



# THE LEGAL ENVIRONMENT OF BUSINESS

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# The Legal Environment of Business





# THE LEGAL ENVIRONMENT OF BUSINESS

**TWELFTH EDITION**

**ROGER E. MEINERS**

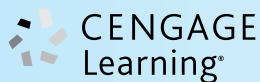
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Twelfth Edition**

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*Dedicated in honor of E. M. "Manny" Rosenthal  
who provided so much for so many by his business and civic leadership.  
Roger E. Meiners*





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# Preface

Knowledge of the legal and regulatory environment of business provides practical background for students in many careers. There are legal, social, political, and ethical issues in every profession. Some situations require an understanding of the principles of law to help resolve an issue or to know when legal counsel is needed.

This textbook presents the legal environment from the perspective of the professional who is not a lawyer. Only a few students who take this course will become lawyers, although some students may take additional classes that cover specific legal areas. This course provides the opportunity for people with various interests to learn key points of the law from the standpoint of a working professional.

Over the years, we have received excellent feedback from professors and students who have used the 11 previous editions of this book and have pointed out shortcomings and strong points, and given good advice for improvements. We have taken these comments into account in preparing this edition to make the book even more helpful and practical as we study the complex legal environment that business professionals face.

## Essential Organization

In developing a one-semester course in the legal environment of business, you face the problem of determining what to cover in a short time. So many topics; so little time. There is agreement that the key elements of the legal system must be covered. This is done in Part 1 of the book, Elements of Law and the Judicial Process. Parts 2 and 3 from previous editions have been reorganized into three separate parts in this edition to offer a better flow of content. Part 2, Elements of Traditional Business Law, reviews the major areas of the common law that apply to business and statutory law that is oriented to business functions. The new Part 3, The Employment Relationship, addresses a part of the business environment that applies to everyone—employment laws. Part 4, The Regulatory Environment of Business, covers the major regulatory laws that managers of different firms may face and reviews major points of international business law.

## Key Features

### *Edited Cases*

A primary way to learn law is to read real cases that the courts had to resolve. Each major case presented in the text has the background facts and legal proceedings summarized by the authors under the label **Case Background**. Then, the court's holding, legal reasoning, and explanation of the law as it applies to the facts at hand are presented from the published opinion in the words of the judge in the **Case Decision**. Because most decisions are long, we present only the key portions of the holding. When there is a long deletion of material from a holding, you see asterisks (\*\*). When the deletion of the logic in a decision is shorter, there are ellipses (...). Finally, **Questions for Analysis** are offered for the reader to consider or for class discussion. (Answers are provided in the *Instructor's Resource Guide*).

### *Test Yourself*

This learning and review tool appears at least twice in each chapter. It provides the student with a quick self-test of material just covered. There are multiple choice,

true–false, and fill-in-the-blank questions. They are intended to cover major points in the chapter, not picky details, so if the reader misses questions, the material should be reviewed.

### ***International Perspectives***

These boxed features discuss how issues similar to those being reviewed in the text are handled in other countries. As globalization reaches more businesses, managers must know how to deal with different legal systems and cultures. This feature makes clear that legal constraints are different in other nations. Managers must be prepared to resolve problems in different ways in different locales in today’s complex legal environment.

### ***Issue Spotter***

More than 50 Issue Spotter features are scattered throughout the text. Each briefly presents a business situation that requires application of legal elements just covered. These challenges are a way for students to self-test their retention and ability to reason as they apply newly learned principles to practice. They also remind readers that the material learned in this course is practical and applicable to everyday issues in business. (Discussion points related to these features are provided in the *Instructor’s Resource Guide*).

### ***Cyber Law***

This feature presents short discussions of applications of the law to developments arising from the information age. E-commerce and e-mail mean legal issues for the courts to resolve as they apply legal principles to never-before-heard-of ways of doing business, transmitting information, and communicating with friends and strangers.

### ***Lighter Side of the Law***

These highlights add a light touch to the topic at hand by discussing an actual case or unusual legal situation. While law and business are serious, odd things happen that remind us that trouble can come from unexpected places, that the results of the legal process can be surprising, that scoundrels are among us, and that truth can be stranger than fiction.

### ***Summary***

The text of each chapter is summarized in a bulleted format that provides a quick review of the major points of law and rules covered and serves as a self-test of points to be included in examinations.

### ***Terms to Know***

After the Summary, there is a list of key terms from the chapter. The reader should know what the terms mean as they are an important part of the vocabulary and substance of the concepts covered in the chapter. Besides being explained in the chapter, each term is also defined in the Glossary at the end of the book.

### ***Discussion Question***

Every chapter has a question for general discussion related to major ideas from the chapter. The purpose is to make sure students understand the concepts of the chapter well enough to discuss a topic that was covered and should be expanded upon.

### ***Case Questions***

Most problems are solved, but some end up in court where judges decide the resolution based on legal principles. Real case problems are summarized in each case question.

Using the knowledge from the chapter, and maybe some instinct about how a court is likely to resolve a dispute, try to decide which party to a dispute is likely to prevail and why. Some of the questions (marked by a “Check your answer”) are answered online at the free companion website at [www.cengagebrain.com](http://www.cengagebrain.com).

### ***Ethics Question***

Each chapter ends with an ethics question that poses a problem related to the legal area covered in the chapter. Remember that ethical issues are different from legal issues, so we go beyond legal reasoning in considering the problem.

### ***Pulling It Together***

At the end of the four major sections of the text, several case questions are posed that bring together more than one legal issue covered in more than one chapter. Many situations involve more than one legal issue, so the cases here serve as a refresher to remind students of earlier material and pull in concepts covered there along with legal principles covered in another chapter.

### ***Glossary***

At the back of the book is a list of about a thousand key terms covered in the text. The terms are defined here to provide a clear understanding of a legal concept that has a specific application in law.

### ***Appendices***

Appendix A is on *Legal Research and the Internet*. Appendix B covers *Case Analysis and Legal Sources*. It explains the structure of court opinions and how they are often briefed by law students and lawyers to give a short summary of a complex matter. The case reporter system and other major legal resources are also reviewed. Appendix C is the full text of the United States Constitution. Appendices that follow give key portions of major statutes, including the Uniform Commercial Code, the National Labor Relations Act, Title VII of the Civil Right Act of 1964, the Americans with Disabilities Act, the Anti-trust Statutes, and Securities Statutes.

## **New to This Edition**

Our reviewers agree that this text focuses on practical aspects of the law. We try to keep to a minimum the legal minutia, such as uncommon exceptions or rules peculiar to only a few states. We focus on primary rules and issues that arise most often. We use business situations and examples to highlight legal principles in practice. In selecting cases that appear in the text, the focus is on practical situations in business that students can best relate to and are realistic in a business career. The holdings are straightforward applications of the law to the facts. However, some major cases are included so students can get a sense of how courts announce major rules, and the evolution of law can be discussed.

While the entire text is revised for updates and clarifications, examples of specific changes include:

- Chapter 1, clarification of the wide scope of federal criminal law;
- Chapter 2, a new case illustrates multiple issues in jurisdiction in a business case;
- Chapter 3, how Twitter use can be construed as juror misconduct, the use of online arbitration in Europe, and how global arbitration works in the cotton market;
- Chapter 4, new cases illustrate due process and equal protection in business situations;

Chapter 5, a new investment scam case illustrates use of sentencing guidelines;

Chapter 6, gross negligence is clarified, and new cases illustrate assumption of risk and emotional distress in business settings, and another new case discusses the privilege of an employer to share negative information about an employee;

Chapter 7, new cases show how interference with contracts occurs in ordinary business situations;

Chapter 8, new cases help explain how covenants work in property development, and how nuisance law is applied in residential property in a case involving wind turbines;

Chapter 9, enhanced discussion of domain name control and a case involving playing of music without a license on a radio station illustrate copyright issues;

Chapter 10, new cases on contract acceptance and on non-competition agreements;

Chapter 11, the issue of whether the UCC or the common law of contracts applies is reviewed in a new case, another case illustrates how courts settle unclear terms in a contract, and another case involving QVC, a shopping channel, shows how damages are calculated when defective goods are delivered;

Chapter 12, on business organizations, is moved up in sequence and new cases include how a partnership may be formed without formal recognition, as reviewers suggested, and a new review of close corporations and benefit corporations is provided;

Chapter 13, on negotiable instruments, credit, and bankruptcy, is moved back in the sequence, with new discussion of web-based credit scoring as well as new cases showing how mechanic's liens function and on bank liability when an employee abuses check signing privileges;

Chapter 14, the first chapter in the three chapter sequence on agency and employment, has been reorganized as a result of the change in structure and has a new case illustrating the relatively common problem of an employee exercising apparent authority in business dealings not approved by the principal;

Chapter 15 has a simplified discussion of OSHA and a new case showing how it works, and includes new information on social media in the workplace, including limits on employer rights to access employee social media sites;

Chapter 16 contains an updated discussion of employment discrimination law in practice, including a new case that illustrates accommodation for disability in the workplace;

Chapter 17 opens the last section of the text by covering regulatory law procedure, including two new cases that give examples of requirements in practice;

Chapter 18, on securities regulation, has been moved up as suggested by some reviewers and is freshened in its coverage of changes in the requirements in this area;

Chapter 19 updates coverage of consumer protection law and includes a new FTC case that illustrates a "wealth creation" scam;

Chapter 20 shows how the complex antitrust case process may now be aided by computer programs that sort documents;

Chapter 21 includes several new environmental law cases, including a 2013 Supreme Court case regarding application of the Clean Water Act and another case illustrating the international reach of the Endangered Species Act;

Chapter 22 freshens and simplifies the discussion of international business transactions.

## Ancillaries

### **Companion Website**

To access additional course materials, including CourseMate, please visit [www.cengagebrain.com](http://www.cengagebrain.com). At the CengageBrain.com home page, search for this book using the search box at the top of the page. This will take you to the product page where many resources can be found. The book companion website offers answers to selected chapter-ending Case Questions, an interactive quiz with multiple choice questions for each chapter in the text, and case updates.

### **Instructor's Materials**

The electronic *Instructor's Resource Guide* has been revised. As before, it answers all questions in the book. It also provides a detailed outline of each chapter, summarizing the content of the text, including all cases. The instructor can refer quickly to this guide to remember the points that students have covered in the text. The guide also provides numerous additional summarized cases that the instructor can use to illustrate key points of law. Additional material, such as more discussion of certain points and examples of the law in practice, is provided as lecture and discussion enhancements.

The updated electronic *Test Bank* contains true–false questions and more than 6,000 multiple choice questions, totally more than 10,000 available questions. Many questions based on fact have been added to test critical thinking ability. The Test Bank questions vary in levels of difficulty and meet a full range of tagging requirements, so instructors can tailor their testing to meet their specific needs. The Test Bank is available online in Cognero. Cengage Learning Testing Powered by Cognero is a flexible, online system that allows you to:

- *author, edit, and manage test bank content from multiple Cengage Learning solutions*
- *create multiple test versions in an instant*
- *deliver tests from your LMS, your classroom, or wherever you want*

A full set of *PowerPoint* slides keyed to the text with lecture outlines is also available.

### **CourseMate**

CourseMate brings course concepts to life with interactive learning, study, and exam preparation tools—including an e-book—that supports the printed textbook. Revised for this edition, student study materials and a set of auto-gradable, interactive quizzes allow students to instantly gauge their comprehension of the material. Built-in engagement tracking tools allow instructors to follow students' study activities and assess their progress.

### **CengageNOW™**

CengageNOW™ is an online teaching and learning resource that gives you more control in less time and delivers better outcomes—NOW. Brand new to this edition, CengageNOW for *The Legal Environment of Business* allows instructors to customize additional test and study materials for their students. Written by Ray Teske of University of Texas at San Antonio, each of the 22 chapters provides several categories of multiple-choice questions that stress different aspects of the chapter materials: Chapter Review, Business Hypotheticals, Legal Reasoning, and IRAC. Along with pre- and post-test questions, all quiz content is tagged to specific standards. These online resources ensure that students possess the study materials needed to understand and apply the legal principles covered in the book.

### ***Business Law Digital Video Library***

Featuring more than 100 video clips that spark class discussion and clarify core legal principles, the Business Law Digital Video Library is organized into six series:

- *Legal Conflicts in Business* (includes specific modern business and e-commerce scenarios)
- *Ask the Instructor* (presents straightforward explanations of concepts for student review)
- *Drama of the Law* (features classic business scenarios that spark classroom participation) *LawFlix* (contains clips from many popular films)
- *Real World Legal* (presents legal scenarios encountered in real businesses)
- *Business Ethics in Action* (presents ethical dilemmas in business scenarios).

For more information about the Digital Video Library, visit [www.cengage.com/blaw/dvl](http://www.cengage.com/blaw/dvl). Access for students is free when bundled with a new textbook or can be purchased separately. Students must register for and purchase access to the Digital Video Library at [www.cengagebrain.com](http://www.cengagebrain.com).

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We welcome and encourage comments from the users of this textbook—both students and instructors. By incorporating your comments and suggestions, we can make this text an even better one in the future.

Roger E. Meiners

Al H. Ringleb

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## OVERVIEW

Part 1 reviews the major components of the legal system and provides the framework for understanding the material presented in the later two parts of the book. Just as people in business should understand the elements of accounting, economics, finance, management, and marketing, it is important that they also know how the legal environment plays a critical role in the way business and the economy function. Law changes as the structure of business evolves, as social pressures produce changes in the way business operates, as the ethical expectations of business increase, as politics change, and as the economy becomes more interwoven in international operations.

The chapters in Part 1 review the major components of the legal system: the origins of law, constitutional law, the role of law in society and business, the structure and functioning of the court system, the use of alternative forms of dispute resolution, and the key elements of criminal law as it applies to business. These chapters serve as the structural background for the rest of the text, which reviews areas of substantive laws that impact business.

# PART 1

## Elements of Law and the Judicial Process

### *Chapter 1*

**Today's Business Environment: Law and Ethics** The evolving legal, social, and ethical pressures that people in business face today in a complex, international political economy are discussed in the context of the origins of our legal system. Our focus is on the purposes, sources, and structure of law and the legal system in the context of the modern economy.

### *Chapter 2*

**The Court Systems** The structure and power of our federal and state court systems are reviewed, followed by a discussion of how a case gets to a court and what powers the courts have over the parties to a case and its resolution.

### *Chapter 3*

**Trials and Resolving Disputes** The steps in litigation—from the time a party files a complaint, through the stages of litigation, the forms of relief possible, and the appeals process—are discussed. Many business disputes are not taken to court but to alternate dispute resolution. The key aspects of arbitration and mediation are reviewed.

### *Chapter 4*

**The Constitution: Focus on Application to Business** The constitutional limits on government actions, especially with respect to business matters, are covered. Congress has nearly unlimited power to regulate and tax, but some protections are provided for civil liberties against an over-reaching state.

### *Chapter 5*

**Criminal Law and Business** Many statutes, increasingly at the federal level, provide the possibility of criminal penalties for violations that may involve persons in business capacities. The criminal processes are reviewed as are key statutes that specifically target certain actions in business.



## CHAPTER 1

# Today's Business Environment: Law and Ethics

Getting a good job and building a career after college are major challenges when economic times are difficult. Afraid of being left jobless and needing income, many people take jobs that are less than what they had hoped to find, but these jobs sometimes turn out better than expected, as they provide experience and entry into organizations. On the other hand, some people land prestigious jobs that turn out to present less-than-ideal circumstances.

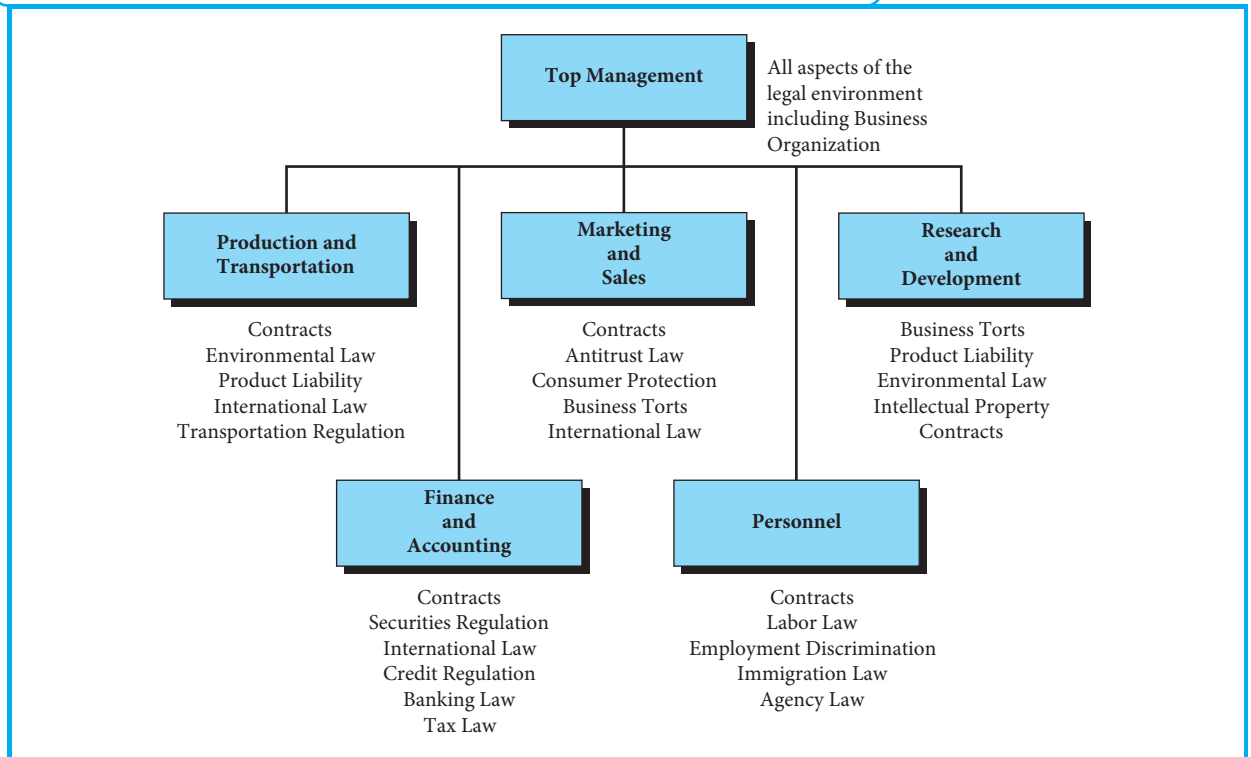
It is not uncommon for recruiters to puff up the qualities of a position. A job billed as “character-building” may be one of unending stress. One advertised as having a “teamwork environment” may just mean people jammed in cubicles. One person reported that when she was recruited, she was shown a nice office and introduced to her supervisor, whom she liked. When she arrived to start work two weeks later, she was stuck in a tiny back room; the likeable supervisor was gone, replaced by someone less agreeable; and, worst of all, the assignments she was given were not of the quality discussed earlier.

Suppose that happens to you. Can you sue the recruiter who brought you to the employer? Can you sue the company that hired you? Do you have the right to demand a better office? What is your legal status in the situation? These are some of the legal issues in business that we will explore.

In the situation just posed, the new employee probably has little choice but to keep the job as is or leave. The employer is unlikely to have violated any legal obligation. What about the ethical obligation to be honest with current and potential employees? Is overstating the quality of a position unethical, even if it is not a violation of the law? This is another aspect of the modern business environment.

Business is complex. Ethical, legal, social, political, and international issues all impact company operations one way or another. As Exhibit 1.1 indicates, whether your field is human resources, sales, banking, advertising, or software development, you must be familiar with a wide range of subjects to have the skills needed to be aware of possible problems and to recognize potential opportunities that someone with a limited view would likely miss. The topics covered in this book, which focuses on the legal environment of business, help to fit one large piece into the complicated puzzle called the business world.

The study of the legal environment of business begins with an overview of the nature of law and the legal system. Composed of law that comes from different sources, the legal environment is influenced by the needs and demands of the business community, consumers, and government. This chapter helps us understand the functions of law in society, the sources of U.S. law, and the classifications of law. It then considers some major ethical issues that play a role in the modern environment of business.

**EXHIBIT 1.1 OVERVIEW OF A BUSINESS'S LEGAL ENVIRONMENT**

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## Law and the Key Functions of the Legal System

There is no generally accepted definition of **law**. In the legal environment of business, law refers to the rules, standards and principles that define the behavioral boundaries for business activities. In more general context, law is a more abstract term. According to *Justinian's Institutes*, a summary of Roman law published in 533 in Constantinople, "The commandments of the law are these: live honorably; harm nobody; give everyone his due."

A bit more specific, a century ago Oliver Wendell Holmes, a legal scholar and Supreme Court justice, offered the following definition:

*Law is a statement of the circumstances, in which the public force is brought to bear... through the courts.*

In his 1934 book, *Growth of Law*, the famed jurist Benjamin N. Cardozo defined law as follows:

*A principle or rule of conduct so established as to justify a prediction with reasonable certainty that it will be enforced by the courts if its authority is challenged.*

Also consider these modern definitions from *Black's Law Dictionary*, an authoritative legal dictionary:

1. *Law, in its generic sense, is a body of rules of action or conduct prescribed by [the] controlling authority and having binding legal force.*
2. *That which must be obeyed and followed by [members of a society] subject to sanctions or legal consequences is a law.*

\*Reprinted from *Black's Law Dictionary* with permission of Thomson Reuters.

In summary, law may be viewed as a collection of rules or principles intended to limit and direct human behavior. Enforcement of such rules or principles provides some predictability and uniformity to the boundaries of acceptable conduct in a society. Nations have both formal rules that are commonly called laws plus informal rules that come from a society's history, customs, commercial practices, and ethics.

Law and the legal system serve several key roles in society. The most important functions include: (1) influencing the behavior of the members of a society, (2) resolving disputes within society, (3) maintaining important social values, and (4) providing a method for assisting social change. The experience of Haiti and other nations, as discussed in the *International Perspective*, reminds us of how difficult it is to do business in a country with a corrupt government that does not provide a workable legal system.

### Improving Social Stability by Influencing Behavior

The legal system helps to define acceptable social behavior. The law limits activities that hurt the public interest. It restricts business practices that are thought to be outside the ethical and social norms of a society. The law can also require or encourage business practices that further social or political goals.

The laws in different jurisdictions reflect social norms. The business of raising and selling marijuana in Amsterdam (Holland) is legal because the government decided that legalizing marijuana would reduce crime in the drug trade and make it less likely that people would use more harmful drugs such as heroin. In the United States, growing and selling marijuana is illegal under federal law and can be punished by long prison terms. Several states have moved to legalize certain marijuana production and use, but

## INTERNATIONAL PERSPECTIVE



### Emerging Nations and the Law

Haiti was devastated by an earthquake in 2010 that killed hundreds of thousands of people. During coverage of the event, many Americans were shocked to see profound poverty so close to the United States. Haiti's poverty is in contrast to the Dominican Republic that is the other half of the island of Hispaniola. Average income in the Dominican Republic is four times higher than in Haiti. What makes Haiti so poor?

The tragedy of the earthquake caused donors to pledge aid to help rebuild Haiti. It sparked discussion about how to encourage economic development, ensure the aid was used effectively, and prevent corruption. All the aid did little good. Haiti, like many poor countries, suffers under a notoriously corrupt government and a legal system that provides no meaningful law to protect people's lives and property. One businessman with operations in several Caribbean nations said that doing business in Haiti was

nearly impossible because the demands for bribes are endless.

This comment is backed up by surveys of Haiti's residents. Transparency International, the Berlin-based organization that studies corruption, ranked Haiti the 168<sup>th</sup> most corrupt country in the world; only nine countries were worse. Haiti's more prosperous neighbor, the Dominican Republic, ranked 99<sup>th</sup>. The least corrupt countries—New Zealand and Denmark—are high-income countries. Many studies have found a strong relationship among less corruption, a well-functioning legal system, and the level of economic development.

There are no easy answers for creating a functioning legal system in a country without one and where government authorities make a living by being on the take. Finding the answer to that puzzle is key to helping develop business opportunities that benefit ordinary citizens.

those state laws conflict with federal law. On the other hand, the production and sale of alcoholic beverages to adults is legal in most of the country, although it was illegal nationwide from 1919 to 1933. In Saudi Arabia, people are executed for being involved in the alcohol business, as alcohol violates Sharia law in that country. Other countries also make alcohol a criminal matter, while some countries have few restrictions on its sale, even to minors. This illustrates how different societies use the law to enforce different social norms.

## Conflict Resolution

A critical function of the law is dispute resolution. Disagreements are inevitable since societies are made up of people with differing desires and values. Karl N. Llewellyn, a famous legal theorist, stated:

*What, then, is this law business about? It is about the fact that our society is honey-combed with disputes. Disputes actual and potential, disputes to be settled and disputes to be prevented; both appealing to law, both making up the business of law. ... This doing of something about disputes, this doing of it reasonably, is the business of law.*

While most disputes are settled informally, a formal mechanism for the resolution of disputes is the court system. It is used for both private disputes between members of society and public disputes between individuals and the government. Our court system is intended to provide a fair mechanism for resolving these disputes. As we will see in Chapter 3, businesses are increasingly turning to formal private settlement techniques by alternate dispute resolution outside of the courts, often because the courts are expensive and slow.

## Social Stability and Change

Every society is shaped in part by its values and customs. It is not surprising, then, that law plays a role in maintaining the social environment. Integrity is reflected in the enforceability of contracts; respect for other people and their property is reflected in tort and property law; and some measures of acceptable behavior are reflected in criminal laws.

Over time, social attitudes change. Not many years ago, gay partners could be subject to criminal prosecution for the fact of a personal, voluntary relationship. Now the discussion has turned to whether such relationships should have the same status as traditional marriages. Some contend that legalizing same-sex marriages would be destructive to the structure of society; others see it as a stabilizing force and a civil right.

The legal system provides a way to bring about changes in “acceptable” behavior. For example, in the past, some states required businesses to discriminate on the basis of race. Attitudes changed, and those laws gradually disappeared, and grossly discriminatory behavior is no longer legally acceptable. Rather than require discrimination, laws now restrict race discrimination in employment decisions. Next, we turn to the sources of law and how law is created.

## Sources of Law in the United States

The U.S. and state constitutions created three branches of government—each of which has the ability to make law. Congress—the legislative branch of government—passes statutes. The executive branch—the President and administrative agencies—issues regulations under those statutes. The courts create legal precedents through their decisions.



## Constitutions

A **constitution** is the fundamental law of a nation. It establishes and limits the powers of government. Other laws are created through a constitution. The U.S. Constitution (see Appendix C) allocates the powers of government between the states and the federal government. Powers not granted to the federal government are retained by states or are left to the people. Note that a constitution need not be a written document—the United Kingdom’s is not—but it is in most nations. It should also be noted that in some countries the constitution is just for show. A document that looks much like the U.S. Constitution may exist, but means little in practice under a dictatorship.

**The U.S. Constitution** The U.S. Constitution is the oldest written constitution in force in the world. Although it contains some clear rules, such as the President must be at least age 35, it also has many general principles. It sets forth the organizational framework, powers, and limits of the federal government. Specifically, the Constitution creates the legislative, executive, and judicial branches as the primary framework of the U.S. government.

This division of governmental power is referred to as the separation of powers. It arose out of the founders’ fear that too much power concentrated in one governmental branch would reproduce the tyranny experienced under King George III. The separation of powers means that each branch of government has functions to perform that can be checked by the other branches. The government structure that has developed is illustrated in Exhibit 1.2.

As the highest legal authority, the U.S. Constitution overrides any state or federal laws that go beyond what the Constitution permits. According to Article VI:

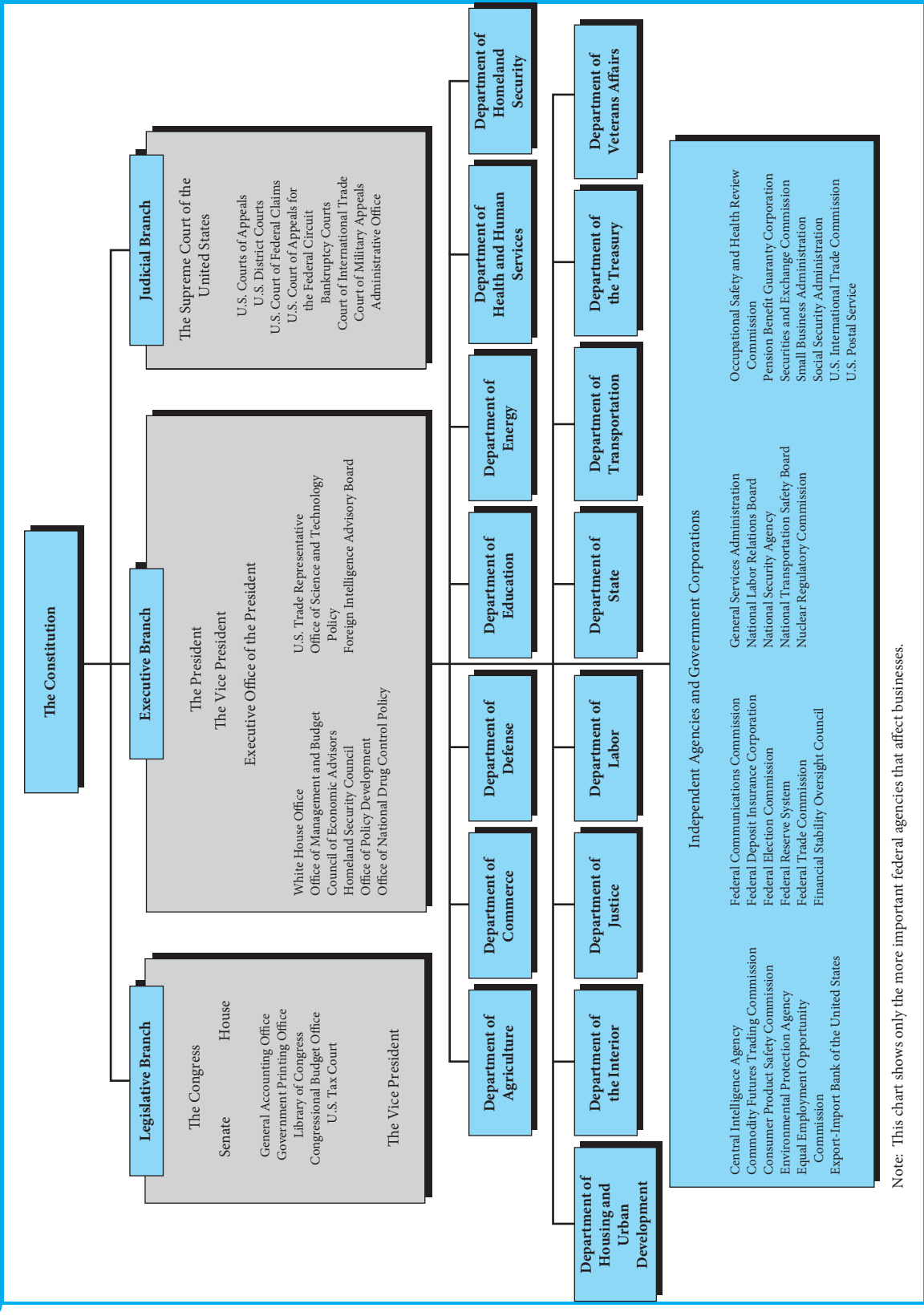
*This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.*

**State Constitutions** The powers and structures of all state governments are based on written constitutions. Like the federal government, state governments are divided into legislative, judicial, and executive branches. Their constitutions specify how state officials are chosen and removed, how laws are passed, how the court systems run, and, in general terms, how finances and revenues are paid and collected. On matters of state law, each state’s constitution is the highest form of law for that state, although the federal Constitution can override the state constitutions. Some state constitutions, unlike the U.S. Constitution, are very long and filled with details, because amending state constitutions is often much easier than changing the U.S. Constitution.

## Legislatures and Statutes

Congress and state legislatures are the sources of statutory law. Statutes that are created by legislation make up much of the law that significantly affects business behavior. For example, Congress enacted the Clean Water Act in 1972. It sets standards for water quality for the nation and grants the Environmental Protection Agency the authority to adopt regulations that help make the goals of the statute effective. Similarly at the state level, every state legislature has passed statutes to regulate the insurance industry. The intent of the legislation is fulfilled, in part, through state insurance commissions created for that role.

**EXHIBIT 1.2 THE GOVERNMENT OF THE UNITED STATES**



Note: This chart shows only the more important federal agencies that affect businesses.

Federal courts may review statutes passed by Congress to ensure that they do not violate the U.S. Constitution. State courts may review statutes passed by their legislatures to ensure that they do not violate the constitution of the state or of the United States. If a state legislature enacts a statute that violates the U.S. Constitution, and a state court does not strike down the statute, it may be stricken by a federal court.

**United States Congress** Article I, Section 1, of the U.S. Constitution provides that all power to make laws for the federal government is given to Congress, a legislature consisting of the Senate and the House of Representatives. Of the thousands of pieces of legislation proposed in each session of Congress, only about 200 to 300 pass both the House and Senate and go to the President for his signature.

**State Legislatures** Every state has lawmaking bodies similar to Congress in their functions and procedures. With the exception of Nebraska, all states have a two-part legislature containing a House of Representatives (sometimes called a House of Delegates or an Assembly) and a Senate. Dividing power between two houses is intended to serve as an added check on government power. The lawmaking process in state legislatures is similar to the procedure followed by the Congress. However, in some states, voters may directly enact legislation through the voting process in referendums or initiatives.

The National Conference of Commissioners on Uniform State Laws works with lawyers, law professors, the business community, and judges. For over a century, it has drafted proposed laws for consideration by state legislatures. Some are ignored, but others have been widely adopted, such as the Uniform Commercial Code (UCC). The UCC, discussed in Chapters 11 and 13, is designed to ease the legal relationship among parties in commercial transactions by making laws uniform among the states. Another important uniform law adopted by most state legislatures is the Uniform Partnership Act, covered in Chapter 12.

## Administrative Agencies and Regulations

An administrative agency is created by a delegation of legislative power to the executive branch. Congress or the state legislature enacts a law that directs the agency to issue regulations, bring lawsuits, and otherwise act to fulfill the law's goals. For example, after President Nixon created the Environmental Protection Agency, Congress gave the EPA authority to enact regulations to implement the goals of environmental statutes and to be the primary enforcer of those laws. Similarly, all states have created state environmental agencies to design and enforce state environmental regulation.

Within the boundaries set by the legislature, administrative agencies exercise their powers to enact regulations, supervise compliance with those regulations, and adjudicate violations of regulations. Regulations issued by administrative agencies are among the important sources of law affecting the legal environment of business today. Agency procedures are discussed in Chapter 17.

## The Judiciary and Common Law

The **common law**—law made and applied by judges as they resolve disputes among private parties—is a major part of the legal environment of business as it is the foundation of agency (employment), contract, property, and tort law. In addition to applying the common law, the judiciary interprets and enforces laws enacted by legislatures. As we will see, some statutes, such as the antitrust laws, are written in broad terms and require significant court interpretation to be understood. The judiciary also reviews actions taken by the executive branch and administrative agencies to make sure they comply with the Constitution.

The oldest source of law in the United States, the common law, dates to colonial times when English common law governed most internal legal matters. To maintain social order and to encourage commerce, the colonists retained English common law when the United States became an independent nation.



### Lighter Side of the Law

#### Creative Common Law

An 18-year-old high school student in California “earned” over \$1 million in a stock scam. When the federal authorities busted his operation, charged him with securities fraud, and made him repay his earnings, he was also booted off his high school baseball team.

He then sued his high school for \$50 million. The basis of his suit was that he had planned to be a major league baseball player, but now that he could not play on his high school team he could not perform in front of baseball scouts who would draft him into the pros. He lost.

Source: True Stella Awards.

**Case Law** Under the common law, a dispute comes to court in the form of a **case**. A case is a dispute between two or more parties that is resolved through the legal process. In common law cases, the judge follows the rules of civil procedure (covered in Chapter 2 and 3) and, to determine the outcome of the matter, follows earlier judicial decisions that resolved similar disputes. For hundreds of years now, the decisions written by judges, often in the courts of appeals, to explain the rulings in important cases and many not-so-newsworthy cases, have been published in books called **case reporters**. The reporters are the official publication of case decisions and are public information. To settle disputes that are similar to past disputes, judges look for guidance by studying decisions from earlier recorded cases. This is referred to as **precedent** that is applied to the facts of the new cases under consideration and helps to guide the decision.

To settle unique or novel disputes, judges create new common law. Even in such cases, their rulings are based on the principles suggested by many previously reported decisions. Since common law is state law, there are some differences across the states in the interpretation of common-law principles, but the judges in one state can look to cases from other states to help resolve disputes if there are not decisions on point from their own state. Sometimes they even look to decisions of courts in other common law countries.

**Doctrine of Stare Decisis** The deciding of new cases by referencing previous decisions is the foundation of the Anglo-American judicial process used to varying degrees in Australia, the United Kingdom, Canada, New Zealand, India, South Africa, and other former British colonies, including the United States. The use of precedent in deciding current cases is a doctrine called **stare decisis**, meaning “to stand on decided cases.” Under this doctrine, judges are expected to stand by established rules of law. According to Judge Richard Posner:

*Judge-made rules are the outcome of the practice of decision according to precedent (stare decisis). When a case is decided, the decision is thereafter a precedent, i.e., a reason for deciding a similar case the same way. While a single precedent is a fragile thing... an accumulation of precedents dealing with the same question will create a rule of law having virtually the force of an explicit statutory rule.*