

THE LEGAL ENVIRONMENT OF BUSINESS

A Managerial Approach: *Theory to Practice*

Third Edition

Sean P. Melvin

F. E. Guerra-Pujol

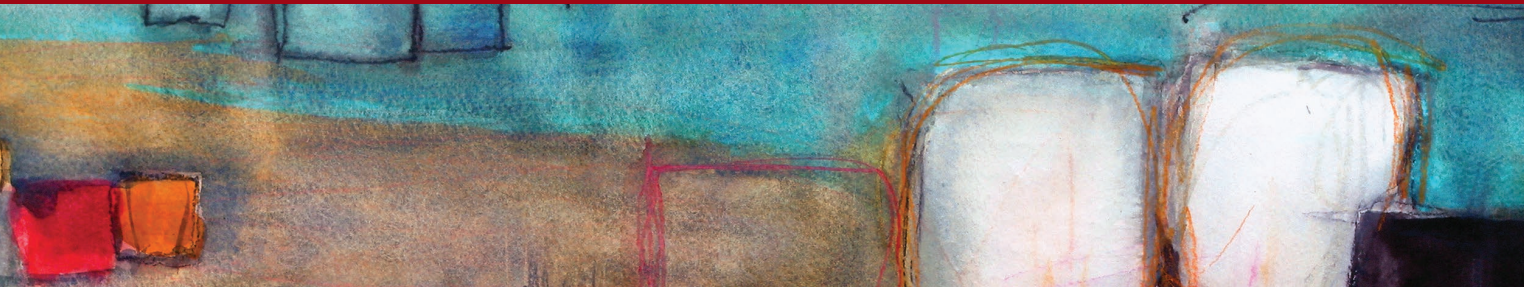


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Elizabethtown College

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THIRD EDITION

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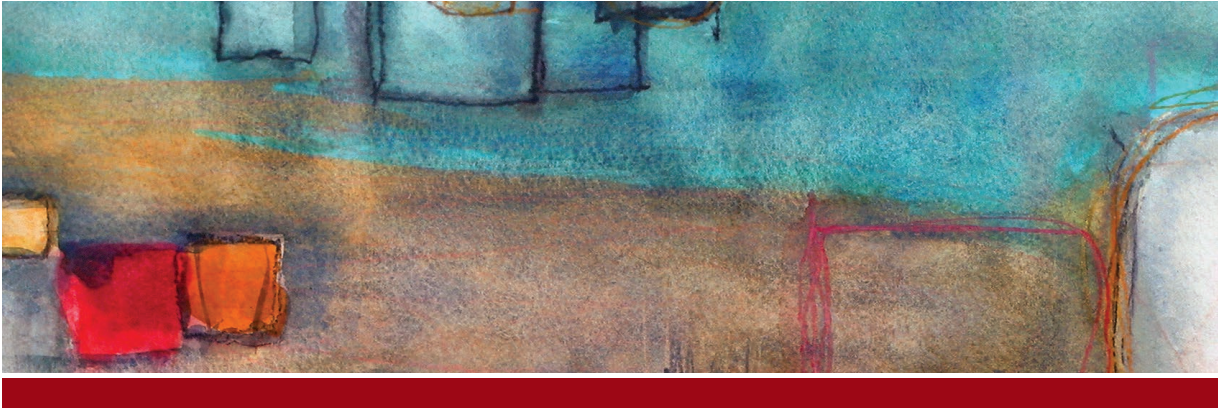
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Dedication

For Joanna, Sean, and Ally—always.

S.P.M.

For Sydja, the love of my life.

F.E.G.P.

For our students: past, present, and future.

The Authors

about the authors



Sean P. Melvin is an associate professor of business law at Elizabethtown College (Pennsylvania), where he served as department chair for eight years, won the Delta Mu Delta Outstanding Teacher of the Year award, and received several Faculty Merit awards for teaching and scholarship. Prior to his appointment at Elizabethtown, he was an assistant professor of business at a large state university where he taught in both the undergraduate and MBA programs. Before his academic career, Professor Melvin was a corporate lawyer in a large Philadelphia-based law firm and went on to become vice president and general counsel at a publicly traded technology company.

Professor Melvin is the author or co-author of eight books (including five textbooks), has contributed scholarly and professional articles and case studies to over two dozen publications, and is a member of the Academy of Legal Studies in Business (ALSB). His article “Case Study of a Coffee War” was selected as Best International Case Study at the 86th annual ALSB conference.



F. E. Guerra-Pujol is a lecturer of business law at the University of Central Florida (UCF), a large state university located in Orlando, where he also serves as faculty editor of the *UCF Undergraduate Research Journal*. Prior to his appointment at UCF, he was an associate professor at the Pontifical Catholic University School of Law in Ponce, Puerto Rico, and practiced corporate and tax law with a large Latin American law firm. Professor Guerra-Pujol received his BA from UC Santa Barbara and his JD from Yale Law School.

Professor Guerra-Pujol has published refereed articles, book chapters, and other scholarly works and is a member of the Academy of Legal Studies in Business (ALSB). He is currently writing a book titled *Alternate Legal Worlds* exploring law from a science fiction perspective, and his work has been featured on Freakonomics Radio, Hacker News, and the website io9.



Think of this textbook as a road map that guides you through the twists and turns of the laws that impact business entities, owners, and managers. This road map will help you understand ways in which business owners and managers can add value to their companies by using legal insight for business planning and for limiting liability. We have tailored the text, examples, cases, and teaching features to the needs of business students by providing concise explanations of law (theory) and then supplying the tools necessary for students to apply their knowledge in the business environment (practice).

MASTERING THE MATERIAL

The first step in mastering the material is to recognize that you must *internalize* the concepts presented in your courses. This requires more than a casual reading of assignments. For many years, we have asked students who earned an “A” in our courses to write a few sentences of advice to future students on how to internalize the material and achieve a top grade in the course. We offer you some of their collective wisdom:

- At the beginning of the course, match the syllabus with the textbook. Note the areas that the instructor is focused on by comparing the amount of coverage between topics. For example, if it appears from the syllabus that you will be spending several classes on constitutional law, that is an area that will undoubtedly be assessed (through an examination, project, etc.) and requires more intense study and review.
- The day before a class, study the assignment as follows: (1) read the major and minor headings in the textbook to get a general sense of what the material covers; (2) go back and read the text carefully, using a highlighter and pencil to mark important text and make notes in the margins; and (3) review the concept summaries, flowcharts, and self-checks to be sure you understand the material, and put question marks next to any concept you do not understand.
- The day of your class, if possible, take 15 minutes before your class to review the highlighted text, margin notes, and concept summaries.
- During class, be sure that your text is open and that your notes are tied to any assignments in the text. For example, suppose your instructor takes time to go over the concept of jurisdiction in some detail during class, draws a flowchart on the board, and goes over the self-check answers. This is a clear sign that jurisdiction will be assessed in some form (most commonly through an examination or quiz). In your notes on jurisdiction, indicate that the concept is important (and requires more intense study) and cross-reference it with page numbers in your textbook.
- As soon as possible after class (ideally, immediately after class but no later than that same evening), take 15 minutes to write out 10 note cards. First, write out five of the most important concepts covered in class that day. Second, write out five terms (words or short phrases) that were used by the instructor during class. This will give you a convenient and portable resource for reviewing.

Finally, we offer you the same advice for success in your course that we have offered our own students for more than a decade: The secret is that there is no secret. No methodology, advice, or review cards substitute for a sustained and diligent study of the material.

A NOTE TO THE INSTRUCTOR

The instructor's materials are based on a turnkey approach that provides a comprehensive set of course materials along with the textbook. These materials have been developed with an eye toward minimizing instructor preparation time while still allowing the instructor to tailor the course in a way that meets the unique needs of instructors and students alike. In addition to the traditional supplementary materials package that includes an Instructor's Manual (written by the authors), test bank, and PowerPoint slides, the instructor's version of the textbook package is also integrated with a robust package of online content including McGraw-Hill's unique interactive exercises via Connect, quizzes, links to streaming videos, case updates, sample text-specific syllabi with alternatives for a variety of classroom circumstances, multiple formats, teaching notes, sample questions, and assignment sheets tied to the simulation materials and the Capstone case studies.

*Sean P. Melvin
F. E. Guerra-Pujol*



walkthrough

Beginning-of-Chapter Features

Each chapter begins with *Learning Objectives* and a short overview that provides students with a map of the chapter. The *Learning Objectives* are a point-by-point checklist of the skills and learning goals that gives students a convenient study guide for previewing and reviewing material in the chapter.

Learning Objectives

After studying this chapter, students who have mastered the material will be able to:


- 3-1 Explain the role of the judiciary in the American legal system.
- 3-2 Distinguish between federal courts and state courts.
- 3-3 Identify the main duties of trial courts versus appellate courts.
- 3-4 Articulate how the law evolves through the adjudication of cases.
- 3-5 Differentiate between subject matter jurisdiction and personal jurisdiction.
- 3-6 Explain original jurisdiction and how state and federal courts may have concurrent jurisdiction.
- 3-7 Recognize the types of controversies over which federal courts have subject matter jurisdiction and those in which diversity jurisdiction applies.
- 3-8 Explain the role of long-arm statutes in determining personal jurisdiction.
- 3-9 Apply the minimum contacts test in both a traditional and an Internet setting.

LEGAL STRATEGY 101

Arbitration and Raiderettes

"Lacy T." is a professional dancer. After moving to California from Louisiana in 2009, she spent two years as a cheerleader for the Golden State Warriors basketball team. In 2013, after getting married and having a daughter, she landed a coveted job as a Raiderette, a cheerleader for the Oakland Raiders football team.

Lacy T. spent months training, rehearsing, and practicing for her rookie season as a Raiderette, but with no paycheck! She eventually hired a lawyer and brought a class-action lawsuit on behalf of all the Raiderettes, alleging the Oakland Raiders routinely break California labor law.¹³ (The team withholds the last names of its cheerleaders for safety reasons; Lacy's attorneys have chosen to do the same.)




Legal Strategy 101

This new feature challenges students to apply their legal knowledge in a strategic context. Each chapter reinforces the opening chapter's *Strategic Legal Solutions: The Big Picture* by posing a real-world legal/ethical dilemma that has a strategic dimension and offering questions/exercises to stimulate critical thinking and discussion.

Strategic Legal Solutions

In keeping with the text's new focus on strategy, *Strategic Legal Solutions* provides practical answers for legal problems faced by managers and business owners. *Strategic Legal Solutions* is structured in a problem and solution format that allows students to understand how a particular section's legal concepts may be used to solve real-world business problems.

STRATEGIC LEGAL SOLUTIONS

Developing Codes of Ethics and Conduct

PROBLEM While many organizations may have a set of informal values and standards to which they aspire to adhere (e.g., "Don't be evil" in the case of Google), such informal value systems may be too vague and thus not very helpful in a practical context.

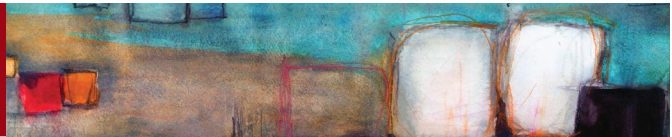
STRATEGIC SOLUTION Develop an effective code of ethics and code of conduct for your business organization. Such codes should be developed in cooperation with (and not exclusively by) the organization's human resource manager and legal counsel. Ideally, the entire organization, not just management, should play a role or have a say in the creation and periodic affirmation of such codes.

Depending on the organization, a code of ethics and code of conduct may be expressed in the same document. Here, they are examined separately.

Examples of ethical values may include:

- **Trustworthiness:** Honesty, integrity, promise-keeping, loyalty.
- **Respect:** Autonomy, privacy, dignity, courtesy, tolerance, acceptance.
- **Responsibility:** Accountability, pursuit of excellence.
- **Caring:** Compassion, consideration, giving, sharing, kindness.
- **Justice and fairness:** Procedural fairness, impartiality, consistency, equity, equality, due process.
- **Civic virtue and citizenship:** Law abiding, community service, protection of the environment.

Codes of ethics are general guidelines to promote ethical decision making. *Codes of conduct*, by contrast, are specific rules stating what actions are prohibited in the workplace. Examples of topics typically addressed by codes of conduct may



BUSINESS ETHICS PERSPECTIVE

Good Faith and the Nuclear Condition Option

Note that while the law imposes a good faith requirement on all contracting parties, as a practical matter the law may also protect those who are ostensibly acting in good faith but may have unethical motives. In some contracts, the parties agree to a conditional clause sometimes known as a *nuclear condition*, that is, a clause whereby one party may cancel the contract completely if a condition is not met to that party's subjective satisfaction. Consider the case in which the president of WidgetCo assigns Manager to purchase a piece of real estate. Manager enters into a contract with Owner for the sale of a piece of commercial real estate. Manager insists that the contract contain an "acceptable financing" clause as follows: "As a specific condition precedent to WidgetCo's obligation to close, the parties agree that WidgetCo must obtain financing for the transaction on terms and conditions acceptable to WidgetCo in WidgetCo's sole discretion."

After entering into the agreement with Owner, the president notifies Manager that WidgetCo is no longer interested in the property and that Manager is to use all "legal means" necessary to break the contract with Owner. Assume that Manager also

learns that WidgetCo is able to obtain financing on extremely favorable terms according to industry standards.

1. Given that the contract requires that any financing terms must be acceptable to WidgetCo, what are Manager's legal obligations to go through with the transaction? Does this differ from Manager's ethical obligations?
2. Is it possible for Manager to comply with the good faith requirement and still avoid the contract with Owner?
3. Recall the discussion of ethical decision-making models in Chapter 5, "Business, Societal, and Ethical Contexts of Law." How could these models help guide Manager's course of action?
4. Assume that the president orders Manager to lie on the loan application, thereby ensuring that any financial institution will reject the loan application. Note that lying on a bank loan application is a crime. What are Manager's options at that point?
5. Is this a case where using the nuclear option is simply a good, hard-nosed business practice? Are there any circumstances you could articulate under which Manager has no legal obligation but does have an ethical obligation to Owner?

Business Ethics Perspective

The coverage of business ethics reflects its increasingly important place in the business world. In addition to Chapter 5, "Business, Societal, and Ethical Contexts of Law," the textbook features logically placed boxes with discussion questions intended to help students understand ethical decision making in contemporary contexts. *Business Ethics Perspective* boxes cover a wide variety of topics, including an examination of the practices of AIG, Countrywide Mortgage, and others involved in the financial crisis that began in 2008.

Legal/Ethical Reflection and Discussion

This feature is strategically placed in parts of the text where the instructor may wish to have students reflect on the ethical dimension of a legal problem. It starts with a short narrative and ends with a series of questions that fundamentally ask students: What would *you* do?

LEGAL/ETHICAL REFLECTION AND DISCUSSION

Made in the USA

A manager for WidgetCo is approached by a foreign vendor who offers to supply widgets at a substantial discount from what his company is currently paying. When determining WidgetCo's course of action, consider both the moral minimum and the maximizing profits approaches to business ethics:

- Why should it matter whether the lower-priced widgets are not made in the USA?
- Why should it matter whether the foreign company is subject to the same quality-control and labor safety regulations as the current USA supplier?
- Why should it matter whether the lower-priced widgets are more (or less) likely to be faulty or substandard?
- Why should it matter whether faulty or substandard widgets could make the company's products more dangerous to users or to the environment?

Self-Check Substantial Performance

Which of the following constitute substantial performance?

1. Wholesaler contracts with Delicatessen to deliver 50 cases of bottled beverages each week in exchange for a \$3,000 monthly payment. Due to heavy holiday volume, the December shipment contains only 45 cases.
2. The Yellow Pages agrees to publish a half-page advertisement for Local Dry Cleaner in exchange for \$2,000. The advertisement is published, but one digit in the telephone number is incorrect.
3. A vegetable cannery contracts with Farmer to buy 54 units of "fancy-grade" spinach, defined as "dark green in color, firm in texture, and with a leaf/stem ratio of less than 15 percent stem." Farmer delivers spinach with a leaf/stem ratio of 25 percent stem.
4. Widower contracts with Artist to paint a portrait of his late wife. The portrait is done on time and professionally, but the likeness, while resembling her, does not look exactly like the woman.
5. Book publisher agrees to sell and deliver certain named textbooks to a college bookstore with delivery on July 1, eight weeks before classes are to begin. Delivery occurs on July 5.

Answers to this Self-Check are provided at the end of the chapter.

Self-Checks

Self-Check exercises offer students an opportunity to reinforce and apply the material being studied in the textbook. Students use black-letter law and cases to answer short hypothetical questions on a specific topic. *Self-Checks* appear in the textbook after important legal concepts and are always keyed to problems faced by business managers and owners. Answers to the *Self-Checks* are provided at the end of the chapter.



walkthrough

Cases

The textbook uses a *hybrid* format to report case law rather than including lengthy excerpts from judicial opinions. Students are provided with (1) a summary of the facts, (2) a decision and opinion synopsis, (3) short excerpts from the actual opinion, called “Words of the Court,” to help students understand a key point in the case, and (4) several case questions to facilitate discussion. Students will find this format useful for understanding legal cases in a business context.

CASE 3.2 Clemens v. McNamee, 615 F.3d 374 (5th Cir. 2010)

FACT SUMMARY In the summer of 2007, federal agents contacted Brian McNamee in connection with a federal investigation into the illegal manufacture and sale of performance-enhancing drugs in professional sports. McNamee was an athletic trainer who had worked for both the Toronto Blue Jays and the New York Yankees baseball clubs. After authorities convinced McNamee that they had sufficient evidence to convict him for injecting athletes with anabolic steroids, McNamee agreed to cooperate with investigators in exchange for immunity from prosecution. During an interview with investigators, McNamee admitted that he had administered steroids to all-star pitcher Roger Clemens in both Toronto and New York. McNamee repeated this allegation to Major League Baseball investigators and to a reporter during an interview with *Sports Illustrated*. In 2008, Clemens, a citizen of Texas, filed a defamation suit against McNamee, a citizen of New York, in federal court based on diversity of citizenship. The trial court dismissed the complaint due to lack of personal jurisdiction over McNamee since his alleged defamatory statements were made outside Texas. Clemens appealed to the Court of Appeals.

WORDS OF THE COURT: Minimal Contacts and Injurious Effect “In support of jurisdiction, Clemens points to the harm he suffered in Texas and to McNamee’s knowledge of the likelihood of such damage in the forum. Yet under [previous case law], Clemens has not made a prima facie showing that McNamee made statements in which Texas was the focal point: the statements did not concern activity in Texas; nor were they made in Texas or directed to Texas residents any more than residents of any state. As such, the district court did not err in dismissing Clemens’ suit for lack of personal jurisdiction over McNamee.”

Case Questions

1. Why is due process relevant to the outcome of this case?
2. What is the practical implication of this decision? Does it mean that Clemens cannot bring suit for defamation in any court?

SYNOPSIS OF DECISION AND OPINION The Court of Appeals for the Fifth Circuit upheld the trial court’s ruling in favor of McNamee and affirmed the dismissal of Clemens’s defamation complaint. The court rejected Clemens’s contention

CONCEPT SUMMARY *Jurisdiction*

	Federal Trial Courts	State Trial Courts
Personal Jurisdiction	<ol style="list-style-type: none"> 1. Residents and business entities located in the state where the federal trial court sits; or 2. Nonresidents with <i>minimum contacts</i> with the state in which the federal trial court sits; or 3. Nonresidents owning property in the state in which the federal trial court sits; or 4. Voluntary 	<ol style="list-style-type: none"> 1. Residents and business entities located in the state; or 2. Nonresidents owning property in the state; or 3. Nonresidents with <i>minimum contacts</i> with the state according to state long-arm statute; or 4. Voluntary
Subject Matter Jurisdiction	<ol style="list-style-type: none"> 1. Federal question; or 2. United States is a party; or 3. Diversity of citizenship exists and amount in controversy exceeds \$75,000 (amount required only in diversity cases) 	State law matters (statutes, common law, state constitutional issues)

Concept Summaries and Flowcharts

To help students with *reinforcing* and *reviewing* the application of the law in a business context, each major section within each chapter features a summary of the section. When a legal procedure is involved, flowcharts are used to summarize the process.



End-of-Chapter Features

Each chapter ends with several features crafted to help students review and connect the different sections of the chapter by applying the material learned in the text in a practical way.

Theory to Practice: Each chapter features a hypothetical legal problem faced by a manager that is related to specific material in that chapter. The hypothetical problem is followed by questions that connect the problem to several different sections in the chapter.

Manager's Challenge: This feature allows students to engage in writing or a group work assignment that sets forth a manager's task relating to the material in the chapter. Some challenges are designed for teams, others for individuals.

Key Terms: Key terms for students are boldfaced in the text and listed as a group at the end of the chapter with a definition and reference to the page number in the chapter where the term is first mentioned.

Case Summaries: Several brief case summaries are included, with a heading for each that indicates its general topic reference to the chapter and with questions about the case summary. These cases are intended to reinforce students' knowledge of how laws apply in different fact circumstances.

THEORY TO PRACTICE

PART I

Santiago Information Systems (Santiago) is a business based in Baltimore, Maryland, that purchases old computers, refurbishes them with new software and hardware parts, and sells them in bulk for about half the price of a new PC. For the past three years, Santiago has shipped approximately 40 percent of its inventory to the same client. The client is the Wilmington School District (Wilmington) in Wilmington, Delaware, and the school pays approximately \$80,000 to Santiago for the computers per year. Santiago also visits each school to be sure that the computers are installed correctly and that the school district is satisfied with the order. Santiago has a website that gives contact information for the company, but the site is only partially interactive because users can transact business only by sending Santiago an e-mail via the website.

PART II

Assume that one of Santiago's suppliers, Parts R Us (Parts), is headquartered in Union City, New Jersey, and has been shipping Santiago parts for approximately four years in a row. Last year, Parts sold approximately \$7,000 in hardware to Santiago. In the past 10 years, Parts R Us has shipped to businesses in Maryland, New York, New Jersey, and Connecticut. Parts has also e-mailed advertisements to potential leads in each of the 50 states. Wilmington has determined that Parts provided the defective components used in the computer order described in Part I.

1. If Wilmington decides to file suit against Parts in Delaware, will a Delaware court have personal jurisdiction over Parts? Why or why not?

Jurisdiction and Business Strategy

Improvements in technology and in product and service delivery make jurisdiction and venue essential to business planning. As with all legal decisions that business owners and managers make, jurisdiction must be considered in a cost-benefit context. For example, consider a company like Facebook, with headquarters in northern California. Facebook now has over a billion active users all over the world. This means that Facebook could potentially be sued in any state and in other countries as well. With so many users worldwide, what can Facebook do to ensure that any lawsuit involving a Facebook user is litigated in northern California? For the answer to this question, keep reading. We will explore this issue in more depth later in the chapter and, in Case 3.3, examine an actual lawsuit brought against Facebook presenting the questions raised here.

For now, consider two hypothetical companies, Ultimate Widget Corporation (UWC) and Knock Off Stores, Inc. (Knock Off). Suppose UWC, a New York company, is considering suing Knock Off, a California company, over copyright infringement. UWC management must consider not only the merits of its potential lawsuit but also the costs involved in pursuing the suit. Specifically, UWC's management must consider (1) the total amount of the possible recovery from Knock Off; (2) the actual benefits UWC will reap from the prevention of Knock Off's copyright infringement; and (3) any alternate dispute resolution methods available. If Knock Off is a small company and not likely to steal any of UWC's customers or markets, it may not be worth the costs of litigation to sue Knock Off in California. Pursuing the infringement action would expose UWC to the expense of traveling to California, hiring local counsel in California, and losing productive hours of managers and other witnesses who would be required to travel to testify and be deposed for the case. However, if a New York court has jurisdiction over the dispute, this fact is likely to change the dynamics of the cost-benefit analysis for UWC because now the expenses of the suit are markedly lower.

Legal Speak >))

Jurisdiction
An English word derived through the combination of two Latin words: *juris* ("of law" or "of right") and *dictio* ("speaking"). Thus, *jurisdiction* refers to a court's authority to *speak the law* or render a decision in a legal dispute.

KEY POINT

The cost-benefit analysis involving jurisdictional restrictions may affect the managerial decision-making process when a company or individual contemplates filing a lawsuit. Litigating disputes in out-of-state courts increases the costs of litigation.

Overview of Jurisdiction

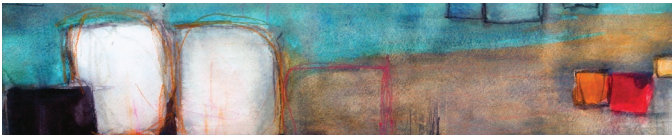
The origins of jurisdiction are found in the U.S. Constitution, specifically, the Due Process Clause of the Fifth and the Fourteenth Amendments. In essence, the Constitution prohibits the deprivation of a property interest (usually money damages) without a fair process. While origins of jurisdiction lie in the Constitution, appellate courts and legislatures have also shaped the rules used by modern courts to analyze questions of jurisdiction.

LO 3-6

Explain original jurisdiction and how state and federal courts may have concurrent jurisdiction.

Other Textbook Features

Key Points briefly reinforce an important concept; **Legal Implications in Cyberspace** apply traditional legal concepts in the context of the Internet; **Legal Speak** presents instant definitions of important legal terms in the margins of the text.



walkthrough

Business Law Simulation Exercises

The textbook features three business law simulation exercises. In a simulation exercise, students are provided with facts, law, and cases related to a hypothetical business dispute and are assigned to analyze the material, understand the legal and ethical issues presented, and then work toward a resolution. The simulations are also excellent for review and reinforcement because the materials involve cases directly related to one or more topics covered in a particular unit of the textbook.



BUSINESS LAW SIMULATION EXERCISE 1

Restrictive Covenants in Contracts: Neurology Associates, LLP v. Elizabeth Blackwell, M.D.

Learning Objectives

After studying this chapter, students who have mastered the material will be able to:

1. Explain the legal doctrines that govern the use of restrictive covenants.
2. Interpret and apply the rules set forth in current case law.
3. Articulate a cogent argument for each party/side in the dispute.
4. Negotiate a tenable solution as an alternative to a judicial forum.

Chapters 6 and 7 provided you with a variety of legal doctrines and rules governing contract formation and performance and then illustrated how these doctrines and rules apply in the corporate sector context. This

Part 3 is an assignment sheet that will be provided to you by your instructor to be used in conjunction with this simulation.



capstone case study 1 COFFEE WARS: STARBUCKS V. CHARBUCKS¹

OVERVIEW AND OBJECTIVES

Two years after opening their family-owned coffee bean roastery, Jim and Annie Clark had become accustomed to long workweeks and bootstrap financing. By 1997, their Black Bear Micro Roastery was finally growing, and the Clarks were hopeful that their new specialty blend, Charbucks, would give their uniquely dark-roasted coffee bean a catchy name to remember. Soon after launching the new blend, Annie Clark received a phone call from an insistent in-house lawyer at coffee giant Starbucks that threatened the very existence of the Clarks' company. Starbucks claimed that the Charbucks name and label infringed on its trademark, and it demanded that the Clarks cease the use of the name Charbucks and that any existing products with that name be removed from supermarket shelves. But the Clarks insisted that they had been careful to design the label with Black Bear Micro Roastery logos and that the name was tied to the dark-roasting process and not to anything related to the name Starbucks. Despite their beliefs that no infringement had taken place, the Clarks entered into settlement negotiations to avoid the legal costs associated with defending a trademark lawsuit. After the settlement negotiations failed, Starbucks sued Black Bear Micro Roastery and the stage was set for a coffee war that pitted a multinational powerhouse against a Main Street merchant. This case study emphasizes use of legal insight and business strategy, gives context for evaluating business ethics, and requires the application of trademark law.

Review Legal Concepts

Prior to reading the case, briefly review the following legal concepts that were covered in the textbook: legal insight and business strategy (Chapter 1), busi-

THE BLACK BEAR MICRO ROASTERY

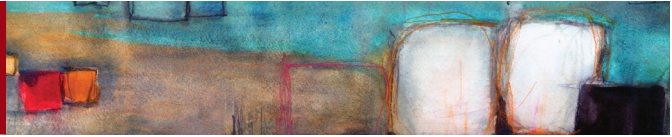
Jim and Annie Clark were native New Englanders who shared a passion for coffee and an entrepreneurial spirit. After three years of research, they launched Black Bear Micro Roastery in 1995 with a mission of creating a unique methodology for roasting gourmet coffee beans through use of advanced technology and the "traditional Yankee work ethic." The company was situated in the lakes region of New Hampshire and targeted connoisseur coffee drinkers, primarily in the New England area, who appreciated the micro-roastery approach of producing small, high-quality batches of coffee beans. The beans were sold via mail order, from the Black Bear website, and through New England specialty stores and supermarkets. Eventually, Black Bear also sold its products through its own retail outlet and café in Portsmouth, New Hampshire.

True to their belief in the micro-roastery concept and their entrepreneurial courage, the Clarks invested their life savings in the company. In order to start the business, the couple sold many of their assets and refinanced the mortgage on their home for extra cash. They enlisted their teenage daughters as their labor force and committed to seven-day workweeks. The family business was the centerpiece of their family's livelihood.

As with many start-ups, business for Black Bear was slow and rocky at first. The price of green coffee beans had fluctuated unexpectedly, and the 1997 Teamsters strike at United Parcel Service had eaten into profit margins. Undeterred, Jim and Annie Clark kept the company going until it began to grow ever so slowly. In order to develop a niche in the gourmet coffee market, Black Bear began to develop unique blends with catchy names that were easy to remember. This included blends such as "Country French," "Kenya Safari," and "Mocha Java."

Capstone Case Studies

Capstone case studies center on the dilemmas of actual corporations that were faced with a corporate crisis involving legal and ethical issues. They are intended to help students connect several different legal and ethical concepts in a single case study. First, students reread concept summaries from specific chapters to reinforce their knowledge of specific legal issues. Second, students study a narrative of facts of the case, dynamics of the marketplace, and important trends of the time. Discussion questions are grouped by topical subject matter such as negligence, products liability, administrative agency regulation, and criminal law. Ethical decision-making questions are integrated into each case. The *Capstone Case Study* feature also provides a short exercise designed for use as a writing assignment, small group work, or class discussion.



Instructor's Manual

The Instructor's Manual, developed by one of the authors, Sean P. Melvin, is designed to be an effective course management tool and an integral part of the turnkey approach used throughout the supplementary material package. The features and format are intended to give instructors maximum flexibility to determine and produce high-quality course content. The IM also has a special "Day One" section addressing important fundamental course decisions for instructors who are new to the course.

Test Bank

The test bank allows instructors to custom design, save, and generate tests. The test bank includes multiple-choice, true-false, fill-in-the-blank, and essay questions for every chapter in the text. To help instructors meet the requirements of AACSB, each question is tagged with the corresponding chapter learning objective and applicable AACSB categories.

TestGen

TestGen is a complete, state-of-the-art test generator and editing application software that allows instructors to quickly and easily select test items from McGraw Hill's test-bank content. The instructors can then organize, edit, and customize questions and answers to rapidly generate tests for paper or online administration. Questions can include stylized text, symbols, graphics, and equations that are inserted directly into questions using built-in mathematical templates. TestGen's random generator provides the option to display different text or calculated number values each time questions are used. With both quick-and-simple test creation and flexible robust editing tools, TestGen is a complete test generator system for today's educators.

Assurance of Learning Ready

Many educational institutions today are focused on the notion of *assurance of learning*, an important element of some accreditation standards. *The Legal Environment of Business* is designed specifically to support your assurance of learning initiatives with a simple, yet powerful solution. Each test bank question for *The Legal Environment of Business* maps to a specific chapter learning objective listed in the text. You can use our test bank software, TestGen, or Connect to easily query for learning objectives that directly relate to the learning objectives for your course. You can then use the reporting features of TestGen to aggregate student results in similar fashion, making the collection and presentation of assurance of learning data simple and easy.

AACSB Statement

McGraw-Hill Education is a proud corporate member of AACSB International. Understanding the importance and value of AACSB accreditation, *The Legal Environment of Business* recognizes the curricula guidelines detailed in the AACSB standards for business accreditation by connecting selected questions in the text and the test bank to the six general knowledge and skill guidelines in the AACSB standards. The statements contained in *The Legal Environment of Business* are provided only as a guide for the



users of this textbook. The AACSB leaves content coverage and assessment within the purview of individual schools, the mission of the school, and the faculty. While *The Legal Environment of Business* and the teaching package make no claim of any specific AACSB qualification or evaluation, we have within the text and the test bank labeled selected questions according to the six general knowledge and skills areas.

PowerPoint Presentation

Each chapter has a PowerPoint Presentation that offers additional support by providing detailed teaching notes, particularly for more complex topics.

Connect

Study materials are located in the Student Resources section under the Connect Library tab. Use the site to access the chapter review quizzes, key terms, legal resources, and additional cases for discussion, in addition to online access to the Uniform Commercial Code and U.S. Constitution, news updates, and other resources.



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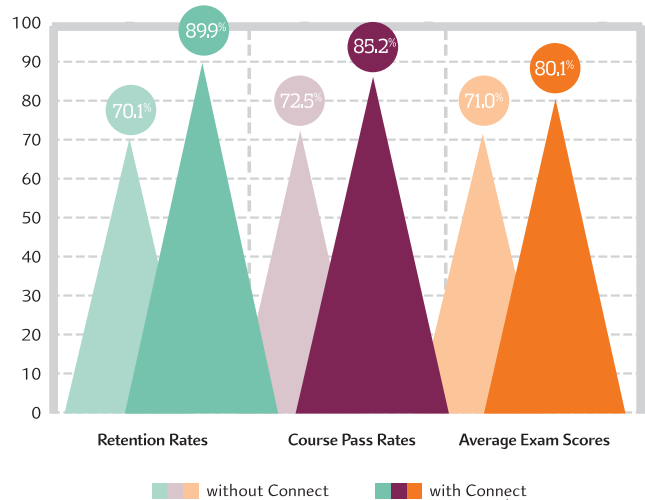
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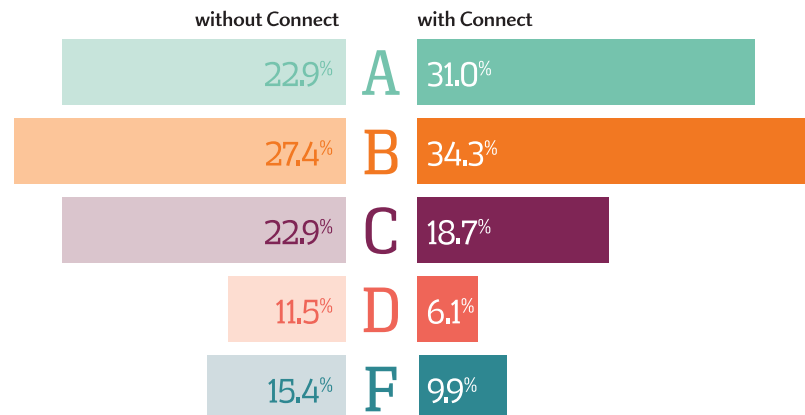
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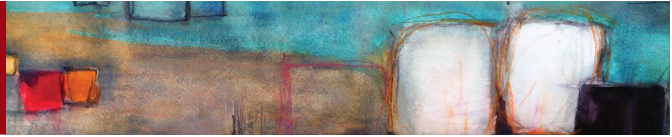
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*Findings based on 2015 focus group results administered by McGraw-Hill Education

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Throughout the development of each edition of this book, we have been privileged to have the candid and valuable advice of our reviewers and focus groups. Our reviewers provided us with priceless suggestions, feedback, and constructive criticism. The depth and sincerity of their reviews indicate that they are a devoted group of teacher-scholars. The content of the book was greatly enhanced because of their efforts.

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changes to this edition



The authors embrace a commitment to continuous improvement of the content, case selection, features, and approach embodied in this textbook. We are privileged to have candid review, suggestions, and guidance from over 100 business law professors from a wide variety of colleges and universities. Much of this third edition is based on specific feedback from our reviewers and students.

- Full Integration of Strategic Approach: Chapter 1 provides an overview *Strategic Legal Solutions: The Big Picture* and *Legal Strategy 101* is featured at the end of each chapter.
- New Coverage for Current Controversies in Business Ethics: Includes material on patent trolls, Facebook’s secret psychology experiment, and products liability for gun manufacturers.
- Streamlined and Updated Contracts Content: Three chapters converted to two chapters with new cases.
- Expanded Fourth Amendment Material: Warrant requirement and exceptions including “electronic searches.”
- New Chapter Review Questions: Plus *Answers and Explanations* at the end of each chapter.
- New Material: Includes coverage of crowdfunding, peer-to-peer lending, the Affordable Care Act, Deepwater Horizon, Uber’s legal challenges, insider trading, whistleblowers, and the Dodd-Frank Act.
- Over 50 New Business-Centered Cases that Connect with Students
 - *EEOC v. Abercrombie* (Employee head scarf)
 - *U.S. v. Ulbricht* (Dread Pirate Roberts/Silk Road)
 - *NFL v. Tom Brady* (Effect of binding arbitration)
 - *Franklin v. Facebook* (Forum selection)
 - *Citizens United v. FEC* (First Amendment)
 - *Yost v. Wabash College and Phi Kappa Psi Fraternity* (Liability for hazing)
 - *O’Bannon v. NCAA* (Antitrust and NCAA athletes)
- Popular Features Expanded and Updated: Three *Business Law Simulations* (hypothetical disputes) centered on restrictive covenants, trademarks in cyberspace, and ADA liability; *Capstone Case Studies* (legal and ethical dilemmas faced by actual

companies) from a multidimensional perspective, including an award-winning case: *Coffee Wars: Starbucks v. Charbucks*; Self-Checks; Key Points; Theory to Practice problems; and Manager’s Challenge.

Chapter 1

- Streamlined introductory material
- New 2015 case: *U.S. v. Ulbricht* (Dread Pirate Roberts/Silk Road)
- New 2016 case: Specific Performance as a Remedy
- New Key Terms
- Replaced Equitable Maxims section with new “Table of Maxims”
- New section: Strategic Legal Solutions: The Big Picture

Chapter 2

- New case: *Citizens United v. FEC*
- New section: The Fourth Amendment
- New case: *U.S. v. Jones*
- New feature: Chapter Review Questions
- New feature: Legal Strategy 101 (“The Strategic Legal Battle for Equality”)

Chapter 3

- Updated table: U.S. Supreme Court Acceptance Rate
- New case: *Goodyear Dunlop Tires Operation v. Brown*
- New figure: Facebook’s Forum Selection Clause
- New case: *Franklin v. Facebook*
- New section: Internet and E-mail Jurisdiction

Chapter 4

- Updated Litigation section
- New section on Labor Arbitration
- New case: *NFL v. Brady*
- New Key Points
- New Critical Thinking case questions

Chapter 5

- New Legal/Ethical Reflection and Discussion: “The Trolley Problem”
- New subsections: “Natural Law” and “Contract-Based Approach”
- Updated Legal/Ethical Reflection and Discussion on “The Penn State Saga”
- New Ethical Decision-Making Case Study: “Facebook’s Secret Psychology Experiment: The Law & Ethics of A/B Testing”
- New Critical Thinking case questions

Chapter 6

- Updated material on Advertisements as Contracts
- Streamlined chapter by combining Overview and Formation
- New case: Capacity to Contract
- New Key Point
- New summary table
- New Critical Thinking case questions

Chapter 7

- Streamlined chapter by combining Enforceability with Performance
- Updated material on Anticipatory Breach
- New case: Statute of Frauds
- New Key Point
- New Self-Check
- New Critical Thinking case questions

Chapter 8

- New Key Points
- New sample form: Purchase Order
- New 2016 case: Battle of the Forms
- New material: Statute of Frauds
- New material and new case: Risk of Loss
- New Critical Thinking questions for cases

Chapter 9

- New 2015 case: Defamation in Employment References
- New material for Defenses to Defamation
- New section on Assumption of Duty
- New 2014 case: Fraternity/College Liability for Hazing
- Updated Legal Implications in Cyberspace

- New material for Inadequate Warning
- New case: Lack of Warning
- New Legal/Ethical Discussion on Products Liability and Guns
- New End-of-Chapter case summaries
- New Critical Thinking case questions

Chapter 10

- New material on ABC Test for Agency Status
- New case: Employee vs. Independent Contractor
- New material on Uber Controversies
- New Critical Thinking case questions
- Updated Strategic Legal Solutions
- New 2014 case: Apparent Authority
- New material on Going-and-Coming Rule
- New 2013 case: Employer Liability for Agents
- New case: Fiduciary Duty of Agents

Chapter 11

- New case: Implied Employment Contracts
- New Critical Thinking case questions
- New material on Whistleblower Statutes
- New 2014 case: Whistleblower Protection
- New material: Affordable Care Act
- New material: Family Medical Leave Act (FMLA)
- New 2012 case: FMLA Retaliation

Chapter 12

- New material on Disparate Treatment Theory
- New 2015 case: *EEOC v. Abercrombie* (Employee head scarf)
- Expanded coverage of Sexual Harassment Claims
- New 2012 case: Hostile Work Environment
- New *Strategic Legal Solutions*: Preventing Harassment
- New flow chart: Title VII Analysis
- New material on Americans with Disabilities Act (ADA)
- New 2014 case: Qualified Individuals under ADA
- New material on Faragher/Ellerth Defense

Chapter 13

- New 2012 case: Successor Liability of Sole Proprietor
- New material on Partnership at Will
- New 2013 case: Wrong Dissociation of a Partner

- New Critical Thinking case questions
- New Key Point

Chapter 14

- Reorganized section on LLCs
- New 2013 case: Breach of Fiduciary Duty by an LLC Member
- New Key Point
- New Critical Thinking case questions
- Revised Manager’s Challenge

Chapter 15

- Updated Fiduciary Duties section
- New material on the Corporate Opportunity Doctrine
- New Concept Summary
- New 2012 case: Reasonable Expectations Test
- New material on Piercing the Corporate Veil
- New Critical Thinking case questions

Chapter 16

- Streamlined material on Fundamentals of the Securities Market and *Howey* Test
- New material: Crowdfunding
- New material: Peer-to-Peer Lending
- New material: Stock Market Games
- New material: Parties in a Securities Transaction
- New Concept Summary (Categories of Securities)
- New material: Process of a Public Offering
- Streamlined material on Regulation D Exemptions
- New table: Summary of Exemptions
- New table: Crowdfunding Regulation
- New material: Safe Harbors
- New material: Insider Trading
- New 2014 case: Tipper-Tippee Liability
- New material: Personal Benefits Test
- New 2015 case coverage: *U.S. v. Newman*
- New 2013 case: Dodd-Frank Whistleblower
- New material on Dodd-Frank Act
- New table: Insider Trading Theories

Chapter 17

- New Legal Implications in Cyberspace: Net Neutrality
- New material: Regulatory Flexibility Act

- New 2012 Case: Regulation of For-Profit Universities
- New Critical Thinking case questions
- New 2016 case: *VanHollen v. Federal Election Commission* (Arb. and Cap. Std.)
- Updated Manager’s Challenge
- Added Critical Thinking questions to cases

Chapter 18

- Updated Strategic Legal Solutions for Managers
- New material on Deepwater Horizon (BP) Oil Spill
- New 2014 case: BP Liability for Reckless Conduct
- Updated Theory to Practice questions
- Added Critical Thinking questions to cases

Chapter 19

- New material: Rule of Reason
- New 2015 case: *O’Bannon v. NCAA* –Rule of Reason and NCAA Athletes
- New 2015 case: FTCA–Monopoly Power
- New Key Points
- Updated “Search Bias” Investigation against Google
- New Antitrust and Sports section
- New Critical Thinking case questions

Chapter 20

- Updated Bankruptcy Guidelines/Amounts to 2016 Regulations
- New material on Bad Faith Filings
- New 2014 case: Power of Trustees
- New material on the Fraud Exception
- New 2015 case: Preferential Transfers
- New Critical Thinking case questions

Chapter 21

- Increased coverage of Warranties
- Added section on CFBP and New Rules as a Result of Dodd-Frank
- Added 2016 case: *CFPB v. Pressler* (Debt Collection)
- Updated section on Credit Transactions
- Added Key Points
- Added new Self-Check questions
- Added Critical Thinking questions to cases

Chapter 22

- New section on the *Park* Doctrine
- Increased coverage of the Fourth Amendment and the Impact of Technology on Warrants Requirements
- New Fourth Amendment summary table
- New Business Ethics feature: Enforcement of Insider Trading Laws
- New section on Cardinals Hacking and CFAA
- Added Critical Thinking questions to cases

Chapter 23

- New section on Mislaid/Lost/Abandoned Property
- New case on Treasure Troves
- New Key Point
- Updated Landlord/Tenant section
- Updated Strategic Legal Solutions for Managers

Chapter 24

- Updated Trade Secret section
- New section on Strategic Use of Trademark Product Design

- New USPTO case: *In re Hershey Chocolate and Confectionary Corp.*
- New section on Enforcing and Maintaining a Trademark
- New section on First Amendment Concerns and the “Slants” Test/Washington Redskins Mark Cancellation
- New section on Patents: Application Process
- New SCOTUS case: *Alice Corporation v. CLS Bank International* (Business Method/Software Patents)
- New Business Ethics feature: Patent Trolls
- New Key Points

Chapter 25

- Updated section on Comity
- New section on “Foreign Official” and the FCPA
- New 2015 case: Haiti Telco (Bribery)
- Updated section on World Court and European Court of Justice

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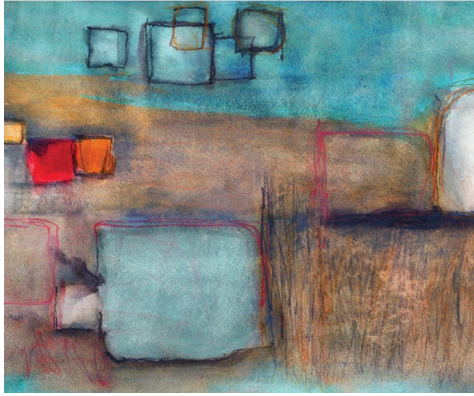
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UNIT ONE Fundamentals of the Legal Environment of Business

CHAPTER 1	Legal Foundations
APPENDIX TO CHAPTER 1	A Business Student's Guide to Understanding Cases and Finding the Law
CHAPTER 2	Business and the Constitution
CHAPTER 3	The American Judicial System, Jurisdiction, and Venue
CHAPTER 4	Resolving Disputes: Litigation and Alternative Dispute Resolution
CHAPTER 5	Business, Societal, and Ethical Contexts of Law



CHAPTER 1

Legal Foundations

Learning Objectives

After studying this chapter, students who have mastered the material will be able to:

- 1-1** Understand the broad definition and origins of law.
- 1-2** List and explain the purposes of the law.
- 1-3** Explain the importance and benefits of legal awareness for business owners and managers in creating a strategy and adding value to a company.
- 1-4** Articulate the role of counsel in legal decision making in a business context.
- 1-5** Recognize, explain, and give examples of sources of American law.
- 1-6** Understand the legal doctrine of stare decisis.
- 1-7** Classify the law into several broad categories.
- 1-8** Differentiate between the concepts of law and equity.
- 1-9** Identify and apply important equitable maxims.

Undertaking the study of law may seem overwhelming. Legal doctrines and rules can be complex and difficult to navigate. Yet the law impacts many facets of our daily life both at home and at work. This textbook is designed to make studying the law more *manageable* by examining legal issues that are most commonly encountered in the business environment. In fact, studies have shown that business owners and managers who have a high level of legal insight create *value* for their business and recognize legal challenges as business planning opportunities. This legal awareness may be gained only by understanding

important legal doctrines and processes. Applying this knowledge allows managers to limit risk and incorporate the law into their business strategies. This chapter introduces students to the foundations of the law and explains why the application of legal doctrines is an important part of the business environment. Specifically, in this chapter students will learn:

- How legal issues impact business planning and strategy.
- The foundations, definitions, and scope of various primary and secondary sources of law.
- Categories of law.

INTRODUCTION TO LAW

The term **law** has been defined in a variety of ways throughout recorded history. A generally accepted generic definition of the law is a *body of rules of action or conduct prescribed by controlling authority and having legal binding force*.¹ When studying law in any context, it is important to think of the law in broad terms. While many equate the law with stacks of neatly bound volumes of codes in a library, this is only one component of a much larger body of law. Law may be set down in a written code as prescribed by an elected legislative body, but it also takes the form of judicial decisions and actions of government agencies. While there are many sources of American law, the common characteristic of the current state of law is that it creates *duties, obligations, and rights* that reflect accepted views of a given society. Much of the origins of the law dealt with issues related to ownership of property; however, modern legal doctrines have evolved into a relatively complex system of principles and protections. Most importantly, the law also provides a mechanism to resolve disputes arising from those duties and rights and allows parties to enforce promises in a court of law. Law is often classified by subject matter so that one refers to certain rules regarding agreements as *contract law*, while other laws that regulate certain rights of employees are referred to as *employment law*. **Jurisprudence**, roughly defined as the science and philosophy of law, defines several schools of thought that are used to describe various approaches to the appropriate function of law and how legal doctrines should be developed and applied. Most schools of jurisprudential thought center on how legal rights are recognized.

Purposes of Law

The most visible function of the law on a day-to-day basis is to provide for some system of order that defines rules of conduct and levies punishment or other consequences for the violation of those rules. However, there are many other purposes of recognizing a uniform system of laws. The origins of recorded law were initially a collection of rules of powerful tribal chieftains intended to perpetuate their domination and the power of their authority with little consideration for the rights of individuals. However, over the better part of three millennia, the purpose of law evolved substantially into ensuring consistency and fairness. In the United States, lawmakers have increasingly embraced legal mechanisms, such as antidiscrimination laws, to help promote equality and justice in society, in education as well as the workplace. The law also sets out a method for resolving disputes by providing a basis for deciding the legal interests and rights of the parties. For purposes of studying the impact of law on business, it is important to recognize that the law also serves as an important catalyst for commerce by promoting *good faith dealing* among merchants and consumers and giving some degree of *reliability* in applying the law evenly so that the law can be considered in business planning and commercial transactions.

For example, assume Clothing Manufacturing Corporation (CMC) orders 100 bales of wool from Woolpack, Inc., in anticipation of a large order for winter clothing from retail outlets. The laws that govern the various transactions that arise from the CMC-Woolpack agreement set a standard of good faith and provide both parties the confidence necessary to set the business process in motion (e.g., to begin making decisions related to financing, operations, and marketing). Moreover, the merchants may rely on the courts if either party needs to recoup any losses resulting from the other party's unlawful actions.

¹ *Black's Law Dictionary*.

LO 1-1

Understand the broad definition and origins of law.

LO 1-2

List and explain the purposes of the law.

KEY POINT

The primary purposes of the law are:

- To provide a system of order that defines conduct and consequences.
- To promote equality and justice in society.
- To provide a method for resolving disputes.
- To promote good faith dealing among merchants.
- To provide a degree of reliability in applying the law evenly.



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Language of the Law

In order to maximize the value of interaction between business owners/managers and attorneys, a basic understanding of legal terminology is useful. Students studying business law face the task of learning legal syntax at the same time as they learn how to apply the legal doctrines in a business context. This is analogous to learning a complicated subject matter in a foreign language, yet it is manageable with careful study. Legal terms are sometimes referred to as *jargon* or *legalese*, but having a working knowledge of some common legal terminology is an important step to mastering the material. Although much of the language of the law has Latin roots, the terminology is primarily a combination of Latin, early and modern English, and French. The vocabulary of American law is drawn from the various cultures and events that shaped American history.

To facilitate your understanding of legal expression, important legal terms are highlighted throughout the text, summarized at the end of each chapter, and also featured alphabetically in the glossary. The authoritative source for legal terms is *Black's Law Dictionary*, first published in 1891. There are also several websites that provide definitions and examples for legal terms.

LO 1-3

Explain the importance and benefits of legal awareness for business owners and managers in creating a strategy and adding value to a company.

LEGAL DECISIONS IN A BUSINESS ENVIRONMENT: THEORY TO PRACTICE

While an in-depth understanding of the various areas of law is a vast undertaking requiring years of intensive study, the primary objective of this textbook is to cover a variety of legal topics that are most commonly encountered in the business environment. However, developing legal insight by understanding the fundamentals of legal theory and how they may impact business is only a first step in learning how legal decisions should be made in a business context. The second step involves learning to *apply* legal theories in practice and recognizing that having legal awareness may present opportunities for proactive business planning—empowering business owners and managers to limit liability, gain a competitive edge, and add value to the business. Relying exclusively on attorneys to drive the legal decision-making process in the context of business is expensive and involves the significant risk that a decision will be made without sufficient knowledge of business operations, objectives, and current economic realities. Instead, studies and research indicate that when managers work *cooperatively* with their attorneys, the results contribute to better strategic business decisions that add value to the business. For example, recognizing that having a code of conduct for employees and creating a standardized procedure for

hiring new employees are issues that a good manager should view as essential, attorneys regularly play a part in ensuring compliance with applicable federal, state, and local laws. Later in this chapter, we will discuss a mechanism that business owners and managers may use to spot legal issues, apply an appropriate analysis, decide on alternative solutions, and plan a legal and ethical course of action that both limits liability and maximizes business opportunities.

KEY POINT

Learning to apply legal theories in practice and having legal awareness present opportunities for proactive business planning, empowering managers to limit liability, gain a competitive edge, and add value to the business.



Management teams with legal insight add value to their company by limiting liability and identifying opportunities. © Eric Audras/PhotoAlto/PictureQuest

Legal Insight and Business Strategy

To understand the way various areas of the law impact business and the importance of having legal insight in a business context, let's examine a typical business planning process. Suppose that the management team at Indiana Printing Company (IPC) is planning to expand its existing business into new markets. The team is considering several options and will have to have a sufficient understanding of the legal risks and business opportunities associated with each option. Table 1.1 sets out possible options for IPC's expansion and some of the potential legal impacts for each option.

The list of legal issues in Table 1.1 is meant to be illustrative and not exhaustive. Indeed, issues regarding negligence, criminal law, administrative law, bankruptcy, consumer protection, agency, and many others may present themselves before, during, or after the transaction is complete.

Role of Counsel

Although this textbook emphasizes understanding legal issues in the context of business decision making, this is not to suggest that an attorney's role in this process is diminished—quite the opposite. The content, features, and exercises contained in this textbook emphasize that working closely with a business attorney results in business opportunities, reduced costs, and limitation of risk and liability. Attorneys, particularly in a business context, may also be referred to as **counsel**. Business owners and managers work with counsel in one of two formats. For larger companies or companies that have extraordinary regulatory burdens (such as complying with securities or patent laws), counsel may very well be a part of the executive or midlevel management team. These attorneys are referred to as *in-house counsel* and usually have the title “general counsel” at the executive management level (e.g., vice president and general counsel). Depending on the size and complexity of the company, the

LO 1-4

Articulate the role of counsel in legal decision making in a business context.

TABLE 1.1

Expansion Options and Potential Legal Impacts

Option	Area of Law	Potential Legal Impact
<p><i>Expansion through acquisition of another company.</i> One common way to expand is to purchase an existing business entity through an acquisition of assets or of stock.</p>	■ Contracts	■ Contract law governs negotiations and agreements for the acquisition.
	■ Property/environmental	■ If the acquisition involves any land purchase, real estate law (such as zoning) and environmental law must be considered.
	■ Employment and labor	■ The hiring of new employees by IPC (even former employees of the target company) or the layoff of IPC or target-company employees must be done in conformance with state and federal employment and labor laws.
	■ Tax	■ The transaction may create tax liability under local, state, and/or federal laws.
	■ Antitrust	■ If the acquisition results in IPC's gaining too much market share, federal antitrust laws must be considered and preacquisition approvals may be needed from the government.
<p><i>Expansion through introducing and aggressively marketing a new product line.</i> Expanding through marketing of a new product line generally involves raising sufficient capital to properly develop, manufacture, and go to market.</p>	■ Securities law	■ Any solicitation by IPC to sell shares of its business to the public is highly regulated by securities law.
	■ Intellectual property	■ In order to maintain its competitive edge, IPC will need to put measures in place to help guarantee protection of ideas and processes by trade secret law; the final design may be protected by patent law.
	■ Administrative law	■ Federal regulatory agencies have guidelines for the advertising and labeling of products.
<p><i>Expansion through aggressive integration of a highly interactive website and e-marketing campaigns, including international markets.</i> In light of the growth in e-commerce, some companies find this to be the most cost-efficient method of expansion.</p>	■ Jurisdiction	■ Website expansion may result in IPC's being subject to the jurisdiction of more out-of-state courts than under its previous business model.
	■ International law	■ IPC may be subject to international agreements and treaties regarding sales and intellectual property.

general counsel may also supervise one or more attorneys, usually with the title “associate counsel.” Additionally, the general counsel may also serve as a corporate officer of the company, called the secretary, and be responsible for record keeping and complying with notice and voting requirements for the board of directors.² The general counsel is also responsible for selecting and supervising lawyers from outside law firms when a particular field of expertise is needed, such as a trial lawyer (also called a *litigator*).

The majority of companies, however, rely on attorneys employed by *law firms* for their legal needs. These attorneys devote a significant amount of their professional time

²The legal structure of corporations and other business entities is discussed in detail in Unit Three, “Regulation in the Workplace.”

to advising businesses on issues such as formation, governance, labor and employment laws, regulatory agency compliance, legal transactions (such as an acquisition), intellectual property (such as trademarks or patents), and other legal issues important to business operations. These attorneys (known as *business lawyers* or *corporate lawyers*) rarely if ever appear in court or perform other tasks that are associated with lawyers in the minds of the general public. Indeed, the law has become increasingly complex and specialized. Therefore, it is not unusual that more than one attorney's advice is needed when facing a significant legal issue such as an employment discrimination lawsuit or when obtaining financing for a corporation from the general public through the sale of stock. Law firms vary greatly in size, from those that have one or just a few lawyers in a local or regional practice to firms that have hundreds of lawyers spread throughout the globe. In a business context, law firms bill clients based on an hourly rate that is tied to an individual lawyer's experience, her reputation in the field, and the market being served (with large cities that are the center of business operations having higher rates).

 **Self-Check** Role of Counsel

What advice might Adams seek from an attorney in the following situations?

1. Adams sells custom-designed T-shirts from his basement apartment. The business begins to turn a profit.
2. Adams wants to expand his T-shirt business by renting a kiosk in a local mall and hiring Baker.
3. Adams wants to obtain trademark protection for his products.
4. Baker offers Adams \$50,000 to purchase the T-shirt business's name and assets.

Answers to this Self-Check are provided at the end of the chapter.

SOURCES AND LEVELS OF AMERICAN LAW

American law is composed of a unique blend from various sources based on U.S. historical roots. Fundamentally, much of American law is derived from English legal doctrines that came with the English settlers of the colonies. In the West and Southwest, land once controlled by Mexico, there are strong Spanish influences, while in Louisiana, once French territory, French civil law roots are evident. Modern law in the United States regulating businesses and individuals is generally a combination of **constitutional law**, **statutory law**, **common law**, and **administrative law** (or *regulatory law*) at the federal, state, and local levels. These sources of law are known as *primary sources* of law and may sometimes work in conjunction with one another or independently. For example, law related to the protection of trade secrets³ is composed from a variety of sources of law. Perhaps the most famous and profitable example of a trade secret is the recipe and process for making Coca-Cola. While most states have specific trade secret statutes that give legal recourse to a party who has suffered a loss as a result of the unlawful use of trade secrets, some do not. Does this mean that the company that owns the Coca-Cola

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Recognize, explain, and give examples of sources of American law.

³Trade secret law, which is covered in detail in Chapter 24, "Intellectual Property," is the legal protection of certain confidential business information.

Enumerated Powers

Article I, Section 8, of the U.S. Constitution names 17 specific powers granted to the federal government. These are known as *enumerated powers*.

recipe has no legal recourse against someone who steals its trade secret in those states where no *specific statutes* exist? The answer is no, because even absent a specific statute, the law still provides the damaged party some recourse against the violator. This recourse is provided by court case history (called *common law*, discussed later), which provides guidance to the trial courts deciding trade secret disputes. Even in states that *do* have statutes related to trade secret protection, there is case law that helps courts apply the statute consistently.

Constitutional Law

Constitutional law is the foundation for all other law in the United States and is the supreme law of the land. It functions in tandem with other sources of law in three broad areas: (1) establishing a *structure* for federal and state governments (including qualifications for certain offices and positions), setting rules for amending the constitution, and granting specific *enumerated powers* to the different branches of government; (2) establishing the concept of *federalism*, allowing the federal and state governments shared powers; and (3) establishing individual *civil rights* and providing *procedural protections* for U.S. citizens from wrongful government actions.

Constitutional law is different from other sources of law primarily in terms of *permanence* and *preemption*. In terms of permanence, a constitution is thought to reflect the basic principles of a particular society and should be amended only in extraordinary cases and only when a majority of its constituents agree over a certain period of time. Preemption in this context means that constitutional law is supreme over all other sources of law such as federal and state statutes, treaties, and common law.

Constitutional law exists at both the federal and state levels because each state has its own constitution that is the highest source of law within the state's borders (so long as it is not inconsistent with federal law). States tend to amend their constitutions more frequently than is the case with the U.S. Constitution. Constitutional issues that impact businesses include Congress's powers to regulate interstate commerce; the creation of legal protections for intellectual property (such as patents and copyrights); the protection of certain forms of commercial speech from unwarranted government regulation; limitations on a state's authority to tax products and services in commerce; and powers of the executive, legislative, and judicial branches to regulate business activity.

In Case 1.1, the U.S. Supreme Court resolves a conflict between federal and state law by applying constitutional preemption. Preemption and other aspects of constitutional law are discussed in detail in Chapter 2, "Business and the Constitution."

CASE 1.1 Arizona v. United States, 132 S.Ct. 2492 (2012)

FACT SUMMARY In 2010, the State of Arizona passed the Support Our Law Enforcement and Safe Neighborhoods Act to address problems that the legislature contended were being created by the large number of unlawful immigrants living and working within the state's borders. Among other provisions, the law created state immigration offenses and expanded the authority of local police

to enforce immigration laws by requiring individuals lawfully detained by the police (e.g., a traffic stop) to verify their citizenship. The law also provided criminal penalties for unauthorized aliens who sought or engaged in work within Arizona. The U.S. Department of Justice filed suit against Arizona seeking to invalidate the law on the basis that federal immigration statutes precluded individual

(continued)

states from enacting their own immigration laws. Arizona argued that weak and uneven enforcement of federal immigration laws necessitated state regulation and that the state law did not conflict with the federal law. The U.S. court of appeals ruled in favor of the United States, and the state of Arizona appealed to the U.S. Supreme Court.

SYNOPSIS OF DECISION AND OPINION The U.S. Supreme Court struck down the Arizona statute as unconstitutional. The Court ruled that the Arizona statute conflicted with the existing federal law and therefore the state statute is preempted and constitutionally unenforceable. The Court reasoned that (1) immigration is a matter within the purview of the federal government and (2) when the federal government creates rules and sanctions with a clear intent to preclude state action, courts will not enforce any state action that conflicts with established federal mandates.

WORDS OF THE COURT: Preemption of a State Statute “Federalism, central to the constitutional design, adopts the principle that both the National and State Governments have elements of sovereignty the other is bound to respect. The Supremacy Clause provides a clear rule that federal law ‘shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.’ Art. VI, cl. 2. Under this principle,

Congress has the power to preempt state law. . . . State law must also give way to federal law in at least two other circumstances. First, States are precluded from regulating conduct in a field that Congress has determined must be regulated by its exclusive governance. Intent can be inferred from a framework of regulation ‘so pervasive . . . that Congress left no room for the States to supplement it’ or where a federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject. Second, state laws are preempted when they conflict with federal law, including when they stand ‘as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.’”

Case Questions

1. If a federal law or policy is perceived as weak or ineffective, should a state have the right to legislate in that area without federal intervention?
2. Arizona’s law affected Arizona alone and was designed to help Arizona citizens regarding, among other issues, increased employment and reduction of crime. At what point should the federal government have the right to challenge such a state law?
3. *Focus on Critical Thinking:* Since a challenge based on preemption was known to be an issue from the onset of this statute’s consideration, how might Arizona have better approached its illegal immigration problem?

Statutory Law

Statutes are written laws that are passed by the federal or a state legislature and then either approved or rejected by the executive branch. The U.S. Congress is the exclusive legislative body for the passage of federal law. When Congress is drafting a federal statute, but has not yet passed it or had the executive branch’s concurrence, it is known as a *bill*. On the *federal* level, the president is the executive and may either sign a bill into law (thereby adopting it as a statute) or veto (reject) the bill, in which case the bill becomes subject to the Congress’s right to override the veto and make the bill into a statute with a two-thirds majority vote.

At the *state* level, the state legislature (called by different names in different states, such as the *General Assembly*) passes statutes that regulate such areas as motor vehicle laws, business corporation and partnership laws, and other traditional state matters.



Visit Connect to see an example of (1) a federal statute (Employment Discrimination), (2) a state statute (Pennsylvania Business Corporation Law), and (3) a local zoning ordinance.