take some time to reflect and perhaps discuss your situation with friends.

If you think you are likely to be fired, see if any policy in the employee handbook will buy you time—for example, the right to file an appeal—so the controversy can die down and, if necessary, you can change your work habits.

Finally, read between the lines to see whether your employer's action may be discriminatory or in other ways unfair. Look particularly at the timing. For example, if you were let go shortly before your rights in the company pension plan were permanently locked in or vested, the company may be guilty of age discrimina-

tion. Look also at uneven applications of discipline: Are women more often given substandard performance reviews or fired before they could be elevated to supervisor?

### What can I do to protect any legal rights I might have before leaving my job?

Even if you decide not to challenge the legality of your firing, you will be in a much better position to enforce all of your workplace rights if you keep careful written records of everything that happens. For example, if you apply for unemployment insurance benefits and your former employer challenges that application, you will probably need to prove that you were dismissed for reasons that were not related to your misconduct.

There are a number of ways to document events. The easiest is to keep an employment diary where you record and date each significant work-related event such as performance reviews, commendations or reprimands, salary increases or decreases and even informal comments your supervisor makes to you about your work. Note the date, time and location for each event, which members of management were involved and whether or not witnesses were present. Whenever possible, back up your log with materials issued by your employer, such as copies of the employee handbook, memos, brochures, employee orientation videos and any written evaluations, commendations or criticisms of your work. In addition, if a problem develops, ask to see your personnel file and make a copy of all reports and reviews in it.

### Am I entitled to severance pay if I'm fired?

No law requires an employer to provide severance pay. Nevertheless, some employers voluntarily offer one or two months' salary to employees who are laid off. A few are more generous to long-term employees, basing severance pay on a formula such as one month's pay for every year an employee worked for the company.

An employer may be legally obligated to give you some severance pay if you were promised it, as evidenced by:

- a written contract stating that severance will be paid
- a promise in an employee handbook of severance pay
- a long history of the company paying severance to other employees in your position, or
- an oral promise to pay you severance—although you may run into difficulties proving the promise existed.

### My biggest concern about losing my job is losing health insurance coverage. Do I have any rights?

Ironically, workers have more rights to health insurance coverage after they lose their jobs than while employed. This is because of a 1986 law, the Consolidated Omnibus Budget Reconciliation Act (COBRA). Under COBRA, employers with 20 or more employees must offer them the option of continuing to be covered by the company's group health insurance plan at the workers' own expense for a specific period—often 18 months—



after employment ends. Family coverage is also included. In some other circumstances, such as the death of the employee, that employee's dependents can continue coverage for up to 36 months.

Another federal law, the Health Insurance Portability and Accountability Act, makes it easier for employees to change jobs without the fear of losing insurance coverage—and makes it easier for many employees to get coverage in the first place. The law imposes some restrictions on group health plans, including HMOs. Under this law:

- Employees with preexisting conditions may not be denied coverage under a new health insurance plan if they have been continuously covered for 12 months under another plan. Employees who do not have this prior coverage may be denied coverage based on a preexisting condition for only one year.
- No group health plan may discriminate in eligibility for coverage or premiums based on health status, physical or mental condition, claims experience, receipt of healthcare, medical history, genetic information, evidence of insurability or disability of the individual or dependents seeking coverage.



## *Getting Money When You're Out of Work*

If you've lost your job, you may be desperately seeking income. It's best to act quickly to apply for unemployment and other possible benefits, as there is often a delay—in a few states, as long as six weeks—between the time you apply and the date on which you actually receive a check.

Here is a brief breakdown of what is covered by each of the three major income replacement programs.

**Unemployment insurance.** This program may provide some financial help if you lose your job, temporarily or permanently, through no fault of your own. Benefits will be less than your former pay and temporary—often lasting for about 26 weeks.

**Workers' compensation.** When you cannot work because of a work-related injury or illness, this program is designed to provide you with prompt replacement income. It may also pay the medical bills resulting from a workplace injury or illness; compensate you for a permanent injury, such as the loss of a limb; and provide death benefits to the survivors of workers who die from a workplace injury or illness. For more information, see the questions and answers on workers' compensation that appear earlier in this chapter.

**Social Security disability insurance.** This is intended to provide income to adults who, because of injury or illness, cannot work for at least 12 months. Unlike the workers' compensation program, it does not require that your disability be caused by a workplace injury or illness.



Also consider possible income from a private disability insurance program if you were paying for it through payroll withholdings, or if your employer paid for such premiums.

In addition, a few states offer disability benefits as part of their unemployment insurance programs. Typical program requirements mandate that you submit your medical records and show that you requested a leave of absence from your employer. Some may also require proof that you intend to return to your job when you recover. Call the local unemployment insurance and workers' compensation insurance offices to determine whether your state is one that maintains this kind of coverage.



**<http://www.nolo.com>**

*Nolo offers self-help information about a wide variety of legal topics, including workplace rights.*

**<http://www.eeoc.gov>**

*The U.S. Equal Employment Opportunity Commission is the federal agency responsible for enforcing federal fair employment laws, including Title VII (which outlaws discrimination in employment based on race, gender, religion and national ori-*

*gin), the Equal Pay Act, the Age Discrimination in Employment Act and the Americans with Disabilities Act. The agency's website is a gold mine of information about these fair employment laws. Among other things, it includes information on your workplace rights, the text of the fair employment laws and instructions on how to file a charge against your employer.*

**<http://www.dol.gov>**

*The U.S. Department of Labor enforces many of the laws that govern your relationship with your employer, including wage and hour laws, health and safety laws and benefits laws. This website offers information about your rights under all of the laws enforced by the department, and it contains links to state labor department websites.*

**<http://www.law.cornell.edu>**

*The Legal Information Institute at Cornell Law School provides information about discrimination in the workplace, including relevant codes and regulations.*

**<http://www.chipubs.com>**

*The Alexander Hamilton Institute serves up common sense packaged as FAQs about many aspects of employment, from benefits to safety and health concerns. The information is aimed at managers, but it's helpful for employees, too.*

# 5

## Small Businesses

- 5.2 *Before You Start*
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- 5.15 *Nonprofit Corporations*
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- 5.29 *Employers' Rights & Responsibilities*

*Business is never so healthy as when, like a chicken, it must do a certain amount of scratching for what it gets.*

—HENRY FORD

**F**or all sorts of personal and economic reasons, more Americans are starting and running their own businesses today than ever before. This trend has been helped by the increasing availability of powerful and affordable data storage and communications equipment, most notably the personal computer and the Internet. Because of this

accessible technology, today's savvy small-time operator can often accomplish tasks that just a few decades ago could be tackled only by large corporations.

But not all change has been positive. When it comes to the law, the relatively informal world of just 40 years ago—where deals were often sealed with a handshake—has given way to a world where legal rules affect almost every small business relationship, including organizing the business, dealing with co-owners, hiring and supervising employees and relating to customers and suppliers. Staying on top of all these rules is as necessary as it is challenging. Fortunately, by using affordable, good quality self-help legal resources and getting additional help from a knowledgeable small business lawyer, you can master the laws you need to know to keep your business healthy.

## Before You Start

*Your  
imagination  
is your preview  
of life's  
coming  
attractions.*

—ALBERT EINSTEIN

No matter what type of business you're thinking of starting, there are some practical and legal issues you'll face right away, including choosing a name and location for your business, deciding whether or not to hire employees, writing a business plan, choosing a legal structure (sole proprietorship, partnership, corporation or limited liability company), establishing a system for reporting and paying taxes and adopting policies to deal with your customers. This section addresses many of these concerns. As you read, don't be discouraged by the details. If you have chosen a business that you will truly enjoy and, after creating a tight business plan, are confident you'll make a decent profit, your big jobs are done. Furthermore, many people and affordable sources of information are available to help you cope with the practical details we discuss here.

### I'm thinking of starting my own business. What should I do first?

Be sure you are genuinely interested in what the business does. If you aren't, you are unlikely to succeed in the long run—no matter how lucrative your work turns out to be. Yes, going into business with a firm plan to make a good living is important, but so, too, is choosing a business that fits your life goals in an authentic way. Here are a few things you might want to consider before you take the leap:

- Do you know how to accomplish the principal tasks of the business? (Don't open a transmission repair

shop if you hate cars, or a restaurant if you can't cook.)

- If the business involves working with others, do you do this well? If not, look into the many opportunities to begin a one-person business.
- Do you understand basic business tasks, such as bookkeeping and how to prepare a profit-and-loss forecast and cash-flow analysis? If not, learn before—not after—you begin.
- Does the business fit your personality? If you are a shy introvert, stay away from businesses that require lots of personal selling. If you are easily bored, find a business which will allow you to deal with new material on a regular basis (publishing a newsletter, for example).

### What should I keep in mind when choosing a name for my business?

First, assume that you will have competitors and that you will want to market your products or services under the name you choose. (This will make your name a trademark.) For marketing purposes, the best names are those that customers will easily remember and associate with your business. Also, if the name is memorable, it will be easier to stop others from using it in the future.

Most memorable business names are made-up words, such as Exxon and Kodak, or are somehow fanciful or surprising, such as Double Rainbow ice cream and Penguin Books. And some notable names are cleverly suggestive, such as The Body Shop (a

store that sells personal hygiene products) and Accuride tires.

Names that tend to be forgotten by consumers are common names (names of people), geographic terms and names that literally describe some aspect of a product or service. For instance, Steve's Web Designs may be very pleasing to Steve as a name, but it's not likely to help Steve's customers remember his company when faced with competitors such as Sam's Web Designs and Sheri's Web Designs. Similarly, names like Central Word Processing Services or Robust Health Foods are not particularly memorable.

Of course, over time even a common name can become memorable through widespread use and advertising, as with Ben and Jerry's Ice Cream. And unusual names of people can sometimes be very memorable indeed, as with Fuddrucker's (restaurants and family entertainment centers).

## Choosing a Domain Name

If your business will have a website, part of choosing your business name will be deciding on a domain name. Using all or part of your business name in your domain name will make your website easier for potential customers to find. But many domain names are already taken, so you'll want to see what's available before you settle on a business name. See *Conducting a Trademark Search* in Chapter 8, *Trademarks*, for more information on conducting name searches.

## How do I find out whether I'm legally permitted to use the business name I've chosen?

Your first step depends on whether you plan to form a corporation or a limited liability company (LLC). If you do, you should check with the Secretary of State's office in your state to see whether your proposed name is the same or confusingly similar to an existing corporate or LLC name in your state. If it is, you'll have to choose a different name.

If you don't plan to incorporate or form an LLC, check with your county clerk to see whether your proposed name is already on the list maintained for fictitious or assumed business names in your county. In the few states where assumed business name registrations are statewide, check with your Secretary of State's office. (The county clerk should be able to tell you whether you'll need to check the name at the state level.) If you find that your chosen name or a very similar name is listed on a fictitious or assumed name register, you shouldn't use it.

## If my proposed business name isn't listed on a county or state register, am I free to use it however I like?

Not necessarily. Even if you are permitted to use your chosen name as a corporate, LLC or assumed business name in your state or county, you might not be able to use the name as a trademark or service mark. To understand what all this is about, consider the potential functions of a business name:

- A business name may be a trade name that describes the business for purposes of bank accounts, invoices, taxes and the public.
- A business name may be a trademark or servicemark used to identify and distinguish products or services sold by the business (for example, Ford Motor Co. sells Ford automobiles, and McDonald's Corporation offers McDonald's fast food services).

While your corporate or assumed business name registration may legally clear the name for the first purpose, it doesn't speak to the second. For example, if your business is organized as a limited liability company or corporation, you may get the green light from your Secretary of State to use IBM Toxics as your business name (if no other corporation or LLC in your state is using it or something confusingly similar), but if you try to use that name out in the marketplace, you're asking for a claim of trademark violation from the IBM general counsel's office.

To find out whether you can use your proposed name as a trademark or servicemark, you will need to do what's known as a trademark search. See Chapter 8, *Trademarks*.

## I've found out that the name I want to use is available. What do I need to do to reserve it for my business?

If you are forming a corporation or an LLC, every state has a procedure—operated by the Secretary of State's office—under which a proposed name can be

reserved for a certain period of time, usually for a fee. Additional reservation periods can usually be purchased for additional fees. (For more information about corporations and LLCs, see *Legal Structures for Small Businesses*, below.)

If you are not forming a corporation or an LLC, then you may need to file a fictitious or assumed business name statement with the agency that handles these registrations in your state (usually the county clerk, but sometimes the Secretary of State). Generally speaking, you need to file a fictitious business name statement only if your business name does not include the legal names of all the owners.

If you plan to use your business name as a trademark or servicemark and your service or product will be marketed in more than one state (or across territorial or international borders), you can file an application with the U.S. Patent and Trademark Office to reserve the name for your use. See Chapter 8, *Trademarks*.

### What should I keep in mind when choosing a location for my business?

Commercial real estate brokers are fond of saying the three most important factors in establishing a business are location, location and location. While true for some types of businesses—such as a retail sandwich shop that depends on lunchtime walk-in trade—for many, locating in a popular, high-cost area is a mistake. For example, if you design computer soft-

ware, repair tile, import jewelry from Indonesia or do any one of ten thousand other things that don't rely on foot traffic, your best bet is to search out convenient, low-cost, utilitarian surroundings. And even if yours is a business that many people will visit, consider the possibility that a low-cost, offbeat location may make more sense than a high-cost, trendy one.

### What about zoning and other rules that restrict where a business may locate?

Never sign a lease without being absolutely sure you will be permitted to operate your business at that location. If the rental space is in a shopping center or other retail complex, this involves first checking carefully with management, because many have contractual restrictions (for example, no more than two pizza restaurants in the Mayfair Mall). If your business will be located in a non-shopping center area, you'll need to be sure that you meet applicable zoning rules, which typically divide a municipality into residential, commercial, industrial and mixed-use areas.

You'll also need to find out whether any other legal restrictions will affect your operations. For example, some cities limit the number of certain types of business—such as fast food restaurants or coffee bars—in certain areas, and others require that a business provide off-street parking, close early on weeknights, limit advertising signs or meet other rules as a condition of getting a permit. Fortunately, many cities have business de-

velopment offices that help small business owners understand and cope with restrictions.

### What is a business plan, and do I need to write one?

A business plan is a written document that describes the business you want to start and how it will become profitable. The document usually starts with a statement outlining the purpose and goals of your business and how you plan to realize them, including a detailed marketing plan. It should also contain a formal profit-and-loss projection and cash-flow analysis designed to show that if the business develops as expected, it will be profitable.

Your business plan enables you to explain your business prospects to potential lenders and investors in a language they can understand. Even more important, the intellectual rigor of creating a tight business plan will help you see whether the business you hope to start is likely to meet your personal and financial goals. Many times when budding entrepreneurs take an honest look at their financial numbers, they see that hoped-for profits are unlikely to materialize. Or, put another way, one of the most important purposes of writing a good business plan is to talk yourself out of starting a bad business.

### I plan to sell products and services directly to the public. What do I need to know to comply with consumer protection laws?

Many federal and state laws regulate the relationship between a business

and its customers. These laws cover such things as advertising, pricing, door-to-door sales, written and implied warranties and, in a few states, layaway plans and refund policies. You can find out more about consumer protection laws by contacting the Federal Trade Commission, 6th and Pennsylvania Avenue, NW, Washington DC 20850, 202-326-2222, <http://www.ftc.gov>, and by contacting your state's consumer protection agency.

Although it's essential to understand and follow the rules that protect consumers, most successful businesses regard them as only a foundation for building friendly customer service policies designed to produce a high level of customer satisfaction. For example, many enlightened businesses tell their customers they can return any purchase for a full cash refund at any time for any reason. Not only does this encourage existing customers to continue to patronize the business, but it can be a highly effective way to get customers to brag about the business to their friends.

## *Selling Goods and Services on Consignment*

Many small business people, especially those who produce art, crafts and specialty clothing items, sell on consignment. In a consignment agreement, the owner of goods (in legal jargon, the consignor) puts the goods in the hands of another person or business—usually a retailer (the consignee)—who then attempts to sell

them. If the goods are sold, the consignee receives a fee, which is usually a percentage of the purchase price, and the rest of the money is sent to the consignor. For example, a sculptor (the consignor) might place his or her work for sale at an art gallery (the consignee) with the understanding that if the artwork sells, the gallery keeps 50% of the sale price. Or a homeowner might leave old furniture with a resale shop that will keep one-third of the proceeds if the item sells. Typically, the consignor remains the owner of the goods until the consignee sells them.

As part of any consignment of valuable items, the consignor (owner) wants to be protected if the goods are lost or stolen while in the consignee's possession. The key here is to establish that the consignee has an insurance policy which will cover any loss. When extremely valuable items are being consigned, it's often appropriate for the consignor to ask to be named as a co-insured so that she can receive a share of the insurance proceeds if a loss occurs.

If you're a consignee, check your insurance coverage. Before you accept the risk of loss or theft, make sure your business insurance policy covers you for loss of "personal property of others" left in your possession—and that the amount of coverage is adequate. Getting full reimbursement for the selling price of consigned goods may require an added supplement (called an endorsement) to your insurance policy. Check with your insurance agent or broker.

For a consignment contract, including detailed instructions and guidance, as well as small business forms and contracts, see Nolo's new business software, *Quicken Lawyer Business*.



### ***More Information About Starting Your Small Business***

*Legal Guide for Starting & Running a Small Business*, by Fred S. Steingold (Nolo), provides clear, plain-English explanations of the laws that affect business owners every day. It covers partnerships, corporations, limited liability companies, leases, trademarks, contracts, franchises, insurance, hiring and firing and much more.

*Legal Forms for Starting & Running a Small Business*, by Fred S. Steingold (Nolo), contains the forms and instructions you need to accomplish many routine legal tasks, such as borrowing money, leasing property and contracting for goods and services.

*The Small Business Start-Up Kit*, by Peri H. Pakroo (Nolo), shows you how to choose from among the basic types of business organizations, write an effective business plan, file the right forms in the right place, acquire good bookkeeping and accounting habits and get the proper licenses and permits.

*Small Time Operator*, by Bernard Kamoroff, C.P.A. (Bell Springs Publishing), is a good source of practical information on getting a small business off the ground—from business licenses, to taxes, to basic accounting. It includes ledgers and worksheets to get you started.

*Quicken Lawyer Business*, (software by Nolo), contains over 60 interactive forms and contracts that all small businesses



should have, plus the text of five best-selling Nolo business titles.

*Running a One-Person Business*, by Claude Whitmyer and Salli Rasberry (Ten Speed Press), covers the nuts and bolts of doing business on your own: finances, time management, marketing and more.

*How to Write a Business Plan*, by Mike McKeever (Nolo), shows you how to write the business plan necessary to finance your business and make it work. It includes up-to-date sources of financing.

*Guerrilla Marketing*, by Jay Conrad Levinson (Houghton Mifflin), contains hundreds of ideas and strategies to help you market your business.

*Marketing Without Advertising*, by Michael Phillips and Salli Rasberry (Nolo), shows you how to generate sales and encourage customer relations without spending a lot of money on advertising.

## Legal Structures for Small Businesses

There is no one legal structure that's best for all small businesses. Whether you're better off starting as a sole proprietor or choosing one of the more complicated organizational structures, such as a partnership, corporation or limited liability company (LLC), usually depends on several factors, in-

cluding the size and profitability of your business, how many people will own it and whether it will entail liability risks not covered by insurance.

### If I'm the only owner, what's the easiest way to structure my business?

The vast majority of small business people begin as sole proprietors, because it's cheap, easy and fast. With a sole proprietorship, there's no need to draft an agreement or go to the trouble and expense of registering a corporation or limited liability company (LLC) with your state regulatory agency. All it usually entails is getting a local business license, and unless you are doing business under your own name, filing and possibly publishing a fictitious name statement.

### If it's so simple, why aren't all businesses sole proprietorships?

There are several reasons why doing business as a sole proprietor is not appropriate for everyone. First, a sole proprietorship is possible only when a business is owned by one person or, in some cases, a husband and wife. Second, the owner of a sole proprietorship is personally responsible for all business debts, whereas limited liability companies and corporations normally shield their owners' assets from such debts. And finally, unlike a corporation (or a partnership or LLC that elects to be taxed as a corporation), which is taxed separately from its owners (something that can result in lower taxes for some small businesses—see below), a sole proprietor and her busi-

ness are considered to be the same legal entity for tax purposes. This means you'll report all of the business's income, expenses and deductions on your individual tax return.

**I'm starting my business with several other people. What are the advantages and disadvantages of forming a general partnership?**

One big advantage of a general partnership is that you usually don't have to register it with your state and pay an often hefty fee, as you do to establish a corporation or limited liability company. And because a partnership is normally a "pass through" tax entity (the partners, not the partnership, are taxed on the partnership's profits), filing income tax returns is easier than it is for a regular corporation, where separate tax returns must be filed for the corporate entity and its owners. But because the business-related acts of one partner legally bind all others, it is essential that you go into business with a partner or partners you completely trust. It is also essential that you prepare a written partnership agreement establishing, among other things, each partner's share of profits or losses and day-to-day duties as well as what happens if one partner dies or retires.

Finally, a major disadvantage of doing business as a partnership is that all partners are personally liable for business debts and liabilities (for example, a judgment in a lawsuit).

While it's true that a good insurance policy can do much to reduce lawsuit worries and that many small, savvy businesses do not face debt problems, it's also true that businesses that face significant risks in either of these areas should probably organize themselves as a corporation or LLC in order to benefit from the limited liability these business structures provide.

**What exactly is "limited liability" — and why is it so important?**

Some types of businesses—corporations and limited liability companies are the most common—shield their owners from personal responsibility for business debts. For instance, if the business goes bankrupt, its owners are not usually required to use their personal assets to make good on business losses—unless they voluntarily assume responsibility. Other types of businesses—sole proprietorships and general partnerships—do not provide this shield, which means their owners are personally responsible for business liabilities. To see how this works, assume someone obtains a large court judgment against an incorporated business. Because corporate stockholders are not personally liable for business debts, their houses and other personal assets can't be taken to pay the judgment, even if the corporation files for bankruptcy. By comparison, if a sole proprietorship or partnership gets into the same kind of trouble, the houses, bank accounts and other valuable personal assets of the business's owners (and possibly their spouses) can be attached and used to satisfy the debt.

## Why do so many small business owners choose not to take advantage of limited liability protection?

Many small businesses simply don't have major debt or lawsuit worries, so they don't need limited liability protection. For example, if you run a small service business (perhaps you are a graphic artist, management consultant or music teacher), your chances of being sued or running up big debts are low. And when it comes to liability for many types of debts, creating a limited liability entity makes little practical difference for newly formed businesses. Often, if you want to borrow money from a commercial lender or establish credit with a vendor, you will be required to pledge your personal assets or personally guarantee payment of the debt (waive limited liability status) should your business be unable to pay.

Finally, organizing your business to achieve limited liability status is no substitute for purchasing a good business insurance policy especially if your business faces serious and predictable financial risks (for instance, the risk that a customer may trip and fall on your premises or that your products may malfunction). After all,

without insurance, if a serious injury occurs, all the assets of your business—which will probably amount to a large portion of your net worth—can be grabbed to satisfy any resulting court judgment. It follows that even if you operate your business as a sole proprietorship, if you purchase comprehensive business insurance, your personal assets may not be at significant risk and you may therefore conclude you don't need limited liability status.

## Given all its limitations, when is it wise for a small business person to seek limited liability status?

You should consider forming a business that offers its owners limited liability if:

- your business subjects you to a risk of lawsuits in an area where insurance coverage is unaffordable or incomplete, or
- your business will incur significant debts and is well established and has a good credit rating so that you no longer need to personally guarantee every loan or credit application.

The easiest and most popular way to gain limited liability status is to form a corporation or a limited liability company (LLC).

# SMALL BUSINESS STRUCTURES: AN OVERVIEW

Type of Entity	Main Advantages	Main Drawbacks
Sole Proprietorship	Simple and inexpensive to create and operate Owner reports profit or loss on his or her personal tax return	Owner personally liable for business debts and liabilities
General Partnership	Relatively easy and inexpensive to create and operate Owners (partners) report their share of profit or loss on their personal tax returns	Owners (partners) personally liable for business debts Must prepare and file separate partnership tax return
Limited Partnership	Limited partners have limited personal liability for business debts as long as they don't participate in management General partners can raise cash without involving outside investors in management of business	General partners personally liable for business debts More expensive to create than a general partnership
Regular Corporation	Owners have limited personal liability for business debts Owners' fringe benefits (such as health insurance and pension plans) can be deducted as business expenses Owners can split corporate profit among owners and corporation, sometimes paying a lower overall tax rate	Suitable mainly for companies that invest in real estate or other businesses More expensive to create than partnership or sole proprietorship Paperwork can seem burdensome to some owners
S Corporation	Owners have limited personal liability for business debts Owners report their share of corporate profit or loss on their personal tax returns Owners can use corporate loss to offset income from other sources (such as another business in which they are active)	Separate taxable entity that must prepare and file a separate corporate tax More expensive to create than partnership or sole proprietorship More paperwork than for a limited liability company, which offers some of the same advantages Income must be allocated to owners in proportion to their ownership interests
Professional Corporation	Owners have no personal liability for malpractice of other owners	Deductibility of fringe benefits limited for owners who own more than 2% of shares More expensive to create than partnership or sole proprietorship Paperwork can seem burdensome to some owners All owners must generally belong to, and often be licensed to practice in, the same profession
Nonprofit Corporation	Corporation doesn't pay income taxes Contributions to charitable corporations are tax-deductible Fringe benefits can be deducted as business expense	Full tax advantages available only to groups organized for charitable, scientific, educational, literary or religious purposes Property transferred to corporation stays there; if corporation ends, property must go to another nonprofit

Type of Entity	Main Advantages	Main Drawbacks
Limited Liability Company	<p>All states except Massachusetts allow LLCs to be organized with only one member</p> <p>Owners have limited personal liability for business debts even if they participate in management</p> <p>Profit and loss can be allocated differently than ownership interests</p> <p>IRS rules now allow LLCs to choose between being taxed as partnership or corporation</p>	<p>More expensive to create than partnership or sole proprietorship</p> <p>Laws for creating LLCs in a few states may not reflect latest federal tax changes</p>
Professional Limited Liability Company	<p>Same advantages as a regular limited liability company</p> <p>Gives state-licensed professionals a way to enjoy those advantages</p>	<p>Same as for a regular limited liability company</p> <p>Members must all belong to the same profession</p> <p>At least one state (CA) does not permit professionals to organize as an LLC</p>
Limited Liability Partnership	<p>Mostly of interest to partners in old-line professions such as law, medicine and accounting</p> <p>Owners (partners) aren't personally liable for the malpractice of other partners</p> <p>Owners report their share of profit or loss on their personal tax returns</p>	<p>Unlike a limited liability company or a professional limited liability company, owners (partners) remain personally liable for many types of obligations owed to business creditors, lenders and landlords</p> <p>Not available in all states</p> <p>Often limited to a short list of professions</p>



### Is forming a corporation difficult?

No. As long as you and close associates and family members will own all of the stock and none of the stock will be sold to the public, the necessary documents—principally your articles of incorporation and corporate bylaws—can usually be prepared in a few hours.

While most states use the term “articles of incorporation” to refer to the basic document creating the corporation, some states (including Connecticut, Delaware, New York and Oklahoma) use the term “certificate of in-

corporation.” Washington calls the document a “certificate of formation” and Tennessee calls it a “charter.”

The first step is to check with your state’s corporate filing office (usually either the Secretary of State or Department of Corporations) and conduct a trademark search to be sure the name you want to use is legally available.

You then fill in blanks in a pre-printed form (available from most states’ corporate filing offices or websites) listing the purpose of your corporation, its principal place of business and the number and type of shares of stock. You’ll file these documents with the appropriate office, along with a registration fee that will usually be between \$200 and \$1,000, depending on the state.

You'll also need to complete, but not file, corporate bylaws. These will outline a number of important corporate housekeeping details, such as when annual shareholder meetings will be held, who can vote and the manner in which shareholders will be notified if there is need for an additional "special" meeting.

Fortunately, a good self-help book can make it easy and safe to incorporate your business without a lawyer.

### What about operating my corporation? Aren't ongoing legal formalities involved?

Assuming your corporation has not sold stock to the public, conducting corporate business is remarkably straightforward and uncomplicated. Often it amounts to little more than recording key corporate decisions (for example, borrowing money or buying real estate) and holding an annual meeting. Even these formalities can often be done by written agreement and don't usually necessitate a face-to-face meeting between the directors.

### Doesn't forming a corporation mean income will be taxed twice—once at the corporate level and then again when dividends are paid to the corporation's owners (shareholders)?

Taxation of business is complicated; we'll be able to cover only the main points here. First, understand that most types of businesses—sole proprietorships and corporations that have qualified for subchapter S status,

as well as partnerships and limited liability companies that have not elected to be taxed as regular, or C, corporations—are known as pass-through tax entities, meaning that all business profits and losses are reflected on the individual tax returns of the owners. For example, if a sole proprietor's convenience store turns a yearly profit of \$85,000, this amount goes right on his personal tax return. By contrast, a regular profit corporation (and any partnership or LLC that elects to be taxed like a corporation) is a separate tax entity—meaning that the business files a tax return and pays its own taxes.

But the fact that a corporation is taxed separately from its owners doesn't always mean that profits will be taxed twice. That's because owners of most incorporated small businesses are also employees of those businesses; the money they receive in the form of salaries and bonuses is tax-deductible to the corporation as an ordinary and necessary business expense. If it pays surplus money to owners in the form of reasonable salaries, along with bonuses and other fringe benefits, a corporation does not have to show a profit, and therefore will pay no corporate income tax. In addition, most small corporations don't pay dividends, so the dividends aren't taxed twice.

### Are there tax advantages to forming a corporation?

Frequently, yes. Corporations pay federal income tax at a lower rate than do most individuals for the first \$75,000 of their profits—15% of the

first \$50,000 of profit and 25% of the next \$25,000. By contrast, in a sole proprietorship or partnership, where the business owner(s) pay taxes on all profits at their personal income tax rates, up to 39.6% could be subject to federal income tax.

A corporation can often reduce taxes by paying its owner-employees a decent salary (which, of course, is tax-deductible to the corporation but taxable to the employee), and then retaining additional profits in the business (say, for future expansion). The additional profits will be taxed at the lower corporate tax rates. Under IRS rules, however, the maximum amount of profits most corporations are allowed to retain is \$250,000, and some professional corporations are limited to \$150,000.

### Recently I've heard a lot about limited liability companies. How do they work?

For many years, small business people have been torn between operating as sole proprietors (or, if several people are involved, as partnerships) or incorporating. On the one hand, many owners are attracted to the tax-reporting simplicity of being a sole proprietor or partner. On the other, they desire the personal liability protection offered by incorporation. Until the mid 1990s it was possible to safely achieve these dual goals only by forming a corporation and then complying with a number of technical rules to gain S-corporation status from the IRS. Then the limited liability com-

pany (LLC) was introduced and slowly gained full IRS acceptance.

LLCs can have many of the most popular attributes of both partnerships (pass-through tax status) and corporations (limited personal liability for the owners). You can establish an LLC by filing a document called articles of organization with your state's corporate filing office (often the Secretary or Department of State).

While most states use the term "articles of organization" to refer to the basic document creating an LLC, some states (including Delaware, Mississippi, New Hampshire, New Jersey and Washington) use the term "certificate of formation." Two other states (Massachusetts and Pennsylvania) call the document a "certificate of organization."

### Can any small business register as a limited liability company?

Most small businesses can be run as LLCs because limited liability companies are recognized by all states. And almost all states (except Massachusetts) now permit one-owner LLCs, which means that sole proprietors can easily organize their businesses as LLCs to obtain both limited liability and pass-through tax status.

### Are there any drawbacks to forming a limited liability company?

Very few, beyond the fact that LLCs require a moderate amount of paperwork at the outset and a filing fee. You must file Articles of Organization with your state's Secretary of State,

along with a filing fee that will range from a few hundred dollars in some states to almost \$1,000 in others.



### *More Information About Choosing a Structure for Your Small Business*

*Legal Guide to Starting & Running a Small Business*, by Fred S. Steingold (Nolo), explains what you need to know to choose the right form for your business and shows you what to do to get started.

*Legal Forms for Starting & Running a Small Business*, by Fred S. Steingold (Nolo), provides all the forms you'll need to get your business up and running, no matter what ownership structure you choose.

*LLC Maker*, by Anthony Mancuso (Nolo), is interactive software containing all the information and forms you'll need to set up an LLC on your own.

*Form Your Own Limited Liability Company*, by Anthony Mancuso (Nolo), explains how to set up an LLC in any state, without the aid of an attorney.

*Incorporate Your Business*, by Anthony Mancuso (Nolo), explains how to set up a corporation in any state.

*How to Form Your Own Corporation (California and Texas editions)*, by Anthony Mancuso (Nolo), offers state-specific instructions and forms for creating a corporation in those states.

## Nonprofit Corporations

*In the long run you hit only what you aim at. Therefore, though you should fail immediately, you had better aim at something high.*

—HENRY DAVID THOREAU

A nonprofit corporation is a group of people who join together to do some activity that benefits the public, such as running a homeless shelter, an artists' performance group or a low-cost medical clinic. Making an incidental profit from these activities is allowed under legal and tax rules, but the primary purpose of the organization should be to do good work, not make money. Nonprofit goals are typically educational, charitable or religious.

### How do nonprofit organizations begin?

Most nonprofits start out as small, informal loosely structured organizations. Volunteers perform the work, and the group spends what little money it earns to keep the organization afloat. Formal legal papers (such as a nonprofit charter or bylaws) are rarely prepared in the beginning. Legally, groups of this sort are considered nonprofit associations, and each member can be held personally liable for organizational debts and liabilities.



Once a nonprofit association gets going and starts to make money, or wishes to obtain a tax exemption to attract public donations and qualify for grant funds, the members will formalize its structure. Usually the members decide to incorporate, but forming an unincorporated nonprofit association by adopting a formal association charter and operating bylaws is an alternative.

Most groups form a nonprofit corporation because it is the traditional form—the IRS and grant agencies are very familiar with it. Also, once incorporated, the individual members of the nonprofit are not personally liable for debts of the organization—a big legal advantage over the unincorporated association.

### Will my association benefit from becoming a nonprofit corporation?

Here are some circumstances that might make it worth your while to incorporate and get tax-exempt status:

- *You want to solicit tax-deductible contributions.* Contributions to nonprofits are generally tax deductible for those who make them. If you want to solicit money to fund your venture, you'll make it more attractive to potential donors if their contributions are tax-deductible.
- *Your association makes a taxable profit from its activities.* If your association will generate any kind of income from its activities, it's wise to incorporate so that you and your associates don't have to pay income tax on this money.

- *You want to apply for public or private grant money.* Without federal tax-exempt status, your group is unlikely to qualify for grants.
- *Your members want some protection from legal liability.* By incorporating your association, you can generally insulate your officers, directors and members from liability for the activities they engage in on behalf of the corporation.
- *Your advocacy efforts might provoke legal quarrels.* If, for instance, your association is taking aim at a powerful industry (such as tobacco companies), it might be worth incorporating so that your association's officers and directors will have some protection from the spurious lawsuits that are sure to come—and will also receive compensation for their legal fees.

Forming a nonprofit corporation brings other benefits as well, such as lower nonprofit mailing rates and local real estate and personal property tax exemptions.

### Is forming a nonprofit corporation difficult?

Legally, no. To form a nonprofit corporation, one of the organization's founders prepares and files standard articles of incorporation—a short legal document that lists the name and the directors of the nonprofit plus other basic information. The articles are filed with the Secretary of State's office for a modest filing fee. After the articles are filed, the group is a legally recognized nonprofit corporation.

### Is there more to forming a nonprofit than this simple legal task?

Taxwise, there is more. In addition to filing your articles, you will want to apply for and obtain federal and state nonprofit tax exemptions. If the formation of your organization depends on its nonprofit tax status, you'll likely want to know whether you'll qualify for tax exemption at the outset. Unfortunately, your corporation must be formed before you submit your federal tax exemption application. Why? Because the IRS requires that you submit a copy of your filed articles with the exemption application. Still, you should carefully review the tax exemption application before you submit your corporation papers. Doing so will give you a good idea of whether your organization will qualify for a tax exemption or not.

### What type of tax exemption do most nonprofits get?

Most organizations obtain a federal tax exemption under Section 501(c)(3) of the Internal Revenue Code, for

charitable, education, religious, scientific or literary purposes. States typically follow the federal lead and grant state tax-exempt status to nonprofits recognized by the IRS as 501(c)(3) organizations.

### How can my organization get a 501(c)(3) tax exemption?

You'll need to get the IRS Package 1023 exemption application. This is a lengthy and technical application with many references to the federal tax code. Most nonprofit organizers need help in addition to the IRS instructions that accompany the form. But you can do it on your own if you have a good self-help resource by your side such as Nolo's *How to Form Your Own Nonprofit Corporation*, by Anthony Mancuso, which shows you, line by line, how to complete your application.

### Are there any restrictions imposed on 501(c)(3) nonprofits?

You must meet the following conditions to qualify for a 501(c)(3) IRS tax exemption:



- The assets of your nonprofit must be irrevocably dedicated to charitable, educational, religious or similar purposes. If your 501(c)(3) nonprofit dissolves, any assets it owns must be transferred to another 501(c)(3) organization. (In your organizational papers, you don't have to name the specific organization that will receive your assets—a broad dedication clause will do.)
- Your organization cannot campaign for or against candidates for public office, and political lobbying activity is restricted.
- If your nonprofit makes a profit from activities unrelated to its nonprofit purpose, it must pay taxes on the profit (but up to \$1,000 of unrelated income can be earned tax-free).



### *More Information About Nonprofit Corporations*

*How to Form a Nonprofit Corporation*, by Anthony Mancuso (Nolo), shows you how to form a tax-exempt corporation in all 50 states. In California, look for *How to Form a Nonprofit Corporation in California*, also by Anthony Mancuso (Nolo).

*The Law of Tax Exempt Organizations*, by Bruce Hopkins (Wiley), is an in-depth guide to the legal and tax requirements for obtaining and maintaining a 501(c)(3) tax exemption and public charity status with the IRS.

## Small Business Taxes

THE MAN WHO IS  
ABOVE HIS BUSINESS  
MAY ONE DAY FIND HIS  
BUSINESS ABOVE HIM.

—SAMUEL DREW



Taxes are a fact of life for every small business. Those who take the time to understand and follow the rules will have little trouble with tax authorities. By contrast, those who are sloppy or dishonest are likely to be dogged by tax bills, audits and penalties. The moral is simple: Meeting your obligations to report business information and pay taxes is one of the cornerstones of operating a successful business.

**I want to start my own small business. What do I have to do to keep out of trouble with the IRS?**

Start by learning a new set of “3 Rs”—recordkeeping, recordkeeping and (you guessed it) recordkeeping. IRS studies show that poor records—not dishonesty—cause most small business people to lose at audits or fail to comply with their tax reporting obligations, with resulting fines and penalties. Even if you hire someone to

keep your records, you need to know how to supervise him—if he goofs up, you'll be held responsible.

**I don't have enough money in my budget to hire a business accountant or tax preparer. Is it safe and sensible for me to keep my own books?**

Yes, if you remember to keep thorough, current records. Consider using a check register-type computer program such as Quicken (Intuit) to track your expenses, and if you are doing your own tax return, use Intuit's companion program, TurboTax for Business. To ensure that you're on the right track, it's a good idea to run your bookkeeping system by a savvy small business tax professional, such as a CPA. With just a few hours of work, she should help you avoid most common mistakes and show you how to dovetail your bookkeeping system with tax filing requirements.

When your business is firmly in the black and your budget allows for it, consider hiring a bookkeeper to do your day-to-day payables and receivables. And hire an outside tax pro to handle your heavy-duty tax work—not only are the fees a tax-deductible business expense, but chances are your business will benefit if you put more of your time into running it and less into completing paperwork.

## *Recordkeeping Basics*

Keep all receipts and canceled checks for business expenses. It will help if you

separate your documents by category, such as:

- auto expenses
- rent
- utilities
- advertising
- travel
- entertainment, and
- professional fees.

Organize your documents by putting them into individual folders or envelopes, and keep them in a safe place. If you are ever audited, the IRS is most likely to zero in on business deductions for travel and entertainment, and car expenses. Remember that the burden will be on you—not the IRS—to explain your deductions. If you're feeling unsure about how to get started or what documents you need to keep, consult a tax professional familiar with recordkeeping for small businesses.

## **What is—and isn't—a tax-deductible business expense?**

Just about any “ordinary, necessary and reasonable” expense that helps you earn business income is deductible. These terms reflect the purpose for which the expense is made. For example, buying a computer, or even a sound system, for your office or store is an “ordinary and necessary” business expense, but buying the same items for your family room obviously isn't. The property must be used in a “trade or business,” which means it is used with the expectation of generating income.

In addition to the “ordinary and necessary” rule, a few expenses are specifically prohibited by law from being tax deductible—for instance, you can't

deduct a bribe paid to a public official. Other deduction no-nos are traffic tickets and clothing you wear on the job, unless it is a required uniform. As a rule, if you think it is necessary for your business, it is probably deductible. Just be ready to explain it to an auditor.

### Business Costs That Are Never Deductible

A few expenses are not deductible even if they are business related, because they violate public policy (IRC § 162). These expenses include:

- any type of government fine, such as a tax penalty paid to the IRS, or even a parking ticket
- bribes and kickbacks
- any kind of payment made for referring a client, patient or customer, if it is contrary to a state or federal law, and
- expenses for lobbying and social club dues.

Thankfully, very few other business expenses are affected by these rules.

### If I use my car for business, how much of that expense can I write off?

You must keep track of how much you use your car for business in order to figure out your deduction. (You'll also need to produce these records if you're ever audited.) Start by keeping a log showing the miles for each business use, always noting the purpose of the trip. Then, at the end of the year, you will usually be able to figure your deduction by using either the "mile-

age method" (for the year 2001 you can take 34.5¢ per mile deduction for business usage) or the "actual expense" method (you can take the total you pay for gas and repairs plus depreciation according to a tax code schedule, multiplied by the percentage of business use). Figure the deduction both ways and use the method that benefits you most.

### Can I claim a deduction for business-related entertainment?

You may deduct only 50% of expenses for entertaining clients, customers or employees, no matter how many martinis or Perriers you swigged. (Yes, this is a fairly recent change. In the old days you could write off 100% of every entertainment expense, and until a few years ago, 80%.)

The entertainment must be either directly related to the business (such as a catered business lunch) or "associated with" the business, meaning that the entertainment took place immediately before or immediately after a business discussion. Qualified business entertainment includes taking a client to a ball game, a concert or dinner at a fancy restaurant, or just inviting a few of your customers over for a Sunday barbecue at your home.

Parties, picnics and other social events you put on for your employees and their families are an exception to the 50% rule—such events are 100% deductible. Keep in mind that if you are audited, you must be able to show some proof that it was a legitimate business expense. So, keep a guest list and note the business (or potential business) relationship of each person entertained.



## *Commonly Overlooked Business Expenses*

Despite the fact that most people keep a sharp eye out for deductible expenses, it's not uncommon to miss a few. Some overlooked routine deductions include:

- advertising giveaways and promotions
- audio and video tapes related to business skills
- bank service charges
- business association dues
- business gifts
- business-related magazines and books (like this one)
- casual labor and tips
- casualty and theft losses
- charitable contributions
- coffee service
- commissions
- consultant fees
- credit bureau fees
- education to improve business skills
- interest on credit cards for business expenses
- interest on personal loans used for business purposes
- office supplies
- online computer services related to business
- parking and meters
- petty cash funds
- postage
- promotion and publicity
- seminars and trade shows
- taxi and bus fare
- telephone calls away from the business.

Must some types of business supplies and equipment be fully deducted in the year they are purchased, but others deducted over several years?

Current expenses, which include the everyday costs of keeping your business going, such as office supplies, rent and electricity, can be deducted from your business's total income in the year you incurred them. But expenditures for things that will generate revenue in future years—for example, a desk, copier or car—must be “capitalized,” that is, written off or “amortized” over their useful life—usually three, five or seven years—according to IRS rules. There is one important exception to this rule, discussed next.

Does this mean that, even if I buy business equipment this year, I must spread the deduction over a period of five years?

Not necessarily. Normally the cost of “capital equipment”—equipment that has a useful life of more than one year—must be deducted over a number of years, but there is one major exception. In 2002, Internal Revenue Code § 179 allowed you to deduct up to \$24,000 worth of capital assets in any one year against your business income. Even if you buy the equip-

ment on credit, with no money down, you can still qualify for this deduction. (The maximum deduction is slated to rise to \$25,00 in 2003.)

### Business Assets That Must Be Capitalized

- Buildings
- Cellular phones and beepers
- Computer components and software
- Copyrights and patents
- Equipment
- Improvements to business property
- Inventory
- Office furnishings and decorations
- Small tools and equipment
- Vehicles
- Window coverings

A friend told me that corporations get the best tax breaks of any type of business, so I am thinking of incorporating my startup. What do you recommend?

There's a seed of truth in what your friend told you, but keep in mind that most tax benefits flow to profitable, established businesses, not to startups in their first few years. For example, corporations can offer more tax-flexible pension plans and greater medical deductions than sole proprietors, partnerships or LLCs, but few startups have the cash flow needed to take full

advantage of this tax break. Similarly, the ability to split income between a corporation and its owners—thereby keeping income in lower tax brackets—is effective only if the business is solidly profitable. And incorporating adds state fees, as well as legal and accounting charges, to your expense load. So unless you are sure that substantial profits will begin to roll in immediately, hold off.

For more information about choosing the right structure for your business, see *Legal Structures for Small Businesses*, above.

I am thinking about setting up a consulting business with two of my business associates. Do we need to have partnership papers drawn up? Does it make any difference tax-wise?

If you go into business with other people and split the expenses and profits, under the tax code you are in partnership whether you have signed a written agreement or not. This means that you will have to file a partnership tax return every year, in addition to your individual tax return.

Even though a formal partnership agreement doesn't affect your tax status, it's essential to prepare one to establish all partners' rights and responsibilities vis-à-vis each other, as well as to provide for how profits and losses will be allocated to each partner. For more information about partnerships, see *Legal Structures for Small Businesses*, above.



I am a building contractor with a chance to land a big job. If I get it, I'll need to hire people quickly. Should I hire independent contractors or employees?

If you will be telling your workers where, when and how to do their jobs, you should treat them as employees, because that's how the IRS will classify them. Generally, you can treat workers as independent contractors only if they have their own businesses and offer their services to several clients—for example, a specialty sign painter with his own shop who you hire to do a particular job.

If in doubt, err on the side of treating workers as employees. While classifying your workers as independent contractors might save you money in the short run (you wouldn't have to pay the employer's share of payroll taxes or have an accountant keep records and file payroll tax forms), it may get you into big trouble if the IRS later audits you. (The IRS is very aware of the tax benefits of misclassifying an employee as an independent contractor and regularly audits companies who hire large numbers of independent contractors.) If your company is audited, the IRS may reclassify your "independent contractors" as employees—with the result that you are assessed hefty back taxes, penalties and interest.

I've heard that I can no longer claim a deduction for an office in my home. But I also see that the IRS has a form for claiming home office expenses. What's the story?

It's not as confusing as it sounds. A while back, the Supreme Court told a doctor who was taking work home from the hospital that he couldn't take a depreciation deduction for the space used at his condo. But this is quite different from maintaining a home-based business. If you run a business out of your home, you can usually claim a deduction for the portion of the home used for business. Also, you can deduct related costs—utilities, insurance, remodeling—whether you own or rent.

For more information about running a home-based business, see the next section.

I am planning a trip to Los Angeles to attend a trade show. Can I take my family along for a vacation and still be able to deduct the expenses?

If you take others with you on a business trip, you can deduct business expenses for the trip no greater than if you were traveling alone. If on the trip your family rides in the back seat of the car and stays with you in one standard motel room, then you can fully deduct your automobile and hotel expenses. You can also fully deduct the cost of your air tickets even if they feature a two-for-one or "bring along the family" discount. You can't claim a deduction for your



family's meals or jaunts to Disneyland or Universal Studios, however. And if you extend your stay and partake in some of the fun after the business is over, the expenses attributed to the nonbusiness days aren't deductible, unless you extended your stay to get discounted airfare (the "Saturday overnight" requirement). In this case, your hotel room and your own meals would be deductible.



#### *More Information About Small Business Taxes*

*Tax Savvy for Small Business*, by Frederick W. Daily (Nolo), tells small business owners what they need to know about federal taxes and shows them how to make the right tax decisions.

*Hiring Independent Contractors: The Employer's Legal Guide*, by Stephen Fishman (Nolo), explains who qualifies as an independent contractor, describes applicable tax rules and shows employers how to set up effective working agreements with independent contractors.

*Working for Yourself: Law & Taxes for Freelancers, Independent Contractors & Consultants*, by Stephen Fishman (Nolo), is designed for the estimated 20 million Americans who are self-employed and offer their services on a contract basis.

## Home-Based Businesses

As technology advances, it becomes more and more convenient and economical to operate a business from home. Depending on local zoning rules, as long as the business is small, quiet and doesn't create traffic or parking problems, it's usually legal to do so. But as with any other business endeavor, it pays to know the rules before you begin.

### *Is a home-based business legally different from other businesses?*

No. The basic legal issues, such as picking a name for your business and deciding whether to operate as a sole proprietorship, partnership, limited liability company or corporation, are the same. Similarly, when it comes to signing contracts, hiring employees and collecting from your customers, the laws are identical whether you run your business from home or the top floor of a high-rise.

### *Are there laws that restrict a person's right to operate a business from home?*

Municipalities have the legal right to establish rules about what types of activities can be carried out in different geographic areas. For example, laws and ordinances often establish

zones for stores and offices (commercial zones), factories (industrial zones) and houses (residential zones). In some residential areas—especially in affluent communities—local zoning ordinances absolutely prohibit all types of business. In the great majority of municipalities, however, residential zoning rules allow small non-polluting home businesses, as long as the home is used primarily as a residence and the business activities don't negatively affect neighbors.

### How can I find out whether residential zoning rules allow the home-based business I have in mind?

Get a copy of your local ordinance from your city or county clerk's office, the city attorney's office or your public library, and read it carefully. Zoning ordinances are worded in many different ways to limit business activities in residential areas. Some are extremely vague, allowing "customary home-based occupations." Others allow homeowners to use their houses for a broad—but, unfortunately, not very specific—list of business purposes (for example, "professions and domestic occupations, crafts or services"). Still others contain a detailed list of approved occupations, such as "law, dentistry, medicine, music lessons, photography, cabinet making."

If you read your ordinance and still aren't sure whether your business is okay, you may be tempted to talk to zoning or planning officials. But until you figure out what the rules and politics of your locality are, it may be best to do this without identifying and calling attention to yourself. (For example, have a friend who lives nearby make inquiries.)

### The business I want to run from home is not specifically allowed or prohibited by my local ordinance. What should I do to avoid trouble?

Start by understanding that in most areas zoning and building officials don't actively search for violations. The great majority of home-based businesses that run into trouble do so when a neighbor complains—often because of noise or parking problems, or even because of the unfounded fear that your business is doing something illegal such as selling drugs.

It follows that your best approach is often to explain your business activities to your neighbors and make sure that your activities are not worrying or inconveniencing them. For example, if you teach piano lessons or do physical therapy from your home and your students or clients will often come and go, make sure your neighbors are not bothered by noise or losing customary on-street parking spaces.

Will the local ordinance regulating home-based businesses include rules about specific activities, such as making noise, putting up signs or having employees?

Quite possibly. Many ordinances—especially those which are fairly vague as to the type of business you can run from your home—restrict how you can carry out your business. The most frequent rules limit your use of on-street parking, prohibit outside signs, limit car and truck traffic and restrict the number of employees who can work at your house on a regular basis (some prohibit employees altogether). In addition, some zoning ordinances limit the percentage of your home's floor space that can be devoted to the business. Again, you'll need to study your local ordinance carefully to see how these rules will affect you.

I live in a planned development that has its own rules for home-based businesses. Do these control my business activities or can I rely on my city's home-based business ordinance, which is less restrictive?

In an effort to protect residential property values, most subdivisions, condos and planned unit develop-

ments create special rules—typically called Covenants, Conditions and Restrictions (CC&Rs)—that govern many aspects of property use. Rules pertaining to home-based businesses are often significantly stricter than those found in city ordinances. As long as the rules of your planned development are reasonably clear and consistently enforced, you must follow them.

### *If Municipal Officials Say No to Your Home-Based Business*

**In many cities and counties, if a planning or zoning board rejects your business permit application, you can appeal—often to the city council or county board of supervisors. While this can be an uphill battle, it is likely to be less so if you have the support of all affected neighbors. You may also be able to get an overly restrictive zoning ordinance amended by your municipality's governing body. For example, in some communities, people are working to amend ordinances that prohibit home-based businesses entirely or allow only "traditional home-based businesses" to permit businesses that rely on the use of computers and other hightech equipment.**

### I sell my consulting services to a number of businesses. Does maintaining a home office help me establish independent contractor status with the IRS?

No. An independent contractor is a person who controls both the outcome of a project and the means of accomplishing it, and who offers services to a number of businesses or individual purchasers. Although having an office or place of business is one factor the IRS looks at in determining whether an individual qualifies as an independent contractor, it makes no difference whether your office is located at home or in a traditional business setting.

### Are there tax advantages to working from home?

Almost all ordinary and necessary business expenses (everything from wages to computers to paper clips) are tax deductible, no matter where they are incurred—in a factory or office, while traveling or at home.

But if you operate your business from home and qualify under IRS rules, you may be able to deduct part of your rent from your income taxes—or if you own your home, take a depreciation deduction.

You may also be eligible to deduct a portion of your total utility, home repair and maintenance, property tax and house insurance costs, based on the percentage of your residence you use for business purposes.

To qualify for home-office deductions, the IRS requires that two legal tests be met:

- you must use your business space regularly and exclusively for business purposes, and
- your home office must be the principal place where you conduct your business. This rule is satisfied if your office is used for administrative or managerial activities, as long as these activities aren't often conducted at another business location. Alternatively, you must meet clients at home or use a separate structure on your property exclusively for business purposes.

Note that the amount of your deduction can't exceed your home-based business's total profit.

## *Insuring Your Home-Based Business*

It's a mistake to rely on a homeowner's or renter's insurance policy to cover your home-based business. These policies often exclude or strictly limit coverage for business equipment and injuries to business visitors. For example, if your computer is stolen or a client or business associate trips and falls on your steps, you may not be covered.

Fortunately, it's easy to avoid these nasty surprises. Sit down with your insurance agent and fully disclose your planned business operation. You'll find that it's relatively inexpensive to add business coverage to your homeowner's policy—and it's a tax-deductible expense. But be sure to check prices—some insurance companies provide special cost-effective policies designed to protect both homes and home-based businesses.

## How big will my home-office tax deduction be if my business qualifies under IRS rules?

To determine your deduction, you first need to figure out how much of your home you use for business as compared to other purposes. Do this by dividing the number of square feet used for your home business by the total square footage of your home. The resulting percentage of business usage determines how much of your rent (or, if you are a homeowner, depreciation), insurance, utilities and other expenses are deductible. But remember, the amount of the deduction can't be larger than the profit your home-based business generates. (Additional technical rules apply to calculating depreciation on houses you own to allow for the fact that the structure, but not the land, depreciates.) For more information, see IRS Publication 587, *Business Use of Your Home* (you can view it online at <http://www.irs.gov>).

## Do I need to watch out for any tax traps when claiming deductions for my home office?

Claiming a home-office deduction increases your audit risk slightly, but this needn't be a big fear if you carefully follow the rules.

Keep in mind that if you sell your house, the depreciation portion of the home-based office deductions you have previously taken will be subject to tax in that year (up to a maximum of 25%), whether you made a profit or not. And you can't use the \$250,000 per person "exclusion of profits" on the sale of a home to offset this tax. For

example, if your depreciation deductions total \$5,000 for the last seven years, you will be taxed on this amount in the year you sell your house. Despite this tax, it's generally wise to continue to take your home-office deductions each year. Especially for people who don't plan to sell their houses anytime soon, it's usually beneficial to receive a tax break today that you won't have to repay for many years. You can use your tax savings to help your business grow.

## I have a full-time job, but I also operate a separate part-time business from home. Can I claim a tax deduction for my home-based business expenses?

Yes, as long as your business meets certain IRS rules. It makes no difference that you work only part-time at your home-based business or that you have another occupation. But your business must be more than a disguised hobby—it has to pass muster with the IRS as a real business.

The IRS defines a business as "any activity engaged in to make a profit." If a venture makes money—even a small amount—in three of five consecutive years, it is presumed to possess a profit motive. (IRC §183(d).) However, courts have held that some activities that failed to meet this three-profitable-years-out-of-five test still qualify as a business if they are run in a businesslike manner. When determining whether a nonprofitable venture qualifies for a deduction, courts may look at whether you kept thorough business records, had a separate business bank account, prepared

advertising or other marketing materials and obtained any necessary licenses and permits (a business license from your city, for example).



### *More Information About Home-Based Business*

*Tax Savvy for Small Business*, by Frederick W. Daily (Nolo), shows you how to take the home-office deduction, including depreciation and household expenses.

*The Best Home Businesses for the 21st Century*, by Paul & Sarah Edwards (J.P. Tarcher), profiles over 100 workable home-based businesses, including information about how each business works and what sets of skills and opportunities are necessary to succeed.

*Working for Yourself: Law & Taxes for Freelancers, Independent Contractors & Consultants*, by Stephen Fishman (Nolo), shows independent contractors how to meet business start-up requirements, comply with strict IRS rules and make sure they get paid in full and on time.

## **Employers' Rights & Responsibilities**

At some point during your business venture, you may need to hire people

to help you manage your workload. When you do, you'll be held accountable to a host of state and federal laws that regulate your relationship with your employees. Among the things you'll be expected to know and understand:

- proper hiring practices, including how to write appropriate job descriptions, conduct interviews and respect applicants' privacy rights
- wage and hour laws, as well as the laws that govern retirement plans, healthcare benefits and life insurance benefits
- workplace safety rules and regulations
- how to write an employee handbook and conduct performance reviews, including what you should and shouldn't put in an employee's personnel file
- how to avoid sexual harassment as well as discrimination based on gender, age, race, pregnancy, sexual orientation and national origin, and
- how to avoid trouble if you need to fire an employee.

This section provides you with an overview of your role as an employer. And you can find more guidance elsewhere in this book. Employee's rights—including questions and answers about wages, hours and workplace safety—are discussed in Chapter 4; pension plans are covered in Chapter 14.

*First things first. How can I write advertisements that will attract the best pool of potential employees—without getting in legal hot water?*

Many small employers get tripped up when summarizing a job in an advertisement. This can easily happen if you're not familiar with the legal guidelines. Nuances in an ad can be used as evidence of discrimination against applicants of a particular gender, age or marital status.

**There are a number of pitfalls to avoid in job ads:**

<b>DON'T USE</b>	<b>USE</b>
Salesman	Salesperson
College Student	Part-time Worker
Handyman	General Repair Person
Gal Friday	Office Manager
Married Couple	Two-Person Job
Counter Girl	Retail Clerk
Waiter	Wait Staff
Young	Energetic

Also, requiring a high school or college degree may be discriminatory in some job categories. You can avoid problems by stating that an applicant must have a "degree or equivalent experience."

Probably the best way to write an ad that meets legal requirements is to stick to the job skills needed and the basic responsibilities. Some examples:

"Fifty-unit apartment complex seeks experienced manager with general maintenance skills."

"Mid-sized manufacturing company has opening for accountant with tax experience to oversee interstate accounts."

"Cook trainee position available in new vegetarian restaurant. Flexible hours."

Help Wanted ads placed by federal contractors must state that all qualified applicants will receive consideration for employment without regard to race, color, religion, sex or national origin. Ads often express this with the phrase, "An Equal Opportunity Employer." To show your intent to be fair, you may want to include this phrase in your ad even if you're not a federal contractor.

**Any tips on how to conduct a good, forthright interview—and again, avoid legal trouble?**

Good preparation is your best ally. Before you begin to interview applicants for a job opening, write down a set of questions focusing on the job duties and the applicant's skills and experience. For example:

"Tell me about your experience in running a mailroom."

"How much experience did you have in making cold calls on your last job?"

"Explain how you typically go about organizing your workday."

"Have any of your jobs required strong leadership skills?"

By writing down the questions and sticking to the same format at all interviews for the position, you reduce the risk that a rejected applicant will later complain about unequal treatment. It's also smart to summarize the applicant's answers for your files—but don't get so involved in documenting the interview that you forget to listen closely to the applicant. And don't be so locked in to your list of questions that you don't follow up on some-



thing significant that an applicant has said, or try to pin down an ambiguous or evasive response.

To break the ice, you might give the applicant some information about the job—the duties, hours, pay range, benefits and career opportunities. Questions about the applicant’s work history and experience that may be relevant to the job opening are always appropriate. But don’t encourage the applicant to divulge the trade secrets of a present or former employer—especially a competitor. That can lead to a lawsuit. And be cautious about an applicant who volunteers such information or promises to bring secrets to the new position; such an applicant will probably play fast and loose with your own company’s secrets, given the chance.

**I’ve heard horror stories about employers who get sued for discriminating—both by employees and even by people they’ve interviewed but decided not to hire. What’s the bottom line?**

Federal and state laws prohibit you from discriminating against an employee or applicant because of race, color, gender, religious beliefs, national origin, disability—or age if the person is at least 40 years old. Also, many states and cities have laws prohibiting employment discrimination based on other characteristics, such as marital status or sexual orientation.

A particular form of discrimination becomes illegal when Congress, a state legislature or a city council decides that a characteristic—race, for

example—bears no legitimate relationship to employment decisions. As an employer, you must be prepared to show that your hiring and promotion decisions have been based on objective criteria and that the more qualified applicant has always succeeded.

Still, when hiring, you can exercise a wide range of discretion based on business considerations. You remain free to hire, promote, discipline and fire employees and to set their duties and salaries based on their skills, experience, performance and reliability—factors that are logically tied to valid business purposes.

The law also prohibits employer practices that seem neutral, but may have a disproportionate impact on a particular group of people. Again, a policy is legal only if there’s a valid business reason for its existence. For example, refusing to hire people who don’t meet a minimum height and weight is permissible if it’s clearly related to the physical demands of the particular job—felling and hauling huge trees, for instance. But applying such a requirement to exclude applicants for a job as a cook or receptionist wouldn’t pass legal muster.

**How can I check out a prospective employee without violating his or her right to privacy?**

As an employer, you likely believe that the more information you have about job applicants, the better your hiring decisions will be. But make sure any information you seek will actually be helpful to you. It’s often a



waste of time and effort to acquire and review transcripts and credit reports—although occasionally they're useful. If you're hiring a bookkeeper, for example, previous job experience is much more important than the grades the applicant received in a community college bookkeeping program ten years ago. On the other hand, if the applicant is fresh out of school and has never held a bookkeeping job, a transcript may yield some insights. Similarly, if you're hiring a switchboard operator, information on a credit report would be irrelevant. But if you're filling a job for a bar manager who will be handling large cash receipts, you might want to see a credit report to learn if the applicant is in financial trouble.

To avoid claims that you've invaded a prospective employee's privacy, always obtain the applicant's written consent before you contact a former employer, request a credit report or send for high school or college transcripts.

Finally, it's usually not wise to resort to screening applicants through personality tests; laws and court rulings restrict your right to use them in most states.

### Can I require job applicants to pass a drug test?

It depends on the laws of your state. Although many states allow employers to test all applicants for illegal drug use, some states allow testing only for certain jobs—those that require driving, carrying a weapon or operating heavy machinery, for ex-

ample. Before requiring any applicant to take a drug test, you should check with your state's department of labor to find out what the law allows.

In general, you will be on safest legal ground if you have a strong, legitimate reason for testing applicants—especially if your reason involves protecting the public's safety.

### Is drug use a disability?

When it passed the Americans with Disabilities Act, Congress refused to recognize illegal drug use or current drug addiction as a disability. Therefore, if an applicant fails a legally administered drug test, you will not violate the ADA by refusing to hire that applicant.

However, the ADA does protect applicants who no longer use illegal drugs and have successfully completed (or are currently attending) a supervised drug rehabilitation program. Although you can require these applicants to take a drug test or show you proof of their participation in a rehabilitation program, you cannot refuse to hire them solely because they used to take illegal drugs.

### How do I avoid legal problems when giving employee evaluations?

Be honest and consistent with your employees. If a fired employee initiates a legal action against you, a judge or jury will probably see those evaluations—and will want to see that you were consistent in word and deed. For example, a jury will sense that something is wrong if you consis-

tently rate a worker's performance as poor or mediocre—but continue to hand out generous raises or perhaps even promote the person. The logical conclusion: You didn't take seriously the criticisms in your evaluation report, so you shouldn't expect the employee to take them seriously, either.

It's just as damaging to give an employee glowing praise in report after report—perhaps to make the employee feel good—and then to fire him or her for a single infraction. That strikes most people as unfair. And unfair employers often lose court fights, especially in situations where a sympathetic employee appears to have been treated harshly.

If your system is working, employees with excellent evaluations should not need to be fired for poor performance. And employees with poor performance shouldn't be getting big raises.

### As a small employer, what should I keep in personnel files—and what right do employees have to see what's inside?

Create a file for each employee in which you keep all job-related information, including:

- job description
- job application
- offer of employment
- IRS form W-4, the Employee's Withholding Allowance Certificate
- receipt for employee handbook
- periodic performance evaluations
- sign-up forms for employee benefits
- complaints from customers and co-workers

- awards or citations for excellent performance
- warnings and disciplinary actions, and
- notes on an employee's attendance or tardiness.

Experts recommend keeping one separate file for all of your employees' INS I-9 Employment Eligibility Verification forms—the forms you have to complete for new employees demonstrating that they are authorized to work in the United States. There are two practical reasons for keeping these forms in their own file—and out of your workers' personnel files. First, this will limit the number of people who know an employee's immigration status. If you keep an employee's I-9 in her personnel file, anyone who reviews that file (a supervisor, human resources employee or payroll administrator) will know whether or not the employee is a citizen. This could lead to problems later, if the employee claims that she was discriminated against based on her immigration status. If you keep the forms in a separate file, fewer people will be aware of the employee's immigration status—and the employee will have a much tougher time trying to prove that important employment decisions were made on that basis.

Second, if the INS decides to audit you, they are entitled to see I-9 forms as they are kept in the normal course of business. If you keep these forms in each employee's personnel file, that means the government will rummage through all of these files—causing inconvenience for you and privacy

concerns for your employees. On the other hand, if you keep your forms in a single folder, you can simply hand over that folder if the INS comes knocking.

## *Special Rules for Medical Records*

The Americans with Disabilities Act (ADA) imposes very strict limitations on how you must handle information obtained from medical examinations and inquiries. You must keep the information in medical files that are separate from nonmedical records, and you must store the medical files in a separate locked cabinet. To further guarantee the confidentiality of medical records, designate a specific person to have access to those files.

The ADA allows very limited disclosure of medical information. Under the ADA, you may:

- inform supervisors about necessary restrictions on an employee's duties and about necessary accommodations
- inform first aid and safety workers about a disability that may require emergency treatment and about specific procedures that are needed if the workplace must be evacuated, and
- provide medical information required by government officials and by insurance companies that require a medical exam for health or life insurance.

Otherwise, don't disclose medical information about employees. Although the confidentiality provisions of the ADA

protect only some disabled workers, some state's laws also require confidential handling of medical records. The best policy is to treat all medical information about all employees as confidential.

Many states have laws giving employees—and former employees—access to their own personnel files. How much access varies from state to state. Typically, if your state allows employees to see their files, you can insist that you or another supervisor be present to make sure nothing is taken, added or changed. Some state laws allow employees to obtain copies of items in their files, but not necessarily all items. For example, a law may limit the employee to copies of documents that he or she has signed, such as a job application. If an employee is entitled to a copy of an item in the file or if you're inclined to let the employee have a copy of any document in the file, you—rather than the employee—should make the copy.

Usually, you won't have to let the employee see sensitive items such as information assembled for a criminal investigation, reference letters and information that might violate the privacy of other people. In a few states, employees may insert rebuttals to information in their personnel files with which they disagree.

## *Am I required to offer my employees paid vacation, disability, maternity or sick leave?*

No law requires you to offer paid vacation time or paid sick or disability

leave to your employees. You could choose to offer none—although a policy like this could make it tough to attract high-quality employees in a competitive market. If you decide to adopt a policy that gives your employees paid vacation or sick time, you must apply the policy consistently to all employees. If you offer some employees a more attractive package than others, you are opening yourself up to claims of unfair treatment.

The same rules apply to pregnancy and maternity leave. No law requires employers to provide paid leave for employees during their pregnancy or immediately after they give birth. However, if you choose to offer paid vacation, sick or disability leave, you must allow pregnant women and women who have just given birth to make use of these policies. For example, a new mother who is physically unable to work following the birth of her child must be allowed to use paid disability leave if such leave is available to other employees.

### Must I offer my employees unpaid leave?

There are two situations in which you might be legally required to offer unpaid leave to your employees. First, if the employee requesting leave qualifies as disabled under the Americans with Disabilities Act (see below for an explanation of the ADA), and requests the leave as a reasonable accommodation for the disability, you may be required to grant the leave request. For example, an employee

who needs time off to undergo surgery or treatment for a disabling condition is probably entitled to unpaid leave, unless you can show that providing the leave would be an undue hardship to your business.

Second, your employees might be entitled to unpaid leave under the Family and Medical Leave Act (FMLA) or a similar state statute. See Chapter 4, *Workplace Rights*, for an explanation of when you must provide leave under the FMLA.

### What am I legally required to do for my disabled employees?

The Americans with Disabilities Act (ADA) prohibits employers from discriminating against disabled applicants or employees. However, the ADA does not require employers to hire or retain workers who can't do their jobs. Only “qualified workers with disabilities”—employees who can perform all the essential elements of the job, with or without some form of accommodation from their employers—are protected by the law.

An employee is legally disabled if:

- He has a physical or mental impairment that substantially limits a major life activity (such as the ability to walk, talk, see, hear, breathe, reason or take care of oneself). Courts tend not to categorically characterize certain conditions as disabilities—instead, they consider the effect of the particular condition on the particular employee.
- He has a record or history of impairment, or

He is regarded by the employer as disabled, even if the employer is incorrect.

The ADA also requires employers to make reasonable accommodations for their disabled employees. This means you may have to provide some assistance or make some changes in the job or workplace to enable the worker to do their job. For example, an employer might lower the height of a workspace or install ramps to accommodate a worker in a wheelchair, provide voice-recognition software for a worker with a repetitive stress disorder or provide TDD telephone equipment for a worker with impaired hearing.

It is your employee's responsibility to inform you of his disability and request a reasonable accommodation—you don't have to be psychic to follow the law. Once an employee raises the issue, you must engage in a dialogue with the worker to try to figure out what kinds of accommodations might be effective and practical. Although you don't have to provide the precise accommodation your worker requests, you do have to work together to come up with a reasonable solution.

Employers don't have to provide an accommodation if it would cause their business to suffer "undue hardship"—essentially, if the cost or effect of the accommodation would be excessive. There are no hard and fast rules about when an accommodation poses an undue hardship. When faced with this issue, courts consider a number of factors, including:

- the cost of the accommodation
- the size and financial resources of the employer
- the structure of the employer's business, and
- the effect the accommodation would have on the business.

## *Employees With Mental Disabilities*

The ADA applies equally to employees with physical disabilities and employees with mental or psychiatric disabilities. Therefore, workers who suffer from severe depression, bipolar disorder, schizophrenia, attention deficit disorder and other mental diseases or conditions may be covered by the ADA, if their condition meets the ADA's definition of a disability.

Workers with mental disabilities are also entitled to reasonable accommodations. For example, you might allow an employee whose anti-depressant medication makes her groggy in the morning to come in a few hours later, or provide an office with soundproofed walls to reduce distractions for an employee who suffers from attention deficit disorder.

**One of my employees just told me that she was sexually harassed by a coworker. What should I do?**

Most employers feel anxious when faced with complaints of sexual harassment. And with good reason: such complaints can lead to workplace ten-

sion, government investigations and even costly legal battles. If the complaint is mishandled, even unintentionally, an employer may unwittingly put itself out of business.

Here are some basics to keep in mind if you receive a complaint:

- *Educate yourself.* Do some research on the law of sexual harassment—learn what sexual harassment is, how it is proven in court and what your responsibilities are as an employer. An excellent place to start is *Sexual Harassment on the Job*, by William Petrocelli and Barbara Kate Repa (Nolo).
- *Follow established procedures.* If you have an employee handbook or other documented policies relating to sexual harassment, follow those policies. Don't open yourself up to claims of unfair treatment by bending the rules.
- *Interview the people involved.* Start by talking to the person who complained. Then talk to the employee accused of harassment and any witnesses. Get details: what was said or done, when, where and who else was there.
- *Look for corroboration or contradiction.* Usually, the accuser and accused offer different versions of the incident, leaving you with no way of knowing who's telling the truth. Turn to other sources for clues. For example, schedules, time cards and other attendance records (for trainings, meetings, and so on) may help you determine if each party was where they claimed to be. Witnesses may have seen part of the incident.

And in some cases, documents will prove one side right. It's hard to argue with an X-rated email.

- *Keep it confidential.* A sexual harassment complaint can polarize a workplace. Workers will likely side with either the complaining employee or the accused employee, and the rumor mill will start working overtime. Worse, if too many details about the complaint are leaked, you may be accused of damaging the reputation of the alleged victim or alleged harasser—and get slapped with a defamation lawsuit. Avoid these problems by insisting on confidentiality, and practicing it in your investigation.
- *Write it all down.* Take notes during your interviews. Before the interview is over, go back through your notes with the interviewee, to make sure you got it right. Write down the steps you have taken to learn the truth, including interviews you have conducted and documents you have reviewed. Document any action taken against the accused, or the reasons for deciding not to take action. This written record will protect you later, if your employee claims that you ignored her complaint or conducted a one-sided investigation.
- *Cooperate with government agencies.* If the accuser makes a complaint with a government agency (either the federal Equal Employment Opportunity Commission (EEOC) or an equivalent state agency), that agency may investigate. Try to provide the agency with the materials it requests,

but remember that the agency is gathering evidence that could be used against you later. This is a good time to consider hiring a lawyer to advise you.

- *Don't retaliate.* It is against the law to punish someone for making a sexual harassment complaint. The most obvious forms of retaliation are termination, discipline, demotion, pay cuts or threats of any of these actions. More subtle forms of retaliation may include changing the shift hours or work area of the accuser, changing the accuser's job responsibilities or reporting relationships and isolating the accuser by leaving her out of meetings and other office functions.
- *Take appropriate action against the harasser.* Once you have gathered all the information available, sit down and decide what you think really happened. If you conclude that some form of sexual harassment occurred, figure out how to discipline the harasser appropriately. Once you have decided on an appropriate action, take it quickly, document it and notify the accuser.

### My employees' religious differences are causing strife in the workplace. What am I required to do?

This is a tricky area. An increasing number of employees are claiming religious discrimination. And unfortunately, the law in this delicate area is unclear.

First, make sure you aren't imposing your religious beliefs on others.

You have the legal right to discuss your own religious beliefs with an employee, if you're so inclined, but you can't persist to the point that the employee feels you're being hostile, intimidating or offensive. So if an employee objects to your discussion of religious subjects or you get even an inkling that your religious advances are unwelcome, back off. Otherwise, you may find yourself embroiled in a lawsuit or administrative proceeding.

If employees complain to you that a co-worker is badgering them with religious views, you have a right—if not a duty—to intervene, although you must, of course, use the utmost tact and sensitivity.

While you may feel that the best way to resolve these knotty problems is to simply banish religion from the workplace, that's generally not a viable alternative. You're legally required to accommodate the religious needs of employees—for example, allowing employees to pick and choose the paid holidays they would like to take during the year. You don't, however, need to do anything that would cost more than a minimum amount or that would cause more than minimal inconvenience.

Some of my employees insist they have a right to smoke during breaks and at lunch, and another group claims they'll quit if I allow smoking on the premises. I'm caught in the middle. What should I do?

It's well established that second-hand tobacco smoke can harm the health of



nonsmokers. Consequently, in many states and municipalities, employers are legally required to limit smoking in the workplace. And a number of locales have specific laws that ban or limit smoking in public places; if your workplace falls within the legal definition of a public place—a bar, restaurant or hotel, for example—your legal rights and responsibilities will be clearly spelled out in the law.

A rule proposed by the Occupational Health and Safety Administration (OSHA) would allow only two choices: you'd have to either prohibit smoking in the workplace, or limit it to areas that are enclosed and ventilated directly to the outdoors. Under the rule, you couldn't require employees to enter the smoking areas when performing their normal job duties. This proposal is still under consideration.

Given the scientific facts and the general direction in which the law is moving, your safest legal course is to restrict smoking in the workplace—and a total ban may be the only practical solution. That's because in many modern buildings, it's too expensive—maybe even impossible—to provide a separate ventilation system for a smokers' room.

In addition to meeting the specific requirements of laws and regulations that limit or prohibit smoking in the workplace, be aware that you may be legally liable to nonsmoking employees if you don't take appropriate actions on their complaints.

**It's been a bad year for my business—and it looks as though I may have to lay off some workers. Are there legal problems to avoid?**

Generally, you're free to lay off or terminate employees because business conditions require it. But if you do cut back, don't leave your business open to claims that the layoffs were really a pretext for getting rid of employees for illegal reasons.

Be sensitive to how your actions may be perceived. If the layoff primarily affects workers of a particular race, or women or older employees, someone may well question your motives. It's better to spread the pain around; don't let the burden fall on just one group of employees.

**How can I make sure that my employees don't reveal my company's trade secrets to a competitor—especially after they leave the company?**

You should take two steps to protect your trade secrets from disclosure by former employees: always treat your trade secrets as confidential, and require any employee who will come in contact with your trade secrets to sign a nondisclosure agreement.

A trade secret is any information that provides its owner with a competitive advantage in the market, and is treated as a secret—that is, handled in a manner that can reasonably be expected to prevent others from learning about it. Examples of trade secrets might include recipes, manufac-



turing processes, customer or pricing lists and ideas for new products. If you own a trade secret, you have the legal right to prevent anyone from disclosing, copying or using it, and can sue anyone who violates these rights to your disadvantage.

Always keep your trade secrets confidential. For example, you should mark documents containing trade secrets “confidential” and limit their circulation, disclose trade secret material only to those employees with a real need to know, keep materials in a safe place and have a written policy which makes it clear that trade secrets are not to be revealed to outsiders.

In addition to taking steps to keep your trade secrets confidential, you should also require any employee who will come in contact with your trade secrets to sign a nondisclosure agreement, or NDA. An NDA is a contract in which the parties promise to keep confidential any trade secrets disclosed during the employment relationship. You can find more information and sample NDA forms in *Non-disclosure Agreements* by Stephen Fishman (Nolo).

### What are my legal obligations to an employee who is leaving the company?

Surprisingly, your responsibility to your employees doesn't necessarily end when the employment relationship ends. Even after an employee quits or is fired, you must:

- Provide the employee's final paycheck in accordance with state law. Most states require that an em-

ployee receive this check fairly quickly, sometimes just a day or two after the last day of work.

- Provide severance pay. No law requires employers to provide severance pay (although a few states require employers to pay severance to workers fired in a plant closure). But if you promise it, you must pay it to all employees who meet your policy's requirements.
- Give information on continuation of health insurance, under a federal law called the Consolidated Omnibus Budget Reconciliation Act (COBRA). If you offer your employees health insurance, and your company has 20 or more employees, you must offer departing employees the option of continued coverage under the company's group health insurance plan, at the worker's expense, for a specified period.
- Allow former employees to view their personnel files. Most states provide employees and former employees with the legal right to see their personnel file, and to receive copies of some of the documents relating to their job. State laws vary as to how long employers must keep these records for former employees.

**I have to give a reference for a former employee I had to fire. I don't want to be too positive about him, but I am also afraid he might sue me for unflattering remarks. Advice?**

The key to protecting yourself is to stick to the facts and act in good faith.

You'll get in trouble only if you exaggerate or cover up the truth—or are motivated by a desire to harm your former employee.

Former employees who feel maligned can sue for defamation—called slander if the statements were spoken or libel if they were written. To win a defamation case, a former employee must prove that you intentionally gave out false information and that the information harmed his or her reputation. If you can show that the information you provided was true, the lawsuit will be dismissed.

And even if it turns out that the information provided is untrue, employers in most states are entitled to some protection in defamation cases. This protection is based on a legal doctrine called “qualified privilege.” To receive the benefits, you must show that:

- you made the statement in good faith
- you and the person to whom you disclosed the information shared a common interest, and
- you limited your statement to this common interest.

The law recognizes that a former employer and a prospective employer share a common interest in the attributes of an employee. To get the protection of the qualified privilege, your main task is to stick to facts that you've reasonably investigated and to lay aside your personal feelings about the former employee.

A practical policy—and one that gives you a high degree of legal protection—is simply not to discuss an

employee with prospective employers if you can't say something positive. Just tell the person inquiring that it's not your policy to comment on former workers.

Where an employee's record is truly mixed, it's usually possible to accent the positive while you try to put negative information into a more favorable perspective. If you do choose to go into detail, don't hide the bad news. In very extreme cases (in which the former employee committed a serious crime or engaged in dangerous wrongdoing), you could be sued by the new employer for concealing this information.

### Do I have the same legal obligations to independent contractors as I do to employees?

Generally, an employer has more obligations, both legally and financially, to employees than to independent contractors. The workplace rights guaranteed to employees do not protect independent contractors, for the most part. And an employer must make certain contributions to the government on behalf of its employees, while independent contractors are expected to make these payments themselves.

Here are a number of rules that apply only to employees:

- *Anti-discrimination laws.* Most laws prohibiting employers from discriminating against employees or applicants for employment based such characteristics as race, gender, national origin, religion, age or

disability do not protect independent contractors.

- *Wage and hour laws.* Independent contractors are not covered by laws governing the minimum wage, overtime pay and the like.
- *Medical and parental leave laws.* You are not required to offer independent contractors medical or parental leave.
- *Workers' compensation laws.* You do not have to provide workers' compensation for independent contractors.
- *Unemployment insurance.* You do not have to contribute to unemployment insurance for independent contractors.
- *Social Security contributions.* You are not required to make any Social Security payments on behalf of independent contractors.
- *Wage withholding.* You are not required to withhold state or federal income tax, or state disability insurance payments (where applicable) from the paychecks of independent contractors.

## When can I classify a worker as an independent contractor?

Different government agencies use different tests to decide whether workers should be classified as independent contractors or employees. Generally, these tests are intended to figure out whether an independent contractor is truly a self-employed businessperson offering services to the general public. The more discretion a worker has to decide how, when and for whom to perform work, the more likely that the worker is an indepen-

dent contractor. For example, an independent contractor might do similar work for other companies, provide the tools and equipment to do the job, decide how to do the job (including when, where and in what order to do the work) and hire employees or assistants to help out with big jobs. On the other hand, a worker who works only for you, under conditions determined by you, is more likely to be classified as an employee.



### More Information About Employers' Rights and Responsibilities

*The Employer's Legal Handbook*, by Fred Steingold (Nolo), explains employers' legal rights and responsibilities in detail.

*Dealing With Problem Employees*, by Amy DelPo and Lisa Guerin (Nolo), offers employers advice and step-by-step instructions for handling problems in the workplace, from giving effective performance evaluations to firing employees who don't work out.

*Everyday Employment Law: The Basics*, by Lisa Guerin and Amy DelPo (Nolo), provides all the basic information, tips and real-world examples employers need to answer their employment law questions.

Information on independent contractors can be found in *Hiring Independent Contractors* by Stephen Fishman (Nolo).

For information on federal discrimination laws and lists of state resources, contact the Equal Employment Opportunity Commission, 1801 L St., NW,

Washington, DC, 20507, 800-669 3362, <http://www.eeoc.gov>.

For information on wage and hour laws, workers' compensation and family and medical leave, contact the Department of Labor, 200 Constitution Ave., NW, Washington, DC, 20210, 202-693-4650, <http://www.dol.gov>.

For a variety of helpful employment law resources—including fact sheets, sample policies and more—visit the website of CCH, Inc., at <http://www.toolkit.cch.com>.



## General Sites for Small Businesses

<http://www.nolo.com>

*Nolo offers free self-help information and small business books, software and forms on a wide variety of subjects, including starting and running your small business.*

<http://www.americanexpress.com/smallbusiness>

*The American Express Small Business Exchange helps you find information, resources and customers for your small business.*

<http://www.nfibonline.com>

*The National Federation of Independent Business provides news, workshops and action alerts for small business owners. The NFIB is the nation's largest advocacy organization for small and independent businesses.*

<http://www.sba.gov>

*The Small Business Administration provides information about starting, financing and expanding your small business.*

<http://smallbusiness.yahoo.com>

*Yahoo offers an abundance of links to resources for small business people.*

## Sites for Nonprofit Corporations

<http://www.igc.org>

*The Institute for Global Communication offers an extensive list of links to resources for activism and nonprofit development.*

<http://www.boardsource.org>

*BoardSource, formerly the National Center for Nonprofit Boards, provides information and publications to help you run a successful nonprofit organization.*

## Sites for Independent Contractors and Home-Based Businesses

<http://www.hoaa.com>

*The Home Office Association of America is a national association for home-based business people. It offers resources, ideas and benefits to help you run a more profitable business from home. The site also contains an extensive list of links to other sites of interest to the self-employed.*

<http://www.ssa.gov>

*The Social Security Administration provides lots of information on regulations and benefits for self-employed people.*



# Patents

- 6.2 *Qualifying for a Patent*
- 6.7 *Obtaining a Patent*
- 6.9 *Enforcing a Patent*
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*To invent, you need a good imagination and a pile of junk.*

—THOMAS EDISON

**M**any of us muse about the million-dollar idea: the invention that will make life easier for others and more lucrative for us. Most of these ideas never get off the ground, however; we decide it's not really worth the time and effort to create the perfect dog toothbrush, clothes hanger or juice squeezer. But every now and then we may hit on a winner—an idea worth developing, marketing and protecting. In these cases, we must turn to the patent laws for help.

This chapter addresses the basic legal issues that arise in the patent area, answering questions such as:

- What is a patent?
- When does a particular invention qualify for a patent?
- How do you get a patent in the U.S. or abroad?
- How are patent rights enforced?
- How can you profit from your patent?

## Qualifying for a Patent

THERE IS NOTHING WHICH  
PERSEVERING EFFORT AND UNCEASING  
AND DILIGENT CARE CANNOT  
ACCOMPLISH.

—SENECA

A patent is a document issued by the U.S. Patent and Trademark Office (PTO) that grants a monopoly for a limited period of time on the manufacture, use and sale of an invention.

### What types of inventions can be patented?

The PTO issues three different kinds of patents: utility patents, design patents and plant patents.

Design patents last for 14 years from the date the patent issues. Plant and utility patents last for 20 years from the date of filing.

To qualify for a utility patent—by far the most common type of patent—an invention must be:

- a process or method for producing a useful, concrete and tangible result (such as a genetic engineering procedure, an investment strategy or computer software)
- a machine (usually something with moving parts or circuitry, such as a cigarette lighter, sewage treatment system, laser or photocopier)
- an article of manufacture (such as an eraser, tire, transistor or hand tool)
- a composition of matter (such as a chemical composition, drug, soap or genetically altered life form), or
- an improvement of an invention that fits within one of the first four categories.

Often, an invention will fall into more than one category. For instance, a laser can usually be described both as a process (the steps necessary to produce the laser beam) and a machine (a device that implements the steps to produce the laser beam). Regardless of the number of categories into which a particular invention fits, it can receive only one utility patent.

If an invention fits into one of the categories described above, it is known as “statutory subject matter” and has passed the first test in qualifying for a patent. But an inventor’s creation must overcome several additional hurdles before the PTO will issue a patent. The invention must also:

- have some utility, no matter how trivial
- be novel (that is, it must be different from all previous inventions in some important way), and

- be nonobvious (a surprising and significant development) to somebody who understands the technical field of the invention.

For design patents, the law requires that the design be novel, nonobvious and nonfunctional. For example, a new shape for a car fender, bottle or flashlight that doesn't improve its functionality would qualify.

Finally, plants may qualify for a patent if they are both novel and nonobvious. Plant patents are issued less frequently than any other type of patent.

## *More Examples of Patentable Subject Matter*

The following items are just some of the things that might qualify for patent protection: biological inventions; carpet designs; new chemical formulas, processes or procedures; clothing accessories and designs; computer hardware and peripherals; computer software; containers; cosmetics; decorative hardware; electrical inventions; electronic circuits; fabrics and fabric designs; food inventions; furniture design; games (board, box and instructions); housewares; jewelry; laser light shows; machines; magic tricks or techniques; mechanical inventions; medical accessories and devices; medicines; methods of doing business; musical instruments; odors; plants; recreational gear; and sporting goods (designs and equipment).

## *What types of inventions are not eligible for patent protection?*

Some types of inventions will not qualify for a patent, no matter how interesting or important they are. For example, mathematical formulas, laws of nature, newly discovered substances that occur naturally in the world, and purely theoretical phenomena—for instance, a scientific principle like superconductivity without regard to its use in the real world—have long been considered unpatentable. This means, for example, that you can't patent a general mathematical approach to problem solving or a newly discovered pain killer in its natural state.

In addition, the following categories of inventions don't qualify for patents:

- processes done entirely by human motor coordination, such as choreographed dance routines or a method for meditation
- most protocols and methods used to perform surgery on humans
- printed matter that has no unique physical shape or structure associated with it
- unsafe new drugs
- inventions useful only for illegal purposes, and
- nonoperable inventions, including "perpetual motion" machines (which are presumed to be nonoperable because to operate they would have to violate certain bedrock scientific principles).

### Can computer software qualify for patent protection?

Yes. Even though you can't get a patent on a mathematical formula per se, you may be able to get protection for a specific application of a formula. Thus, software may qualify for a patent if it produces a useful, concrete and tangible result. For example, the PTO will not issue a patent on the complex mathematical formulae that are used in space navigation, but will grant a patent for the software and machines that translate those equations and make the space shuttle go where it's supposed to go.

### Can a business method qualify for a utility patent?

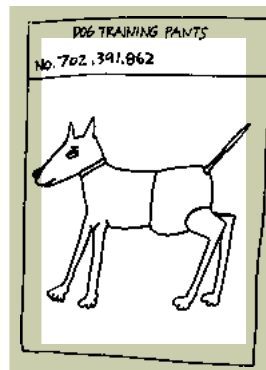
A business method is a series of steps that express some business activity, for example, a method of calculating an interest rate or a system for evaluating employee performance. Before 1988, the PTO rarely granted patents for methods of doing business. Then, in 1988, the United States Court of Appeals for the Federal Circuit changed this. (*State Street Bank & Trust Co. v. Signal Financial Group, Inc.* 149 F.3d 1368 (Fed. Cir. 1998).) The court ruled that patent laws were intended to protect business methods, so long as the method produced a "useful, concrete and tangible result."

In the six months following the *State Street* ruling, patent filings for business methods increased by 40%. In response to the development of

these new methods, the PTO created a new classification for such applications: "Data processing: financial, business practice, management or cost/price determination."

### Is it possible to obtain a patent on forms of life?

Forms of life, from bacteria to cows, that are genetically altered to have new and useful characteristics or behaviors may qualify for utility patents. Also patentable are sequences of DNA that have been created to test genetic behaviors and the methods used to accomplish this sequencing. With the advent of cloning techniques and the ability to mix genes across species—for example, the human immune system genetic code transplanted into a mouse for testing purposes—the question of what life forms can and cannot be patented promises to be a subject of fierce debate for years to come.





### What makes an invention novel?

In the context of a patent application, an invention is considered novel when it is different from all previous inventions (called “prior art”) in one or more of its constituent elements.

When deciding whether an invention is novel, the PTO will consider all prior art that existed as of the date the inventor files a patent application on the invention, or if necessary, as of the date the inventor can prove he or she first built and tested the invention. If prior art is uncovered, the invention may still qualify for a patent if the inventor can show that he or she conceived of the invention before the prior art existed and was diligent in building and testing the invention or filing a patent application on it.

An invention will flunk the novelty test if it was described in a published document or put to public use more than one year prior to the date the patent application was filed. This is known as the one-year rule.

### When is an invention considered nonobvious?

To qualify for a patent, an invention must be nonobvious as well as novel. An invention is considered nonobvious if someone who is skilled in the particular field of the invention would view it as an unexpected or surprising development.

For example, in August of 2000, Future Enterprises invents a portable high quality virtual reality system. A virtual reality engineer would most likely find this invention to be truly surprising and unexpected. Even

though increased portability of a computer-based technology is always expected in the broad sense, the specific way in which the portability is accomplished by this invention would be a breakthrough in the field and thus unobvious. Contrast this with a bicycle developer who uses a new, light but strong metal alloy to build his bicycles. Most people skilled in the art of bicycle manufacturing would consider the use of the new alloy in the bicycle to be obvious, given that lightness of weight is a desirable aspect of high-quality bicycles.

Knowing whether an invention will be considered nonobvious by the PTO is difficult because it is such a subjective exercise—what one patent examiner considers surprising, another may not. In addition, the examiner will usually be asked to make the nonobviousness determination well after the date of the invention, because of delays inherent in the patent process. The danger of this type of retroactive assessment is that the examiner may unconsciously be affected by the intervening technical improvements. To avoid this, the examiner generally relies only on the prior-art references (documents describing previous inventions) that existed as of the date of invention.

As an example, assume that in 2003, Future Enterprises’ application for a patent on the 2000 invention is being examined in the Patent and Trademark Office. Assume further that by 2003, you can find a portable virtual reality unit in any consumer electronics store for under \$200. The

patent examiner will have to go back to the time of the invention to fully appreciate how surprising and unexpected it was when it was first conceived, and ignore the fact that in 2003 the technology of the invention is very common.

### What makes an invention useful?

Patents may be granted for inventions that have some type of usefulness (utility), even if the use is humorous, such as a musical condom or a motorized spaghetti fork. However, the invention must work—at least in theory. Thus, a new approach to manufacturing superconducting materials may qualify for a patent if it has a sound theoretical basis—even if it hasn't yet been shown to work in practice. But a new drug that has no theoretical basis and which hasn't been tested will not qualify for a patent.

Remember that to qualify for a design or plant patent, the other two types of patents obtained in the U.S., the inventor need not show utility



## *Are You the First?*

As discussed previously, patents are awarded only on new and nonobvious inventions. How can an inventor find out whether his or her invention is really new? The place to start is to see whether it has ever been patented. Although a number of great inventions have never received a patent, most have. A quick spin through the patent database can provide a good headstart on finding out just how innovative an invention really is.

The Internet can be used for free access to patents issued since 1971. The U.S. Patent and Trademark Office (<http://www.uspto.gov>) provides free online databases where you simply type in words which describe your invention—called keywords.

Commercial fee-based databases often offer more choices than the free USPTO site. Below are some fee-based patent databases and a brief description of their contents.

- **MicroPatent** (<http://www.micropatent.com>). You can search U.S. and Japanese patents from 1976 to the present, International patents issued under the Patent Cooperation Treaty (PCT) from 1983 and European patents from 1988.
- **Delphion** (<http://www.delphion.com>). You can search U.S. patents from 1971 to the present and full-text patents from the European Patent Office, the World Intellectual Property Organization PCT collection and abstracts from Derwent world patent index.

- **LEXPAT** (<http://www.lexis-nexis.com>). You can search U.S. patents from 1971 to the present. In addition, the LEXPAT library offers extensive prior-art searching capability of technical journals and magazines.
- **QPAT** (<http://www.qpat.com>) and **Questel/Orbit** (<http://www.questel.orbit.com>). You can search U.S. patents from 1974 to the present and full-text European patents from 1987 to the present.

Sometimes an inventor needs to search for patents issued before 1971. All patents since the founding of the United States count when deciding whether an invention is sufficiently new to deserve a patent. And if the invention involves time-less technology (another way to core an apple), these pre-1971 patents are as important as those that were issued later.

A great resource for complete patent searching—from the first patent ever issued to the latest—is a network of special libraries called Patent and Trademark Depository Libraries (PTDLs). Every state but Connecticut has at least one. While a complete patent search can be done for free in these libraries, many of them also offer computer searches for a reasonable fee. Consult the PTO website at <http://www.uspto.gov> to find the PTDL nearest you.

## Obtaining a Patent

*Many times a day I realize how much my own outer and inner life is built upon the labors of my fellow men, both living and dead, and how earnestly I must exert myself in order to give in return as much as I have received.*

—ALBERT EINSTEIN

Because a patent grants the inventor a monopoly on his or her invention for a relatively long period of time, patent applications are rigorously examined by the Patent and Trademark Office (PTO). Typically, a patent application travels back and forth between the applicant and the patent examiner until both sides agree on which aspects of an invention the patent will cover, if any. This process typically takes between one and two years.

If an agreement is reached, the PTO “allows” the application and publishes a brief description of the patent in a weekly publication called the *Official Gazette*. If no one objects to the patent as published, and the applicant pays the required issuance fee, the PTO provides the applicant with a document called a patent deed, which we colloquially refer to as a patent. The patent deed consists primarily of the information submitted in the patent

application, as modified during the patent examination process.

### What information is typically included in a patent application?

There is no such thing as an automatic patent through creation or usage of an invention. To receive patent protection, an inventor must file an application, pay the appropriate fees and obtain a patent. To apply for a U.S. patent, the inventor must file the application with a branch of the U.S. Department of Commerce known as the U.S. Patent and Trademark Office, or PTO. A U.S. patent application typically consists of:

- an Information Disclosure Statement—that is, an explanation of why the invention is different from all previous and similar developments (the “prior art”)
- a detailed description of the structure and operation of the invention (called a patent specification) that teaches how to build and use the invention
- a precise description of the aspects of the invention to be covered by the patent (called the patent claims)
- all drawings that are necessary to fully explain the specification and claims
- a Patent Application Declaration—a statement under oath that the information in the application is true, and
- the filing fee.

In addition, small inventors often include a declaration asking for a reduction in the filing fee.

## *Understanding the Provisional Patent Application*

Often inventors want to have a patent application on file when they go out to show their invention to prospective manufacturers because it will discourage ripoffs. Also, inventors like to get their invention on record as early as possible in case someone else comes up with the same invention. To accomplish both these goals, an inventor may file what is known as a Provisional Patent Application (PPA). The PPA need only contain a complete description of the structure and operation of an invention and any drawings that are necessary to understand it—it need not contain claims, formal drawings, a Patent Application Declaration or an Information Disclosure Statement.

An inventor who files a regular patent application within one year of filing a PPA can claim the PPA's filing date for the regular patent application. If the regular patent application includes any new matter (technical information about the invention) that wasn't in the PPA, the inventor won't be able to rely on the PPA's filing date for the new matter. The PPA's filing date doesn't affect when the patent on the invention will expire; it still expires 20 years from the date the regular patent application is filed. So, the PPA has the practical effect of delaying examination of a regular patent application and extending—up to one year—the patent's expiration date.

### What happens if there are multiple applications for the same invention?

If a patent examiner discovers that another pending application involves the same invention and that both inventions appear to qualify for a patent, the patent examiner will declare that a conflict (called an interference) exists between the two applications. In that event, a hearing is held to determine who is entitled to the patent.

Who gets the patent depends on such variables as who first conceived the invention and worked on it diligently, who first built and tested the invention and who filed the first provisional or regular patent application. Because of the possibility of a patent interference, it is wise to document all invention-related activities in a signed and witnessed inventor's notebook so that you can later prove the date the invention was conceived and the steps you took to build and test the invention or quickly file a patent application.

### How are U.S. patents protected abroad?

Patent rights originate in the U.S. Constitution and are implemented exclusively by federal laws passed by Congress. These laws define the kinds of inventions that are patentable and the procedures that must be followed to apply for, receive and maintain patent rights for the duration of the patent.

All other industrialized countries offer patent protection as well. While

patent requirements and rules differ from country to country, several international treaties (including the Patent Cooperation Treaty and the Paris Convention) allow U.S. inventors to obtain patent protection in other countries that have adopted the treaties if the inventors take certain required steps, such as filing a patent application in the countries on a timely basis and paying required patent fees.

## Enforcing a Patent

Once a patent is issued, it is up to the owner to enforce it. If friendly negotiations fail, enforcement involves two basic steps:

- making a determination that the patent is being illegally violated (infringed), and
- filing a federal court action to enforce the patent.

Because enforcing a patent can be a long and expensive process, many patent infringement suits that could have been filed, aren't. Instead, the patent owner often settles with the infringer. Frequently, an infringer will pay a reasonable license fee that allows the infringer to continue using the invention.

### What constitutes infringement of a patent?

To decide whether an inventor is violating a patent, it is necessary to carefully examine the patent's claims

(most patents contain more than one of these terse statements of the scope of the invention) and compare the elements of each claim with the elements of the accused infringer's device or process. If the elements of a patent claim match the elements of the device or process (called "reading on" or "teaching" the device or process), an infringement has occurred. Even if the claims don't literally match the infringing device, it is possible that a court would find an infringement by applying what's known as the "doctrine of equivalents," that is, the invention in the patent and the allegedly infringing device or process are sufficiently equivalent in what they do and how they do it to warrant a finding of infringement.

For example, Steve invents a tennis racket with a score keeper embedded in the racket handle's end. The invention is claimed as a tennis racket handle that combines grasping and score keeping functions. Steve receives a patent on this invention. Later, Megan invents and sells a tennis racket with a transparent handle that provides a more sophisticated score keeping device than Steve's racket. Even though Megan's invention improves on Steve's invention in certain respects, it will most likely be held to be an infringement of Steve's invention, for one of two reasons:

- Megan's invention teaches the same elements as those claimed in Steve's patent (a tennis racket handle with two functions), or

- when considering what it is and how it works, Megan's invention is the substantial equivalent of Steve's invention (the doctrine of equivalents).

### What remedies are available for patent infringement?

A patent owner may enforce his patent by bringing a patent infringement action (lawsuit) in federal court against anyone who uses his invention without permission. If the lawsuit is successful, the court will take one of two approaches. It may issue a court order (called an injunction) preventing the infringer from any further use or sale of the infringing device, and award damages to the patent owner. Or, the court may work with the parties to hammer out an agreement under which the infringing party will pay the patent owner royalties in exchange for permission to use the infringing device.

Bringing a patent infringement action can be tricky, because it is possible for the alleged infringer to defend by proving to the court that the patent is really invalid (most often by showing that the PTO made a mistake in issuing the patent in the first place). In a substantial number of patent infringement cases, the patent is found invalid and the lawsuit dismissed, leaving the patent owner in a worse position than before the lawsuit.

### When does patent protection end?

Patent protection usually ends when the patent expires. For all utility patents filed before June 8, 1995, the patent term is 17 years from date of

issuance. For utility patents filed on or after June 8, 1995, the patent term is 20 years from the date of filing. For design patents, the period is 14 years from date of issuance. For plant patents, the period is 17 years from date of issuance.

A patent may expire if its owner fails to pay required maintenance fees. Usually this occurs because attempts to commercially exploit the underlying invention have failed and the patent owner chooses to not throw good money after bad.

Patent protection ends if a patent is found to be invalid. This may happen if someone shows that the patent application was insufficient or that the applicant committed fraud on the PTO, usually by lying or failing to disclose the applicant's knowledge about prior art that would legally prevent issuance of the patent. A patent may also be invalidated if someone shows that the inventor engaged in illegal conduct when using the patent—such as conspiring with a patent licensee to exclude other companies from competing with them.

Once a patent has expired, the invention described by the patent falls into the public domain: It can be used by anyone without permission from the owner of the expired patent. The basic technologies underlying television and personal computers are good examples of valuable inventions that are no longer covered by in-force patents.

The fact that an invention is in the public domain does not mean that subsequent developments based on the

original invention are also in the public domain. Rather, new inventions that improve public domain technology are constantly being conceived and patented. For example, televisions and personal computers that roll off today's assembly lines employ many recent inventions that are covered by in-force patents.

## *The Life of an Invention*

Although most inventors are concerned with the rights a patent grants during its monopoly or in-force period (from the date the patent issues until it expires), the law actually recognizes five "rights" periods in the life of an invention. These five periods are as follows:

1. Invention conceived but not yet documented. When an inventor conceives an invention but hasn't yet made any written, signed, dated and witnessed record of it, the inventor has no rights whatsoever.
2. Invention documented but patent application not yet filed. After making a proper signed, dated and witnessed documentation of an invention, the inventor has valuable rights against any inventor who later conceives the same invention and applies for a patent. The invention may also be treated as a "trade secret"—that is, kept confidential. This gives the inventor the legal right to sue and recover damages against anyone who immorally learns of the invention—for example, through industrial spying.
3. Patent pending (patent application filed but not yet issued). During the

patent pending period, including the one-year period after a provisional patent application is filed, the inventor's rights are the same as they are in Period 2, above, with one exception. Effective December 2000, if the patent owner intends to also file for a patent abroad, the PTO will publish the application 18 months after the earliest claimed filing date. Under the new 18-month publication statute, an inventor whose application is published prior to issuance may obtain royalties from an infringer from the date of publication, provided the application later issues as a patent and the infringer had actual notice of the published application. Otherwise, the inventor has no rights whatsoever against infringers—only the hope of a future monopoly, which doesn't commence until a patent issues. By law, the PTO must keep all patent applications secret until the application is published or the patent issues, whichever comes first. The patent pending period usually lasts from one to three years.

4. In-force patent (patent issued but hasn't yet expired). After the patent issues, the patent owner can bring and maintain a lawsuit for patent infringement against anyone who makes, uses or sells the invention without permission. The patent's in-force period lasts from the date it issues until it expires. Also, after the patent issues, it becomes a public record or publication that prevents others from getting patents on the same or similar inventions—that is, it becomes "prior art" to anyone who

- files a subsequent patent application.
5. Patent expired. After the patent expires, the patent owner has no further rights, although infringement suits can still be brought for any infringement that occurred during the patent's in-force period as long as the suit is filed within the time required by law. An expired patent remains a valid "prior-art reference" forever.

## Putting a Patent to Work

OUR ASPIRATIONS ARE OUR  
POSSIBILITIES.

—ROBERT BROWNING

On its own, a patent has no value. Value arises only when a patent owner takes action to realize commercial gain from his or her monopoly position. There are several basic approaches to making money from a patent.

### How can an inventor make money with a patent?

Some inventors start new companies to develop and market their patented inventions. This is not typical, however, because the majority of inventors would rather invent than run a business. More often, an inventor makes arrangements with an existing com-



pany to develop and market the invention. This arrangement usually takes the form of a license (contract) under which the developer is authorized to commercially exploit the invention in exchange for paying the patent owner royalties for each invention sold. Or, in a common variation of this arrangement, the inventor may sell all the rights to the invention for a lump sum.

### What does it mean to license an invention?

A license is written permission to use an invention. A license may be exclusive (if only one manufacturer is licensed to develop the invention) or nonexclusive (if a number of manufacturers are licensed to develop it). The license may be for the duration of the patent or for a shorter period of time.

The developer itself may license other companies to market or distribute the invention. The extent to which the inventor will benefit from these sub-licenses depends on the terms of the agreement between the inventor and the developer. Especially when inventions result from work done in the course of employment, the employer-business usually ends up owning the patent rights, and receives all or most of the royalties based on subsequent licensing activity. (See the next question.)

In many cases, a developer will trade licenses with other companies—called cross-licensing—so that companies involved in the trade will benefit from each other’s technology. For example, assume that two computer

companies each own several patents on newly developed remote-controlled techniques. Because each company would be strengthened by being able to use the other company’s inventions as well as its own, the companies will most likely agree to swap permissions to use their respective inventions.

### Can inventors who are employed by a company benefit from their inventions?

Typically, inventor-employees who invent in the course of their employment are bound by employment agreements that automatically assign all rights in the invention to the employer. While smart research and development companies give their inventors bonuses for valuable inventions, this is a matter of contract rather than law.

If there is no employment agreement, the employer may still own rights to an employee-created invention under the “employed to invent” doctrine. How does this rule apply? If an inventor is employed—even without a written employment agreement—to accomplish a defined task, or is hired or directed to create an invention, the employer will own all rights to the subsequent invention.

If there is no employment agreement and the inventor is not employed to invent, the inventor may retain the right to exploit the invention, but the employer is given a non-exclusive right to use the invention for its internal purposes (called shop rights). For example, Robert is a machinist in a machine shop and invents

a new process for handling a particular type of metal. If Robert isn't employed to invent and hasn't signed an employment agreement giving the shop all rights to the invention, Robert can patent and exploit the invention for himself. The shop, however, would retain the right to use the new process without having to pay Robert.

## How Patents Differ From Copyrights and Trademarks

While it is possible to invent definitions that draw clear lines between the areas of patent, copyright and trademark (the three major types of intellectual property protection), there are complications when it comes to certain innovative designs. In some cases, a design may be subject to patent, trademark and copyright protection all at the same time.

### How do patents differ from copyrights?

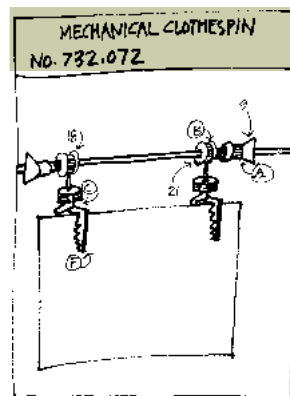
With the exception of innovative designs, patents are closely associated with things and processes which are useful in the real world. Almost at the opposite end of the spectrum, copy-

right applies to expressive arts such as novels, fine and graphic arts, music, phonorecords, photography, software, video, cinema and choreography.

While it is possible to get a patent on technologies used in the arts, it is copyright that keeps one artist from stealing another artist's creative work.

An exception to the general rule that patents and copyright don't overlap can be found in product designs. It is theoretically possible to get a design patent on the purely ornamental (nonfunctional) aspects of the product design and also claim a copyright in this same design. For example, the stylistic fins of a car's rear fenders may qualify for both a design patent (because they are strictly ornamental) and copyright (as to their expressive elements). In practice, however, a product is usually granted one type of protection or the other—not both.

For more information about copyright law, see Chapter 7.



## What's the difference between patent and trademark?

Generally speaking, patents allow the creator of certain kinds of inventions that contain new ideas to keep others from making commercial use of those ideas without the creator's permission. Trademark, on the other hand, is not concerned with how a new technology is used. Rather, it applies to the names, logos and other devices—such as color, sound and smell—that are used to identify the source of goods or services and distinguish them from their competition.

Generally, patent and trademark laws do not overlap. When it comes to a product design, however—say, jewelry or a distinctively shaped musical instrument—it may be possible to obtain a patent on a design aspect of the device while invoking trademark law to protect the design as a product identifier. For example, a surfboard manufacturer might receive a patent for a surfboard design that mimics the design used in a popular surfing film. Then, if the design is intended to be—and actually is—used to distinguish the particular type of surfboard in the marketplace, trademark law may kick in to protect the appearance of the board.

For more information about trademarks, see Chapter 8.



### *More Information About Patents*

*Patent It Yourself*, by David Pressman (Nolo), takes you step by step through the process of getting a patent without hiring a patent lawyer. Patent It Yourself software (for Windows) is also available.

*Patent Searching Made Easy*, by David Hitchcock (Nolo), shows you how to search the U.S. Patent Database on the internet and in the library.

*How to Make Patent Drawings Yourself*, by Jack Lo and David Pressman (Nolo), takes you step by step through the process of making your own patent drawing.

*License Your Invention*, by Richard Stim (Nolo), walks you through the process of realizing your invention's commercial potential.

*Patent, Copyright & Trademark*, by Stephen Elias and Richard Stim (Nolo), provides concise definitions and examples of the important words and phrases commonly used in patent law.

*Nolo's Patents for Beginners*, by David Pressman and Richard Stim (Nolo), is a primer that explains all of the essential patent principles in plain English.



**<http://www.nolo.com>**

*Nolo offers self-help information about a wide variety of legal topics, including patent law.*

**<http://www.uspto.gov>**

*The U.S. Patent and Trademark Office is the place to go for recent policy and statutory changes and transcripts of hearings on various patent law issues. The U.S. Patent and Trademark Office maintains a searchable electronic database of the front page of all patents issued since 1971. This site is an excellent way to initiate a search for relevant patents. Also, the USPTO has announced that it is putting the full U.S. patent database online for free searching near the end of 1998.*

**<http://www.inventionconvention.com>**

*The National Congress of Inventor Organizations (NCIO) maintain this invention website that includes links, trade show information, and advice for inventors.*

**<http://www.patentcafe.com>**

*The Patent Café is an inventor resource that provides software, inventor kits and advice on patent searching, patent attorneys and marketing.*

**<http://www.sci3.com>**

*Sci3 provides in-depth patent searching services, patent-related products and seminars.*

**<http://www.spi.org>**

*The Software Patent Institute lets you search for previous software developments that may affect whether your software qualifies for a patent.*

# C

## opyrights



- 7.2 *Copyright Basics*
- 7.4 *Copyright Ownership*
- 7.6 *Copyright Protection*
- 7.10 *Copyright Registration and Enforcement*

*People seldom improve when they have no other model but themselves to copy after.*

—OLIVER GOLDSMITH

It has long been recognized that everyone benefits when creative people are encouraged to develop new intellectual and artistic works. When the United States Constitution was written in 1787, the framers took care to include a copyright clause (Article I, Section 8) giving Congress the power to “promote the Progress of Science and useful Arts” by passing laws that give creative people exclusive rights in their own artistic works for a limited period of time.

Copyright laws are not designed to enrich creative artists, but to promote human knowledge and development. These laws encourage artists in their creative efforts by giving them a mini-monopoly over their works—called a copyright. But this monopoly is limited when it conflicts with the overriding purpose of encouraging people to create new works of scholarship or art.

This chapter introduces you to copyright law and guides you through the first steps of creating, owning and protecting a copyright. To learn about how copyrights differ from—and work with—patents and trademarks, see Chapters 6 and 8.

## Copyright Basics

IT IS NECESSARY TO ANY ORIGINALITY  
TO HAVE THE COURAGE TO BE AN  
AMATEUR.

—WALLACE STEVENS

Copyright is a legal device that gives the creator of a work of art or literature, or a work that conveys information or ideas, the right to control how that work is used. The Copyright Act of 1976—the federal law providing for copyright protection—grants authors a bundle of exclusive rights over their works, including the right to reproduce, distribute, adapt or perform them.

An author's copyright rights may be exercised only by the author—or by a person or entity to whom the author has transferred all or part of her rights. If someone wrongfully uses the material covered by a copyright, the copyright owner can sue and obtain compensation for any losses suffered.

### What types of creative work does copyright protect?

Copyright protects works such as poetry, movies, video games, videos, DVDs, plays, paintings, sheet music, recorded music performances, novels, software code, sculptures, photographs, choreography and architectural designs.

To qualify for copyright protection, a work must be “fixed in a tangible medium of expression.” This means that the work must exist in some physical form for at least some period of time, no matter how brief. Virtually any form of expression will qualify as a tangible medium, including a computer's random access memory (RAM), the recording media that capture all radio and television broadcasts and the scribbled notes on the back of an envelope that contain the basis for an impromptu speech.

In addition, the work must be original—that is, independently created by the author. It doesn't matter if an author's creation is similar to existing works, or even if it is arguably lacking in quality, ingenuity or aesthetic merit. So long as the author toils without copying from someone else, the results are protected by copyright.

Finally, to receive copyright protection, a work must be the result of at least some creative effort on the part of its author. There is no hard and fast rule as to how much creativity is enough. As one example, a work must be more creative than a telephone book's white pages, which involve a straightforward alphabetical listing of telephone numbers rather than a creative selection of listings.

### Does copyright protect an author's creative ideas?

No. Copyright shelters only fixed, original and creative expression, not the ideas or facts upon which the expression is based. For example, copyright may protect a particular song, novel or computer game about a romance in space, but it cannot protect the underlying idea of having a love affair among the stars. Allowing authors to monopolize their ideas would thwart the underlying purpose of copyright law, which is to encourage people to create new work.

For similar reasons, copyright does not protect facts—whether scientific, historical, biographical or news of the day. Any facts that an author discovers in the course of research are in the public domain, free to all. For instance, anyone is free to use information included in a book about how the brain works, an article about the life and times of Neanderthals or a TV documentary about the childhood of President Clinton—provided that they express the information in their own words.

Facts are not protected even if the author spends considerable time and

effort discovering things that were previously unknown. For example, the author of the book on Neanderthals takes ten years to gather all the necessary materials and information for her work. At great expense, she travels to hundreds of museums and excavations around the world. But after the book is published, any reader is free to use the results of this ten-year research project to write his or her own book on Neanderthals—without paying the original author.

### How long does a copyright last?

For works published after 1977, the copyright lasts for the life of the author plus 70 years. However, if the work is a work for hire (that is, the work is done in the course of employment or has been specifically commissioned) or is published anonymously or under a pseudonym, the copyright lasts between 95 and 120 years, depending on the date the work is published.

All works published in the United States before 1923 are in the public domain. Works published after 1922, but before 1964, are protected for 95 years from the date of publication if a renewal was filed with the Copyright Office during the 28th year after publication. If no renewal was filed, such works are in the public domain in the U.S. Works published during 1964–1977 are protected for 95 years whether or not a renewal was filed. If the work was created, but not published, before 1978, the copyright lasts for the life of the author plus 70 years. However, even if the author died over 70 years ago, the copyright in an unpublished work lasts until De-

December 31, 2002. And if such a work is published before 2003, the copyright lasts until December 31, 2047.

## *Is the Work Published?*

In the complicated scheme of copyright laws, which law applies to a particular work depends on when that work is published. A work is considered published when the author makes it available to the public on an unrestricted basis. This means that it is possible to distribute or display a work without publishing it if there are significant restrictions placed on what can be done with the work and when it can be shown to others. For example, Andres Miczslava writes an essay called "Blood Bath" about the war in Bosnia, and distributes it to five human rights organizations under a non exclusive license that places restrictions on their right to disclose the essay's contents. "Blood Bath" has not been "published" in the copyright sense. If Miczslava authorizes posting of the essay on the Internet, however, it would likely be considered published.

# Copyright Ownership

HE WHO CAN COPY, CAN DO.

—LEONARDO DA VINCI

A copyright is initially owned by a creative work's author or authors. But

under the law, a person need not actually create the work to be its "author" for copyright purposes. A protectible work created by an employee as part of his or her job is initially owned by the employer—that is, the employer is considered to be the work's author. Such works are called "works made for hire." Works created by nonemployees (independent contractors) may also be works made for hire if they sign written agreements to that effect and the work falls within one of eight enumerated categories.

Like any other property, a copyright can be bought and sold. Transfers of copyright ownership are unique in one respect, however: Authors or their heirs have the right to terminate any transfer of copyright ownership 35 to 40 years after it is made.

## What are the exceptions to the rule that the creator of a work owns the copyright?

Copyrights are generally owned by the people who create the works of expression, with some important exceptions:

- If a work is created by an employee in the course of his or her employment, the employer owns the copyright.
- If the work is created by an independent contractor and the independent contractor signs a written agreement stating that the work shall be "made for hire," the commissioning person or organization owns the copyright only if the work is (1) a part of a larger literary work, such as an article in a magazine or a



poem or story in an anthology; (2) part of a motion picture or other audiovisual work, such as a screenplay; (3) a translation; (4) a supplementary work such as an afterword, an introduction, chart, editorial note, bibliography, appendix or index; (5) a compilation; (6) an instructional text; (7) a test or answer material for a test; or (8) an atlas. Works that don't fall within one of these eight categories constitute works made for hire only if created by an employee within the scope of his or her employment.

- If the creator has sold the entire copyright, the purchasing business or person becomes the copyright owner.

### Who owns the copyright in a joint work?

When two or more authors prepare a work with the intent to combine their contributions into inseparable or interdependent parts, the work is considered joint work and the authors are considered joint copyright owners. The most common example of a joint work is when a book or article has two or more authors. However, if a book is written primarily by one author, but another author contributes a specific chapter to the book and is given credit for that chapter, then this probably wouldn't be a joint work because the contributions aren't inseparable or interdependent.

The U.S. Copyright Office considers joint copyright owners to have an equal right to register and enforce the copyright. Unless the joint owners

make a written agreement to the contrary, each copyright owner has the right to commercially exploit the copyright, provided that the other copyright owners get an equal share of the proceeds.

### Can two or more authors provide contributions to a single work without being considered a joint authors?

Yes. If at the time of creation, the authors did not intend their works to be part of an inseparable whole, the fact that their works are later put together does not create a joint work. Rather, the result is considered a collective work. In this case, each author owns a copyright in only the material he or she added to the finished product. For example, in the 1950s, Vladimir writes a famous novel full of complex literary allusions. In the 1980s, his publisher issues a student edition of the work with detailed annotations written by an English professor. The student edition is a collective work. Vladimir owns the copyright in the novel, but the professor owns the annotations.

### What rights do copyright owners have under the Copyright Act?

The Copyright Act of 1976 grants a number of exclusive rights to copyright owners, including:

- reproduction right—the right to make copies of a protected work
- distribution right—the right to sell or otherwise distribute copies to the public

- right to create adaptations (called derivative works)—the right to prepare new works based on the protected work, and
- performance and display rights—the rights to perform a protected work (such as a stageplay) or to display a work in public.

This bundle of rights allows a copyright owner to be flexible when deciding how to realize commercial gain from the underlying work; the owner may sell or license any of the rights.

### Can a copyright owner transfer some or all of his specific rights?

Yes. When a copyright owner wishes to commercially exploit the work covered by the copyright, the owner typically transfers one or more of these rights to the person or entity who will be responsible for getting the work to market, such as a book or software publisher. It is also common for the copyright owner to place some limitations on the exclusive rights being transferred. For example, the owner may limit the transfer to a specific period of time, allow the right to be exercised only in a specific part of the country or world or require that the right be exercised only through certain media, such as hardcover books, audiotapes, magazines or computers.

If a copyright owner transfers all of his rights unconditionally, it is generally termed an “assignment.” When only some of the rights associated with the copyright are transferred, it is known as a “license.” An exclusive

license exists when the transferred rights can be exercised only by the owner of the license (the licensee), and no one else—including the person who granted the license (the licensor). If the license allows others (including the licensor) to exercise the same rights being transferred in the license, the license is said to be nonexclusive.

The U.S. Copyright Office allows buyers of exclusive and non-exclusive copyright rights to record the transfers in the U.S. Copyright Office. This helps to protect the buyers in case the original copyright owner later tries to transfer the same rights to another party.

## Copyright Protection

Probably the most important fact to grasp about copyright protection is that it automatically comes into existence when the protected work is created. However, the degree of protection that copyright laws extend to a protected work can be influenced by later events.

### What role does a copyright notice play?

Until 1989, a published work had to contain a valid copyright notice to receive protection under the copyright laws. But this requirement is no longer in force—works first published after March 1, 1989 need not include a copyright notice to gain protection under the law.

But even though a copyright notice is not required, it's still important to include one. When a work contains a valid notice, an infringer cannot claim in court that he or she didn't know it was copyrighted. This makes it much easier to win a copyright infringement case and perhaps collect enough damages to make the cost of the case worthwhile. And the very existence of a notice might discourage infringement.

Finally, including a copyright notice may make it easier for a potential infringer to track down a copyright owner and legitimately obtain permission to use the work.



### What is a valid copyright notice?

A copyright notice should contain:

- the word “copyright”
- a “c” in a circle (©)
- the date of publication, and
- the name of either the author or the owner of all the copyright rights in the published work.

For example, the correct copyright for the fifth edition of *The Copyright Handbook*, by Stephen Fishman (Nolo), is *Copyright © 2001 by Stephen Fishman*.

## International Copyright Protection

Copyright protection rules are fairly similar worldwide, due to several international copyright treaties, the most important of which is the Berne Convention. Under this treaty, all member countries—and there are more than 100, including virtually all industrialized nations—must afford copyright protection to authors who are nationals of any member country. This protection must last for at least the life of the author plus 50 years, and must be automatic, without the need for the author to take any legal steps to preserve the copyright.

In addition to the Berne Convention, the GATT (General Agreement on Tariffs and Trade) treaty contains a number of provisions that affect copyright protection in signatory countries. Together, the Berne Copyright Convention and the GATT treaty allow U.S. authors to enforce their copyrights in most industrialized nations, and allow the nationals of those nations to enforce their copyrights in the U.S.

### When can I use a work without the author's permission?

When a work becomes available for use without permission from a copyright owner, it is said to be “in the public domain.” Most works enter the public domain because their copyrights have expired.

To determine whether a work is in the public domain and available for use without the author's permission,

you first have to find out when it was published. Then you can apply the periods of time set out earlier in this chapter. (See *How long does a copyright last?*, above.) If the work was published between 1923 and 1963, however, you must check with the U.S. Copyright Office to see whether the copyright was properly renewed. If the author failed to renew the copyright, the work has fallen into the public domain and you may use it.

The Copyright Office will check renewal information for you, at a charge of \$65 per hour. (Call the Reference & Bibliography Section at 202-707-6850.) You can also hire a private copyright search firm to see if a renewal was filed. Finally, you may be able to conduct a renewal search yourself. The renewal records for works published from 1950 to the present are available online at <http://lcweb.loc.gov/copyright>. Renewal searches for earlier works can be conducted at the Copyright Office in Washington DC or by visiting one of the many government depository libraries throughout the country. Call the Copyright Office for more information.

With one important exception, you should assume that every work is protected by copyright unless you can establish that it is not. As mentioned above, you can't rely on the presence or absence of a copyright notice (©) to make this determination, because a notice is not required for works published after March 1, 1989. And even for works published before 1989, the absence of a copyright notice may not affect the validity of the copyright—

for example, if the author made diligent attempts to correct the situation.

The exception is for materials put to work under the “fair use rule.” This rule recognizes that society can often benefit from the unauthorized use of copyrighted materials when the purpose of the use serves the ends of scholarship, education or an informed public. For example, scholars must be free to quote from their research resources in order to comment on the material. To strike a balance between the needs of a public to be well informed and the rights of copyright owners to profit from their creativity, Congress passed a law authorizing the use of copyrighted materials in certain circumstances deemed to be “fair”—even if the copyright owner doesn't give permission.

Often, it's difficult to know whether a court will consider a proposed use to be fair. The fair use statute requires the courts to consider the following questions in deciding this issue:

- Is it a competitive use? If the use potentially affects the sales of the copied material, it's probably not fair.
- How much material was taken compared to the entire work of which the material was a part? The more someone takes, the less likely it is that the use is fair.
- How was the material used? Did the defendant change the original by adding new expression or meaning? Did the defendant add value to the original by creating new information, new aesthetics, new insights and understandings? If the use was

transformative, this weighs in favor of a fair use finding. Criticism, comment, news reporting, research, scholarship and nonprofit educational uses are also likely to be judged fair uses. Uses motivated primarily by a desire for a commercial gain are less likely to be fair use.

As a general rule, if you are using a small portion of somebody else's work in a noncompetitive way and the purpose for your use is to benefit the public, you're on pretty safe ground. On the other hand, if you take large portions of someone else's expression for your own purely commercial reasons, the rule usually won't apply.

## *If You Want to Use Material on the Internet*

Each day, people post vast quantities of creative material on the Internet—material that is available for downloading by anyone who has the right computer equipment. Because the information is stored somewhere on an Internet server, it is fixed in a tangible medium and potentially qualifies for copyright protection. Whether it does, in fact, qualify depends on other factors that you would have no way of knowing about, such as when the work was first published (which affects the need for a copyright notice), whether the copyright in the work has been

renewed (for works published before 1964), whether the work is a work made for hire (which affects the length of the copyright) and whether the copyright owner intends to dedicate the work to the public domain.

As a general rule, it is wise to operate under the assumption that all materials are protected by either copyright or trademark law unless conclusive information indicates otherwise. A work is not in the public domain simply because it has been posted on the Internet (a popular fallacy) or because it lacks a copyright notice (another fallacy). As a general rule permission is needed to reproduce copyrighted materials including photos, text, music and artwork. It's best to track down the author of the material and ask for permission.

The most useful sources for finding information and obtaining permission are copyright collectives or clearinghouses. These are organizations that organize and license works by their members. For example, the Copyright Clearinghouse (<http://www.copyright.com>), and icopyright (<http://www.icopyright.com>) provide permissions for written materials. You can use an Internet search engine to locate other collectives for music, photos and artwork.

The only exception to this advice is for situations where you want to use only a very small portion of text for educational or nonprofit purposes. (See the previous question for a discussion of the "fair use rule.")

# Copyright Registration and Enforcement

Although every work published after 1989 is automatically protected by copyright, you can strengthen your rights by registering your work with the U.S. Copyright Office. This registration makes it possible to bring a lawsuit to protect your copyright if someone violates (infringes) it. The registration process is straightforward and inexpensive, and can be done without a lawyer.

## Why register your work with the U.S. Copyright Office?

You must register your copyright with the U.S. Copyright Office before you are legally permitted to bring a lawsuit to enforce it.

You can register a copyright at any time, but filing promptly may pay off in the long run. “Timely registration”—that is, registration within three months of the work’s publication date or before any copyright infringement actually begins—makes it much easier to sue and recover money from an infringer. Specifically, timely registration creates a legal presumption

that your copyright is valid, and allows you to recover up to \$100,000 (and possibly lawyer’s fees) without having to prove any actual monetary harm.

## How do you register a copyright?

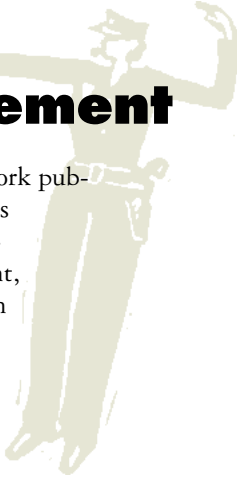
You can register your copyright by filing a simple form and depositing one or two samples of the work (depending on what it is) with the U.S. Copyright Office. There are different forms for different types of works—for example, form TX is for literary works while form VA is for a visual art work. Forms and instructions may be obtained from the U.S. Copyright Office by telephone, (202) 707-9100, or online at <http://www.loc.gov/copyright>. Registration currently costs \$30 per work. If you’re registering several works that are part of one series, you may be able to save money by registering the works together (called “group registration”).

## How are copyrights enforced? Is going to court necessary?

If someone violates the rights of a copyright owner, the owner is entitled to file a lawsuit in federal court asking the court to:

- issue orders (restraining orders and injunctions) to prevent further violations
- award money damages if appropriate, and
- in some circumstances, award attorney fees.

Whether the lawsuit will be effective and whether damages will be awarded depends on whether the alleged infringer can raise one or more legal de-



fenses to the charge. Common legal defenses to copyright infringement are:

- too much time has elapsed between the infringing act and the lawsuit (the statute of limitations defense)
- the infringement is allowed under the fair use doctrine (discussed above)
- the infringement was innocent (the infringer had no reason to know the work was protected by copyright)
- the infringing work was independently created (that is, it wasn't copied from the original), or
- the copyright owner authorized the use in a license.

If someone has good reason to believe that a use is fair—but later finds herself on the wrong end of a court order—she is likely to be considered an innocent infringer at worst. Innocent infringers usually don't have to pay any damages to the copyright owner, but do have to cease the infringing activity or pay the owner for the reasonable commercial value of that use.



### *More Information About Copyrights*

*The Copyright Handbook: How to Protect & Use Written Works*, by Stephen Fishman (Nolo), is a complete guide to the law of copyright. The book includes forms for registering a copyright.

*Copyright Your Software*, by Stephen Fishman (Nolo), explains copyright protection for computer software and include all the forms and instructions necessary for registering a software copyright.

*Patent, Copyright & Trademark*, by Stephen Elias and Richard Stim (Nolo), provides concise definitions and examples of the important words and phrases commonly used in copyright law.

*Getting Permission: How to License & Clear Copyrighted Materials Online & Off*, by Richard Stim (Nolo), spells out how to obtain permission to use art, music, writing or other copyrighted works and includes a variety of permission and licensing agreements.

*The Public Domain: How to Find & Use Copyright-Free Writings, Music, Art & More*, by Stephen Fishman (Nolo), is an authoritative book devoted to what is and is not protected by copyright law.



**<http://www.nolo.com>**

*Nolo offers self-help information about a wide variety of legal topics, including copyright law.*

**<http://lcweb.loc.gov/copyright>**

*The U.S. Copyright office offers regulations, guidelines, forms and links to other helpful copyright sites.*

**<http://fairuse.stanford.edu>**

*This is one of the leading websites for measuring fair use. It provides academic fair use links and guidelines.*

**<http://www.benedict.com>**

*The Copyright Website has articles, good links and slick design. Best of all, you can examine actual examples from real cases.*

**<http://www.ipmall.fplc.edu>**

*The Intellectual Property Mall provided by the Franklin Pierce Law Center is a source of ever-changing links and information about copyrights, trademarks and patents.*





# 8

## Trademarks

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- 8.5 *Trademark Protection*
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*A good name lost is seldom regained.*

—JOEL HAWES

**M**ost of us encounter many trademarks each day; we might eat Kellogg's cornflakes for breakfast, drive our Ford car to work and sit down at an IBM computer. But as we go about our daily tasks, we rarely think about the laws behind the familiar words and images that identify the products and services we use.

Trademark law consists of the legal rules that govern how businesses may:

- distinguish their products or services in the marketplace to prevent consumer confusion, and
- protect the means they've chosen to identify their products or services against use by competitors.

This chapter will introduce you to trademark law and answer common questions about choosing, using and protecting a trademark.

## Types of Trademarks

The term trademark is commonly used to describe many different types of devices that label, identify and distinguish products or services in the marketplace. The basic purpose of all these devices is to inform potential customers of the origin and quality of the underlying products or services.

### What is a trademark?

A trademark is a distinctive word, phrase, logo, graphic symbol, slogan or other device that is used to identify the source of a product and to distinguish a manufacturer's or merchant's products from others. Some examples are Nike sports apparel, Gatorade beverages and Microsoft software. In the trademark context, "distinctive" means unique enough to help customers recognize a particular product in the marketplace. A mark may either

be inherently distinctive (the mark is unusual in and of itself, such as Milky Way candy bars) or may become distinctive over time because customers come to associate the mark with the product or service (for example, Beef & Brew restaurants).

Consumers often make their purchasing choices on the basis of recognizable trademarks. For this reason, the main thrust of trademark law is to make sure that trademarks don't overlap in a manner that causes customers to become confused about the source of a product. However, in the case of trademarks that have become famous—for example, McDonald's—the courts are willing to prohibit a wider range of uses of the trademark (or anything close to it) by anyone other than the famous mark's owner. For instance, McDonald's was able to prevent the use of the mark McSleep by a motel chain because McSleep traded on the McDonald's mark reputation for a particular type of service (quick, inexpensive, standardized). This type of sweeping protection is authorized by federal and state statutes (referred to as antidilution laws) designed to prevent the weakening of a famous mark's reputation for quality.

### What is a servicemark?

For practical purposes, a servicemark is the same as a trademark—but while trademarks promote products, servicemarks promote services and events. As a general rule, when a business uses its name to market its goods or services in the yellow pages, on signs or in advertising copy, the name quali-

fies as a servicemark. Some familiar servicemarks: Jack in the Box (fast food service), Kinko's (photocopying service), ACLU (legal service), Blockbuster (video rental service), CBS's stylized eye in a circle (television network service) and the Olympic Games' multicolored interlocking circles (international sporting event).



### What is a certification mark?

A certification mark is a symbol, name or device used by an organization to vouch for products and services provided by others—for example, the “Good Housekeeping Seal of Approval.” This type of mark may cover characteristics such as regional origin, method of manufacture, product quality and service accuracy. Some other examples of certification marks: Stilton cheese (a product from the Stilton locale in England), Carneros wines (from grapes grown in the Carneros region of Sonoma/Napa counties) and Harris Tweeds (a special weave from a specific area in Scotland).

### What is a collective mark?

A collective mark is a symbol, label, word, phrase or other mark used by members of a group or organization to identify goods, members, products or

services they render. Collective marks are often used to show membership in a union, association or other organization.

The use of a collective mark is restricted to members of the group or organization that owns the mark. Even the group itself—as opposed to its members—cannot use the collective mark on any goods it produces. If the group wants to identify its product or service, it must use its own trademark or servicemark.

### EXAMPLE

*The letters “ILGWU” on a shirt label is the collective mark that identifies the shirt as a product of a member of the International Ladies Garment Workers Union. If, however, the ILGWU wanted to start marketing its own products, it could not use the ILGWU collective mark to identify them; the union would have to get a trademark of its own.*

### What is trade dress?

In addition to a label, logo or other identifying symbol, a product may come to be known by its distinctive packaging—for example, Kodak film or the Galliano liquor bottle—and a service by its distinctive decor or shape, such as the decor of Gap clothing stores. Collectively, these types of identifying features are commonly termed “trade dress.” Because trade dress often serves the same function as a trademark or service-mark—the identification of goods and services in the marketplace—trade dress can be protected under the federal trademark laws and in some cases registered as a trademark or servicemark with the Patent and Trademark Office.

## What kinds of things can be considered trademarks or service marks?

Most often, trademarks are words or phrases that are clever or unique enough to stick in a consumer's mind. Logos and graphics that become strongly associated with a product line or service are also typical. But a trademark or servicemark can also consist of letters, numbers, a sound, a smell, a color, a product shape or any other nonfunctional but distinctive aspect of a product or service that tends to promote and distinguish it in the marketplace. Titles, character names or other distinctive features of movies, television and radio programs can also serve as trademarks or servicemarks when used to promote a service or product. Some examples of unusual trademarks are the pink color of housing insulation manufactured by Owens-Corning and the shape of the Absolut vodka bottle.

## What's the difference between a business name and a trademark or servicemark?

The name that a business uses to identify itself is called a "trade name." This is the name the business uses on its stock certificates, bank accounts, invoices and letterhead. When used to identify a business in this way—as an entity for nonmarketing purposes—the business name is given some protection under state and local corporate and fictitious business name registration laws, but it is not considered a trademark or entitled to protection under trademark laws.

If, however, a business uses its name to identify a product or service produced by the business, the name will then be considered a trademark or servicemark and will be entitled to protection if it is distinctive enough. For instance, Apple Computer Corporation uses the trade name Apple as a trademark on its line of computer products.

Although trade names by themselves are not considered trademarks for purposes of legal protection, they may still be protected under federal and state unfair competition laws against a confusing use by a competing business.

## If my trade name is registered with the Secretary of State as a corporate name, or placed on a fictitious business name list, can I use it as a trademark?

Not necessarily. When you register a corporate name with a state agency or place your name on a local fictitious business name register, there is no guarantee that the name has not already been taken by another business as a trademark. It is only the trade name aspect of the name that is affected by your registration. This means that before you start using your business name as a trademark, you will need to make sure it isn't already being used as a trademark by another company in a context that precludes your using it. For more information about trademark searches, see *Conducting a Trademark Search*, below.

# Trademark Protection

If a trademark or servicemark is protected, the owner of the mark can:

- prevent others from using it in a context where it might confuse consumers, and
- recover money damages from someone who used the mark knowing that it was already owned by someone else.

Trademark law also protects famous marks by allowing owners to sue to prevent others from using the same or similar mark, even if customer confusion is unlikely.

Not all marks are entitled to an equal amount of protection, however—and some aren't entitled to any protection at all.

## What laws offer protection to trademark owners?

The basic rules for resolving disputes over who is entitled to use a trademark come from decisions by federal and state courts (the common law). These rules usually favor the business that first used the mark where the second use would be likely to cause customer confusion. A number of additional legal principles used to protect owners against improper use of their marks derive from federal statutes known collectively as the Lanham Act (Title 15 U.S.C. §§ 1051 to 1127). And all states have statutes that govern the use and protection of marks within the state's boundaries.

In addition to laws that specifically protect trademark owners, all states have laws that protect one business against unfair competition by another business, including the use by one business of a name already used by another business in a context that's likely to confuse customers.

## What types of marks are entitled to the most legal protection?

Trademark law grants the most legal protection to the owners of names, logos and other marketing devices that are distinctive—that is, memorable because they are creative or out of the ordinary, or because they have become well known to the public through their use over time or because of a marketing blitz.

## *Inherently Distinctive Marks*

Trademarks that are unusually creative are known as inherently distinctive marks. Typically, these marks consist of:

- unique logos or symbols (such as the McDonald's Golden Arch and the IBM symbol)
- made-up words or words that have no dictionary meaning such as *Exxon* or *Kodak* (called "fanciful" or "coined" marks)
- words that are surprising or unexpected in the context of their usage, such as *Time Magazine* or *Diesel* for a bookstore (called "arbitrary marks"), and

- words that cleverly connote qualities about the product or service, such as Slenderella diet food products (called “suggestive or evocative marks”).

### Which marks receive the least protection?

Trademarks and servicemarks consisting of common or ordinary words are not considered inherently distinctive and receive less protection under federal and state laws. Typical examples of trademarks using common or ordinary words are:

- people's names, such as Pete's Muffins or Smith Graphics
- geographic terms, such as Northern Dairy or Central Insect Control, and
- descriptive terms—that is, words that attempt to literally describe the product or some characteristic of the product, such as Rapid Computers, Clarity Video Monitors or Ice Cold Ice Cream.

However, nondistinctive marks may become distinctive through use over time or through intensive marketing efforts.

### What about Ben and Jerry's Ice Cream? Even though Ben and Jerry are common names, isn't the Ben and Jerry's trademark entitled to maximum protection?

Absolutely. Even if a mark is not inherently distinctive, it may become distinctive if it develops great public recognition through long use and exposure in the marketplace. A mark that becomes protected in this way is said to have acquired a “secondary



meaning.” In addition to Ben and Jerry's, examples of otherwise common marks that have acquired a secondary meaning and are now considered to be distinctive include Sears (department stores) and Park 'n Fly (airport parking services.)

### What cannot be protected under trademark law?

There are five common situations in which there is no trademark protection. In any of these situations the intended trademark cannot be registered and the owner has no right to stop others from using a similar name. Generally, when speaking of what *cannot* be protected under trademark law, we are referring to the standards established under the Lanham Act (the federal statute that provides for registration of marks and federal court remedies in case a mark is infringed).

- **Nonuse.** An owner may lose trademark protection if she “abandons” a trademark. This can happen in many ways. The most common is when the mark is no longer used in commerce and there is sufficient evidence that the owner intends to

discontinue its use. Under the Lanham Act, a trademark is presumed to be abandoned after three years of nonuse. But, if the owner can prove that she intended to resume commercial use of the mark, she will not lose trademark protection.

- *Generics and genericide.* A generic term describes a type of goods or services; it is not a brand name. Examples of generic terms are “computer,” “eyeglasses” and “eBook.” Consumers are used to seeing a generic term used in conjunction with a trademark (for example, Avery labels or Hewlett-Packard printers). On some occasions, a company invents a new word for a product (for example, Kleenex for a tissue) that functions so successfully as a trademark that the public eventually comes to believe that it is the name of the goods. This is called genericide. When that happens, the term loses its trademark protection. Other famous examples of genericide are “aspirin,” “yo-yo,” “escalator,” “thermos” and “kerosene”.
- *Confusingly similar marks.* A mark will not receive trademark protection if it is so similar to another existing trademark that it causes confusion among consumers. This standard, known as likelihood of confusion, is a foundation of trademark law. Many factors are weighed when considering “likelihood of confusion.” The most important are: the similarity of the marks, the similarity of the goods, the degree of care exercised by the consumer when making the pur-

chase, the intent of the person using the similar mark and any actual confusion that has occurred.

- *Weak marks.* A weak trademark will not be protected unless the owner can prove that consumers are aware of the mark. There are three types of weak marks: descriptive marks, geographic marks that describe a location and marks that are primarily surnames (last names). When an applicant attempts to register a weak mark, the PTO will permit the applicant to submit proof of distinctiveness or to move the application from the Principal Register to the Supplemental Register. (See Registering a Trademark, below, for more information about the different benefits offered these registers.)
- *Functional features.* Trademark law, like copyright law, will not protect functional features. Generally, a functional feature is something that is necessary for the item to work. The issue usually arises with product packaging or shapes. For instance, the unique shape of the Mrs. Butterworth bottle is not a functional feature because it is not necessary for the bottle to work. Therefore, it is eligible for trademark protection.

### Are Internet domain names—names for sites on the World Wide Web—protected by trademark law?

Domain name registration, by itself, does not permit you to stop another business from using the same name for its business or product. Instead, it gives you only the right to use that specific Internet address. To protect

your domain name as a trademark, the name must meet the usual trademark standards. That is, the domain name must be distinctive or must achieve distinction through customer awareness, and you must be the first to use the name in connection with your type of services or products. An example of a domain name that meets these criteria and has trademark protection is Amazon.com. Amazon.com was the first to use this distinctive name for online retail sales and the name has been promoted to customers through advertising and sales.

## Using and Enforcing a Trademark

Generally, a trademark is owned by the business that first uses it in a commercial context—that is, attaches the mark to a product or uses the mark when marketing a product or service. A business may also obtain trademark protection if it files for trademark registration before anyone else uses the mark. (Trademark registration is discussed in more detail in the series of questions, *Registering a Trademark*, below.)

Once a business owns a trademark, it may be able to prevent others from using that mark, or a similar one, on their goods and services.

### More specifically, what does it mean to “use” a trademark?

In trademark law, “use” means that the mark is at work in the marketplace, identifying the underlying goods or services. This doesn’t mean that the product or service actually has to be sold, as long as it is legitimately offered to the public under the mark in question. For example, Robert creates a website where he offers his new invention—a humane mouse-trap—for sale under the trademark “MiceFree.” Even if Robert doesn’t sell any traps, he is still “using” the trademark as long as “MiceFree” appears on the traps or on tags attached to them and the traps are ready to be shipped when a sale is made. Similarly, if Kristin, a trademark attorney, puts up a website to offer her services under the servicemark Trademark Queen, her servicemark will be in use as long as she is ready to respond to customer requests for her advice.

### How can a business reserve a trademark for future use?

It is possible to acquire ownership of a mark by filing an “intent-to-use” (ITU) trademark registration application with the U.S. Patent and Trademark Office before someone else has actually started using the mark. The filing date of this application will be considered the date of first use of the mark if the applicant actually uses the mark within the required time limits—six months to three years after the PTO approves the mark, depending on whether the applicant seeks and pays for extensions of time.



For more information about trademark registration, see *Registering a Trademark*, below.

### When can the owner of a trademark stop others from using it?

Whether the owner of a trademark can stop others from using it depends on such factors as:

- whether the trademark is being used on competing goods or services (goods or services compete if the sale of one is likely to affect the sale of the other)
- whether consumers would likely be confused by the dual use of the trademark, and
- whether the trademark is being used in the same part of the country or is being used on related goods (goods that will probably be noticed by the same customers, even if they don't compete with each other).

In addition, under federal and state laws known as “antidilution statutes,” a trademark owner may go to court to prevent its mark from being used by someone else if the mark is famous and the later use would dilute the mark's strength—that is, weaken its reputation for quality (called tarnishment) or render it common through overuse in different contexts.

Antidilution statutes can apply even if there is no way customers would be likely to confuse the source of the goods or services designated by the later mark with the famous mark's owner. For instance, consumers would not think that Microsoft Bakery is associated with Microsoft, the software company, but

Microsoft Bakery could still be forced to choose another name under federal and state antidilution laws.

### How does a trademark owner prevent others from using the mark?

Typically, the owner will begin by sending a letter, called a “cease and desist letter,” to the wrongful user, demanding that it stop using the mark. If the wrongful user continues to infringe the mark, the owner can file a lawsuit to stop the improper use. The lawsuit is usually filed in federal court if the mark is used in more than one state or country, and in state court if the dispute is between purely local marks. In addition to preventing further use of the mark, a trademark owner can sometimes obtain money damages from the wrongful user.

### When can a trademark owner get money from someone who has infringed the owner's mark?

If a trademark owner proves in federal court that the infringing use is likely to confuse consumers and that it suffered economically as a result of the infringement, the competitor may have to pay the owner damages based on the loss. And if the court finds that the competitor intentionally copied the owner's trademark, or at least should have known about the mark, the competitor may have to give up the profits it made by using the mark as well as pay other damages, such as punitive damages, fines or attorney fees. On the other hand, if the trademark's owner has not been damaged, a court has dis-

cretion to allow the competitor to continue to use the trademark under limited circumstances designed to avoid consumer confusion.

### Do people have the right to use their last names as marks even if someone else is already using them for a similar business?

It depends on the name. A mark that is primarily a surname (last name) does not qualify for protection under federal trademark law unless the name becomes well known as a mark through advertising or long use. If this happens, the mark is said to have acquired a “secondary meaning.”

If a surname acquires a secondary meaning, it is off limits for all uses that might cause customer confusion, whether or not the name is registered. Sears, McDonald's, Hyatt, Champion, Howard Johnson's and Calvin Klein are just a few of the hundreds of surnames that have become effective and protected marks over time.

Also, a business that tries to capitalize on the name of its owner to take advantage of an identical famous name being used as a trademark may be forced, under the state or federal antidilution laws, to stop using the name. This may happen if the trademark owner files a lawsuit.



### *“TM” and ®: What do they mean?*

Many people like to put a “TM” (or “SM” for servicemark) next to their mark to let the world know that they are claiming ownership of it. However, it is not legally necessary to provide this type of notice; the use of the mark itself is the act that confers ownership.

The “R” in a circle (®) is a different matter entirely. This notice may not be put on a mark unless it has been registered with the U.S. Patent and Trademark Office—and it should accompany a mark after registration is complete. Failure to put the notice on a registered trademark can greatly reduce the possibility of recovering significant damages if it later becomes necessary to file a lawsuit against an infringer.

# Conducting a Trademark Search

If you want to find out whether the trademark you've chosen for your products or services is available, you'll need to conduct a trademark search—an investigation to discover potential conflicts between your desired mark and any existing marks. Ideally, the search should be done before you begin to use a mark; this will help you avoid the expensive mistake of infringing a mark belonging to someone else.

## Why do I need to conduct a trademark search?

The consequences of failing to conduct a reasonably thorough trademark search may be severe, depending on how widely you intend to use your mark and how much it would cost you to change it if a conflict later develops. If the mark you want to use has been federally registered by someone else, a court will presume that you knew about the registration—even if you did not. You will be precluded from using the mark in any context where customers might become confused. And if you do use the mark improperly, you will be cast in

the role of a “willful infringer.” Willful infringers can be held liable for large damages and payment of the registered owner's attorney fees; they can also be forced to stop using the mark altogether.

## My business is local. Why should I care what name or mark someone else in another part of the country is using?

Most small retail or service-oriented business owners well know the mantra for success: location, location, location. But as the Internet takes firm hold in the late 1990s, the concept of location, while still central to business success, takes on a whole new meaning. Instead of being rooted in physical space, businesses are now required to jockey for locations in the virtual or electronic space known as the Internet.

Vast numbers of businesses—even local enterprises—are putting up their own websites, creating a new potential for competition (and confusion) in the marketplace. Because of this, every business owner must pay attention to whether a proposed name or mark has already been taken by another business, regardless of the location or scope of that business.



## Can I do my own trademark search?

Yes. Although the most thorough trademark searches are accomplished by professional search firms such as Thomson & Thomson, it is also possible to conduct a preliminary online trademark search to determine if a trademark is distinguishable from other federally registered trademarks. You can accomplish this with the PTO's trademark databases (<http://www.uspto.gov>), which provide free access to records of federally registered marks or marks that are pending. In addition, privately owned fee-based online trademark databases often provide more current PTO trademark information. Below are some private fee-based online search companies:

**Saegis** (<http://www.thomson-thomson.com>). Provides access to all Trademarkscan databases (state, federal and international trademark databases), domain name databases, common law sources on the Internet and access to newly filed United States federal trademark applications. Saegis also provides access to Dialog services, discussed next.

**Dialog** (<http://www.dialog.com>). Provides access to Trademarkscan databases including state and federal registration and some international trademarks and provides common law searching of news databases.

**MicroPatent** (<http://www.micropatent.com>). Provides access to federal and state trademarks.

**Trademark.com** (<http://www.trademark.com>). Provides access

to current federal registration information.

**Trademark Register** (<http://www.trademarkregister.com>). Provides access to current federal registration information.

**Marks on Line** (<http://www.marksonline.com>). This is a comprehensive trademark link site providing access to federal registration information and a listing of state and international trademark offices.

**LEXIS/NEXIS** (<http://www.lexis-nexis.com>). LEXIS provides access to federal and state registrations. You can also search for non-registered trademarks through its NEXIS news services. The PTO uses NEXIS to evaluate descriptive and generic terms.

You can also visit one of the Patent and Trademark Depository Libraries available in every state. These libraries offer a combination of hardcover directories of federally registered marks and an online database of both registered marks and marks for which a registration application is pending. To find the Patent and Trademark Depository Library nearest you, consult the PTO website at <http://www.uspto.gov>.

You should also search for marks that have not been registered.

This is important because an existing mark, even if it's unregistered, would preclude you from:

- registering the same or a confusingly similar mark in your own name, and
- using the mark in any part of the country or commercial transaction where customers might be confused.

You can search for unregistered marks in the Patent and Trademark Depository Libraries and on the Internet. In the libraries, use the available product guides and other materials. On the Internet, look for online shopping websites and review the inventory for items similar to yours. For example, go to eToys (<http://www.etoys.com>) to find hundreds of trademarked toys. You can also search for unregistered marks by using an Internet search engine. Enter your proposed name in the search field of an Internet search engine (such as Alta Vista). You will get a report of every instance that the name appears on Web pages indexed by that engine. Because no search engine is 100% complete, you should do this same search on a several different search engines.

### How can I find out whether a mark I want to use is already being used as a domain name (the name of a site on the World Wide Web)?

Every website is identified by a unique phrase known as a “domain name.” For example, the domain name for Nolo is Nolo.com. Because so much business is now being done online, most people will want to be able to use their proposed mark as a domain name so that their customers can easily locate them on the Web.

The easiest way to find out if a domain name is already in use is to check with one of the dozens of online companies that have been approved to

register domain names. You can access a listing of these registrars through InterNIC’s site at <http://www.internic.net> or ICANN’s site at <http://www.icann.org>. ICANN is the organization that oversees the process of approving domain name registrars.

### Would it be better to have a professional firm conduct my trademark search?

Many people do prefer to pay a professional search firm to handle a trademark search. This can make sense if your financial plans justify an initial outlay of several hundred dollars, the minimum cost for a thorough professional search for both registered and unregistered marks. Depending on the search firm, you may also get a legal opinion as to whether your proposed mark is legally safe to use in light of existing registered and unregistered marks. Obtaining a legal opinion may provide important protection down the road if someone later sues you for using the mark.

### How do I find a professional search firm?

There are many trademark search services in the United States. Here are three of the most well known:

*The Sunnyvale Center on Innovation, Invention and Ideas* (Sci3) (<http://www.sci3.com>). Sci3 (pronounced “sigh-cubed”) is one of three Patent and Trademark Depository Libraries—the others are in Detroit and Houston—that have formed partnerships with the U.S. Patent and Trademark Office. Under this partnership,

Sc[i]s is encouraged to offer a variety of information services—including trademark searches—for very reasonable fees.

**Trademark Express** (<http://www.tmexpress.com>). Trademark Express is a private company that, in addition to other trademark-related services, offers a full choice of trademark searches.

**Thomson & Thomson** (<http://www.thomson-thomson.com>). Thomson & Thomson is the trademark search service of choice for the legal professional.

If you don't like doing business at a distance, you can find trademark search services in your area by looking in the Yellow Pages of the nearest good-sized city under "trademark consultants" or "information brokers." If that yields nothing, consult the advertisements in a local legal journal or magazine. Finally, you can find a good list of trademark search firms at <http://www.ggmark.com>.

## Registering a Trademark

It is possible to register certain types of trademarks and servicemarks with the U.S. Patent and Trademark Office (PTO). Federal registration puts the rest of the country on notice that the trademark is already taken, and makes it easier to protect a mark against would-be copiers.

### How does a mark qualify for federal registration?

To register a trademark with the PTO, the mark's owner first must put it into use "in commerce that Congress may regulate." This means the mark must be used on a product or service that crosses state, national or territorial lines or that affects commerce crossing such lines—for example, a catalog business or a restaurant or motel that caters to interstate or international customers. Even if the owner files an intent-to-use (ITU) trademark application (ITU applications are discussed in the previous set of questions), the mark will not actually be registered until it is used in commerce.

Once the PTO receives a trademark registration application, the office must answer the following questions:

- Is the trademark the same as or similar to an existing mark used on similar or related goods or services?
- Is the trademark on the list of prohibited or reserved names?
- Is the trademark generic—that is, does the mark describe the product itself rather than its source?
- Is the trademark too descriptive (not distinctive enough) to qualify for protection?

If the answer to each question is "no," the trademark is eligible for registration and the PTO will continue to process the application.

I know the PTO won't register a mark if it's not distinctive or already in use. But are there other types of marks that are ineligible for federal registration?

Yes. The PTO won't register any marks that contain:

- names of living persons without their consent
- the U.S. flag
- other federal and local governmental insignias
- the name or likeness of a deceased U.S. President without his widow's consent
- words or symbols that disparage living or deceased persons, institutions, beliefs or national symbols, or
- marks that are judged immoral, deceptive or scandalous.

As a general rule the PTO takes a liberal view of the terms immoral and scandalous and will rarely refuse to register a mark on those grounds.

If the PTO decides that a mark is eligible for federal registration, what happens next?

Next, the PTO publishes the trademark in the *Official Gazette* (a publication of the U.S. Patent and Trademark Office). The *Gazette* states that the mark is a candidate for registration; this provides existing trademark owners with an opportunity to object to the registration. If someone objects, the PTO will schedule a hearing to resolve the dispute.

Is it possible to federally register a mark made up of common or ordinary words?

Yes, if the combination of the words is distinctive. But even if the entire mark is judged to lack sufficient distinctiveness, it can be placed on a list called the Supplemental Register. (Marks that are considered distinctive—either inherently or because they have become well known—are placed on a list called the Principal Register.) Marks on the Supplemental Register receive far less protection than do those on the Principal Register. The benefits granted by each type of registration are discussed in more detail in the next question.

What are the benefits of federal trademark registration?

It depends on which register carries the mark. Probably the most important benefit of placing a mark on the Principal Register is that anybody who later initiates use of the same or a confusingly similar trademark may be presumed by the courts to be a “willful infringer” and therefore liable for large money damages.

Placing a trademark on the Supplemental Register produces significantly fewer benefits, but still provides notice of ownership. This notice makes it far less likely that someone will use that identical mark; the fear of being sued for damages should keep potential infringers away. Also, if the trademark remains on the Supplemental Register for five years—meaning that the registration



isn't canceled for some reason—and the mark remains in use during that time, it may be moved to the Principal Register under the secondary meaning rule (secondary meaning will be presumed).

Even if a mark is not registered, it is still possible for the owner to sue the infringer under a federal statute which forbids use of a “false designation of origin” (Title 15 U.S.C. § 1125). It is usually much easier to prove the case and collect large damages, however, if the mark has been registered.

### How long does federal registration last?

Once a trademark or servicemark is placed on the Principal Register, the owner receives a certificate of registration good for an initial term of ten years. The registration may lapse before the ten-year period expires, however, unless the owner files a form within six years of the registration date (called the Section 8 Declaration) stating that the mark is either still in use in commerce or that the mark is not in use for legitimate reasons.

The Section 8 Declaration is usually combined with a Section 15 Declaration, which effectively renders the trademark incontestable except for limited reasons.

The original registration may be renewed indefinitely for additional ten-year periods if the owner files the required renewal applications (called a Section 9 Affidavit) with the U.S. Patent and Trademark Office. A Section 8 Declaration must also be filed at the time of trademark renewal.

Failure to renew a registration does not void all rights to the mark, but if the owner fails to re-register, the special benefits of federal registration will be lost.

### What happens if there is a conflict between an Internet domain name and an existing trademark?

The answer depends on the nature of the conflict. There are three reasons why a conflict may develop between the owner of a trademark and the owner of a domain name:

*The domain name registrant is a cybersquatter.* If a domain name is registered in bad faith—for example, the name is registered with the intent of selling it back to a company with the same name—the domain name can be taken away under federal law or under international arbitration rules for domain name owners. A victim of cybersquatting in the U.S. can now sue under the provisions of the Anticybersquatting Consumer Protection Act (ACPA) or can fight the cybersquatter using an international arbitration system created by the Internet Corporation of Assigned Names and Numbers (ICANN). The ICANN arbitration system is usually faster and less expensive than suing under the ACPA. In addition, it does not require an attorney. For information on the ICANN policy visit the organization's website at <http://www.icann.org>.

*The domain name infringes an existing trademark.* If a domain name is likely to confuse consumers



because it is similar to an existing trademark, the owner of the federally owned trademark can sue for infringement in federal court. For example, it's likely that the Adobe company, makers of graphics software, would be able to prevent another software company from using the domain name of [www.adoobie.com](http://www.adoobie.com).

***The domain name dilutes a famous trademark.*** If a domain name dilutes the power of a famous trademark, the trademark owner can sue under federal laws to stop the continued use. Dilution occurs when the domain name blurs or tarnishes the reputation of a famous trademark. For example, Gucci could probably prevent a company from using the domain name “[guccigoo.com](http://guccigoo.com)” for the purpose of selling baby diapers.

### Can a business register its mark at the state level?

It is possible to register a mark with the state trademark agency, although the state registration does not offer the same level of protection provided by federal law. The main benefit of state registration is that it notifies anyone who checks the list that the mark is owned by the registrant. This fact will lead most would-be users of the same mark to choose another one rather than risk a legal dispute with the registered mark's owner. If the mark is also federally registered, this notice is presumed and the state registration isn't necessary. If, however, the mark is used only within the state and doesn't qualify for federal registration, state registration is a good idea.

## *How to Register Your Trademark*

For most trademarks already in use, federal registration is a relatively straightforward process. You use a simple two-sided form provided by the PTO to:

- describe your mark
- state when it was first used
- describe the products or services on which the mark will be used, and
- suggest the classification under which the mark should be registered (there are approximately 40 classifications for goods and services; the PTO can help you figure out which one is right for your mark).

In addition, your form must be accompanied by:

- a “drawing” of your mark (for word marks, this simply involves setting the mark out in the middle of a page in capital letters)
- samples of how your proposed mark is being used, and
- the registration fee—currently \$325.

On its website, <http://www.uspto.gov>, the PTO offers two electronic registration options. PrintEAS lets you fill in the form online but requires you to print out and mail in a hardcopy. eTEAS lets you both fill in and file the form online.

If you are applying to register your mark on the basis of its intended use (See *How can a business reserve a trademark for future use?*, above), then you needn't provide the samples or the date of first use, but you can't complete your registration until you put your mark into actual use and file some additional paperwork with the PTO.

The PTO offers a free booklet containing plain English instructions for filling out this form, and also provides help on its website: <http://www.uspto.com>. For more information about registering your trademark, see the resource list at the end of this chapter.

## How Trademarks Differ From Patents and Copyrights

Trademarks are often mentioned in the same breath as copyrights and patents. While they do sometimes apply to the same thing, they're more often defined by their differences. It's important to understand how trademark law differs from other laws protecting creative works (collectively called "intellectual property laws"); rules and benefits depend on the type of intellectual property at issue.

### How does trademark differ from copyright?

Copyright protects original works of expression, such as novels, fine and graphic arts, music, phonorecords, photography, software, video, cinema and choreography by preventing people from copying or commercially exploiting them without the copy-

right owner's permission. But the copyright laws specifically do not protect names, titles or short phrases. That's where trademark law comes in. Trademark protects distinctive words, phrases, logos, symbols, slogans and any other devices used to identify and distinguish products or services in the marketplace.

There are, however, areas where both trademark and copyright law may be used to protect different aspects of the same product. For example, copyright laws may protect the artistic aspects of a graphic or logo used by a business to identify its goods or services, while trademark may protect the graphic or logo from use by others in a confusing manner in the marketplace. Similarly, trademark laws are often used in conjunction with copyright laws to protect advertising copy. The trademark laws protect the product or service name and any slogans used in the advertising, while the copyright laws protect the additional creative written expression contained in the ad.

For more information about copyright law, see Chapter 7, *Copyrights*.

### What's the difference between patent and trademark?

Patents allow the creator of certain kinds of inventions that contain new ideas to keep others from making commercial use of those ideas without the creator's permission. For example, Tom invents a new type of hammer that makes it very difficult to miss the nail. Not only can Tom keep others from making, selling or using the

precise type of hammer he invented, but he may also be able to apply his patent monopoly rights to prevent people from making commercial use of any similar type of hammer during the time the patent is in effect (20 years from the date the patent application is filed).

Generally, patent and trademark laws do not overlap. When it comes to a product design, however—say, jewelry or a distinctively shaped musical instrument—it may be possible to obtain a patent on a design aspect of the device while invoking trademark law to protect the design as a product identifier. For instance, an auto manufacturer might receive a design patent for the stylistic fins that are part of a car's rear fenders. Then, if the fins were intended to be—and actually are—used to distinguish the particular model car in the marketplace, trademark law may kick in to protect the appearance of the fins.

For more information about patent law, see Chapter 6, *Patents*.



### *More Information About Trademarks*

*Trademark: Legal Care for Your Business & Product Name*, by Stephen Elias (Nolo), shows you how to choose a legally strong business and product name, register the name with state and federal agencies and sort out any name disputes that arise.

*Patent, Copyright & Trademark*, by Stephen Elias and Richard Stim (Nolo), provides concise definitions and examples of the important words and phrases commonly used in trademark law.

*Domain Names: How to Choose & Protect a Great Name for Your Website*, by Stephen Elias & Patricia Gima (Nolo). This how-to book provides information on selecting, registering and protecting a domain name.

*McCarthy on Trademarks and Unfair Competition*, by J. Thomas McCarthy (Clark Boardman Callaghan), is a book intended for lawyers that provides an exhaustive treatment of trademark law.

*Trademark Law—A Practitioners Guide*, by Siegrun D. Kane (Practicing Law Institute), is a good overview of trademark law written for lawyers.

*Trademark Registration Practice*, by James E. Hawes (Clark Boardman Callaghan), a book for trademark lawyers, provides the ins and outs of registering a trademark with the U.S. Patent and Trademark Office.

The following associations of trademark lawyers offer a number of helpful publications. Write or call for a list of available materials.

International Trademark Association (INTA)  
1133 Avenue of the Americas  
New York, NY 10036  
212-768-9887  
<http://www.inta.org>

American Intellectual Property Law Association (AIPLA)  
2001 Jefferson Davis Highway, Suite 203  
Arlington, VA 22202  
703-415-0780  
<http://www.aipla.org>



**<http://www.nolo.com>**

*Nolo Press offers self-help information about a wide variety of legal topics, including trademarks.*

**<http://www.marksonline.com>**

*This comprehensive trademark site provides trademark searching services, news and links as well as domain name information. It's easy to navigate, contains lots of practical information for trademark owners and includes links to state and federal trademark offices.*

**<http://www.inta.org>**

*The International Trademark Association (INTA) provides trademark services, publications and online resources.*

**<http://www.uspto.gov>**

*The U.S. Patent and Trademark Office provides new trademark rules and regulations and, as of August 1998, is expected to put the federal registered trademark database online.*

**<http://www.sci3.com>**

*The Sunnyvale Center for Invention, Innovation and Ideas (a Patent and Trademark Depository Library), provides information about their excellent, low-cost trademark search service conducted by the Center's librarians.*

**<http://www.ggmark.com>**

*This site, maintained by a trademark lawyer, provides basic trademark information and a fine collection of links to other trademark resources.*

# Y our Money



- 9.2 *Purchasing Goods and Services*
- 9.7 *Using Credit and Charge Cards*
- 9.10 *Using an ATM or Debit Card*
- 9.11 *Strategies for Repaying Debts*
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*Too many people spend money they haven't earned, to buy things they don't want, to impress people they don't like.*

—WILL ROGERS

**A**merica's economy is driven by consumer spending. When we open any newspaper or magazine, turn on the radio or television, or take a drive across town, we're bombarded with ads urging us to spend our hard-earned dollars. And so we do. We pull out our cash, checks, credit cards, and increasingly, debit cards.

What the ads don't tell you is what to do when things go wrong—for example, when the item you buy is defective, when you lose your credit card, when you need extra time to pay or when you fall behind and the bill collectors start calling.

Fortunately, many federal (and some state) laws provide some protections to consumers; this chapter describes some of those that are most important. While no law substitutes for common sense, comparison shopping and avoiding offers that sound too good to be true, if you do face problems as a consumer, many laws can help.

## Purchasing Goods and Services

*I did not have three thousand pairs of shoes: I had one thousand and sixty.*

—IMELDA MARCOS



While 19th century business relationships were governed by the doctrine “caveat emptor” or “let the buyer beware,” the notion that a buyer-seller arrangement should be fair gained ground in the 20th century. As a result, you now have a right to receive nondefective goods and services that meet a minimum standard.

### When I buy something, is it covered by a warranty?

Generally, yes. A warranty (also called a guarantee) is an assurance about the quality of goods or services you buy, and is intended to give you recourse if something you purchase fails to live up to what you were promised.

Some warranties are implied and some are expressed. Virtually everything you buy comes with two implied warranties—one for “merchantability” and one for “fitness.” The implied warranty of merchantability is an assurance that a new item will work if you use it for a reasonably expected purpose. For used items, the warranty of merchantability is a promise that the product will work as

expected, given its age and condition. The implied warranty of fitness applies when you buy an item with a specific (even unusual) purpose in mind. If you communicated your specific needs to the seller, the implied warranty of fitness assures you that the item will fill your need.

Most expressed warranties state something such as “the product is warranted against defects in materials or workmanship” for a specified time. Most either come directly from the manufacturer or are included in the sales contract you sign with the seller. But an expressed warranty may also be in an advertisement or on a sign in the store (“all dresses 100% silk”), or it may even be an oral description of a product’s features.

### How long does a warranty last?

In most states, an implied warranty lasts forever. In a few states, however, the implied warranty lasts only as long as any expressed warranty that comes with a product. In these states, if there is no expressed warranty, the implied warranty lasts forever.

### Can a seller avoid a warranty by selling a product “as is”?

The answer depends on whether the warranty is express or implied (see the previous questions for an explanation of implied and express warranties) and in what state you live. Sellers cannot avoid express warranties by claiming the product is sold “as is.” On the other hand, if there is no express warranty, sellers can sometimes avoid an implied warranty by selling the item

“as is.” Some states prohibit all “as is” sales. And in all states, the buyer must know that the item is sold “as is” in order for the seller to avoid an implied warranty.

### How do I enforce a warranty if something is wrong with what I bought?

Most of the time, a defect in an item will show up immediately and you can ask the seller or manufacturer to fix or replace it. If the seller won’t, or tries only once and the fixed or replaced item is still defective, you can withhold payment (or refuse to pay a credit card charge). If you are uncomfortable doing this or have already paid for the item, call the seller and try to work out an arrangement. If the seller refuses, try to mediate the dispute through a community or Better Business Bureau mediation program. (For more information about mediation, see Chapter 17.)

If you can’t get anywhere informally, you can sue. In most states, if the seller or manufacturer won’t make good under a warranty you must sue within four years of when you discovered the defect.

### Do I have any recourse if the item breaks after the warranty expires?

Usually not. But in most states, if the item gave you some trouble while it was under the warranty and you had it repaired by someone authorized by the manufacturer to make repairs, the manufacturer must extend your original warranty for the amount of time

the item sat in the shop. If you think you're entitled to an extension, call the manufacturer and ask to speak to the department that handles warranties.

You may have other options as well. If your product was trouble-free during the warranty period, the manufacturer may offer a free repair for a problem that arose after the warranty expired if the problem is widespread. Many manufacturers have secret "fix it" lists—items with defects that don't affect safety and therefore don't require a recall, but that the manufacturer will repair for free. It can't hurt to call and ask.

**I just bought a stereo system and the salesclerk tried to sell me an extended warranty contract. Should I have bought it?**

Probably not. Merchants encourage you to buy extended warranties (also called service contracts) because they are a source of big profits for stores, which pocket up to 50% of the amount you pay.

Rarely will you have the chance to exercise your rights under an extended warranty. Name-brand electronic equipment and appliances usually don't break down during the first few years (and if they do they're covered by the original warranty), and often have a lifespan well beyond the length of the extended warranty.

**I think I was the victim of a scam. Can I get my money back?**

Federal and state laws prohibit "unfair or deceptive trade acts or practices." If

you think you've been cheated, *immediately* let the appropriate government offices know. Although any government investigation will take some time, these agencies often have the resources to go after unscrupulous merchants. And, the more agencies you notify, the more likely someone will take notice of your complaint and act on it.

Unfortunately, government agencies are rarely able to get you your money back. If the business is a reputable one, however, it may refund your money when a consumer fraud law enforcement investigator shows up. It certainly can't hurt to complain.

If you can't get relief from a government agency, consider suing the company in small claims court. *Everybody's Guide to Small Claims Court*, by Ralph Warner (Nolo), provides extensive information on how to sue in small claims court.

## How to File a Complaint for Fraud

The National Fraud Information Center, a project of the National Consumer's League, can help you if you've been defrauded. NFIC provides:

- assistance in filing a complaint with appropriate federal agencies
- recorded information on current fraud schemes
- tips on how to avoid becoming a fraud victim, and
- direct ordering of consumer publications in English or Spanish.



You can contact NFIC at P.O. Box 65868, Washington, DC 20035, 800-876-7060, 202-737-5084 (TTD), <http://www.fraud.org>.

Also contact your local prosecutor to find out if it investigates consumer fraud complaints. Finally, contact any local newspaper, radio station or television station "action line." Especially in metropolitan areas, these folks often have an army of volunteers ready to pursue consumer complaints.

### I received some unordered merchandise in the mail and now I'm getting billed. Do I have to pay?

You don't owe any money if you receive an item you never ordered. It's considered a gift. If you get bills or collection letters from a seller who sent you something you never ordered, write to the seller stating your intention to treat the item as a gift. If the bills continue, insist that the seller send you proof of your order. If this doesn't stop the bills, notify the state consumer protection agency in the state where the merchant is located.

If you sent for something in response to an advertisement claiming a "free" gift or "trial" period, but are now being billed, be sure to read the fine print of the ad. It may say something about charging shipping and handling; or worse, you may have inadvertently joined a club or subscribed to a magazine. Write the seller, offer to return the merchandise and state that you believe the ad was misleading.

### I just signed a contract to have carpeting installed in my house and I changed my mind. Can I cancel?

Possibly. Under the Federal Trade Commission's "Cooling Off Rule," you have until midnight of the third business day after a contract was signed to cancel either of the following:

- door-to-door sales contracts for more than \$25, or
- a contract for more than \$25 made anywhere other than the seller's normal place of business—for instance, at a sales presentation at a hotel or restaurant, outdoor exhibit, computer show or trade show (other than public car auctions and craft fairs).

### Do I have the right to cancel any other kinds of contracts?

The federal Truth in Lending Act lets you cancel some loans up until midnight of the third business day after you signed the contract. It applies only to loans for which you pledged your home as security, as long as the loan is not a first mortgage. For example, the Act applies to home improvement loans and second mortgages. If the lender never notified you of the three-day right to cancel, you have even longer to cancel your loan.

In addition, many states have laws that allow you to cancel written contracts covering the purchase of certain goods or services within a few days of signing, including contracts for dance or martial arts lessons, credit repair services, health club memberships,

dating services, weight loss programs, time share properties and hearing aids. In a few states, you can also cancel a contract if you negotiated the transaction in a language other than English but the seller did not give you a copy of the contract in that language. Call your state consumer protection agency (check directory assistance in your state capital) to find out what contracts, if any, are covered in your state.

### I ordered some clothes through a catalogue and there's a delay in shipping. Can I cancel my order?

If you order goods by mail, phone, computer or fax (other than photo development, magazine subscriptions, seeds or plants), the Federal Trade Commission's "Mail or Telephone Order Rule" requires that the seller ship to you within the time promised or, if no time was stated, within 30 days.

If the seller cannot ship within those time frames, the seller must send you a notice with a new shipping date and offer you the option of canceling your order and getting a refund, or accepting the new date. If you opt for the second deadline, but the seller can't meet it, it must send a notice requesting your signature to agree to yet a third date. If you don't return the notice, the seller must automatically cancel your order and refund your money. The seller must issue the refund promptly—within seven days if you paid by check or money order and within one billing cycle if you charged your purchase.



### Do I have the right to a cash refund after I make a purchase?

Generally, no. A seller isn't required to offer refunds or exchanges, though many do.

But at least four states do have laws governing refund policies:

- *California*. Sellers who do not allow a full cash or credit refund (or an equal exchange) within seven days of purchase must post the store's refund-credit-exchange policy. If the seller fails to post the policy, you may return the goods, for a full refund, within 30 days of your purchase.
- *Florida*. If the seller has no refund policy, such a statement must be posted in the store. If a "no refund" isn't posted, you may return unused goods in the original packaging within seven days for a full refund.
- *New York*. Sellers with a no refund policy must post it. If a seller does not post a policy, you're entitled to a choice of cash or credit refund within 20 days if goods are not used or damaged.
- *Virginia*. Sellers must post their refund or exchange policies unless they give a full cash refund (or full credit) within 20 days after purchase.



### *More Information About Purchasing Goods and Services*

#### *Everybody's Guide to Small Claims*

*Court*, by Ralph Warner (Nolo), has extensive information on pursuing your rights in the event a seller or manufacturer won't make good on a warranty.

The Direct Marketing Association is a membership organization made up of mail-order companies and other direct marketers. If you have a complaint about a particular company, contact Mail-Order Action Line, c/o DMA, 1111 19th Street, NW, Suite 1100, Washington, DC 20036, 202-955-5030, [http://www.the\\_dma.org](http://www.the_dma.org). DMA may contact the mail-order company and try to resolve your problem.

## Using Credit and Charge Cards

American adults hold approximately two billion total credit and charge cards—an average of nine cards per person. Buying on credit has become a cornerstone of the American economy. But buying on credit can be very expensive—the interest rate on bank credit cards averages about 18%; on gasoline company and department

store cards, it's over 20%. Only charge cards (also called travel and entertainment cards), such as American Express and Diners Club, don't generally impose interest. Of course, charge cards usually require that you pay off the entire balance each month.

### *My credit card debt is consuming my life. How can I cut credit card costs?*

If you have more than one card, pay down the balances with the highest interest rates and then use (or obtain) a card with a low rate. Because there is great competition among credit card issuers, you might get a rate reduction simply by asking for one from your current credit card company.

### *Which Cards Should You Keep?*

When you think about the costs of using your credit cards, you may decide that you're better off canceling most of them. If so, you'll have to choose which cards to keep. If you don't carry a monthly balance, keep a card with no annual fee, but make sure it has a grace period. If you carry a balance each month, get rid of the cards that come with the worst of the following features:

- High interest rates.
- Unfair interest calculations. Avoid cards that charge interest on the average daily balance, not the balance due. Here's why. Let's say you pay \$1,200 of your \$1,500 balance in January. If your bank uses the average daily

balance method, in February it will charge you interest on the \$1,500 average daily balance from January, not on the \$300 you still owe.

- No grace periods. This means you pay interest from the time of purchase until the time of payment even if you pay your balance in full.
- Nuisance fees. Get rid of cards with late payment fees, over-the-limit fees, inactivity fees, fees for not carrying a balance or for carrying a balance under a certain amount or a flat monthly fee that's a percentage of your credit limit.

**I'm always getting credit card offers with low interest rates in the mail. Should I sign up and transfer the balance from my current card to the new card?**

It depends. Check the fine print of the offer. Many credit card companies offer a "teaser" rate—a low rate that lasts for a short period of time. Once the "teaser" period is over, a much higher rate kicks in. Also be sure to consider any annual fees, grace periods and nuisance fees (see Which Cards Should You Keep?, above) before you switch.

**I can't afford the minimum payment required on my statement. Can I pay less?**

Most card companies insist that you make the monthly minimum payment, which is usually 2% to 2.5% of the outstanding balance. If you can convince the card issuer that your financial situation is desperate, the issuer may cut your payments in half. In some cases, the issuer may waive

payments altogether for a few months. This courtesy is usually extended only to people who have never made late payments.

Bear in mind that paying nothing or very little on your credit card should be a temporary solution only. The longer you pay only a small amount, the quicker your balance will increase due to interest charges.

**My checking account and Visa card are from the same bank. Can the bank take money out of my checking account to cover my missed credit card payments?**

No. A bank that takes money out of a deposit account to cover a missed credit card payment violates the federal Truth in Lending Act. You can sue for damages—the amount taken out of your account and any other damages you suffer, such as lost interest or bounced-check fees.

**My wallet was stolen. Will I have to pay charges that the thief made using my credit cards?**

No. Federal law limits your liability for unauthorized charges made on your credit or charge card after it has been lost or stolen. If you notify the card issuer within a reasonable time after you discover the loss or theft (usually 30 days), you're not responsible for any charges made after the notification, and are liable for only the first \$50 of charges made before you notified the card issuer. In practice, card issuers rarely even charge the \$50.

### I purchased an item using my credit card and it fell apart. Can I refuse to pay?

Maybe. Under federal law, you must first attempt in good faith to resolve the dispute with the merchant. If that fails, you can withhold payment on non-seller-issued cards only if the purchase was for more than \$50 and was made within your home state or within 100 miles of your home. This limitation applies only if you used a card not issued by the seller, such as a MasterCard. There is no \$50, 100-mile or in-state limitation if you use a seller's card, such as your Sears card.

The 100-mile limitation is easy to calculate when purchases are made in person. But if you order through the mail, over the telephone or using your computer, the law is unclear as to where the purchase took place. Your best bet is to claim that the purchase was made in the state where you live (even if the catalogue company is on the other side of the country) because you placed the order from home.

### My credit card billing statement contains an error. What should I do?

Immediately write a letter to the customer service department of the card issuer. Give your name, account number, an explanation of the error and the amount involved. Enclose copies of supporting documents, such as receipts showing the correct amount of the charge. You must act quickly—the issuer must receive your letter within 60 days after it mailed the bill to you.

Under the federal Fair Credit Billing Act, the issuer must acknowledge receipt of your letter within 30 days, unless it corrects the bill within that time. Furthermore, the issuer must, within two billing cycles (but in no event more than 90 days), correct the error or explain why it believes the amount to be correct.

During the two-billing-cycle/90-day period, the issuer cannot report the amount to credit bureaus or other creditors as delinquent. The issuer can charge you interest on the amount you dispute during this period, but if it later agrees that you were correct, it must drop the interest accrued.

### Must I give my phone number when I use a credit card?

Most often, no. Several states, including California, Delaware, Georgia, Kansas, Massachusetts, Minnesota, Nevada, New Jersey, New York, Oregon, Pennsylvania, Rhode Island and Wisconsin, bar merchants from recording personal information when you use a credit card. Furthermore, merchant agreements with Visa and MasterCard prohibit them from requiring a customer to furnish a phone number when paying with Visa or MasterCard.

### I took out a cash advance using my credit card, and feel I was gouged. What are all those fees?

Cash advances usually come with the following fees:

- *Transaction fees.* Most banks charge a transaction fee of up to 4% for taking a cash advance.

- *No grace period.* Most banks charge interest from the date the cash advance is posted, even if you pay it back in full when your bill comes.
- *Interest rates.* The interest rate is often higher on cash advances than it is on ordinary credit card charges.

## Using an ATM or Debit Card

*A bank is a place where they lend you an umbrella in fair weather and ask for it back when it begins to rain.*

—ROBERT FROST

Banks issue ATM cards to allow customers to withdraw money, make deposits, transfer money between accounts, find out their balances, get cash advances and even make loan payments at all hours of the day or night.

Debit cards combine the functions of ATM cards and checks. Debit cards are issued by banks, but can be used at stores. When you pay with a debit card, the money is automatically deducted from your checking account.

### What are the advantages of using an ATM or debit card?

There are generally two advantages:

- You don't have to carry your checkbook and identification, but you can
- make purchases directly from your checking account.
- You pay immediately—without running up interest charges on a credit card bill.

### Are there disadvantages?

Yes. You don't have the 20- to 25-day delay in paying the bill. Also, you don't have the right to withhold payment (the money is immediately removed from the account) in the event of a dispute with the merchant over goods or services. Finally, many banks charge transaction fees when you use an ATM or debit card at locations other than those owned by the bank.

### Do I have to pay if there's a mistake on my statement or receipt?

Although ATM statements and debit receipts don't usually contain errors, mistakes do happen. If you find an error, you have 60 days from the date of the statement or receipt to notify the bank. Always call first and follow up with a letter. If you don't notify the bank within 60 days, it has no obligation to investigate the error and you're out of luck.

The bank has ten business days from the date of your notification to investigate the problem and tell you the result. If the bank needs more time, it can take up to 45 days, but only if it deposits the disputed amount of money into your account. If the bank later determines that there was no error, it can take the money back, but it must first send you a written explanation.

## If Your ATM Card Is Lost or Stolen

If your ATM or debit card is lost or stolen (never, never, never keep your personal identification number—PIN—near your card), call your bank immediately, and follow up with a confirming letter. Under the federal Electronic Fund Transfers Act, your liability is:

- \$0—after you report the card missing
- up to \$50—if you notify the bank within two business days after you realize the card is missing (unless you were on extended travel or in the hospital)
- up to \$500—if you fail to notify the bank within two business days after you realize the card is missing (unless you were on extended travel or in the hospital), but do notify the bank within 60 days after your bank statement is mailed to you listing the unauthorized withdrawals
- unlimited—if you fail to notify the bank within 60 days after your bank statement is mailed to you listing the unauthorized withdrawals.

In response to consumer complaints about the possibility of unlimited liability, Visa and MasterCard now cap the liability on debit cards at \$50. A few states have capped the liability for unauthorized withdrawals on an ATM or debit card at \$50 as well. And some large debit card issuers won't charge you anything if unauthorized withdrawals appear on your statement.



### More Information About Credit, Charge, ATM and Debit Cards

*Money Troubles: Legal Strategies to Cope With Your Debts*, by Robin Leonard and Deanne Loonon (Nolo), contains extensive information on credit, charge, ATM and debit card laws and practical usage tips.

The Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429, 877-275-3342, <http://www.fdic.gov>, publishes free pamphlets, including *Fair Credit Billing*.

The Federal Trade Commission, CRC-240, Washington, DC 20580, 877-FTC-HELP (382-4357), <http://www.ftc.gov>, publishes free pamphlets, including *Billing Errors*, *Fair Credit Billing*, *Lost or Stolen Credit and ATM Cards* and *Solving Credit Problems*.

## Strategies for Repaying Debts

*If you think nobody cares if you're alive, try missing a couple of car payments.*

—EARL WILSON



The recent economic downturn has left many folks in financial trouble. Many others never reaped any benefit from the previous economic boom and have struggled with debt for an even longer time. Today, many people are either unemployed or forced to work harder than ever (often in more than one job), earning less, saving little and struggling with debt. If this story sounds familiar to you, you're not alone. Here are some specific suggestions for dealing with debts.

### I feel completely overwhelmed by my debts and don't know where to begin. What should I do?

Take a deep breath and realize that for the most part, your creditors want to help you. Whether you're behind on your bills or are afraid of getting behind, call your creditors. Let them know what's going on—job loss, reduction in hours, medical problem or whatever—and ask for help. Suggest possible solutions such as a temporary reduction of your payments, skipping a few payments and tacking them on at the end of a loan or paying them off over a few months, dropping late fees and other charges or even rewriting a loan. If you need help negotiating with your creditors, consider contacting a nonprofit debt counseling organization, such as Myvesta.org (<http://www.myvesta.org>) or a local Consumer Credit Counseling Service office (to find the office nearest you, contact the National Foundation for Consumer Credit at 800-388-2227 or visit <http://www.nfcc.org>).

### I'm afraid I might miss a car payment—should I just let the lender repossess?

No. Before your car payment is due, call the lender and ask for extra time. If you're at least a few months into the loan and haven't missed any payments, the lender will probably let you miss one or two months' payments and tack them on at the end. If you don't pay or make arrangements with the lender, the lender can repossess without warning, although many will warn you and give you a chance to pay what's due.

If your car is repossessed, you can get it back by paying the entire balance due and the cost of repossession or, in some cases, by paying the cost of the repossession and the missed payments, and then making payments under your contract. If you don't get the car back, the lender will sell it at an auction for far less than it's worth. You'll owe the lender the difference between the balance of your loan and what the sale brings in. The amount is usually in the thousands.

If you are far behind on your car payments and can't catch up, think hard about whether you can really afford the car. If you decide to give up your car, there are two options that are almost always better than waiting for the dealer to repossess it. First, if you act quickly, you can sell the car yourself and use the proceeds to pay off the loan (or most of the loan). You'll get more for the car if you sell it yourself than the dealer will by selling it at an auction after repossession—which



means you'll be able to pay off more of the loan. Or, you can voluntarily "surrender" your car to the dealer before repossession. This will save you expensive repossession costs and attorneys' fees. Because it also makes life easier for the dealer, try to negotiate a deal. Many dealers will agree to waive any deficiency balance or promise not to report the default or repossession to credit bureaus.

### How soon after I miss a house payment will the bank begin foreclosure proceedings?

This varies from state to state and lender to lender, but most lenders don't start foreclosure proceedings until you've missed four or five payments. Before taking back your house, a lender would usually rather rewrite the loan, suspend principal payments for a while (have you pay interest only), reduce your payments or even let you miss a few payments and spread them out over time.

If your loan is owned by one of the giant U.S. government mortgage holders, Fannie Mae or Freddie Mac, foreclosure could come even more slowly. Fannie Mae and Freddie Mac often work with homeowners to avoid foreclosure when a loan is delinquent.

If your loan is insured by a federal agency such as the Department of Housing and Urban Development (HUD), the Federal Housing Administration (FHA), the Veterans Administration (VA) or the Farmers Home Administration (FmHA), the lender may be required to try to help you avoid

foreclosure. Contact the federal agency to find out more.

### Might I be better off just selling my house?

You're certainly better off selling the house than having it go to foreclosure. If you can find a buyer who will offer to pay at least what you owe your lender, take the offer. If the offer is for less than what you owe your lender, your lender can block the sale. But many lenders will agree to a "short sale"—where the sale brings in less than you owe the lender and the lender agrees to forego the rest. Some lenders require documentation of any financial or medical hardship you are experiencing before agreeing to a short sale.

### Can I just walk away from the house?

If you get no offers for your house or the lender won't approve a short sale, you can walk away from your house. To do this, you transfer your ownership interest in your home to the lender — called a deed in lieu of foreclosure. Keep in mind that with a deed in lieu, you won't get any cash back, even if you have lots of equity in your home. The deed in lieu may also appear on your credit report as a negative mark. If you opt for a deed in lieu, try to get concessions from the lender — after all, you are saving it the expense and hassle of foreclosing on your home. For example, ask the lender to eliminate negative references on your credit report or give you more time to stay in the house.

## Beware of the IRS

IRS regulations could cost you money if you settle a debt or if a creditor writes off money you owe. The rules state that if a creditor agrees to forego a debt you owe, you must treat the amount you didn't pay as income. Similarly, if a creditor ceases collection efforts, declares a debt uncollectible and reports it as a tax loss to the IRS, you must treat this amount as income. This includes any amount owed after a house foreclosure or property repossession, or on a credit card bill.

The rule applies to a debt or part of a debt for \$600 or more forgiven by any bank, credit union, savings and loan or other financial institution. The institution must send you and the IRS a Form 1099-C at the end of the tax year. These forms report that income, which means that when you file your tax return for the tax year in which your debt was forgiven, the IRS will make sure that you report the amount on the Form 1099-C as income.

There are five exceptions to this rule stated in the Internal Revenue Code, three of which apply to consumers. Even if the financial institution issues a Form 1099-C or 1099-A, you do not have to report the income if:

- the cancellation of the debt is intended as a gift (this would be unusual)
- you discharge the debt in bankruptcy, or
- you were insolvent before the creditor agreed to waive the debt.

The Internal Revenue Code does not define what is meant by insolvent. Generally it means that your debts exceed the value of your assets. To figure out

whether or not you are insolvent, you will have to total up your assets and your debts, including the debt that was forgiven or written off.

Let's say your assets are worth \$35,000 and your debts total \$45,000. You are insolvent to the tune of \$10,000. If a creditor forgives or writes off debts up to that amount, you will not have to include the Form 1099-C income on your tax return.

On the other hand, let's say your assets and debts are \$35,000 and \$45,000 respectively, but your creditor forgives or writes off a \$14,000 debt. Now, you can ignore \$10,000 of the Form 1099-C income (the amount you are insolvent), but you will have to report \$4,000 on your tax return.

### My utility bill was huge because of a very cold winter. Do I have to pay it all at once?

Maybe not. Many utility companies offer customers an amortization program. This means that if your bills are higher in certain months than others, the company averages your yearly bills so you can spread out the large bills. Also, if you are elderly, disabled or earn a low income, you may be eligible for reduced rates—ask your utility company.

### I'm swamped with student loans and can't afford my payments. What can I do to avoid default?

First, know that you're right to do all you can to avoid default, rather than ignoring your loans and hoping they'll just go away. If you default, the amount you owe will probably skyrocket be-

cause the government can add a hefty collections fee—often up to 25% of the principal.

To avoid default, contact the companies that service your student loans and tell them why you can't make your payments. You may be eligible for a deferment or forbearance—ways of postponing repayment. In very limited circumstances, you may be able to cancel a loan. Also talk to your loan holders about flexible payment options—many now offer payments geared to borrowers' incomes.

In addition, consider consolidating your student loans. You can consolidate federal student loans through the government's direct lending program or through a private loan servicing company, such as Sallie Mae or USA Group. With loan consolidation, you can lower your monthly payments by extending your repayment period; you may also be able to lower your interest rate. Most loan consolidators offer flexible repayment options based on your income, and you may be able to consolidate even if one or more of your loans is in default. Types of loans eligible for consolidation, repayment options and interest rates vary slightly from lender to lender. Contact loan servicers for more information:

- Federal Direct Consolidation Loan Center: 800-557-7392, <http://www.ed.gov/DirectLoan/consolid.html>
- Sallie Mae: 800-340-1086, <http://www.Salliemae.com>
- USA Group: 888-272-5543, <http://www.usagroup.com>.

Finally, if you can prove that repayment would cause you extreme hardship, you may be able to discharge your student loans in bankruptcy.

**I defaulted on a student loan a long time ago and I just received collection letters. I can't afford very much, but I can pay something. Any suggestions?**

The Higher Education Act allows you to rehabilitate your student loan by making "reasonable and affordable" payments based on your income and expenses. The holder cannot insist on a monthly minimum. If you make six consecutive monthly payments on time, you will become eligible to apply for new federal student loans or grants if you want to return to school. You must continue to make the monthly payments, however, until you make at least 12 consecutive payments. Then your loans will come out of default. The default notation will come off your credit report, and if you return to school, you can apply for an in-school deferment to postpone your payments.

If you do not return to school, after you make 12 consecutive monthly payments, the holder of your loan will sell it back to a regular loan servicing company. (This is called loan rehabilitation.) Your new loan servicer will put you on a standard ten-year repayment plan, which may cause your monthly payments to increase dramatically. If you can't afford them, you will need to apply for a deferment (if you are eligible) or request a flexible repayment option.

I paid off my student loan a long time ago, but the Department of Education recently wrote me saying I still owe it. Help!

You need documentation. First, contact your school and ask for its Department of Education report showing the loan's status. Then, think about ways you can show that you paid the loan: Do you have canceled checks or old bank statements? Can you get microfiche copies of checks from your bank or a government regulatory agency if your bank is out of business? Does an old roommate remember seeing you write a check every month? Can you get old credit reports (check with lenders from whom you've borrowed in years past) which may show a payment status on an old loan? Get old tax returns (from the IRS, if necessary) showing that you itemized the interest deduction on student loan payments back when that was permitted. The last holder of the loan might have a copy of the signed promissory note. Any of these things will help you prove to the Department of Education that you paid your loan.

To find out more about the status of your loan, visit the Department of Education's website at <http://www.ed.gov> or the National Student Loan Data System's website at <http://www.nslds.ed.gov>

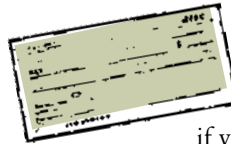
www.nslsds.ed.gov. Or call 800-4-FED-AID or the student loan ombudsman at 877-557-2575.

When can a creditor garnish my wages, place a lien on my house, seize my bank account or take my tax refund?

For the most part, a creditor must sue you, obtain a court judgment and then solicit the help of a sheriff or other law enforcement officer to garnish wages. Even then, the maximum the creditor can take is 25% of your net pay—and you can protest that amount in court if you can't live on only 75% of your wages.

In two situations your wages may be garnished without your being sued:

- Most federal administrative agencies (including the IRS and the Department of Education) can garnish your wages to collect debts owed to that agency.
- Up to 50% of your wages can be garnished to pay child support or alimony (even more if you don't currently support any dependents or if you are in arrears).



To place a lien on your house or empty your bank account, almost all creditors must first sue you, get a judgment and then use a law enforcement officer. A few creditors, such as an unpaid contractor who worked on your house, can put a lien on your house without suing. And again, the IRS is an exception—it can place a lien or empty your bank account without suing first.

Your tax refund can never be taken unless the Treasury Department receives such a request from the IRS, the Department of Education or a child support collection agency.

## *If You Bounce a Check*

In every state, writing a bad check is a crime. Aggressive district attorneys don't hesitate to prosecute, especially given that an estimated 450 million rubber checks are written each year. If you are prosecuted, you may be able to avoid a trial if your county has a "diversion" program where you attend classes for bad check writers. You must pay the tuition and make good on the bad checks you wrote.

Even if you escape criminal prosecution, you'll be charged a bad check "processing" fee by your bank. Many banks charge as much as \$20 or \$30. In addition, most creditors who receive a bad check can sue for damages. Before suing you, the creditor usually must first make a written demand that you make good on the bad check. If you don't pay up within approximately 30 days, the creditor can sue you. Damages recoverable by the merchant vary from state to state, but are often a minimum of \$50, and in most states more like a few hundred or a thousand dollars.

## **Can I go to jail for not paying my debts?**

Debtor's prisons were eliminated in the U.S. by 1850. In a few unusual situations, however, you could be jailed: you willfully violate a court order, especially an order to pay child

support; you are convicted of willfully refusing to pay income taxes; or you are about to conceal yourself or your property to avoid paying a debt for which a creditor has a judgment against you.



## **More Information About Repaying Debts**

*Money Troubles: Legal Strategies to Cope With Your Debts*, by Robin Leonard and Deanne Loonin (Nolo), explains your legal rights and offers practical strategies for dealing with debts and creditors.

*Take Control of Your Student Loans*, by Robin Leonard and Deanne Loonin (Nolo), provides strategies for repaying your loans, dealing with loan collectors and getting out of default.

*The Ultimate Credit Handbook*, by Gerri Detweiler (Penguin Books), provides tips on doubling your credit and cutting your debt.

*Surviving Debt: A Guide for Consumers*, by Gary Klein, Deanne Loonin and Jonathan Sheldon (National Consumer Law Center), contains tips on dealing with debt collectors and repaying debts.

Myvesta.org, 800-680-3328, <http://www.myvesta.org>, offers free publications, recommended books, a forum for posting your debt questions, information on obtaining your credit report and special programs to help you get out of debt.

National Foundation for Consumer Credit, 800-388-2227, <http://www.nfcc.org>, can put you in contact with the CCCS office located nearest you.

The Federal Student Aid Information Center, 800-4-FED-AID, (433-3243) provides information about federal student loan programs.

The Federal Trade Commission, CRC-240, Washington, DC 20580, 877-FTC-HELP (382-4357), <http://www.ftc.gov>, publishes nearly 50 free pamphlets on debts and credit. Go to the FTC website and click on "Consumer Preotection," or call or write and ask for a complete list.

## Dealing With the IRS

*Of all debts men are least willing to pay the taxes.*

—RALPH WALDO EMERSON

No three letters bring more fear to the average American than IRS. Yet, at one time or another in our lives, nearly everyone will owe a tax bill they can't pay, need extra time to file a tax return or even get audited. This section suggests several strategies for dealing with the government's largest bureaucracy.

### How long should I keep my tax papers?

Keep anything related to your tax return—W-2 and 1099 forms, receipts and canceled checks for deductible items—for at least three years after you file. The IRS usually has three years from the day you file your return to audit you. For example, if you filed your 1997 tax return on April 15, 1998, keep those records until at least April 16, 2001. To be completely safe, you should keep your records for six years. The reason is that the IRS can audit you up to six years after you file if the IRS believes you underreported your income by 25% or more.

One last caution: Keep records showing purchase costs and sales figures for real estate, stocks or other investments for at least three years after you sell these assets. This is because you must be able to show your taxable gain or loss to an auditor.

### If I can't pay my taxes, should I file a return anyway?

Absolutely. The consequences of filing and not paying are less severe than those for simply not filing. If you don't file a tax return, the IRS will assess a penalty of up to 25% of the tax due, plus interest. In addition, the IRS could criminally charge you for failing to file a return (although it isn't likely to). By contrast, if you file a return but can't pay, you'll only be on the hook for interest and penalties of 6%–12% on any amounts you owe.

## Who has access to my IRS files?

The federal Privacy Act of 1976 declares tax files to be “confidential.” This was an attempt by Congress to correct the abuses of power uncovered in the Watergate scandal. Even IRS officials cannot rummage willy-nilly through your tax files unless they are involved in some kind of case involving you and your taxes. Consequently, individuals, businesses and credit reporting agencies do not have access to your tax information unless you authorize its release to the IRS in writing.

The privacy law has exceptions, however, and IRS security is sometimes lax. Your IRS files are shared with other federal and state agencies that can demonstrate a “need to know.” This usually occurs when your affairs are being investigated by a law enforcement agency. In fairness to the IRS, most leakage of information is the result of sloppiness by other federal or state agencies granted access to IRS files. Furthermore, computer hackers have broken into IRS and government databases and retrieved private tax information. While violation of the Privacy Act is a crime, violators are rarely prosecuted.

## Do many people cheat on their taxes? And what will happen to me if I cheat on mine?

No one really knows how many people cheat the IRS, but several years ago an independent poll found that 20% of Americans admitted to cheating. This is somewhat in line with government studies showing that

82% of us faithfully file and pay our taxes every year. The IRS claims that most cheating is by self-employed small business people who do not have taxes withheld by their employers. Arguably, cheating by the self-employed approaches 100% if you count small violations like mailing a personal letter with a business-bought stamp.

If you are caught in some major cheating, the government can (but rarely does) throw you in jail. Fewer than 1,500 individuals are jailed in the U.S. for tax crimes each year, many of whom also are charged with drug crimes. That is really not many people, considering there are over 200 million American adults.

The IRS would much prefer collecting money to putting anyone in prison. More likely, if you’re caught cheating, you’ll be assessed heavy penalties, and will probably be audited for several years.

## I am faced with a tax bill that I can’t pay. Am I completely at the IRS’s mercy, or do I have some options?

There are six ways to deal with a tax bill you can’t pay:

- Borrow from a financial institution, family or friends and pay the tax bill in full.
- Negotiate a monthly payment plan with the IRS. This will include interest and penalty charges.
- File for Chapter 13 bankruptcy to set up a payment plan for your debts, including your taxes.



- Find out whether you can wipe out the debt in a Chapter 7 bankruptcy (only certain tax debts are dischargeable).
- Make an offer in compromise by filing IRS Form 656, *Offer in Compromise*. That is, ask the IRS to accept less than the full amount due.
- Ask the IRS to designate your debt temporarily uncollectible if you are out of work or your income is very low. This will buy you time to get back on your feet before dealing with the IRS. Interest and penalties will continue to accrue.

## Tax Avoidance Schemes Don't Work

Dozens of tax avoidance schemes emerge every decade. Some promoters are very persuasive, particularly if you are predisposed to believing that it's possible to opt out of the tax system. Sad to say, these promoters are all snake-oil salesmen, the most successful of whom make millions peddling their products at expensive "seminars" and through underground publications. One recent scheme involves holding your assets in multiple family trusts, limited partnerships and offshore banks. While these artifices may put your assets beyond the reach of your creditors, they won't beat the IRS.

## I made a mistake on my tax return and am now being billed for the taxes, plus interest and penalties. Do I have to pay it all?

Maybe not. The IRS must charge you interest on your tax bill, but penalties are discretionary. The IRS abates (cancels) one-third of all penalties it charges. The trick is to convince the IRS that you had "reasonable cause" (a good excuse) for failing to observe the tax law. Examples that might work include:

- serious illness or a death in the family
- destruction of your records by a flood, fire or other catastrophe
- wrong advice from the IRS over the phone
- bookkeeper or accountant error, or
- your being in jail or out of the country at the time the tax return was due.

You can ask anyone at the IRS to cancel a penalty, in person or over the phone. And, you can ask for a penalty to be canceled even if you already paid it. The best way to get the IRS's attention is to use IRS Form 843, *Claim for Refund and Request for Abatement*. Send this form to your IRS Service Center.

## Can the IRS take my house if I owe back taxes?

The IRS can seize just about anything you own—including your home and pension plans. There is a list of items exempt by federal law from IRS seizures, but it is hardly generous, and

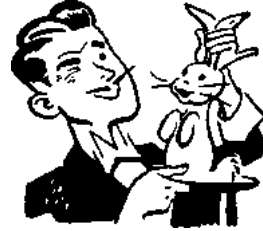


doesn't include your residence. Moreover, state homestead protection laws don't apply to the IRS. With that said, the good news is that the federal Taxpayer Bill of Rights discourages the IRS from taking homes of people who owe back taxes. In addition, the IRS doesn't like the negative publicity generated when it takes a home, unless of course it is the home of a notorious public enemy.

Nevertheless, if the IRS collection division has tried—and failed—to get any cooperation from a tax debtor (for example, if the debtor has not answered correspondence or returned phone calls, or has made threats, lied about her income or hidden her assets), the IRS may go after a residence as a last resort. An IRS tax collector can't make the decision on his own—it must come from top IRS personnel.

If the IRS lets you know that it plans to take your house, your Congressman may be able to intervene and put some pressure on the IRS to stop the seizure. And, if the seizure would add you and your family to the ranks of the homeless, you can contact your local IRS Problems Resolution Office to plead that the seizure would create a substantial hardship.

In the unhappy event the IRS does seize your home, all may not be lost. The IRS must sell the home at public auction, usually held about 45 days after the seizure. Then, the high bidder at auction must wait 180 days to get clear title. In this interim period you have the right to redeem (buy back) the home by coming up with the bid price plus interest.



### What are my chances of getting through an audit without owing additional taxes?

Although only about 1% of all tax returns are audited, the IRS has a pretty high success rate. Fewer than 15% of all IRS audit victims make a clean getaway. This is primarily because the IRS's sophisticated computer selection process makes it likely that the agency will audit returns in which "adjustments" are almost a certainty.

If you receive an audit notice, focus on limiting the damage rather than getting off scot-free. Most adjustments made following an audit result from poor taxpayer records, so make sure you have organized documentation to back up your deductions, exemptions and other claims. Ignore the tales about dumping a box of receipts on the auditor's desk in the hope that she will throw up her hands and let you off rather than go through the mess. It doesn't work like that. If you have any significant worries, get a tax pro to represent you or to help you navigate through the perilous audit waters.

## Can I challenge the IRS if I get audited and don't agree with the result?

Yes, you do not have to accept any audit report. In most cases, you can appeal by sending a protest letter to the IRS within 30 days after receiving the audit report. If you request an appeals consideration, you will be granted a meeting with an appeals officer who is not part of the IRS division that performed your audit. See IRS Publication 5, *Your Appeal Rights and How to Prepare a Protest If You Don't Agree*.

If your appeal fails, you still can file a petition in Tax Court. This is a fairly inexpensive and simple process if the audit bill is for less than \$50,000. If it's for more, you will most likely need the help of a tax attorney.

Generally, it pays to contest an audit report by appealing and going to court. About half the people who challenge their audit report succeed in lowering their tax bill.



### More Information About Dealing With the IRS

*Stand Up to the IRS*, by Frederick W. Daily (Nolo), explains your legal rights and offers practical strategies for dealing with the IRS.

*Surviving an Audit*, by Frederick W. Daily (Nolo), provides a wealth of information for minimizing the damage when you are audited.

## Debt Collections

Laws prohibit debt collectors from using abusive or deceptive tactics to collect a debt. Unfortunately, many collectors ignore the rules and don't play fair. In addition, creditors and debt collectors have powerful collection tools once they have won a lawsuit for the debt. Here are some frequently asked questions and answers to help you deal with debt collectors.

### Collection agencies have been calling me all hours of the day and night. Can I get them to stop contacting me?

It's against the law for a bill collector who works for a collection agency (as opposed to working in the collections department of the creditor itself) to call you at an unreasonable time. The law presumes that calls before 8 a.m. or after 9 p.m. are unreasonable. But other hours may be unreasonable too, such as daytime hours for a person who works nights. The law, the federal Fair Debt Collection Practices Act (FDCPA), also bars collectors from calling you at work if you ask them not to, harassing you, using abusive language, making false or misleading statements, adding unauthorized charges and many other practices. Under the FDCPA, you can demand that the collection agency stop contacting you, except to tell you that collection efforts have ended or that the creditor or collection agency will sue you. You must put your request in writing.

I'm also getting calls from the collections department of a local merchant I did business with. Can I tell that collector to stop contacting me?

Usually not. The FDCPA applies only to bill collectors who work for collection agencies. While many states have laws prohibiting all debt collectors—including those working for the creditor itself—from harassing, abusing or threatening you, these laws don't give you the right to demand that the collector stop contacting you. There is at least one exception: Residents of New York City can use a local consumer protection law to write any bill collector and say, "Leave me alone." A few states, including Colorado and Massachusetts, prohibit all collectors from calling you at work if you tell them not to.

**A bill collector insisted that I wire the money I owe through Western Union. Am I required to do so?**

No, and it could be expensive if you do. Many collectors, especially when a debt is more than 90 days past due, will suggest several "urgency payment" options, including:

- *Sending money by express or overnight mail.* This will add at least \$10 to your bill; a first class stamp is fine.
- *Wiring money through Western Union's Quick Collect or American Express's Moneygram.* This is another \$10 down the drain.
- *Putting your payment on a credit card.* You'll never get out of debt if you do this.

## *You Can Run, But You Can't Hide*



In this technological age, it's easy to run from collectors—but hard to hide. Collectors use many different resources to find debtors. They may contact relatives, friends, neighbors and employers, posing as long-lost friends to get these people to reveal your new whereabouts. In addition, collectors often get information from post office change of address forms, state motor vehicle registration information, voter registration records, former landlords and banks.

**Can a collection agency add interest to my debt?**

In most cases, yes. But only if either:

- the original agreement allows for additional interest during collection proceedings, or
- state law authorizes the addition of interest.

Virtually all states do allow this interest.

**A collection agency sued me and won. Will I still get calls and letters demanding payment?**

Probably not. Before obtaining a court judgment, a bill collector generally has only one way of getting paid: demand payment. This is done with calls and letters. You can ignore the phone calls and throw out your mail, and the col-

lector can't do much else short of suing you. Once the collector (or creditor) sues and gets a judgment, however, you can expect more aggressive collection actions. If you have a job, the collector will try to garnish up to 25% of your net wages. The collector may also try to seize any bank or other deposit accounts you have. If you own real property, the collector will probably record a lien, which will have to be paid when you sell or refinance your property. Even if you're not currently working or have no property, you're not home free. Depending on the state, court judgments can last up to 20 years and, in many states, can be renewed so they last even longer.

### What can I do if a bill collector violates the FDCPA?

Document the violation as soon as it occurs. Write down what happened, when it happened and who witnessed it. In some states, you can tape record phone conversations with debt collectors without their knowledge. But beware. In about a dozen states, this is illegal. Instead, try to have a witness present (or on another phone extension) the next time you talk to the collector.

Then file a complaint with the Federal Trade Commission (the address and phone number are at the end of this section). Next, complain to your state consumer protection agency. Fi-

nally, send a copy of your complaint to the creditor who hired the collection agency. If the violations are severe enough, the creditor may stop the collection efforts.

Also, you can sue a collection agency (and the creditor that hired the agency) in small claims court for violating the FDCPA. You are less likely to win if you can prove only a few minor violations. If the violations are outrageous, you can sue the collection agency and creditor in regular civil court. One Texas jury awarded a debtor \$11 million when a debt collector made death and bomb threats against her and her husband that frightened them so much they moved out of the county.



### More Information About Debt Collections

*Money Troubles: Legal Strategies to Cope With Your Debts*, by Robin Leonard and Deanne Loonin (Nolo), explains your legal rights and offers practical strategies for dealing with debts and creditors.

The Federal Trade Commission, CRC-240, Washington, DC 20580, 877-FTC-HELP (382-4357), <http://www.ftc.gov>, publishes free pamphlets on debts and credit, including a couple on the Fair Debt Collections Practices Act. It also takes complaints about collection agencies.

# Bankruptcy

*Where everything is bad it must be good to know the worst.*

—FRANCIS HERBERT BRADLEY

If you are seriously in debt, you might consider filing for bankruptcy. Here are some common questions and answers designed to help you understand the bankruptcy process and what bankruptcy can and cannot do for you.

## What exactly is bankruptcy?

Bankruptcy is a federal court process designed to help consumers and businesses eliminate their debts or repay them under the protection of the bankruptcy court. Bankruptcy's roots can be traced to the Bible. (Deuteronomy 15:1-2 —“Every seventh year you shall practice remission of debts. This shall be the nature of the remission: Every creditor shall remit the due that he claims from his neighbor; he shall not dun his neighbor or kinsman.”)

## Aren't there different kinds of bankruptcy?

Yes. Bankruptcies can generally be described as “liquidation” or “reorganization.”

Liquidation bankruptcy is called Chapter 7. Under Chapter 7 bankruptcy, a consumer or business asks the bankruptcy court to wipe out (discharge) the debts owed. Certain debts cannot be discharged—these are discussed below. In exchange for the discharge of debts, the business assets or the consumer's nonexempt property

are sold—that is, liquidated—and the proceeds are used to pay off creditors. The property a consumer might lose is discussed below.

In any reorganization bankruptcy, you file a plan with the bankruptcy court proposing how you will repay your creditors. Some debts must be repaid in full; others you pay only a percentage; others aren't paid at all. Some debts you have to pay with interest; some are paid at the beginning of your plan and some at the end.

There are several types of reorganization bankruptcy. Consumers with secured debts under \$871,550 and unsecured debts under \$290,525 can file for Chapter 13. Family farmers can file for Chapter 12. Consumers with debts in excess of the Chapter 13 debt limits or businesses can file for Chapter 11—a complex, time-consuming and expensive process.

## What generally happens in consumer bankruptcy cases?

In a Chapter 7 case, you file several forms with the bankruptcy court listing income and expenses, assets, debts and property transactions for the past two years. The cost to file is \$200, which may be waived for people who receive public assistance or live below the poverty level. A court-appointed person, the trustee, is assigned to oversee your case. About a month after filing, you must attend a “meeting of creditors” where the trustee reviews your forms and asks questions. Despite the name, creditors rarely attend. If you have any nonexempt property, you must give it (or its value in cash) to the trustee. The

meeting lasts about five minutes. Three to six months later, you receive a notice from the court that “all debts that qualified for discharge were discharged.” Then your case is over.

Chapter 13 is a little different. You file the same forms plus a proposed repayment plan, in which you describe how you intend to repay your debts over the next three, or in some cases five, years. The cost to file is \$185 (it cannot be waived but it can be paid in installments), and a trustee is assigned to oversee the case. Here, too, you attend the meeting of creditors, but often one or two creditors attend this meeting, especially if they don't like something in your plan. After the meeting of the creditors, you attend a hearing before a bankruptcy judge who either confirms or denies your plan. If your plan is confirmed, and you make all the payments called for under your plan, any remaining balance on a dischargeable debt will be wiped out at the end of your case (see “Nondischargeable Debts,” below, to learn which debts will have balances that are not wiped out at the end of the case).

## *Nondischargeable Debts*

The following debts are nondischargeable in both Chapter 7 and Chapter 13. If you file for Chapter 7, these will remain when your case is over. If you file for Chapter 13, these debts will have to be paid in full during your plan. If they are not, the balance will remain at the end of your case:

- debts you forget to list in your

bankruptcy papers, unless the creditor learns of your bankruptcy case

- child support and alimony
- debts for personal injury or death caused by your intoxicated driving
- student loans, unless it would be an undue hardship for you to repay
- fines and penalties imposed for violating the law, such as traffic tickets and criminal restitution
- recent income tax debts and all other tax debts, and
- debts you couldn't discharge in a previous bankruptcy because that bankruptcy was dismissed due to your fraud or other bad acts.

In addition, the following debts may be declared nondischargeable by a bankruptcy judge in Chapter 7 if the creditor challenges your request to discharge them. These debts may be discharged in Chapter 13. You can include them in your plan—at the end of your case, the balance is wiped out:

- debts you incurred on the basis of fraud, such as lying on a credit application
- credit purchases of \$1,150 or more for luxury goods or services made within 60 days of filing
- loans or cash advances of \$1,150 or more taken within 60 days of filing
- debts from willful or malicious injury to another person or another person's property
- debts from embezzlement, larceny or breach of trust, and
- debts you owe under a divorce decree or settlement unless after bankruptcy you would still not be able to afford to pay them or the benefit you'd receive by the discharge outweighs any detriment to your ex-spouse (who would have to pay them if you discharge them in bankruptcy).

## What property might I lose if I file for bankruptcy?

You lose no property in Chapter 13. In Chapter 7, you select property you are eligible to keep from either a list of state exemptions or exemptions provided in the federal Bankruptcy Code. Most debtors use the exemptions provided by their state.

Exemptions are generally as follows:

- *Equity in your home, called a homestead exemption.* Under the Bankruptcy Code, you can exempt up to \$17,425. Some states have no homestead exemption; others allow debtors to protect all or most of the equity in their home.
- *Insurance.* You usually get to keep the cash value of your policies.
- *Retirement plans.* Pensions which qualify under the Employee Retirement Income Security Act (ERISA) are fully protected in bankruptcy. So are many other retirement benefits; often, however, IRAs and Keoghs are not.
- *Personal property.* You'll be able to keep most household goods, furniture, furnishings, clothing (other than furs), appliances, books and musical instruments. You may be limited up to \$1,000 or so in how much jewelry you can keep. Most states let you keep a vehicle with more than \$2,400 of equity. And many states give you a "wild card" amount of money—often \$1,000 or more—that you can apply toward any property.
- *Public benefits.* All public benefits, such as welfare, Social Security and unemployment insurance, are fully protected.
- *Tools used on your job.* You'll probably be able to keep up to a few thousand dollars worth of the tools used in your trade or profession.
- *Wages.* In most states, you can protect at least 75% of earned but unpaid wages.

## Why choose Chapter 13 over Chapter 7?

Although the overwhelming number of people who file for bankruptcy choose Chapter 7, there are several reasons why people select Chapter 13:

- You cannot file for Chapter 7 bankruptcy if you received a Chapter 7 or Chapter 13 discharge within the previous six years.
- You have valuable nonexempt property.
- You're behind on your mortgage or car loan. In Chapter 7, you'll have to give up the property or pay for it in full during your bankruptcy case. In Chapter 13, you can repay the arrears through your plan, and keep the property by making the payments required under the contract.
- You have debts that cannot be discharged in Chapter 7.
- You have codebtors on personal (nonbusiness) loans. In Chapter 7, the creditors will go after your codebtors for payment. In Chapter 13, the creditors may not seek payment from your codebtors for the duration of your case.
- You feel a moral obligation to repay your debts or you want to learn money management.





### ***More Information About Bankruptcy***

*How to File for Chapter 7 Bankruptcy*, by Stephen Elias, Albin Renauer, Robin Leonard and Kathleen Michon (Nolo), is a complete guide to filing for Chapter 7 bankruptcy, including all the forms you need.

*Nolo's Law Form Kit: Personal Bankruptcy*, by Stephen Elias, Albin Renauer, Robin Leonard and Kathleen Michon (Nolo), contains all the forms and instructions necessary for filing a Chapter 7 bankruptcy.

*Chapter 13 Bankruptcy: Repay Your Debts*, by Robin Leonard (Nolo), contains the forms and instructions necessary to file your own Chapter 13 bankruptcy or successfully work with a lawyer.

*Bankruptcy: Is It the Right Solution to Your Debt Problems?*, by Robin Leonard (Nolo), provides tools to help you decide if filing for bankruptcy is for you and, if so, which type is best.

## *Will Bankruptcy Law Change for the Worse?*

In March 2001, the U.S. Congress passed legislation that would make it difficult—or impossible—for some people to file for bankruptcy. The House and Senate were scheduled to meet in September 2001 to work out differences between their respective versions of the bill. That meeting was cancelled due to the events of September

11. At the time this book went to print, Congressional committees were once again discussing whether a final version of the legislation could be hammered out. However, the future of the legislation is uncertain. Many experts believe that the legislation is no longer a priority, especially given the recent downturn in the economy and rising unemployment.

The legislation is very unfriendly to debtors. Among other things, it would prohibit some people from filing for bankruptcy, add to the list of debts that people cannot get rid of in bankruptcy and make it harder for people to come up with manageable repayment plans.

To learn more about the legislation, check Legal Updates on Nolo's website (<http://www.nolo.com>).

## **Rebuilding Credit**

People who have been through a financial crisis—bankruptcy, repossession, foreclosure, history of late payments, IRS lien or levy or something similar—may think they will never get credit again. Not true. Following some simple steps, you can rebuild your credit in just a couple of years.

### **What's the first step in rebuilding credit?**

To avoid getting into financial problems in the future, you must understand your flow of income and expenses. Some people call this making a budget. Others find the term budget



too restrictive and use the term “spending plan.” Whatever you call it, spend at least two months writing down every expenditure you make. At each month’s end, compare your total expenses with your income. If you’re overspending, you have to cut back or find more income. As best you can, plan how you’ll spend your money each month. If you have trouble putting together your own budget, consider getting help from a nonprofit group, such as Myvesta.org or your local Consumer Credit Counseling Service, which provides budgeting help for free or at a low cost.

### Okay, I’ve made my budget. What do I do next?

Now it’s time to clean up your credit report. Credit reports are compiled by credit bureaus—private, for-profit companies that gather information about your credit history and sell it to banks, mortgage lenders, credit unions, credit card companies, department stores, insurance companies, landlords and even a few employers.

Credit bureaus get most of their data from creditors. They also search court records for lawsuits, judgments and bankruptcy filings. And they go through county records to find recorded liens (legal claims against property).

To create a credit file for a given person, a credit bureau searches its computer files until it finds entries that match the name, Social Security number and any other available identifying information. All matches are gathered together to make the report.

Noncredit data in a credit report usually includes names you previously

used, past and present addresses, Social Security number, employment history, marriages and divorces. Your credit history includes the names of your creditors, type and number of each account, when each account was opened, your payment history for the previous 24–36 months, your credit limit or the original amount of a loan, and your current balance. The report will show if an account has been turned over to a collection agency or is in dispute.

## *How to Get Your Credit Report*

There are three major credit bureaus—Equifax, Trans Union and Experian. The federal Fair Credit Reporting Act (FCRA) entitles you to a copy of your credit report, and you can get one for free if any of the following are true:

- you were denied credit because of information in your credit report and you request a copy within 60 days of being denied credit
- you receive public assistance
- you are unemployed and plan to apply for a job within 60 days, or
- you believe your file contains errors due to fraud.

Residents of Colorado, Georgia, Maryland, Massachusetts, New Jersey and Vermont are entitled to a free copy of their report once a year from each credit bureau.

If you don’t qualify for a free report, you’ll have to pay about \$8.50 (less in

some states) to obtain one. Write to Equifax (P.O. Box 740241, Atlanta, GA 30374, 800-685-1111, <http://www.equifax.com>), Trans Union (Consumer Disclosure Center, P.O. Box 1000, Chester, PA 19022, 800-888-4213, <http://www.tuc.com>) or Experian (P.O. Box 2002, Allen, TX 75013, 888-397-3742, <http://www.experian.com>).

Send the following information:

- your full name (including generations such as Jr., Sr., III)
- your birth date
- your Social Security number
- your spouse's name (if relevant)
- your telephone number, and
- your current address and addresses for the previous five years.

## What should I do if I find mistakes in my report?

As you read through your report, make a list of everything out of date:

- Lawsuits, paid tax liens, accounts sent out for collection, late payments and any other adverse information older than seven years.
- Bankruptcies older than ten years from the discharge or dismissal. (Credit bureaus often list Chapter 13 bankruptcies for only seven years, but they can stay for as many as ten.)
- Credit inquiries (requests by companies for a copy of your report) older than two years.

Next, look for incorrect or misleading information, such as:

- incorrect or incomplete name, address, phone number, Social

Security number or employment information

- bankruptcies not identified by their specific chapter number
- accounts not yours or lawsuits in which you were not involved
- incorrect account histories—such as late payments when you paid on time
- closed accounts listed as open—it may look as if you have too much open credit, and
- any account you closed that doesn't say "closed by consumer."

After reviewing your report, complete the "request for reinvestigation" form the credit bureau sent you or send a letter listing each item that is incorrect or too old to be reported. Once the credit bureau receives your request, it must investigate the items you dispute and contact you within 30 days. If you don't hear back within 30 days, send a follow-up letter.

If you are right, or if the creditor who provided the information can no longer verify it, the credit bureau must remove the information from your report. Often credit bureaus will remove an item on request without an investigation if rechecking the item is more bother than it's worth.

If the credit bureau insists that the information is correct, call the bureau to discuss the problem:

- Experian: 888-397-3742
- Trans Union: 800-916-8800
- Equifax: 800-685-1111

If you don't get anywhere with the credit bureau, contact the creditor directly and ask that the information be removed. Write to the customer

service department, vice president of marketing and president or CEO. If the information was reported by a collection agency, send the agency a copy of your letter, too.

If the creditor will not remove the information, remind the creditor that under the 1997 amendments to the Fair Credit Reporting Act, the creditor must do the following:

- refrain from reporting information they know is incorrect
- refrain from ignoring information they know contradicts what they have on file, and
- provide credit bureaus with correct information when that information becomes available.

If a credit bureau is including the wrong information in your report, or you want to explain a particular entry, you have the right to put a brief explanatory statement in your report. The credit bureau must give a copy of your statement—or a summary—to anyone who requests your report. Be clear and concise; use the fewest words possible.

### I've been told that I need to use credit to rebuild my credit. Is this true?

Yes. The one type of positive information creditors like to see in credit reports is credit payment history. If you have a credit card, use it every month. (Make small purchases and pay them off to avoid interest charges.) If you don't have a credit card, apply for one. If your application is rejected, try to find a cosigner or apply for a secured card—where you

deposit some money into a savings account and then get a credit card with a line of credit close to the amount you deposited. But beware. Don't apply for new credit before getting back on your feet. Defaulting on new credit will only make matters worse.

### What else can I do to rebuild my credit?

After you've cleaned up your credit report, work on getting positive information into your record. Here are two suggestions:

- If your credit report is missing accounts you pay on time, send the credit bureaus a recent account statement and copies of canceled checks showing your payment history. Ask that these be added to your report. The credit bureau doesn't have to add anything, but often will.
- Creditors like to see evidence of stability, so if any of the following information is not in your report, send it to the bureaus and ask that it be added: your current employment, your previous employment (especially if you've been at your current job fewer than two years), your current residence, your telephone number (especially if it's unlisted), your date of birth and your checking account number. Again, the credit bureau doesn't have to add these, but often will.

### How long does it take to rebuild credit?

If you follow the steps outlined above, it will take about two years to rebuild

your credit to the point that you won't be turned down for a major credit card or loan. After approximately four years, you may be able to qualify for a mortgage.



### More Information About Rebuilding Your Credit

**Credit Repair**, by Robin Leonard and Deanne Loonin (Nolo), is a quick guide to lawfully rebuilding your credit. It contains several strategies for improving credit, sample credit reports with explanations on how to read them and the text of the federal and many state credit reporting laws.

**Money Troubles: Legal Strategies to Cope With Your Debts**, by Robin Leonard and Deanne Loonin (Nolo), explains your legal rights and offers practical strategies for dealing with debts and creditors, including rebuilding your credit.

The Federal Trade Commission, CRC-240, Washington, DC 20580, 877-FTC-HELP (382-4357), <http://www.ftc.gov>, publishes free pamphlets on debts and credit, including *Building a Better Credit Record*, *Cosigning a Loan*, *Fair Credit Reporting* and *Fix Your Own Credit Problems and Save Money*.

The Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429, 877-275-3342, 800-925-4618 (TDD), <http://www.fdic.gov>, publishes free pamphlets about credit, including *Fair Credit Reporting*.



### <http://www.nolo.com>

*Nolo offers self-help information about a wide variety of legal topics, including advice about consumer law, debts and credit.*

### <http://www.fraud.org>

*The National Fraud Information Center helps you file a complaint with federal agencies if you've been defrauded. It also offers information on how to avoid becoming the victim of a scam.*

### <http://www.financenter.com>

*The FinanCenter provides financial advice and includes a calculator to help you compare various financing alternatives when you're making a budget or considering a major purchase, such as a home or automobile. The cool graphics alone make visiting this site worthwhile.*

### <http://www.bbb.org>

*The Better Business Bureau provides general information on their programs and services, including alerts, warnings and updates about businesses. You can also find information about filing a complaint against a business and using the BBB's dispute resolution program.*

### <http://www.lawguru.com>

*The Internet Law Library provides the texts of finance, economic and consumer protection laws including the federal bankruptcy code and bankruptcy rules, banking laws, Fed-*

*eral Trade Commission publications and selected state consumer protection laws.*

**<http://www.pueblo.gsa.gov>**

*The Consumer Information Center provides the latest in consumer news as well as many publications of interest to consumers, including the Consumer Information Catalog.*

**<http://www.fdic.gov>**

**<http://www.ftc.gov>**

*Both the Federal Deposit Insurance Corporation and the Federal Trade Commission offer consumer protection rules, guides and publications.*

**<http://www.irs.ustreas.gov>**

*The Internal Revenue Service provides tax information, forms and publications.*

**<http://www.agin.com/lawfind>**

*This site provides an extensive list of online bankruptcy-related materials, including other online bankruptcy sites.*





# Cars and Driving

- 10.2 *Buying a New Car*
- 10.7 *Leasing a Car*
- 10.10 *Buying a Used Car*
- 10.12 *Financing a Vehicle Purchase*
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WHEN SOLOMON SAID THAT THERE WAS  
A TIME AND A PLACE FOR EVERYTHING  
HE HAD NOT ENCOUNTERED THE PROBLEM  
OF PARKING AN AUTOMOBILE.

—BOB EDWARDS

**T**ogether, Americans own more than 137 million automobiles—that's at least one car for every 1.7 people in the country. It is not surprising that this average is well above that for the rest of the world, where there is approximately one car for every 12 people. Plainly, Americans love their cars—or at least the mobility they provide. For the privilege of owning and operating a vehicle, we pay an average of more than \$8,000 per year. We also expend plenty of time and energy figuring out which cars to buy, how to insure and maintain them, and how to keep out of trouble on the road. This chapter provides answers to many of your questions about owning a car and driving responsibly.

## Buying a New Car

These days, the average new car costs more than \$20,000. For that amount of money, you would hope for a hassle-free buying experience and a safe and reliable product. Unfortunately, new car buyers are frequently overwhelmed with the pressure to buy immediately or spend more than planned, and worse—the product you bring home might be plagued with problems ranging from annoying engine “pings,” to frequent stalls, to safety hazards such as poor acceleration or carbon monoxide leaks.

### I want to get a good deal on a new car. What make and model should I buy?

There are several good resources to help you comparison shop when you're looking for a new car. *Consumer Reports* magazine publishes an annual car-buying issue that compares price, features, service history, resale value and reliability. Other helpful sources of information are *Motor Trend* magazine and *The Car Buyer's Art*, by Darrell Parrish (Book Express). Finally, many websites provide price and feature information. To start, try <http://www.autosite.com>, <http://www.carwizard.com> or <http://www.carprices.com>.

When deciding which car to buy, resist the urge to buy more car than you can afford—and don't talk yourself into a more expensive car by financing it for four or five years. You'll pay a bundle in interest that way.

### Do you have any tips for negotiating with a car dealer?

Negotiating price with a dealer is almost never a pleasant experience. And, if you don't do it well, you are likely to pay hundreds or thousands of dollars more for a car. Here are some tips for getting the best deal.

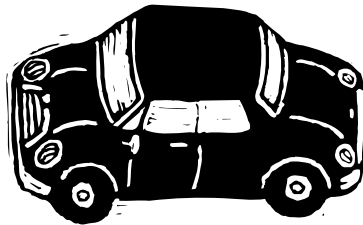
- Know which car you want (or a few you are interested in), which features you want and what you can afford to pay before you walk into the dealership. Then, stick to your guns.
- Know the dealer's cost for the car before you start negotiating. Then,

use this figure as the starting point from which you negotiate up. The dealer invoice price is how much the dealer paid for the car. Many websites list dealer invoice prices. But the dealer's final cost is often even lower, because manufacturers offer dealers behind-the-scenes financial incentives. To find out the car's true cost to the dealer, you can order a report from *Consumer Reports* (<http://www.consumerreports.org> or 800-888-8275) for about \$12.

- Don't buy in a hurry. You need time to compare prices. And usually, the longer you take and the more times you walk away, the lower the price will go.
- Order your new car if the one you want is not on the lot. Cars on the lot frequently have options you don't want, which jack up the price.
- Don't make a deposit on a vehicle before the dealership has accepted your offer.
- If a rebate is offered, negotiate the price as if the rebate didn't exist. And have the rebate sent to your home—don't allow the dealership to "apply" it to the amount you owe. Rebates come from the manufacturer and shouldn't be a reason to pay the dealer more for the car.
- Don't discuss the possibility of a trade-in until you fix the price for your new car.
- Don't trade in your old vehicle without doing your homework. A dealer will give you the low *Kelley Blue Book* value, at most. (The *Kelley*

*Blue Book* lists wholesale and retail prices for cars by year and model. You can find it in libraries, bookstores or online at <http://www.kbb.com>.) Take a look at classified ads to get an idea of how much you could get if you sold your car yourself. Or, order a used car price report from *Consumer Reports* magazine (<http://www.consumerreports.org> or 800-258-1169). Don't accept less than what you can get on the street. Or, forget the trade-in and sell your old car yourself.

- You might want to read up on the sales tactics dealerships use to get you to pay top dollar. Armed with this information, you will be better able to deflect the tactics and get a good deal. There are lots of books on this subject. Two of the best are *Don't Get Taken Every Time*, by Remar Sutton (Penguin Books), and *So... You Wanna Buy a Car*, by Bruce Fuller and Tony Whitney (Self-Counsel Press).





## What other information do I need to know before I buy my new car?

Be sure you know the following before you sign any contract:

- what the warranty covers and how long it lasts
- how you might lose warranty coverage (such as driving off-road)
- whether an extended warranty is available to you, and if so, the following:
  - what it will cost
  - what it covers
  - how long it lasts
  - whether it duplicates coverage provided by the manufacturer's warranty
  - how likely it is that you'll need it (whether the covered parts have a history of problems)
- the vehicle's estimated miles per gallon for city and highway driving, and
- the dealer's suggested maintenance schedule.

## Is there anything I should do when my new car is delivered?

Yes. Before signing a receipt and paying for your new vehicle, do the following:

- Check the vehicle against your order, item by item. Make sure all features are included.
- Inspect the vehicle for damage. Some new vehicles are damaged during manufacturing or in transit. For this reason, never take delivery

of a new vehicle at night. Even in good artificial light, it's hard to see nicks or dents. You'll also miss subtle changes in paint that may indicate the car was damaged in transit and was repainted.

- Test drive the vehicle and pay attention to odd noises, smells or vibrations.
- Make sure the warranty matches what the dealer agreed to.

## If I change my mind after I buy a new car, do I have the right to cancel the contract?

No. Unfortunately, many people think they have a right to change their mind, drive the car back to the dealer a day or two after buying, and cancel the contract. But the truth is, the dealer doesn't have to take the car back and probably won't, and you'll be stuck with a car you no longer want or cannot afford. Never buy a car unless you are absolutely certain you want it and can afford it.

This misunderstanding is so widespread that one state—California—requires the following to be included in new car contracts:

*California law does not provide for a "cooling off" or other cancellation period for vehicle sales. Therefore, you cannot later cancel this contract simply because you change your mind, decide the vehicle costs too much, or wish you had acquired a different vehicle. After you sign below, you may only cancel this contract with the agreement of the seller or for legal cause, such as fraud.*

## Soon after I brought my new car home, it started having problems. How do I know if it's a lemon?

An estimated 150,000 vehicles each year (or 1% of new cars) are lemons. Although the precise definition of a



lemon varies by state, in general, a new car is a lemon if a number of attempts have been made to repair a "substantial defect" and the car continues to have this defect. A substantial defect is one that impairs the car's use, value or safety, such as faulty brakes or turn signals. Minor defects, such as loose radio and door knobs, don't qualify.

In all states, the defect must occur within a certain period of time (usually 1 or 2 years) or within a certain number of miles (usually 12,000 or 24,000). And you must usually meet one of the following standards for repair attempts:

- the defect is a serious safety defect involving brakes or steering and remains unfixed after one repair attempt
- the defect is not a serious safety defect and remains unfixed after three or four repair attempts (the number depends on the state), or

- the vehicle is in the shop for a certain number of days (usually 30) in a one year period.

## *How to Find Your State's Lemon Law*

If you want to find out if your car qualifies as a lemon in your state, get a copy of your state's lemon law. If you have access to the Internet, <http://www.autopedia.com> has links to each state's lemon law. Or, see this book's Appendix on Legal Research for information on how to find the law in the library. For a summary of each state's lemon law, check out *Return to Sender*, by Nancy Barron (National Consumer Law Center). You can order the book from NCLC at <http://www.consumerlaw.org> or 617-523-8089.

## What should I do if my new car is a lemon?

If your new car meets the lemon law requirements for your state (see the previous question), every state gives you the right to obtain a refund or replacement vehicle from the manufacturer. The process for getting this relief is different in each state. In all states, you must first notify the manufacturer of the defect. If you're not offered a satisfactory settlement, most states require you to go to arbitration before going to court. Automakers use the following types of arbitration programs:

- in-house programs run by the auto makers
- programs set up by the Better Business Bureau's Auto Line
- programs run by the American Automobile Association or the National Automobile Dealer's Association, and
- programs run through a state consumer protection agency.

You probably won't get to choose which program to use—the manufacturer selects it. If you do have a choice, however, know that consumers who appear before a state consumer protection agency usually fare much better than those who use a manufacturer's in-house program or a private arbitration program run by the BBB, AAA or NADA.

### What happens at a lemon law arbitration?

At the arbitration hearing, the arbitrator hears both sides of the dispute. The arbitrator has approximately 60 days to decide if your car is a lemon and if you're entitled to a refund or a replacement. Consumers who bring substantial documentation to the hearing tend to do better than those with little evidence to back up their claims. The types of documentation that can help include:

- brochures and ads about the vehicle—an arbitration panel is likely to make the manufacturer live up to its claims
- vehicle service records showing how often you took the car into the shop, and
- any other documents showing your attempts to get the dealer to repair your car, including old calendars and phone records.

It is important to take the arbitration seriously and be as prepared as possible. Although usually you can appeal a bad arbitration decision in court, the decision can greatly influence your case. For example, the manufacturer may be able to use the decision as evidence against you.

### If I continue to drive my car while I wait for a decision, will it hurt my case?

Because it often takes a long time to get relief, most lemon laws allow you to keep using your car while pursuing a claim. But keep in mind that some courts may look less favorably on your case if you are able to drive your car. And of course, you should never drive your car if it is unsafe to do so.

## "Secret" Warranty Adjustments

Many automobile manufacturers have "secret warranty," or warranty adjustment, programs. Under these programs, a manufacturer makes repairs for free on vehicles with persistent problems after a warranty expires in order to avoid a recall and bad press. According to the Center for Auto Safety, at any given time there are a total of 500 secret adjustment warranty programs available through automobile manufacturers. The

Center for Auto Safety's website, at <http://www.autosafety.org>, and the Car Talk site, at <http://www.cartalk.cars.com/Got-a-car/lemon>, have information about many of these programs.

Unfortunately, consumers aren't told of these warranty adjustments unless they come forward after the warranty has expired, complain about a problem and demand that the manufacturer repair it.

A few states, including California, Connecticut, Virginia and Wisconsin, require manufacturers to tell eligible consumers when they adopt a secret warranty adjustment, usually within 90 days of adopting the program.

### What if I don't like the arbitrator's decision?

If you don't like the ruling, you can usually sue the manufacturer in court. You may want to do this if you have substantial "consequential" damages—that is, damages that resulted from owning the lemon, such as the cost of renting a car while your lemon was in the shop or time off from work every time your car broke down.



#### *More Information About Lemons*

If you think your new car is a lemon, an excellent book to help you sort out your rights and remedies is *Return to Sender*, by Nancy Barron (National Consumer Law Center). You can order the book from NCLC at <http://www.consumerlaw.org> or 617-523-8089.

## Leasing a Car

More than one-third of new car owners lease, rather than purchase, their vehicles. Although leasing isn't for everyone, some people swear by it. Before you sign on the dotted line, be sure you know what you're getting into.

### What are the advantages of leasing a new car?

There are three main reasons people lease, rather than buy, a new vehicle:

- People who like to drive a new car every few years will pay much less by leasing than if they buy. They also don't have to deal with getting rid of their old car—they just turn it in at the end of the lease period.
- Lease payments are lower than loan payments for any given car.
- Leasing gives people the opportunity to drive a more expensive car than they could afford to buy.

### Are there any obvious disadvantages to leasing?

Yes—there are many.

- If you continually lease your cars, you will have never-ending car payments. If you look forward to paying off your car and owning it free and clear, don't lease.
- If you decide to buy the car at the lease-end, you'll pay several thousands of dollars more than if you had bought initially. For example, if you buy a car, paying \$500 a month for four years, you'll pay a total of \$24,000. You might be able to lease it for only \$400 a

month (total payments of \$19,200), but you'll probably have to pay another \$8,000 to keep it—and if you finance that \$8,000, you'll pay even more.

- Most leases charge you as much as 25¢ a mile if you exceed the annual mileage limit—usually between 12,000 and 15,000 miles. If you plan to do extensive driving, leasing probably isn't for you.
- It's very, very expensive to break a lease early. If you no longer want, or can afford, to keep your car—for example, because you lost your job or your financial situation changed—you are stuck.
- If you lease a lemon, the leasing company has to do the complaining (remember, you don't own the car) in order to get redress.

### Are all leasing costs disclosed up front?

Not necessarily. While the federal Consumer Leasing Act requires lease agreements to include a statement of costs (such as the number and amount of regular payments), insurance requirements, the penalty for defaulting, and whether you'll have a balloon payment at the end, many lease agreements are ambiguously drafted, with key provisions buried in the fine print.

Even the revised regulations—which strengthened the existing disclosures and added others—do not eliminate all of the abuses. For example, the revised law does not obligate a dealer to disclose the interest rate that's been built into your pay-

ments. If you want to lease, you'll have to be a diligent consumer willing to read all the fine print. Also, ask a lot of questions and demand that the answers be put in writing.

### Is there any way to find out the interest rate on a lease?

Yes. Ask the dealer for something called the “leasing factor.” Multiply that factor by 24 and you'll get the approximate interest rate.

### Are there any good leasing deals?

Yes—especially those heavily advertised by car manufacturers. Those deals usually offer low monthly payments or a high value for the vehicle at the end (so that you're not paying for a lot of depreciation during the lease term), and offer to lock-in the price you'd have to pay at lease-end if you want to keep the vehicle.

To get these good deals, you cannot deviate from the advertised terms. If you want air conditioning, a larger engine or any other feature that's not in the ad, the dealer will throw out the entire lease offer and you'll wind up paying a bundle.

Another way to get a good deal is to explore financing your lease through someone other than the dealer. A number of independent companies offer leases—look for these companies in your telephone Yellow Pages under “Automotive—Leasing.” Also, if you belong to a credit union or AAA, ask about the possibility of financing your lease through them. Such deals are still in their infancy, but are catching on.

When buying a new car, I usually shop in the fall when dealers are trying to get rid of old inventory. Does this strategy work for leasing?

In general, no. Because dealers have lost money on cars sitting in their lots, they often increase the monthly lease payments to make up for lost revenue.

If I do lease a vehicle, who pays for maintenance and repairs?

Your lease agreement will specify who must pay. In addition, the agreement should come with a manufacturer's warranty. Ideally, it will cover the entire length of the lease and the number of miles you are likely to drive.

Most lease agreements obligate you to pay for "excessive wear and tear." This means that when you return the vehicle at lease-end, the dealer could charge you to fix anything deemed "excessive." You should insist that the dealer specify in writing exactly what is meant by "excessive" before you sign the lease contract.

Finally, look for a deal that includes "gap" insurance. If the vehicle is stolen or totaled, gap insurance will pay the difference between what you owe under the lease and what the dealer can recover on the vehicle (assuming it's not stolen)—a difference that could amount to thousands of dollars.

Can I cancel my lease agreement early?

Probably not, unless you're willing to pay a substantial penalty. If you want to cancel your lease, look carefully at the provision describing what happens if you default or want to terminate the lease early. The provision may state that you'll owe an enormous sum of money, or may use a complex formula to calculate what you owe.

While the federal Consumer Leasing Act gives you the right to cancel the lease if the termination formula is so complex that you can't easily figure out how much you owe, this will be hard for you to assert with success. Because of successful consumer lawsuits, lawyers for car manufacturers have rewritten lease contracts to avoid most of the ambiguities.

Even so, if you can't understand the formula, write to the dealer stating that you want to terminate the lease early but that the termination provision of the lease agreement is ambiguous. State further that you know you are entitled to sue for damages because of the dealer's failure to use a reasonable formula. Finally, state that you are willing to waive your right to sue if the dealer will waive the balance you owe.

If you can't get the dealer to drop his claim that you owe money, try to negotiate to reduce your payments or to extend them over time.



### More Information About Leasing a Car

Both the Federal Trade Commission (at <http://www.ftc.gov>) and the Federal Reserve Board (at <http://federalreserve.gov>) publish brochures to help you understand your rights when leasing a car.

## Buying a Used Car

HORSEPOWER WAS A WONDERFUL  
THING WHEN ONLY HORSES HAD IT.

—ANONYMOUS

While buying a used car might be the only way you can afford a new set of wheels, it's a transaction ripe with potential disaster. We probably all know someone who bought a used car—assured that “my grandmother drove it once a week for ten years to church and the grocery store”—only to have it need \$5,000 of work shortly after bringing it home.

### How do I go about finding a used car?

It's best if you have some idea of the make, model and year that you're interested in. There are many good

sources to help you compare cars. *Consumer Reports* magazine publishes an annual car-buying issue, comparing price, features, service histories, resale values and reliability. Other sources of information are *Motor Trend* magazine and *Used Cars*, by Darrell Parrish (Book Express). Once you've made this preliminary decision, look at the listings in your local newspaper. Don't forget weekly advertising papers or local automobile publications as well. Call any mechanics that you trust to see if they know of any available vehicles. Finally, check with car dealers; they often have used cars that people have traded in.

### How much should I spend on a used car?

Check the wholesale and retail values of the cars that interest you. Bookstores and libraries have copies of the *Kelley Blue Book* (which lists wholesale and retail prices), or you can find it online at <http://www.kbb.com>. Lenders and insurance companies should be able to give you the same information.

For a small fee (about \$10), *Consumer Reports* (<http://www.consumerreports.org> or 800-258-1169) will tell you how much a particular car is worth, taking into consideration the car's mileage, condition and additional equipment (such as power windows or compact disc player). The report also provides information about the car's reliability. You can also get most of this information from the *Kelley Blue Book* website at <http://www.kbb.com>.

Once you know the vehicle's wholesale and retail values, you'll

want to pay wholesale (the lower number) and the seller will want to charge retail (the higher number). You'll probably settle somewhere in between. Your final price will depend on a number of factors, including the condition of the car and the person from whom you buy it.

## *The Buyers Guide*

Federal law requires an automobile dealer to post a Buyers Guide in every used car it offers for sale (motorcycles and most recreational vehicles are exempt from this requirement). Among other things, the Buyers Guide tells you whether the vehicle is sold "as is" or with a warranty and describes the warranty. Be sure to get the Buyers Guide when you buy a used car and make sure it reflects any changes to warranty coverage that you negotiated with the dealer. The Buyers Guide becomes part of the sales contract—if the dealer refuses to make good on the warranty, you'll need it as proof of your original agreement.

Obviously, price isn't the only factor to consider when buying a used car. What else do I need to know?

With used cars, reliability is as important as price. You should do the following:

- Have the car checked out by a mechanic you trust.
- Have the car inspected by a diagnostic center. These businesses will check virtually every aspect and

component of a car. They're more expensive—but more thorough—than a mechanic.

- Ask for copies of the maintenance records for the life of the car.
- From your state motor vehicle department, find out all previous owners, the mileage each time it was sold and all states (other than where you live) where the car has been registered. If this information doesn't match up or looks fishy, don't buy the car.
- Do your own visual inspection—you'll want to look for oddities that might indicate damage (such as scratches or new paint).

Also, look at the vehicle identification number (VIN) on the lower left-hand side of the front windshield. If it shows any signs of tampering, the car may be stolen. And finally, if you're buying the car from a private party (as opposed to a car dealer), make sure the person selling the car actually holds title. Ask to see the seller's driver's license (or other form of ID) and the title certificate for the vehicle.

## *Will a warranty protect me if I get a bad deal on a used car?*

If you're buying a used car from a dealer, the dealer will probably offer you an extended warranty. Before buying, be sure you know exactly what is covered and what isn't, and for how long. You'll also need to know the type of problems the car has had in the past, and what types of problems that particular make of car is likely to have in the future. It makes no sense to buy an extended



warranty that doesn't cover emissions, for example, if the type of car you're buying is likely to have emission problems in a year or so.

If you're buying a car from a private party, check to see if the car is still under a factory warranty or if the original owner purchased an extended warranty—and whether either of these warranties can be transferred to you as the new owner.

## Used Car "Lemon Laws"

Arizona, California, Connecticut, Washington D.C., Florida, Hawaii, Iowa, Massachusetts, Maryland, Maine, Minnesota, New Hampshire, New Jersey, New York and Ohio have lemon laws or warranty coverage for used cars. If you're in one of these states and you buy a used car that turns out to be defective, contact your state attorney general or department of consumer affairs for the details of the law and how you can get redress under it. You can also obtain a copy of most of these laws by visiting <http://www.autopedia.com>.

## Financing a Vehicle Purchase

If you are like most people, you don't have a large sum of cash to plunk down for a new or used car. This means you'll have to finance your

purchase. Of course, after you spend time shopping for a car and negotiating a good deal, the last thing you'll want to do is haggle over financing terms. But if you don't shop around for the best financing deal and read the finance contract carefully, you could end up paying lots more for a loan than you should.

**I want to buy a car, but I'm not sure how to finance my purchase. Do you have any general advice?**

Clearly, if you can pay for the purchase outright you'll save money by not paying any interest charges. But if you don't happen to have \$20,000 lying around and need to borrow money to buy your new car, consider the following sources:

- *The car dealer.* Many offer generous terms—for example, interest at 1.5% or 2%—especially in the early fall when dealers are anxious to clear out stock to make room for new models. Be careful that these low-interest loans don't require you to buy upgraded features—such as air conditioning or rust protection—or credit insurance. And don't assume you are getting the best deal around. Always compare dealer terms to those of banks and credit unions.
- *Banks you do business with.* Dealer financing isn't your only option. Before you buy, contact the banks where you have your savings, checking, credit card or business accounts. Ask about the going rate for car loans. Also ask about dis-

count rates for loans tied to your other accounts.

- **Credit unions.** If you're a member of a credit union (or are eligible to join one), be sure to investigate its car loans. Historically, credit unions have offered some of the best loan terms.

Regardless of who finances the contract, if you want a good interest rate but have a poor credit history, you'll need to either put a substantial amount down or get a cosigner.

## Do You Need Credit Insurance?

Many dealers and lenders will ask you to buy credit insurance—insurance that will pay off your loan if you die or become disabled. Before you add this cost to your contract, consider whether you really need it. Remember, you can always sell the car and use the proceeds to pay off the loan. In fact, most financial experts say credit insurance is unnecessary and advise consumers not to buy it. If you do decide you want this protection, you can almost always buy this type of insurance from an outside source at a much better price.

**If I borrow money for the purchase, what should the lender tell me about my loan?**

If you get a car loan from a bank, credit union or car dealer, the federal Truth in Lending Act requires that the lender disclose, in writing, impor-

tant information about your loan, including:

- your right to a written itemization of the amount borrowed
- the total amount of the loan
- the monthly finance charge
- the annual percentage rate (APR)
- the number, amount and due dates of all payments, and
- whether any late payment fee or penalty may be imposed.

## Insuring Your Car

*Certainly those so inclined can have lots of fun imagining possible needs for insurance.*

—HAYDEN CURRY

Most states require that every registered vehicle or licensed driver have some vehicle liability insurance. But even where it's not required by law, most drivers have some liability coverage. Before you buy auto insurance, you must decide how much coverage you need and what types of coverage are appropriate for you. And of course, you'll want to find ways to cut your insurance costs.

**Who is usually covered under an auto insurance liability policy?**

An auto insurance liability policy usually covers the following people no matter what car they are driving:

- *Named insured*—the person or people named in the policy.
- *Spouse*—a spouse not named in the policy, unless he or she does not live with the named insured.
- *Other relative*—anyone living in the household with the named insured who is related by blood, marriage or adoption, usually including a legal ward or foster child.

Auto insurance liability policies also cover anyone driving the insured vehicle with permission. Someone who steals the car is not covered.

### Which vehicles are normally covered under an auto insurance liability policy?

- *Named vehicles*—an accident in a nonnamed vehicle is covered only if a named insured (see above) was driving.
- *Added vehicles*—any vehicle with which the named insured replaces the original named vehicle, and any additional vehicle the named insured acquires during the policy period (you may be required to notify the company of the new or different vehicle within 30 days after you acquire it).
- *Temporary vehicles*—any vehicle, including a rental vehicle, that substitutes for an insured vehicle that is out of use because it needs repair or service, or has been destroyed.

### What kinds of damage are covered under an auto insurance liability policy?

Liability insurance covers money owed when a driver is at fault for hurting

another person or damaging another car. Coverage includes medical costs for diagnosis and treatment of injuries, property damage, loss of use of damaged property, expenses incurred (such as the cost of renting a replacement vehicle), lost income and costs of defending a lawsuit.

In addition, an injured person is entitled to a certain amount of “general damages,” also referred to as pain and suffering.

### What is collision coverage?

Collision coverage pays for property damage to your vehicle resulting from a collision.

### What is comprehensive coverage?

Comprehensive coverage pays for property damage to your vehicle resulting from anything other than a collision, such as a theft or a break-in.

### What is uninsured motorist coverage?

If you have an accident with an uninsured vehicle or hit-and-run driver, the place to turn for compensation for your injuries is the uninsured motorist (UM) coverage of your own vehicle insurance policy. Normally, UM covers only bodily injury and not property damage to your vehicle. Vehicle damage would be covered by the collision coverage of your own policy.

### What are the limits on my ability to collect under an uninsured motorist provision?

UM coverage usually limits your ability to collect as follows:

- If your accident involves a hit-and-run driver, you must notify the police within 24 hours of the accident.
- If your accident involves a hit-and-run driver, the driver's car must have actually hit you—being forced off the road by a driver who disappears is not sufficient.
- Your UM coverage will be reduced by any amounts you receive under other insurance coverage, such as your personal medical insurance or any applicable workers' compensation coverage.
- If you or a relative are injured by an uninsured motorist while you are in someone else's car, your UM coverage will be secondary to the UM coverage of that other car's owner.

### What is no-fault automobile insurance?

Under no-fault insurance, each person's own insurance company pays for his or her medical bills and lost wages—up to certain dollar amounts—regardless of who was at fault.

About half the states have some form of no-fault law, often referred to in policies as Personal Injury Protection (PIP). The advantage of no-fault insurance is prompt payment of medical bills and lost wages without any arguments about who caused the accident. But most no-fault insurance provides extremely limited coverage:

- No-fault pays benefits for medical bills and lost income only. It provides no compensation for pain, suffering, emotional distress, inconvenience or lost opportunities.
- No-fault coverage does not pay for medical bills and lost income higher than the PIP limits of each person's policy. PIP benefits often fail to reimburse fully for medical bills and lost income.
- No-fault often does not apply to vehicle damage; those claims are paid under the liability insurance of the person at fault, or by your own collision insurance.

### *When No-Fault Benefits Aren't Enough*

All no-fault laws permit an injured driver to file a liability claim, and lawsuit if necessary, against another driver who was at fault in an accident. The liability claim permits an injured driver to obtain compensation for medical and income losses above what the PIP benefits have paid, as well as compensation for pain, suffering and other general damages.

Whether and when you can file a liability claim for further damages against the person at fault in your accident depends on the specifics of the no-fault law in your state. In some states, you can always file a liability claim for all damages in excess of your PIP benefits. In others you must meet a monetary threshold, a serious injury threshold, or both, before you can file a liability claim.

### *My auto insurance rates seem to keep going up. How can I cut some of the cost?*

Here are a few suggestions for ways to reduce your premiums:

- Shop around for insurance. Just because your current company once offered you the best deal doesn't mean it's still competitive.
- Increase your deductibles.
- Reduce your collision or comprehensive coverage on older cars.
- Find out what discounts are available from your company (or from a different company). Discounts are often given to people who:
  - use public transit or carpool to work
  - take a class in defensive driving (especially if you are older)
  - own a car with safety features such as airbags or anti-lock brakes
  - install anti-theft devices
  - are students with good academic records
  - have no accidents or moving violations, or
  - have multiple insurance policies with the same company—such as automobile and homeowner's insurance.
- Find out which vehicles cost more to insure. If you're looking to buy a new car, call your insurance agent and find out which cars are expensive to repair, targeted by thieves or involved in a higher rate of accidents. These vehicles all have higher insurance rates.
- Consolidate your policies. Most of the time you will pay less if all owners or drivers who live in the same household are on one policy or at least are insured with the same company.



### *More Information About Insuring Your Car*

*How to Insure Your Car*, by The Merritt Editors (Merritt Publishing), is a step-by-step guide to buying the right kind of auto insurance at a price you can afford.

## Your Driver's License

To a teenager, a driver's license seems magical—a ticket to freedom. For the rest of us, driver's licenses aren't much more than scraps of paper or plastic bearing bad pictures. But every now and then a question may arise about a license: Is it still good if I move to another state? What if I take a trip to a foreign country? And how do I know if I'm in danger of losing my license?

State laws governing how you can get, use and lose your driver's license vary tremendously. We can't answer every question here, but we do discuss some of the bigger issues that arise in connection with driving privileges.

### *Is my driver's license good in every state?*

If you have a valid license from one state, you may use it in other states that you visit. But if you make a permanent move to another state, you'll

have to take a trip to the local department of motor vehicles to apply for a new license. Usually, you must do this within 30 days after moving to the new state. Most states will issue your new license without requiring tests, though some may ask you to take a vision test and a written exam covering basic driving rules.

In some situations, you may be unsure as to whether you need to apply for a new license. If you make frequent business trips to another state, or even if you attend school in a state away from home, there's no need to get another driver's license. But when you set up housekeeping in the new state and pay taxes there as well, it's time to apply.

### *Young Drivers Who Cross State Lines*

Adults who visit another state may rely on their driver's licenses, but the same may not be true for young drivers. The driving age varies significantly from state to state (from 15 to 21), and a state that makes people wait longer to drive may not honor a license from a state that issues licenses to younger folks. For example, if you are 16 and legally allowed to drive in your home state, but travel to another state where the legal age limit for driving is 17, you may not be permitted to drive in that state. A young driver who plans to drive in another state where the legal limit is above his or her age should call that state's department of motor vehicles to find out what the rules are.

### *If I get a ticket in another state, will it affect my license?*

Forty-eight states belong either to an agreement called the "Driver's License Compact" or to the "Non-Resident Violator Compact." (The only states that don't are Michigan and Wisconsin.) When you get a ticket in one of these states, the department of motor vehicles will relay the information to your state—and the violation will affect your driving record as if the ticket had been issued in your home state.

### *Can I use my license in a foreign country?*

Many countries, including the United States, have signed an international agreement allowing visitors to use their own licenses in other nations. Before traveling to another country, contact its consulate office or embassy to find out whether your license will be sufficient. Look in the telephone book under the name of the country. Or, visit the U.S. State Department website at <http://www.travel.state.gov>.

In addition, you may want to obtain an International Driver's Permit, issued by the American Automobile Association. This document translates the information on your driver's license into ten languages. Many countries require the permit, not because it meets their requirements for a license, but because it is a ready-made copy of the important information on your American license.

Finally, if you intend to stay in another country for an extended period of time, you should check with the

consulate to find out whether you'll need to apply for a license in that country. Every country will have its own rules about when a "visit" turns into something more permanent.

### When can my driver's license be suspended or revoked?

Driving a car is considered a privilege—and a state won't hesitate to take it away if a driver behaves irresponsibly on the road. A state may temporarily suspend your driving privileges for a number of reasons, including:

- driving under the influence of alcohol or drugs
- refusing to take a blood-alcohol test
- driving without liability insurance
- speeding
- reckless driving
- leaving the scene of an injury accident
- failing to pay a driving-related fine
- failing to answer a traffic summons, or
- failing to file an accident report.

In addition, many states use a "point" system to keep track of a driver's moving violations: Each moving violation is assigned a certain number of points. If a driver accumulates too many points within a given period of time, the department of motor vehicles suspends the license.

If you have too many serious problems as a driver, your state may take away (revoke) your license altogether. If this happens, you'll have to wait a certain period of time before you can apply for another license. Your state

may deny your application if you have a poor driving record or fail to pass required tests.

Finally, a few states revoke or refuse to renew the driver's licenses of parents who owe back child support. (See Chapter 16, *Parents and Children*, for more information.)

### My elderly friend is becoming unsafe at the wheel. Will her license be taken away?

The number of drivers over 65 years old has more than doubled in the last 20 years. At present, there are 13 million older drivers; by the year 2020 there will be 30 million. Studies show that, as a group, older drivers drive less than younger drivers, but they have more accidents per mile.

Elderly, unsafe drivers who continue to drive despite the advice of family and friends often do not come to the attention of the state until the inevitable—the driver is stopped for erratic driving or, worse, is involved in an accident. A few states try to screen out unsafe older drivers by requiring more frequent written tests. But the added tests are expensive and don't always identify unsafe driving habits.

All licensing departments accept information from police officers, families and physicians about a driver's abilities. If a licensing agency moves to cancel someone's license as the result of an officer's observations, an accident or the report of family members or a doctor, the driver usually has an opportunity to protest.

## What will happen if I'm caught driving with a suspended or revoked license?

You'll probably be arrested. Driving with a suspended or revoked license is usually considered a crime that carries a heavy fine and possibly even jail time. At worst, it may be a felony; you'll end up in state prison or with an obligation to perform many hours of community service. The penalties will probably be heaviest if the suspension or revocation was the result of a conviction for driving under the influence of alcohol or drugs (DUI).

## *The Whole Truth and Nothing but the Truth*

Many states will ask you specific questions regarding your health when you renew your driver's license. For example, you might receive a questionnaire that asks you whether you have ever had seizures, strokes, heart problems, dizziness, eyesight problems or other medical troubles. If you have medical problems and answer the questions truthfully, an examiner may question you further and may even deny you a license. If you don't tell the truth, you may get your license—but you're setting yourself up for big legal trouble if you are in an accident caused by one of these impairments. It's not that different from driving a car when you know the brakes are bad: If you go out on the road with defective

equipment that you know about (including the driver), you greatly increase the chance that you will be held responsible if the defect causes an accident.

## **If You're Stopped by the Police**

Most of us know the fear of being pulled over by the police. An officer may stop your car for any number of reasons, including an equipment defect (such as a burned-out headlight), expired registration tags, a moving violation or your car's resemblance to a crime suspect's car. You may also have to stop if you encounter a police roadblock or sobriety checkpoint.

### What should I do if a police officer pulls me over?

Remain as calm as possible, and pull over to the side of the road as quickly and safely as you can. Roll down your window, but stay in the car—don't get out unless the officer directs you to do so. It's a good idea to turn on the interior light, turn off the engine, put your keys on the dash and place your hands on top of the steering wheel. In short, make yourself visible and do nothing that can be mistaken for a dangerous move. For example, don't reach for a purse or backpack or open the glove box unless you've asked the officer's permission, even if you are just looking for your license





and registration card. The officer may think you're reaching for a weapon.

When the officer approaches your window, you may want to ask (with all the politeness you can muster)

why you were stopped. If you are at all concerned that the person who stopped you is not actually a police officer (for example, if the car that pulled you over is unmarked), you should ask to see the officer's photo identification along with her badge. If you still have doubts, you can ask that the officer call a supervisor to the scene or you can request that you be allowed to follow the officer to a police station.

### If an officer pulls me over for a traffic violation, can she search me or my car?

In most cases, no. Just because an officer has a justifiable reason for making a traffic stop—and even if she issues you a valid ticket for a traffic violation—that does not automatically give the officer authority to search you or your car. If the officer has a reasonable suspicion (based on observable facts, and not just a “hunch”) that you are armed and dangerous or involved in criminal activity, then the officer can do a “pat-

down” search of you, and can search the passenger compartment of your car. The officer can also frisk any purses, bags or other objects within the car that might reasonably contain a weapon. The officer does have the authority, however, to ask you and any passengers to exit the car during a traffic stop.

### If my car is towed and impounded, can the police search it?

Yes. If your car is impounded, the police are allowed to conduct a thorough search of it, including its trunk and any closed containers that they find inside. This is true even if your car was towed after you parked it illegally, or if the police recover your car after it is stolen.

The police are required, however, to follow fair and standardized procedures when they search your car, and may not stop you and impound your car simply to perform a search.

### I was pulled over at a roadblock and asked to wait and answer an officer's questions. Is this legal?

Yes, as long as the police use a neutral policy when stopping cars (such as stopping all cars or stopping every third car) and minimize any inconvenience to you and the other drivers. The police can't single out your car unless they have good reason to believe that you've broken the law.

# Drunk Driving

If you're caught while driving drunk or under the influence of drugs, you'll face serious legal penalties. Many states will put you in jail, even for a first offense, and almost all will impose hefty fines. If you're convicted more than once, you may also lose your driver's license.

## How drunk or high does someone have to be before he can be convicted of driving under the influence?

In most states, it's illegal to drive a car while "impaired" by the effects of alcohol or drugs (including prescription drugs). This means that there must be enough alcohol or drugs in the driver's body to prevent him from thinking clearly or driving safely. Many people reach this level well before they'd be considered "drunk" or "stoned."

## How can the police find out whether a driver is under the influence?

Police typically use three methods of determining whether a driver has had too much to be driving:

- **Observation.** A police officer will pull you over if he notices that you are driving erratically—swerving, speeding, failing to stop or even driving too slowly. Of course, you may have a good explanation for your driving (tiredness, for example), but an officer is unlikely to

buy your story if he smells alcohol on your breath or notices slurred words or unsteady movements.

- **Sobriety tests.** If an officer suspects that you are under the influence, he will probably ask you to get out of the car and perform a series of balance and speech tests, such as standing on one leg, walking a straight line heel-to-toe or reciting a line of letters or numbers. The officer will look closely at your eyes, checking for pupil enlargement or constriction, which can be evidence of intoxication. If you fail these tests, the officer may arrest you or ask you to take a chemical test.
- **Blood-alcohol level.** The amount of alcohol in your body is understood by measuring the amount of alcohol in your blood. This measurement can be taken directly, by drawing a sample of your blood, or it can be calculated by applying a mathematical formula to the amount of alcohol in your breath or urine. Some states give you a choice of whether to take a breath, blood or urine test—others do not. If you test at or above the level of intoxication for your state (.08 to .10 percent blood-alcohol concentration, depending on the state), you are presumed to be driving under the influence unless you can convince a judge or jury that your judgment was not impaired and you were not driving dangerously. In many states, this level is even lower for young drivers. (In California, the level is .05% for drivers under 21.) Defense attorneys often question the validity of the

conversion formula when driver's alcohol levels are based on breath or urine tests.

## *The New National Drunk Driving Standard*

On October 23, 2000, President Clinton signed a new law encouraging states to pass laws that define drunk driving as having a blood alcohol concentration (BAC) of .08%. Many states currently set the level for drunk driving at .10% BAC. States have until October 1, 2003 to change their laws to meet the federal standard. Otherwise, they'll lose a portion of their federal highway funds.

### *Do I have to take a blood, breath or urine test if asked to do so by the police?*

No, but it may be in your best interests to take the test. Many states will automatically suspend your license if you refuse to take a chemical test. And if your drunk driving case goes to trial, the prosecutor can tell the jury that you wouldn't take the test, which may lead the jury members to conclude that you refused because you were, in fact, drunk or stoned.

### *Am I entitled to talk to an attorney before I decide which chemical test to take?*

The answer depends on where you live. In California, for example, you don't have the right to speak with an

attorney first. But many other states allow you to talk to your lawyer before you take a chemical test.

### *If I am pulled over, does the officer have to read me my rights before he asks me how much I had to drink?*

No. During a traffic stop, an officer does not have to read you your rights until you are under arrest. (See Chapter 18 for a description of Miranda rights.) Determining whether you are "under arrest" can be tricky—you can be under arrest even before a police officer says you are. But if an officer is just asking you questions at the side of the road or even if you are detained in the officer's car for a few minutes, you are probably not under arrest. Keep in mind that you don't have to answer an officer's questions, whether you are under arrest or not—and whether or not the officer has read your rights to you. Of course, sometimes it is wise to do so, as long as you don't say anything that can be used against you.

## *When to Get a Lawyer*

Defending against a charge of drunk driving is tricky business. To fight this charge, you need someone who understands scientific and medical concepts, and can question tough witnesses, including scientists and police officers. If you want to challenge your DUI charge, you're well advised to hire an attorney who specializes in these types of cases.

# Traffic Accidents

Anyone who drives or rides in a car long enough is likely to be involved in at least a minor fender-bender. Anyone who rides a bicycle or motorcycle knows the roads are even more dangerous for two-wheelers. And on our crowded streets, pedestrians, too, are often involved in accidents with buses, cars and bikes. Knowing a few laws of the road, and the best steps to take when an accident occurs, can help ease the pain of any accident that occurs—and help make any insurance claims process less painful, too.

## What should I do if I'm involved in a traffic accident?

The most important thing to do is document the entire situation by taking careful notes soon after the accident. Good notes (rather than relying on your memory) will help with the claim process—and increase your chances of receiving full compensation for your injuries and damage to your vehicle.

Write things down as soon as you can: begin with what you were doing and where you were going, the people you were with, the time and the weather. Include every detail of what you saw, heard and felt. Be sure to include everything that others—those involved in the accident or witnesses—said about the accident.

Finally, make daily notes of the effects of your injuries. Always in-

clude pain, discomfort, anxiety, loss of sleep or other problems which are not as visible or serious as other injuries.

## *Reporting to the DMV*

In many states, you must report a vehicle accident resulting in physical injury or a certain amount of property damage to the state department of motor vehicles. Check with your insurance agent or your local department of motor vehicles to find out the time limits for filing this report; you often have just a few days. Be sure to ask whether you'll need any specific form for the report.

If you must file a report, and the report asks for a statement about how the accident occurred, give only a very brief statement—and admit no responsibility for the accident. Similarly, if the official form asks what your injuries are, list every injury and not just the most serious or obvious. An insurance company may later gain access to the report, and if you have admitted some fault in it, or failed to mention an injury, you might run into some trouble explaining yourself.

## What determines who is responsible for a traffic accident?

Figuring out who is at fault in a traffic accident is a matter of deciding who was careless. Each state has a set of traffic rules (which apply to automobiles, motorcycles, bicycles and pedestrians) that tell people how they are supposed to drive and provide guidelines for measuring liability.

Sometimes it is obvious that one driver violated a traffic rule which caused the accident—for example, one driver runs a stop sign and crashes into another. In other situations, whether or not there was a violation will be less obvious. A common example is a crash that occurs when drivers merge into a single lane of traffic. And at other times, neither driver violated a traffic rule, although one driver may still have been careless.

## *Finding Your State's Traffic Rules*

The traffic rules are contained in each state's Vehicle Code. You can usually obtain a simplified version of these rules—often called the “Rules of the Road”—from the department of motor vehicles (DMV). Most DMV offices also have the complete Vehicle Code. Or, you can find the Vehicle Code in a public library, law library or the Internet. (See this book's Appendix on Legal Research for more information on how to find state laws.)

### **What if the cause of the accident is not clear?**

It is sometimes difficult to say that one particular act caused an accident. This is especially true if what you claim the other driver did is vague or seems minor. But if you can show that the other driver made several minor driving errors or committed several minor traffic violations, you can argue

that the combination of those actions caused the accident.

## *Special Rules for No-Fault Policyholders*

Almost half the states have some form of no-fault auto insurance, also called Personal Injury Protection. (See *Insuring Your Car*, above.)

In general, no-fault coverage eliminates injury liability claims and lawsuits in smaller accidents in exchange for direct payment by the injured person's own insurance company of medical bills and lost wages—up to certain dollar amounts—regardless of who was at fault for the accident. Usually, no-fault does not cover vehicle damage; those claims are still handled by filing a liability claim against the one who is responsible for the accident, or by looking to your own collision insurance.

### **Who is liable if my car is rear-ended in a crash?**

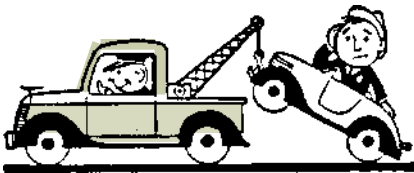
The driver who hit you from behind is almost always at fault, regardless of your reason for stopping. Traffic rules require that a driver travel at a speed at which she can stop safely if a vehicle ahead stops suddenly. In rear-end accidents, the vehicle damage provides strong proof of liability. If the other car's front end and your car's rear end are both damaged, there is no doubt that you were struck from behind.

In some situations, both you and the car behind you are stopped when a third car runs into the car behind you, pushing it into the rear of your car. In that case, the driver of the third car is at fault and you should file a claim against her insurance.

### Are there any other clear patterns of liability in traffic accidents?

A car making a left turn is almost always liable to a car coming straight in the other direction. According to traffic rules, a car making a left turn must wait until it can safely complete the turn before moving in front of oncoming traffic. There may be exceptions to this rule if:

- the car going straight was going too fast (this is usually difficult to prove)
- the car going straight went through a red light, or
- the left-turning car began its turn when it was safe but something unexpected happened which made it have to slow down or stop its turn.



## Police Reports: Powerful Evidence

If the police responded to the scene of your accident, they probably made a written accident report (particularly if someone was injured).

Sometimes a police report will plainly state that a driver violated a specific Vehicle Code section and that the violation caused the accident. It may even indicate that the officer issued a citation. Other times, the report merely describes or briefly mentions negligent driving.

Any mention in a police report of a Vehicle Code violation or other evidence of careless driving will provide support for your claim that the other driver was at fault.



**<http://www.nolo.com>**

*Nolo offers self-help information about a wide variety of legal topics, including what to do if you're in an accident.*

**<http://www.kbb.com>**

*Kelley Blue Book can give you the resale and wholesale values of your vehicle, as well as new car prices.*

**<http://www.edmunds.com>**

*Edmund's offers information about buying a new car, including reviews, comparisons, prices and strategies.*

**<http://www.bbb.org>**

*The Better Business Bureau offers tips on buying new and used cars, including financing suggestions.*

**<http://www.autopedia.com>**

*Autopedia is an encyclopedia of automotive-related information. In addition to articles on many topics, it includes links to each state's lemon law.*

**<http://www.consumerreports.org>**

*Consumer Reports provides articles on how to buy or lease a car and, for a small fee, a price service for both new and used cars.*

**<http://www.nhtsa.dot.gov>**

*The National Highway Traffic Safety Administration provides recall notices, service bulletins, defect investigations, consumer complaints and other data about vehicle problems.*

**<http://www.leaseguide.com>**

*Automobile Leasing: The Art of the Deal offers information about leasing a car, including frequently asked questions, an auto consumer's lease kit and tips for getting a good deal.*

**<http://www.insure.com>**

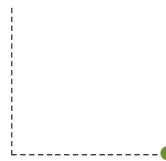
*The Insurance News Network provides information about choosing auto insurance, including an interactive experts forum.*

**<http://www.dui.com>**

*The Driver Performance Institutes provide information about driving under the influence.*

**<http://www.motorists.org>**

*This national organization for motorists offers lots of information on fighting traffic tickets.*



**T**ravel



- 11.2 *Airlines*
- 11.11 *Rental Cars*
- 11.16 *Hotels and Other Accommodations*
- 11.21 *Travel Agents*
- 11.25 *Travel Scams*

*Travel is the frivolous part of serious lives, and the serious part of frivolous ones.*

—MADAME SWETCHINE

**E**ach year, Americans spend billions of dollars on traveling. And though most of us fondly recall our annual vacations—the trip to Europe after graduating from college or our children’s faces the first time they visited a Disney theme park—we often share with one another the horror stories: The plane that took off



16 hours late, the rental company that charged \$1,000 for returning the car with a slight scratch or the tour company that went out of business the night before the trip. The questions and answers in this chapter are designed to help your travels go more smoothly—and to let you know your rights should you encounter troubles along the way.

## Airlines

The terrorist attacks on September 11, 2001, fundamentally changed airline travel. If you haven't flown since the attacks, you might be surprised to see armed national guard troops in the gate area, security guards inspecting passengers' shoes and food and people becoming irate when they learn that they must leave personal items, such as grandpa's antique pocket knife or Aunt Lucy's silver knitting needles, behind because they pose a "security risk."

Although some changes are consistent across airlines and airports because they are mandated by the federal Aviation Security Act or by the Federal Aviation Administration, other changes will depend on a number of factors, including which airline you are using, which airports you will be

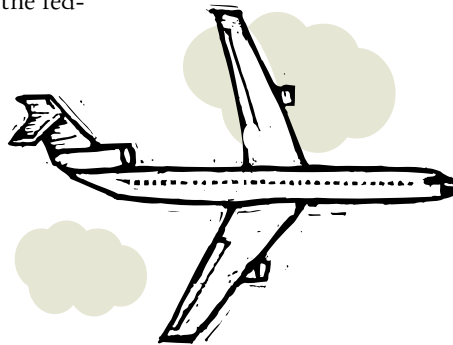
flying into and out of and whether your flight is domestic or international. Prudent travelers will do a little homework to find out about such things as permissible personal items, necessary identification and number and size of bags.

Of course, a lot of things haven't changed. Airlines still overbook flights and bump passengers. Ticket prices are still a confusing game of luck. And baggage still gets lost—much too often.

### What personal items can I no longer bring with me in my carry-on baggage?

According to the Federal Aviation Administration, you cannot bring any of the following items onto the plane with you—either on your person or in your carry-on baggage:

- knives of any length, composition or description (including steak knives and plastic knives)
- all cutting and puncturing instruments, including pocketknives, carpet knives, box cutters, ice picks, straight razors, metal scissors and metal nail files



- corkscrews
- athletic equipment that could be used as a weapon, such as baseball/softball bats, golf clubs, pool cues, ski poles and hockey sticks
- fireworks, such as signal flares, sparklers or other explosives
- flammable liquids or solids, such as fuel, paints, lighter refills and matches
- certain dangerous household items, such as drain cleaners and solvent
- pressure containers, such as spray cans, butane fuel, scuba tanks, propane tanks, CO2 cartridges and self-inflating rafts
- weapons, such as firearms, ammunition, gunpowder, mace, tear gas or pepper spray
- dry ice, gasoline-powered tools, wet-cell batteries, camping equipment with fuel, radioactive materials (except limited quantities), poisons and infectious substances.

Some personal care items—such as perfume and aerosol hairspray—contain hazardous materials. You may take those on board with you if they total no more than 70 ounces. The contents of each container cannot exceed 16 fluid ounces.

Although “strike-anywhere” matches, lighters with flammable liquid reservoirs and lighter fluid are forbidden, you may carry ordinary matches and lighters on your person.

You may carry dry ice for packing perishables so long as it doesn’t weigh more than four pounds and so long as the package is vented.

If you need to carry with you medically necessary items such as needles and syringes, you should contact the airline in advance to find out what kind of documentation (such as a prescription) you will need to get the items through security.

The best thing you can do is a careful appraisal of your items and put into checked baggage anything that looks remotely threatening—or call your airline to find out its position on the item.

### Can my family still accompany me to the gate when I fly?

No. As of the printing of this book, regulations from the Federal Aviation Administration required that only passengers with proof of travel be allowed beyond security checkpoints and into the gate area. If you would like to accompany a minor or a passenger who needs extra assistance, contact your airline in advance to find out what procedures you have to follow.

### How do airlines calculate fares?

The price of most airfares is determined by complicated computer programs which calculate how many passengers are likely to book seats on any given flight. But rather than fly with empty seats, an airline might offer discount fares. Ticket prices may also be affected by competition with other airlines that offer discounted prices. The result is that passengers on the same flight could be paying as many as a dozen different fares.



## *Benefits and Risks of E-Tickets*

E-tickets aren't really tickets at all, but are reservations for air travel that are kept in the airline's computer system instead of being printed on paper. Prior to the September 11 terrorist attacks, all you needed to travel on an e-ticket was a photo ID and credit card. Although the Federal Aviation Administration still allows airlines to use e-tickets, you're going to need more than just your driver's license to get into the gate area and onto the plane. The documentation rules vary by airline, so check with your carrier before going to the airport to make sure you have what you need. Most airlines require a photo ID, credit card and e-ticket receipt or confirmation email.

If you are booked on a single airline and are flying in the United States, you will most likely have little trouble using your e-ticket. In fact, many find e-tickets to be convenient, since there's no paper ticket to keep track of or use.

E-tickets are not foolproof, however, especially if you are traveling internationally. Many countries require that you show some sort of ticket to gain access to a boarding area, and sometimes your e-ticket receipt and itinerary is not enough. In addition, some countries require that you present a roundtrip ticket at the point of entry—they want you to visit, but they don't want you to stay. If you have an e-ticket, you might have trouble convincing officials that you have booked passage out of their country. If you are traveling internationally by e-ticket, carry your itinerary and receipt with you.

On the domestic front, if your flight is canceled, your airline must first print a paper ticket before it can put you on another airline's flight. This can be time consuming. And, if your airline goes on strike, other airlines that might honor a paper ticket won't accept your e-ticket. If you have an e-ticket and an airline strike is imminent, exchange your e-ticket for a paper ticket as soon as possible.

## **What's all that fine print on the back of my airline ticket?**

The back of all standard airline tickets has at least 11 paragraphs of fine print under the heading "Conditions of Contract." In Paragraph 3 you'll find a statement that various "applicable tariffs" and the "Carrier's Conditions of Carriage and Related Regulations" are incorporated into the contract. This means that each airline has filed with the U.S. Department of Transportation a series of statements about its obligations to its passengers and

its limitations of liability. These tariffs and conditions are the terms of your contract with the airline.

The Conditions of Carriage cover everything from the number of bags you can check to the type of compensation you receive if your flight is delayed or canceled. Boarding priority, check-in requirements and most of the other fine-print terms that describe an airline's rights and responsibilities to its passengers are set forth in the Conditions of Carriage.

Conditions of Carriage vary from airline to airline. Although most airline tickets look identical, the subtle differences in the hidden terms can make a substantial difference in your rights as a passenger. You can obtain a summary of the hidden terms and conditions of most major airlines' contracts by requesting a copy of *United States Air Carriers, Conditions of Contract, Summary of Incorporated Terms (Domestic Air Transportation)* from the Air Transport Association, Distribution Center, P.O. Box 511, Annapolis, MD, 20701. Enclose a \$65 check payable to ATAA. You can also call the ATAA at 800-497-3326.

### Are there restrictions on my airline ticket?

Before the substantial deregulation of the airline industry in the 1980s, unused tickets were almost as good as cash—tickets could be cashed in, traded and even used on other airlines. This is still true for many full-fare, unrestricted tickets.

Most tickets, however, carry some sort of restrictions. Today, tickets usually have any or all of the following features:

- *Nontransferable.* A nontransferable ticket can be used only by the passenger whose name appears on the face of the ticket. If the names on the ID and the ticket do not match, the airline can confiscate the ticket. If a ticket is nontransferable but refundable, however, you may be able to cash in the old ticket and buy a new one with the new passenger's name.
- *Nonrefundable.* A nonrefundable ticket means you cannot get your money back if you decide not to travel. But each airline has exceptions. If you cannot make a flight for which you have a nonrefundable ticket, you may be able to apply the ticket toward a future flight or exchange it for credit toward future travel. If the fare has dropped on a flight for which you have a nonrefundable ticket, you may be able to get "re-ticketed." In either situation, you will probably have to pay a fee to make the change.
- *Penalties.* Often, there are penalties for canceling or making changes.

### Do airlines offer discounted tickets or let you change a ticket if you need to travel because of death or serious illness?

In certain exceptional cases, the airlines will allow nonrefundable tickets

to be refunded if you need to cancel because of the illness or death of your traveling companion or a close relative. Similarly, an airline may offer a discounted fare (sometimes minor, sometimes generous) when a close relative becomes seriously ill or dies and you need to travel without any advanced planning. Who must be ill or have died for you to obtain a “bereavement fare” varies among airlines—for example, some airlines will give a discounted fare to attend the funeral of a parent, child, sibling, spouse or in-laws only, while other airlines include nonmarital partners and their immediate family members.

### What should I do if I lose my ticket?

Contact the airline immediately. You will be required to fill out a lost-ticket application. The airline will either issue a replacement ticket (after you sign an agreement to reimburse it for the cost of the replacement ticket if someone uses your lost ticket) or force you to purchase a replacement ticket at the currently available fare (often outrageously expensive because you don’t get any advance purchase discounts). In addition, you usually have to pay some sort of service charge or penalty for issuing a replacement ticket.

After waiting three months to a year, the airline will issue you a refund for the price of your replacement ticket if your lost ticket was not used during that time.

### Am I entitled to be compensated if the airline overbooks and I get bumped off the flight?

If a flight is overbooked, the airline is required to ask passengers to volunteer to take a later flight. Normally, the airline will offer some kind of incentive such as a free domestic or international round-trip ticket. If an insufficient number of passengers volunteer to be bumped from a flight, the airline must begin involuntary bumping. Generally, passengers with the most recent reservations or those who checked in the latest are the first to be bumped.

If you are bumped, you are entitled to compensation if you have a confirmed reservation (your ticket has an “ok” or “hk” in the Status column) and the scheduled plane has a seating capacity of more than 60 passengers. Even if you meet both of these requirements, the airline might refuse to compensate you if any of the following is true:

- You did not comply with the airline’s ticketing, check-in and reconfirmation requirements.
- You are not acceptable for transportation under the airline’s usual rules and practices—for example, you are drunk.
- The entire flight was canceled.
- A smaller aircraft was substituted for safety or operational reasons.
- You refuse an offer to take a seat in a different section (class) of the aircraft at no extra charge.

- The airline offers to place you on another flight or flights scheduled to reach your final destination within one hour of the scheduled arrival of the original flight.

### Am I entitled to compensation if my flight is delayed, diverted or canceled?

A flight is considered on-time if it arrives at its destination within 15 minutes of the scheduled arrival time. Generally, a 15-minute delay will not affect your schedule very much.

Longer delays can have serious consequences, particularly if you cannot make a connecting flight.

If your trip is delayed because of overbooking, the rules discussed in the previous question apply. If the delay is caused by any other reason, your rights depend on whether it's a domestic or international flight.

*Domestic flights.* Generally, airlines are not obliged to provide any compensation if the delay, diversion or cancellation was caused by factors outside of the airline's control, such as bad weather or air traffic congestion at a particular airport. On the other hand, airlines are required to compensate you for problems deemed in their control, such as mechanical difficulties or late-arriving crew members. The offered compensation can vary substantially among airlines—full-service airlines are likely to offer more generous terms, such as meals, hotels, alternate transportation or even emergency toiletries in the event of an overnight delay, while budget or no-

frills airlines may offer little, if any, compensation.

*International flights.* Recovering damages for an international flight delay is very difficult if the delay was caused by anything other than the airline's overbooking. Under an international treaty called the Warsaw Convention, an airline can escape liability for damages caused by flight delay if it can show that it took all necessary measures to avoid the damage or that it was impossible to take such measures.

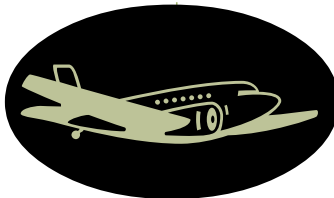
If your international flight is delayed, you may be able to persuade the airline that it should cover direct costs caused by the delay, such as meal, hotel or telephone expenses. To back up your argument, you can quote Article 19 of the Warsaw Convention which states: "The Carrier shall be liable for damages occasioned by delay in the transportation by air of passengers, baggage or goods."



## Compensation for Involuntarily Bumping

(Flights Within or Leaving U.S.)

<i>Scheduled Arrival of New Flight</i>	<i>Domestic Flights</i>	<i>International Flights (Departing From the U.S.)</i>
New flight scheduled to arrive less than one hour after original flight	No compensation	No compensation
New flight scheduled to arrive between one and two hours after original flight	Value of ticket segment, \$200 maximum	Value of ticket segment, \$200 maximum
New flight scheduled to arrive more than two hours after original flight (domestic only)	Twice the value of ticket segment, \$400 maximum	N/A
New flight scheduled to arrive more than four hours after original flight (international only)	N/A	Twice the value of ticket segment, \$400 maximum



## Compensation for Involuntarily Bumping

(Flight Departing European Union Country)

<i>Scheduled Duration or Distance of Original Flight</i>	<i>Arrival at Destination</i>	<i>Compensation</i>
Less than two hours or 3,500 kilometers	Within two hours of originally scheduled arrival	75 ECUs (approximately \$50)
Less than two hours or 3,500 kilometers	More than two hours late	150 ECUs (approximately \$100)
Over two hours or over 3,500 kilometers	Within two hours of originally scheduled arrival	150 ECUs (approximately \$100)
Over two hours or over 3,500 kilometers	More than two hours late	300 ECUs (approximately \$200)

## Am I entitled to compensation if my baggage is lost or damaged?

The airlines' treatment of baggage is a constant source of passenger complaints. At some point, nearly every airline passenger has waited for what seemed like an eternity for his or her baggage to show up on the baggage carousel. Many passengers can identify with the old suitcase commercial which showed a gorilla jumping up and down on the passenger's bags and throwing the passenger's suitcase around a room.

To be fair, most of the time baggage does arrive, in good shape, on the same flight you were on. When your luggage is damaged, delayed or lost, however, the results can be disastrous. The best way to protect yourself from the most serious losses is to follow one simple rule: *Never* put anything valuable or irreplaceable (such as jewelry), or that you might urgently need (such as medications), in checked baggage. Your compensation will rarely cover your actual loss.

*Domestic flights.* An airline can limit the amount it must pay if baggage is lost, damaged or delayed to \$1,250 per passenger. You can get around this limit by declaring at check-in a higher value for the baggage, up to the airline's maximum, which is likely to be between \$2,500 and \$5,000. If you declare a higher value, the airline will charge you a fee based on a percentage of the declared value. The airline then becomes liable up to the declared value if it loses, damages or delays delivery of the baggage, un-

less the airline can prove that the actual loss was lower than the declared value.

*International flights.* The Warsaw Convention provides the rules under which liability for lost, delayed or damaged baggage is determined; these rules will not work to your advantage. Damages are calculated based on the weight of the baggage, regardless of the real value of the baggage or its contents. The Warsaw Convention states that the value for lost or damaged baggage is \$9.07 per pound (or \$20 per kilogram).

If your bag was weighed before the flight, then the value is determined by multiplying the weight of the bag times \$9.07. For example, a 20-pound bag would be valued at \$181.40. If your bags were not weighed, the airline will generally assume that all of your bags weighed a total of 70 pounds, and will reimburse you \$634.90.

To add insult to injury, an airline can completely avoid responsibility for lost or damaged baggage if it can prove "that the damage was occasioned by error in piloting, in the handling of the aircraft or in navigation" and that, in all other respects, "the airline and its agents have taken all necessary measures to avoid the damage." It is difficult to understand why an airline should not be liable for your lost or damaged baggage if one of its pilots mishandles the airplane. On the other hand, if a pilot seriously mishandles the plane, your baggage may be the least of your concerns.



## Are there any legal protections for the credits I earn in a frequent flyer program?

While frequent flyer programs can provide you with some travel bargains, understand that there are few legal protections for the credits you earn. Under the rules of almost all frequent flyer programs, the airline can change award levels, have credits expire or even cancel the whole program without warning.

## Does it pay to belong to more than one frequent flyer program?

Some travelers will pay more for their tickets if they receive frequent flyer credit or will take an indirect or inconvenient flight on an airline in order to get frequent flyer credit. One way to avoid this frequent flyer trap is to join more than one program. Although you can get travel awards faster by concentrating your travel on one airline, you may get better fares and connections if you don't restrict yourself in that way. When you compare tickets, keep in mind that frequent flyer miles are worth approximately 2¢ per mile; use that figure to help calculate which option is best. The 2¢ per mile estimate was calculated by dividing the average cost of a domestic round trip ticket (approximately \$500) by the number of frequent flyer miles needed for such a ticket (25,000 miles).

## Can I trade or sell my frequent flyer awards?

You can use your frequent flyer awards or give them to anyone you choose, but you cannot sell or trade them. Despite this clear limitation, frequent flyer awards are often bartered. Many of the deeply discounted tickets advertised in newspapers are actually tickets obtained by agents using purchased frequent flyer awards. Because airlines require you to present a photo ID when you check in and are traveling on a ticket obtained through a frequent flyer program, it is difficult to use these purchased coupons.

## I have a ticket on an airline that seems headed for bankruptcy. What can I do?

When an airline goes bankrupt, you technically become one of the airline's creditors in bankruptcy. If you file a claim in the bankruptcy court, there is a chance you will recover some very small percentage of the value of the ticket, but more likely you will recover nothing at all.

In the past, most airlines would honor a bankrupt airline's ticket and allow you on a substitute flight. But these days, given the competitive nature of the airline industry, this is rarely done. Sometimes, as a gesture of good will (and a way of luring new customers), an airline will offer a special discounted fare for passengers holding tickets on a bankrupt airline. If you have a ticket on a bankrupt airline and are a frequent flyer on another airline, try to negotiate free or

discounted travel using the bankrupt airline's ticket. Trip cancellation or trip interruption insurance can sometimes cover the cost of a replacement ticket.

If you have an e-ticket, run fast to the nearest ticket counter for your airline and exchange it for a paper ticket. Any airline nice enough to accept passengers from a bankrupt airline will accept only those passengers with paper tickets.

## Rental Cars

A TOURIST IS A FELLOW WHO TRAVELS  
THOUSANDS OF MILES SO HE CAN BE  
PHOTOGRAPHED STANDING IN FRONT  
OF HIS CAR.

—EMILE GANEST

Whether on business or vacation, you may need to rent a car for at least part of your trip. This section outlines some of your basic rights as a renter. Most laws related to rental cars were enacted by state legislatures or derived from cases interpreting those state laws.

**Do I have any recourse if the rental car company doesn't provide me with the type of car I reserved?**

If you have guaranteed payment and the company does not have the car you reserved available for you, the

company must do everything it can to find you a different car from its fleet. Theoretically, the company must find you a car from another rental car company if it has no suitable substitute, but in practice this rarely happens. If the alternate car found for you is more expensive, you should not have to pay the difference.

If you haven't put down a deposit or guarantee, the company is still required to have a car available. But rental car companies often overbook to cover no-shows, which means that the class of car you reserved won't be available. The rental car company will usually provide you with a larger, more expensive car and tell you it is giving you a "free upgrade." Most renters are happy to accept the upgrade to a larger, more expensive car. If you accept a smaller, cheaper car than the one you reserved, the rental company is obliged to charge you the lower rate. If you refuse to accept a substitute car, you will probably have difficulty getting compensation afterward—you had a duty to reduce your damages by accepting a car that was a reasonable substitute for the car you reserved.

**What if the company fails to provide any car at all?**

A company's overbooking may mean that no cars are available when you arrive. Your only real alternatives may be to find a substitute rental car at a different company or to take a taxi and seek reimbursement from the original car rental company. In addition, the rental car company may offer you future discounts.

## My son was told he couldn't rent a car because he's only 20. Is that legal?

Yes. Most major companies refuse to rent a car to someone who is under 21, or in some cases 25, unless that person is an employee using a corporate account or is military personnel traveling on orders. Companies that do rent to people as young as 21 usually charge an additional fee for drivers between 21 and 24.

This discrimination is not illegal. Rental car companies can do business with whomever they choose, as long as they do not discriminate based on race, religion, national origin, sex or other categories protected under civil rights laws.

## Do I need a credit card to rent a car?

Most rental car companies require a major credit card as a way to secure a deposit from you at the time of rental, although you can use the card or cash when you actually pay for the car. The company will check your credit limit and "freeze" an amount slightly greater than your estimated rental charges against your card, meaning that this amount is not available for you to charge. This freeze can last for several days after you return the car, even once the actual amount is charged or you pay with cash.

If you don't have a credit card, you can get a prepaid voucher through your travel agent by paying for the rental car first at the travel agency and bringing the voucher to the rental

counter. The voucher may not cover taxes, surcharges, additional drivers, upgrades and other charges, so be sure to find out exactly what is included with the voucher before you pick up the car. Many companies require you to present a credit card or provide some other form of deposit even if you are using a voucher, so call ahead to find out.

## Can a rental car company charge a penalty if I don't show up or if I cancel my reservation?

Nearly all rental car companies charge penalties for four-wheel drives, minivans, convertibles and other specialty rentals if you fail to cancel a reservation in advance or are a no-show. Some companies are testing similar policies on their standard rental cars.

## Can a rental car company screen me based on my driving record?

Yes, and many companies now screen drivers when they rent in vacation-popular destinations such as Arizona, California, Florida, Nevada, New York, Virginia and Washington, DC. Sales agents conduct screening checks by entering your license number into a computer program that calls up your driver's record as reported by your state department of motor vehicles. If your record doesn't meet the screening criteria of the rental company, the agent will refuse to rent you a car.

Instead of screening you, some rental car companies may require you

to sign a statement that you have an acceptable driving record. This shifts the responsibility for providing accurate information away from the company and to you. If you have an accident and signed a statement that turns out to be incorrect, the rental car company could use it against you by claiming that you acted in violation of the rental agreement.

## *Screening Standards*

Generally, a rental car company that screens drivers will deny you a vehicle if, during the past 36-month period, you:

- were caught driving with a suspended or invalid license
- had one instance of drunk driving, hit-and-run, driving a stolen car or other serious offense
- had three moving violations, or
- were at fault in two accidents.

The standards adopted by each rental car company vary and are subject to change, so you need to inquire about the specific rental screening standards of any company you are considering using.

If your driving record is questionable, do the following:

- Call your motor vehicle department to see if your state makes driver records available. If it doesn't, then relax and don't worry about being screened.
- If your state makes driver records available, when you call to reserve a rental car, ask if the company screens driving records and whether it maintains a nationwide blacklist.
- Get your driver record evaluated by a

screening company. Several companies evaluate driving records to determine in advance whether drivers will be disqualified from renting. TML Information Services, the leading evaluator of vehicle records for rental car companies, operates a program for drivers from states that make driver record data available online. For around \$11 (less for AAA members), you can get an evaluation of your driving record against the criteria for screening risky drivers used by six major rental car companies. You can reach TML on the Web at <http://web2.tml.com> or by phone at 800-743-7891.

- If you don't want to pay for an evaluation, get a copy of your driving record from the motor vehicle agency in your state (allow plenty of time), obtain the screening criteria of the rental car companies you are considering and make an evaluation on your own.
- If you are traveling for business, rent from a company that has a liability agreement with your employer—the screening company may overlook items that would otherwise disqualify you.

Finally, if you are disqualified by a screening system, have someone you are traveling with rent the car and do the driving.

## How do rental car companies establish rental rates?

Car rental fees are set by each company and vary depending on the location of the rental office, time period

the car will be rented, season, car model, special promotions or vacation packages, and your eligibility for discounts. In addition, because many rental car companies have franchises, the rates and policies of the central office may vary substantially from those of a local office. There is nothing illegal about these multiple prices, and there is nothing to stop you from asking about special fares when you rent or for a reduction after the rental if you learn that a better rate was available but was not offered to you. Although the company is not obligated to offer you the lower price, it may do so to maintain good customer relations.

### Can the rental car company tack on other fees?

Yes, but the company must tell you about the fees before you rent. Here are the most common fees you're likely to encounter:

- *Mileage charges.* While many companies offer unlimited mileage, mileage charge policies change frequently, and you should ask each time you rent.
- *Fees for renting at an airport.* Renting at an airport may be more expensive

than renting at an urban or suburban location because airports and local governments often add surcharges and taxes to rental car rates.

- *Additional driver fees.* Most rental car companies charge extra for anyone who drives the car other than the person who signs the rental agreement. Often, additional driver charges are waived for your spouse, immediate family member or business associate.

- *Young driver fees.* As indicated above, many rental car companies add a daily surcharge for any driver aged 21 to 24.

- *Child safety seat fees.* All states require children under a certain age to be placed in child car seats. If you don't bring your own seat, you will be required to rent one,

usually at a cost of \$3-\$5

per day or \$25 per week. You may be charged more for one-way rentals, and you may be required to make an extra deposit for the seat if you are paying cash for the car rental.

- *Vehicle drop-off fees.* Many rental car companies charge high rates for dropping off a car at a location other



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