
SECOND EDITION

THE LEGAL ENVIRONMENT OF BUSINESS

A MANAGERIAL APPROACH: Theory to Practice

Sean P. Melvin / Michael A. Katz



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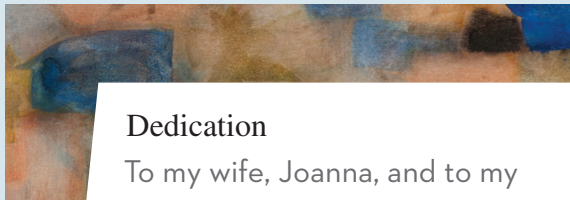
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Dedication

To my wife, Joanna, and to my children, Sean and Ally.

S.P.M.

To my parents, my children, and their families, who have always directly and indirectly provided inspiration and support, and in particular to my grandson Isaac, who reminds me every day that working to ensure a safe and secure future is our primary obligation.

M.A.K.

To 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 West Chester University of Pennsylvania, 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 of five books (including three textbooks), has contributed scholarly and professional articles and case studies to dozens of publications, and is a member of the Academy of Legal Studies in Business (ALSB). In 2011, his article “Case Study of a Coffee War” was selected as Best International Case Study at the annual ALSB conference.



Michael A. Katz is a professor of business law at Delaware State University, where he has taught since 1990 and is currently serving as department chair. Prior to his appointment at Delaware State, he maintained general civil law practices as an associate in a 16-member firm and as a solo practitioner. He managed the mortgage origination department at Delaware Trust, the second-largest bank in Delaware at that time. Professor Katz began his teaching career at Goldey Beacom College, where he taught for eight years before moving into banking and the practice of law. He is the author of a dozen scholarly and professional peer-reviewed publications and over a dozen textbook supplements. Professor Katz is a member of the Academy of Legal Studies in Business, for which he was the director of the Academy’s Student Research Paper Competition for eight years. He is a past president of both the Midwest Academy of Legal Studies in Business and the Mid-Atlantic Academy of Legal Studies in Business.

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 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.

Contact Information We invite you to contact us with any comments, suggestions, or updates. A special link to our e-mail address is located on this textbook's website www.mhhe.com/melvinleb2e.

Sean P. Melvin

Michael A. Katz

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 context of the American legal system.
- 3-2 Distinguish between the roles of federal courts and state courts.
- 3-3 Identify the responsibilities of trial courts versus appellate courts.
- 3-4 Articulate how the law develops via adjudication of cases.
- 3-5 Differentiate between subject matter jurisdiction and personal jurisdiction.
- 3-6 Explain original jurisdiction and how courts may have concurrent jurisdiction.

CASE 3.1 Estate of Weingeroff v. Pilatus Aircraft, 566 F.3d 94 (3d Cir. 2009)

FACT SUMMARY The legal representative of the estate of Weingeroff (Weingeroff), a passenger on a turboprop plane who was killed when the plane crashed near State College, Pennsylvania, brought a negligence and product liability lawsuit against Pilatus Air (Pilatus), the manufacturer of the plane. The plane crashed when approaching a small airport in Pennsylvania on a planned stop en route between Florida and Rhode Island. Weingeroff sued Pilatus in a federal district court situated in the Eastern District of Pennsylvania. Pilatus, a Swiss company, asked the court to dismiss the case for lack of personal jurisdiction. Pilatus claimed that it had no offices, no agents, no commercial transactions with Pennsylvania residents, and no physical presence in the state that constitutes purposeful availment. Weingeroff pointed to evidence that (1) Pilatus had conducted a nationwide marketing campaign in the United States to sell its planes, including in Pennsylvania, and (2) Pilatus had purchased over \$1 million in products, services, and equipment from Pennsylvania suppliers. The trial court ruled in favor of Pilatus and dismissed the suit for lack of personal jurisdiction.

SYNOPSIS OF DECISION AND OPINION The Court of Appeals for the Third Circuit upheld the trial court's decision in favor of Pilatus. The court pointed out that Pilatus had not sold any aircraft to purchasers in Pennsylvania or shipped anything directly to persons or entities in Pennsylvania. Moreover, Pilatus had not advertised or marketed its products in Pennsylvania and did not do so for the Pennsylvania market.

suppliers in Pennsylvania, this amount represented less than 1 percent of Pilatus's total annual purchases for an approximately five-year period.

WORDS OF THE COURT: Purposeful Availment
 "We acknowledge that there is a certain reasonableness to an argument that a manufacturer should be subject to suit in a jurisdiction in which its plane crashes if the suit charges that a manufacturing defect caused the crash. Yet it is clear that the critical finding that the defendant purposefully availed itself of the privilege of conducting activities within the forum [state] requires contacts that amount to a deliberate reaching into the forum state to target its citizens. Pilatus's efforts to exploit a national market necessarily included Pennsylvania as a target, but those efforts simply do not constitute the type of deliberate contacts within Pennsylvania that could amount to purposeful availment of the privilege of conducting activities in that state. Rather, any connection of Pilatus to Pennsylvania merely was a derivative benefit of its successful attempt to exploit the United States as a national market."

Case Questions

1. What facts could you change that may sway the court's judgment in analyzing personal jurisdiction over Pilatus in this case?
2. Does this decision mean that Weingeroff is without any legal recourse against Pilatus unless the case is brought in Swiss courts?

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," that helps 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.

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.

BUSINESS ETHICS PERSPECTIVE

Ethical Issues Involved in Abusive Litigation

While commercial litigation typically involves two parties attempting to resolve a legitimate dispute in good faith, the costs, burdens, and uncontrollable risks of litigation render it subject to potential abuse. Although federal and state courts have strict procedural rules intended to curb abusive litigation, it is sometimes difficult to enforce those rules because of the inherent vagueness in defining what constitutes "abusive." Abusive litigation may be defined as vexatious litigation or abuse of the litigation process.

Vexatious litigation may be defined as lawsuits that are filed for reasons other than legitimate damages being suffered by the plaintiff. These illegitimate reasons include using a lawsuit to harass, annoy, intimidate, or cause the opposite party to expend unnecessary costs. Consider the case of *Alston v. Advanced Brands and Importing Company* where a group of parents formed a consumer activist group and filed a lawsuit against manufacturers of alcoholic beverages. The suit alleged that the manufacturers' advertising contributed to the illegal purchase of alcohol by minors. The parent group conceded that there was no evidence that their own minor children had actually purchased alcoholic beverages, so the suit was dismissed for lack of standing.⁸

1. Once the company was threatened with a lawsuit, what ethical obligation did the management of Advance Brands have to its stockholders?⁹ Should the management have settled the case for a small sum to avoid legal costs even if they were convinced the suit had no merit?
2. Does Advance have an ethical obligation to the community and public? Would that duty include fighting vexatious litigation to prevent future abuses of the legal system?
3. Does management's ethical duty to stockholders to settle this case for minimal costs override any ethical duty owed to the community?
4. Are there any circumstances under which a business could ethically use litigation as a legitimate business strategy?
 Abuse of the litigation process occurs when, after the lawsuit is filed, one party engages in a course of conduct that is contrary to the good faith requirements underlying all litigation. Destroying documents, refusing to hand over evidence during discovery, stalling, and making overly broad discovery requests can all be categorized as abuse of the process.
5. Suppose you were a manager who was ordered by your senior manager to shred certain documents. Do you have an ethical obli-

The UCC sets out different rules regarding contract formation when a sales contract involves two nonmerchants, a merchant and a nonmerchant, or two merchants.

1. Two nonmerchants may strike a \$1,000 deal for the sale of a used television, while two merchants may contract to buy 1,000 new televisions for \$1 million. Why are the rules of contract formation stricter for the two nonmerchants than they are for the two merchants?
2. Are different rules necessary? Why or why not?
3. Would UCC gap fillers work for nonmerchant contracts? Why or why not?

4. If company A sends a purchase order to company B and company B returns an acknowledgment of the order with additional or modified terms, courts may determine that those additional or modified terms become part of the final contract. Is it ethical to force company A to adhere to the additional or modified terms without an express agreement to them by company A? Is company B acting unethically by adding or modifying the terms of company A's purchase order?

Legal/Ethical Reflection and Discussion

This new 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?

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.

Self-Check Source of Constitutional Authority

What is the constitutional source of authority for each of the following laws?

1. A federal statute that makes it more difficult for businesses to qualify for protection under bankruptcy laws.
2. An increase in the federal corporate income tax.
3. A federal statute that adds criminal penalties for patent infringement.
4. A federal statute creating an agency to regulate ground shipping between states.
5. A federal statute that requires that 25 percent of federal government construction contracts be awarded to companies that are women- or minority-owned enterprises.

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

Online Dispute Resolution

PROBLEM In situations involving small amounts of money, is there a way for a business to resolve such relatively minor disputes in a cost-effective manner?

A business may be engaged in hundreds of relatively low-cost transactions per year with various out-of-state vendors such as suppliers, shipping companies, office supply stores, contractors, and the like. When disputes arise, a business may be at a distinct disadvantage and bargaining position because the amount in controversy is too low to justify even the least expensive form of alternative dispute resolution. However, over an extended period of time these small losses add up to unnecessary liabilities, leaving managers with a difficult choice when faced with a dispute over a relatively low amount of money with an out-of-state vendor: (1) Invest in a dispute resolution method despite the fact that the costs may very well exceed the

then sends both parties a fair price based on their initial demands.

Another form of ODR is geared more toward complex transactions—for example, the Square Trade website proposes prewritten resolutions and you have received a damaged shipment of goods. The site might offer a standard menu of solutions such as (1) replacement with an undamaged good, (2) return for a full refund, or (3) keep the merchandise with a partial refund. The parties may also fill in their own solution, but the site's guided approach helps the parties focus on a resolution to the dispute.

If direct negotiation fails to resolve the issue, Square Trade users can request a mediator for a \$20 fee per participant plus a percentage fee if the dispute exceeds \$1,000. At OnlineResolution.com, mediation fees range between \$15 and \$25. For disputes of more than \$500, each participant pays \$50 to \$150 per hour, based on the value under dispute.

Solutions for Managers

In keeping with the text's managerial focus, *Solutions for Managers* provides practical answers for legal problems faced by managers and business owners. *Solutions for Managers* 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.

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.

CONCEPT SUMMARY Jurisdiction

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

THEORY TO PRACTICE

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 shipped approximately 40 percent of its inventory to the same client. The client was the Wilmington, Delaware, school system (Wilmington) and the school paid approximately \$80,000 to Santiago for the computers per year. Santiago would also visit each school to be sure that the computers were installed correctly and that the school district was satisfied with the order. Santiago has a website that gives contact information for the company, but the site is not interactive because users can transact business only by sending Santiago e-mail via the website.

Recently, Wilmington discovered that large shipments of Santiago's products were defective, and it has been unable to come to a resolution with Santiago over the matter.

- If Wilmington wishes to sue Santiago, what court(s) would have jurisdiction over this matter?
- What would be the best venue and why?
- If a Delaware court decides that it does not have jurisdiction, how may that affect Wilmington's decision on whether or not to file a lawsuit?

Assume that one of Santiago's suppliers, Parts R Us (Parts) is headquartered in Union, 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,

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 was 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.

parties are and (2) the subject matter of the dispute. **Venue** is a determination of the most appropriate court *location* for litigating a dispute.

Jurisdiction and Business Strategy

The increasing integration of advanced technology in product and service delivery has made jurisdiction and venue an important part of business planning for business managers and owners. As with all legal decisions that business owners and managers make, jurisdiction must be considered in a cost-benefit context. For example, consider a dispute between 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 a trademark dispute. UWC management should consider the costs involved in pursuing the suit in a business context. In considering their strategy, 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 use of the trademark; and (3) any alternate dispute resolution methods available. If Knock Off is a small company and not likely to dilute the trademark in any of UWC's markets, it may not be worth the costs of litigation to sue UWC in its home state. Pursuing the infringement action would involve UWC's 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 could possibly have jurisdiction over the dispute, that fact will change the cost-benefit analysis because the expenses of the suit would be markedly lower.

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 federal jurisdiction law 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 legal process being applied. While origins of jurisdiction lie in the Constitution, appellate courts and legislatures have shaped the framework and rules used by modern courts to analyze jurisdiction questions.

Two-Part Analysis Jurisdiction requires a two-part analysis: A court must have both (1) *subject matter jurisdiction* and (2) *personal jurisdiction* (also known as *in personam*).

Legal Speak →)

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

LO 3-6

Other Textbook Features

Key Points briefly reinforce an important concept; **Web Checks** provide websites related to the material in the textbook; **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.

Business Law Simulation Exercises for Managers

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 simulation, 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 through 9 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 simulation is designed to help you understand how the various topics covered in the contract law chapters connect. By focusing on a simulated legal dispute, you will replicate a real-world experience by applying legal doctrines and using analytical and critical-thinking skills. This simulation is a essential

The simulation is structured in three parts:

- Part 1 is a hypothetical fact pattern describing events leading up to a legal dispute in the hypothetical U.S. state of Longville.
- Part 2 is a set of two hypothetical case summaries from Longville appellate courts that provide a brief set of facts, several legal points, and short excerpts from the opinion itself. While these cases are hypothetical, they are based on actual cases from appellate courts in various

Flexercises

New to this edition: Each Flexercise is a case presented in a way that is scalable (may be used as an individual, team, or full-class exercise) and adaptable (suitable for a writing exercise, discussion, or mock situation). The flexibility allows the professor to vary class assignments and keep students engaged, and it provides a wide range of student-learning assessment opportunities and measures.

UNIT ONE FLEXERCISE

The plaintiffs, husband and wife, attended a Halloween party dressed as Little Bo Peep (wife) and a sheep (husband). The wife made her husband's costume from long underwear covered with glued-on cotton batting. The husband was covered with cotton batting from head to toe, excluding his face and hands. During the party the husband attempted to smoke a cigarette, and the flame from his lighter ignited the cotton. The husband admitted that he knew that cotton batting burned but emphasized that he did not know "how it burned." His wife also admitted that she knew that cotton could burn, "[but] not burn that fast." She knew her husband smoked and used a cigarette lighter. The husband suffered burns on one-third of his body, and he underwent several surgeries as a consequence of the fire.

The plaintiffs sued the cotton manufacturer for failing to warn that cotton could ignite so easily and that the flames of the burning cotton would spread so quickly. The jury awarded the husband \$550,000 and his wife \$70,000 in damages. The defendants motioned for a judgment non obstante veredicto (JNOV). (A JNOV asks a judge to disregard the jury's verdict and award the judgment to the moving party.)

ENGAGEMENT QUESTIONS

1. Should a judge have the right to overrule a jury? Why have juries if a single person can overrule the entire jury?
2. Is it feasible for companies to put warning labels on their products listing every possible hazard? When should warning labels be required, if ever?
3. The husband regularly smoked and ignored warnings on cigarette packages. Do you think a warning label on the cotton batting would have deterred him from smoking that night?
4. The wife made the costume so if there had been a warning label on the cotton, the husband most likely wouldn't have been aware of it. Would this change anyone's liability?

CAPSTONE CASE STUDY 1
Coffee Wars: Starbucks v. Charbucks!

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

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

Capstone Case Studies

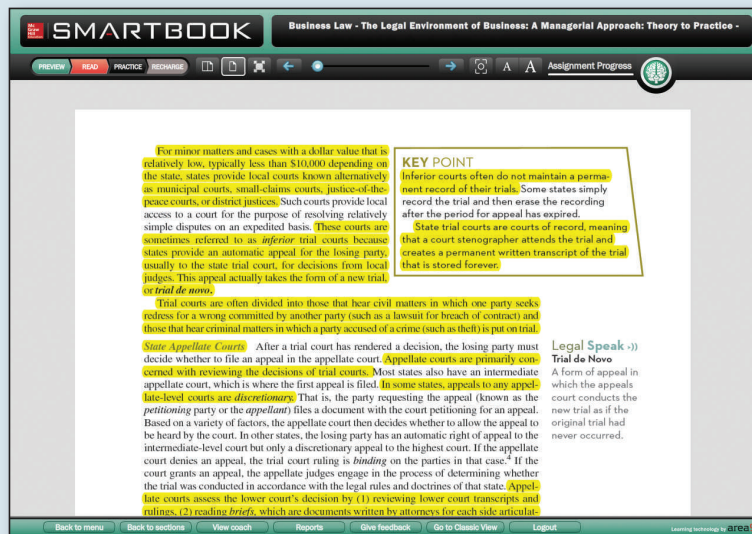
Capstone case studies center on the dilemmas of actual corporations that were faced with a corporate crisis involving legal and ethical issues. They are intended to help students connect several different legal and ethical concepts in a single case study. First, students reread concept summaries from 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, criminal law, and so forth. 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.

learn with adaptive technology



Fueled by LearnSmart—the most widely used and intelligent adaptive learning resource—SmartBook is the first and only adaptive reading experience available today.

Distinguishing what a student knows from what they don't, and honing in on concepts they are most likely to forget, SmartBook personalizes content for each student in a continuously adapting reading experience. Reading is no longer a passive and linear



experience, but an engaging and dynamic one where students are more likely to master and retain important concepts, coming to class better prepared. Valuable reports provide instructors insight as to how students are progressing through textbook content, and are useful for shaping in-class time or assessment. As a result of the adaptive reading experience found in SmartBook, students are more likely to retain knowledge, stay in class, and get better grades.

This revolutionary technology is available only from McGraw-Hill Education and for hundreds of course areas as part of the LearnSmart Advantage series.

How Does SmartBook Work?

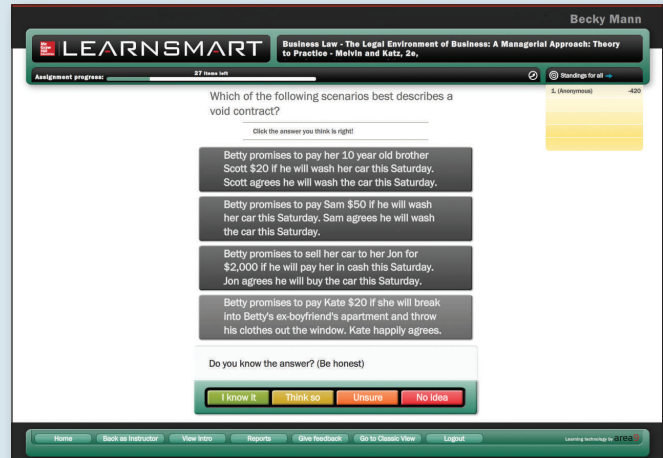
Each SmartBook contains four components: Preview, Read, Practice, and Recharge. Starting with an initial preview of each chapter and key learning objectives, students read the material and are guided to topics that need the most practice based on their responses to a continuously adapting diagnostic. Read and practice continue until SmartBook directs students to recharge important material they are most likely to forget to ensure concept mastery and retention.

LEARNSMART®

LearnSmart is one of the most effective and successful adaptive learning resources available on the market today. More than 2 million students have answered more than 1.3 billion questions in LearnSmart since 2009, making it the most widely used and intelligent adaptive study tool that's proven to strengthen memory recall, keep students in class, and boost grades. Students using LearnSmart are 13% more likely to pass their classes and 35% less likely to dropout.

Distinguishing what students know from what they don't, and honing in on concepts they are most likely to forget, LearnSmart continuously adapts to each student's needs by building an individual learning path so students study smarter and retain more knowledge. Turnkey reports provide valuable insight to instructors, so precious class time can be spent on higher-level concepts and discussion.

This revolutionary learning resource is available only from McGraw-Hill Education, and because LearnSmart is available for most course areas, instructors can recommend it to students in almost every class they teach.



The screenshot shows the LearnSmart interface for a user named Becky Mann. The course is "Business Law - The Legal Environment of Business: A Managerial Approach: Theory to Practice - Malin and Katz, 2e". The question asks: "Which of the following scenarios best describes a void contract?" with the instruction "Click the answer you think is right!". There are four options, each in a dark grey box: 1. Betty promises to pay her 10 year old brother Scott \$20 if he will wash her car this Saturday. Scott agrees he will wash the car this Saturday. 2. Betty promises to pay Sam \$50 if he will wash her car this Saturday. Sam agrees he will wash the car this Saturday. 3. Betty promises to sell her car to her Jon for \$2,000 if he will pay her in cash this Saturday. Jon agrees he will buy the car this Saturday. 4. Betty promises to pay Kate \$20 if she will break into Betty's ex-boyfriend's apartment and throw his clothes out the window. Kate happily agrees. Below the options is a question: "Do you know the answer? (Be honest)" with four buttons: "I know it" (green), "Think so" (yellow), "Unsure" (orange), and "No idea" (red). The interface also shows a progress bar at 27 items left and a score of 4/5 (80%) for the user.



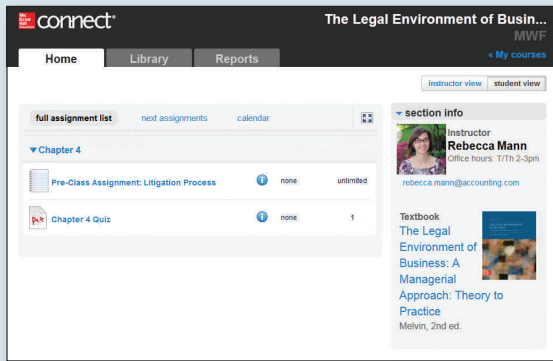
The screenshot shows the LearnSmart interface for a user named Becky Mann. The question asks: "Which of the following are typically answered when mutual assent has been reached?" with the instruction "Click ALL answers that you think are right!". There are four options, each in a dark grey box: 1. Do the parties intend to enter into a contract? 2. Do the parties understand their rights under the contract? 3. Has something of value been given in exchange? 4. Do the parties understand their obligations under the contract? The fourth option is selected with a checkmark. Below the options is a question: "Do you know the answer? (Be honest)" with four buttons: "I know it" (green), "Think so" (yellow), "Unsure" (orange), and "No idea" (red).

leading technology extends learning beyond the classroom



MCGRAW-HILL CONNECT BUSINESS LAW

Get *Connect Business Law*. Get Results.



McGraw-Hill *Connect Business Law* is an online assignment and assessment system that gives students the means to better connect with their coursework, with their instructors, and with the important concepts that they will need to know for success now and in the future. With *Connect Business Law*, instructors can deliver assignments, quizzes, and tests easily online. *Connect Business Law* helps students master critical conceptual material in the course. By using *Connect Business Law* to master concepts, students are more prepared to apply those concepts to higher level discussions and topics in the Business Law course. *Connect Business Law* offers you the features described below.

- Chapter quizzes for the 26 chapters, consisting of 15–25 multiple-choice questions, testing students’ overall comprehension of concepts presented in the chapter.
- At least 2 specially crafted interactive applications for each of the 26 chapters that drill students in the use and application of the concepts and tools of strategic analysis.
- The majority of the Connect exercises are automatically graded, thereby simplifying the task of evaluating each class member’s performance and monitoring the learning outcomes.

“As a student I need to interact with course material in order to retain it, and **Connect** offers a perfect platform for this kind of learning. Rather than just reading through textbooks, **Connect** has given me the tools to feel engaged in the learning process.

—Jennah Epstein Kraus, Student, Bunker Hill Community College

Interactive Applications

Interactive Applications offer a variety of automatically graded exercises that require student to apply key concepts. Whether the assignment includes a click & drag, video case, or decision generator, these applications provide instant feedback and progress tracking for students and detailed results for the instructor.

Click and Drag Interactive Applications—These fun and interactive click and drag exercises motivate students to apply concepts within the context of a scenario or case allowing them to think about legal issues.

Comprehension Case Interactive Applications—These cases generate deeper understanding of the core concepts by applying chapter concepts in an open-ended question format. They are the most difficult Interactive Applications in Connect and are the only exercises that are manually graded.

Decision Generator Interactive Applications—These exercises ask students to apply critical thinking skills and allow students to see the interdependencies of their decisions in a mini case scenario.

Video Case Interactive Applications—These case study videos include pop-up questions that appear as the video plays to test concept and/or terminology comprehension.

Student Library

The *Connect Business Law* Student Library gives students access to additional resources such as recorded lectures, online practice materials, an eBook, and more.

QUESTION PROGRESS Introduction Click And Drag

Click And Drag

Roll over the items to read a hint about what category of court best matches the item. Then click and drag each item to the related category of court.

Court with final decision on state law matters

Florida Supreme Court U.S. Court of Appeals for the Second Circuit U.S. District Court for S.D. of Florida Chancery Court

State Trial Court State Appellate Court Federal Trial Court Federal Appellate Court

prev glossary

QUESTION PROGRESS Introduction Decision Generator

Decision Generator

An Ethical Fork in the Road

Consider the dilemma of the hypothetical company in the following case study. It involves resolving clashing values during business planning and operations. Use the ethical decision-making paradigm featured in Figure 5.1 to arrive at a solution.

Dorian Industries employs 500 people at its headquarters in Metropolis. Dorian has an active values management program and has been committed to "producing high-quality products, while being an outstanding corporate citizen, an employee-focused workplace, and first-class neighbor." After complaints by employees about commuting conditions, the company hired a consultant to study how to alleviate the traffic jams near the company's headquarters that were created by Dorian employees during rush hours. Additionally, several residents in the adjoining neighborhood complained that delivery trucks and others bound for Dorian headquarters were spending through residential streets to avoid the traffic congestion.

Although the consultants offered short-term solutions such as staggered employee shifts, ultimately, the company faced three major options for a long-term solution. All long-term solution

1. Define Dorian's dilemma.

The company's commitment to employees is at odds with its commitment to corporate citizenship.

2. Which of Dorian's standards and values guides his decision?

select

3. Dorian's concern for the convenience of its employees is at odds with its commitment to corporate citizenship, its employees, and its neighbors.

Dorian's commitment to protect the environment.

4. Which option is the most consistent with Dorian's standards and values?

prev glossary

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The Legal Environment of Business

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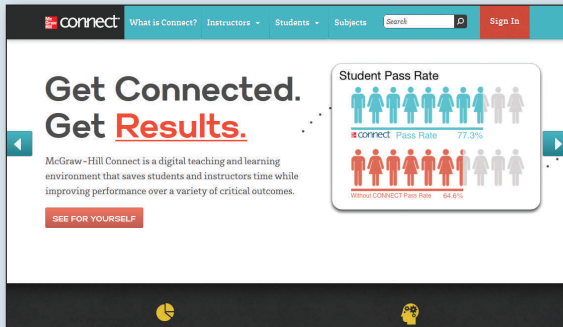
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MCGRAW-HILL CONNECT BUSINESS LAW FEATURES

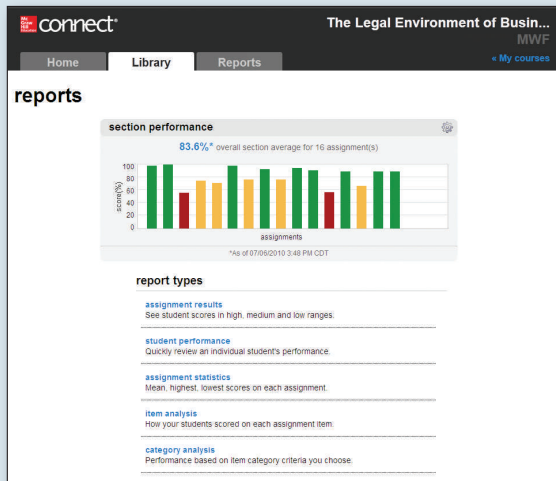
Connect Business Law offers a number of powerful tools and features to make managing assignments easier, so faculty can spend more time teaching.



Simple Assignment Management and Smart Grading

With *Connect Business Law*, creating assignments is easier than ever, so instructors can spend more time teaching and less time managing.

- Create and deliver assignments easily with selectable interactive applications, quizzes and Test Bank items.
- Go paperless with the eBook and online submission and grading of student assignments.
- Have assignments scored automatically, giving students immediate feedback on their work and side-by-side comparisons with correct answers.
- Access and review each response; manually change grades or leave comments for students to review.
- Reinforce classroom concepts with practice tests and instant quizzes.



Student Reporting

Connect Business Law keeps instructors informed about how each student, section, and class is performing, allowing for more productive use of lecture and office hours. The progress-tracking function enables you to:

- View scored work immediately and track individual or group performance with assignment and grade reports.
- Access an instant view of student or class performance relative to learning objectives.
- Collect data and generate reports required by many accreditation organizations, such as AACSB.

Instructor Library

The *Connect Business Law* Instructor Library is a repository for additional resources to improve student engagement in and out of class. You can select and use any asset that enhances your lecture. The *Connect Business Law* Instructor Library includes access to the eBook version of the text, videos, slide presentations, Instructor's Manual, and Test Bank. The *Connect Business Law* Instructor Library also allows you to upload your own files.

MCGRAW-HILL CONNECT PLUS BUSINESS LAW



McGraw-Hill reinvents the textbook learning experience for the modern student with *Connect Plus Business Law*. A seamless integration of an eBook and *Connect Business*

Law, *Connect Plus Business Law* provides all of the *Connect Business Law* features plus the following:

- An integrated eBook, allowing for anytime, anywhere access to the textbook.
- Media-rich capabilities like highlighting and sharing notes.
- Dynamic links between the problems or questions you assign to your students and the location in the eBook where that concept is covered.
- A powerful search function to pinpoint key concepts for review.

In short, *Connect Plus Business Law* offers students powerful tools and features that optimize their time and energy, enabling them to focus on learning.

For more information about *Connect Plus Business Law*, go to www.mcgrawhillconnect.com, or contact your local McGraw-Hill sales representative.



Tegrity Campus: Lectures 24/7



Tegrity Campus is a service that makes class time available 24/7 by automatically capturing every lecture. With a simple one-click start-and-stop process, you capture all computer screens and corresponding audio in a format that is easily searchable, frame by frame. Students can replay any part of any class with easy-to-use browser-based viewing on a PC, Mac, iPod, or other mobile device.

Educators know that the more students can see, hear, and experience class resources, the better they learn. In fact, studies prove it. Tegrity Campus's unique search feature helps students efficiently find what they need, when they need it, across an entire semester of class recordings. Help turn your students' study time into learning moments immediately supported by your lecture. With Tegrity Campus, you also increase intent listening and class participation by easing students' concerns about note-taking. Tegrity Campus will make it more likely you will see students' faces, not the tops of their heads.

To learn more about Tegrity, watch a 2-minute Flash demo at <http://tegritycampus.mhhe.com>.

MCGRAW-HILL CAMPUS



McGraw-Hill Campus™ is a new one-stop teaching and learning experience available to users of any learning management system. This institutional service allows faculty and students to enjoy single sign-on (SSO) access to all McGraw-Hill Higher Education materials, including the award-winning McGraw-Hill *Connect* platform, directly from within the institution's website. McGraw-Hill Campus provides faculty with instant access to teaching materials (e.g., eTextbooks, Test Banks, PowerPoint slides, animations, and learning objects), allowing them to browse, search, and use any ancillary content in our vast library. Students enjoy SSO access to a variety of free products (e.g., quizzes, flash cards, and presentations) and subscription-based products (e.g., McGraw-Hill *Connect*). With McGraw-Hill Campus, faculty and students will never need to create another account to access McGraw-Hill products and services.

CUSTOM PUBLISHING THROUGH CREATE

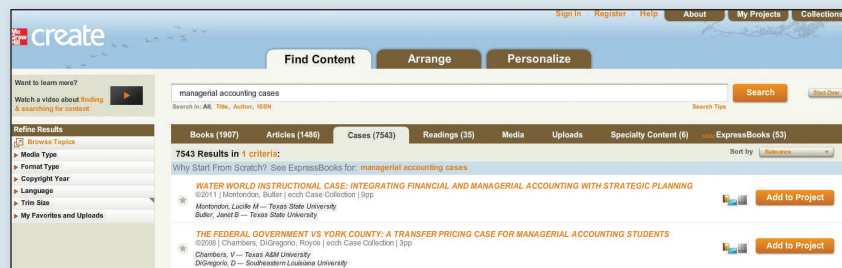


McGraw-Hill Create™ is a self-service website that allows instructors to create custom course materials by drawing upon McGraw-Hill's comprehensive, cross-disciplinary content. Instructors can add their own content quickly and easily and tap into other rights-secured third party sources as well, then arrange the content in a way that makes the most sense for their course. Instructors can even personalize their book with the course name and information and choose the best format for their students—color print, black-and-white print, or an eBook.

Through Create, instructors can

- Select and arrange the content in a way that makes the most sense for their course.
- Combine material from different sources and even upload their own content.
- Choose the best format for their students—print or eBook.
- Edit and update their course materials as often as they'd like.

Begin creating now at www.mcgrawhillcreate.com.



COURSESMART



Learn Smart. Choose Smart.

CourseSmart is a way for faculty to find and review eTextbooks. It's also a great option for students who are interested in accessing their course materials digitally and saving money.

CourseSmart offers thousands of the most commonly adopted textbooks across hundreds of courses from a wide variety of higher education publishers. It is the only place for faculty to review and compare the full text of a textbook online, providing immediate access without the environmental impact of requesting a print exam copy.

With the CourseSmart eTextbook, students can save up to 45 percent off the cost of a print book, reduce their impact on the environment, and access powerful web tools for learning. CourseSmart is an online eTextbook, which means users access and view their textbook online when connected to the Internet. Students can also print sections of the book for maximum portability. CourseSmart eTextbooks are available in one standard online reader with full text search, notes and highlighting, and e-mail tools for sharing notes between classmates. For more information on CourseSmart, go to **www.coursesmart.com**.

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.

EZ Test Online

McGraw-Hill's flexible and easy-to-use electronic testing program allows instructors to create tests from book-specific items. It accommodates a wide range of question types, and instructors may add their own questions. Multiple versions of a test can be created, and any test can be exported for use with online course management systems. EZ Test Online allows you to administer EZ Test-created exams and quizzes online.

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, EZ Test and EZ Test Online, or *Connect Business Law* to easily query for learning objectives that directly relate to the learning objectives for your course. You can then use the reporting features of EZ Test to aggregate student results in similar fashion, making the collection and presentation of assurance of learning data simple and easy.

AACSB Statement

The McGraw-Hill Companies 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 of *The Legal Environment of Business* 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.

Online Learning Center, www.mhhe.com/melvinleb2e

The Online Learning Center includes study materials for students. Use the site to access the chapter review quizzes, key term review, legal resources, additional cases for discussion, online access to the Uniform Commercial Code and U.S. Constitution, and news updates, and other resources.

MCGRAW-HILL CUSTOMER CARE CONTACT INFORMATION

At McGraw-Hill, we understand that getting the most from new technology can be challenging. That's why our services don't stop after you purchase our products. You can e-mail our Product Specialists 24 hours a day to get product-training online. Or you can search our knowledge bank of Frequently Asked Questions on our support website. For Customer Support, call **800-331-5094** or visit **www.mhhe.com/support**. One of our Technical Support Analysts will be able to assist you in a timely fashion.

acknowledgments

We owe a great deal of gratitude to our entire team at McGraw-Hill. Although many team members worked diligently with us in developing and strengthening this book, our Managing Director, Tim Vertovec, our Development Editor, Rebecca Mann, and our Content Project Manager, Marianne Musni, are owed special thanks for their insight in navigating the waters of publication. Sean J. Melvin is owed thanks for his case research contribution.

Throughout the development of the first and second editions of this book, we have been privileged to have the candid and valuable advice of our reviewers and focus group. These 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 are committed to ongoing improvement of this textbook through the generous feedback, suggestions, and guidance from over 100 business law professors and reviewers. The second edition of *The Legal Environment of Business: A Managerial Approach* features the following:

- Award winning capstone case: **Charbucks v. Starbucks**
- **Flexercises:** Scalable and flexible exercises with blind case fact patterns/questions and templates for exercises, assessment, or class discussion.
- **Legal/Ethical Discussion points:** Encourages critical thinking about a particular topic of law and/or ethics of a legal solution.
- **Expanded coverage of contracts** by splitting Chapter 6, “Overview and Formation of Contracts,” into two separate chapters Chapter 6 “Overview and Language of Contracts” and Chapter 7 “Contract Formation.”
- **New and/or expanded coverage** of the following topics:
 - Affordable Care Act
 - Wall Street Reform Act
 - Regulation of Financial Markets
 - TARP Program
 - Antitrust law and Professional Sports
 - Trademark Dilution
- **Over 40 new cases added** including cutting edge cases such as: *Arizona v. U.S.* (Immigration); *U.S. v. Alvarez* (Stolen Valor Act); *Brown v. Entertainment Merchants Association* (Violent Video Games); *U.S. v. Bhagat* (Insider trading).
- Increased use of popular features including Key Points, Concept Summaries, Legal Speak.

Chapter 1

- Updated Learning Objectives
- Updated Introduction to Law section
- New example added to Purpose of Law section
- Updated Legal Decisions in a Business Environment section
- Updated Table 1.1
- Expanded Role of Counsel section
- Expanded Sources and Levels of American Law
- Expanded Constitutional Law section
- New Case 1.1 added
- Expanded Statutory Law section
- New Case 1.2 added
- New content added to Statutory Scheme and Legislative History section
- Content reworded and expanded in Common Law section
- Law versus Equity and Important Equitable Maxims subheadings moved to later in the chapter
- Expanded Uniform Model Laws section
- Updated Concept Summary for Sources of Law
- Expanded Criminal Law versus Civil Law section
- Expanded Substantive Law versus Procedural Law section
- Expanded Law versus Equity section
- Equitable Maxims content revised with new examples in the Law versus Equity section
- Three new Case Summaries added
- Key Terms added

Chapter 2

- Learning Objectives revised
- Expanded Nature of the Constitution section
- Separation of Powers subsection moved to subheading Article III—Judicial Powers
- Key Point added
- Expanded Amendments section
- Expanded Article I—Congressional Powers
- Expanded Article II—Executive Powers
- Expanded Article III—Judicial Powers
- New Key Point added
- New Case 2.2
- Updated Rational Basis section
- New Case 2.3
- New example added to Constitutional Restrictions on State Regulation of Commerce section
- New Case 2.4
- New Legal/Ethical Reflection and Discussion added
- Expanded Tax and Spend Power section
- Expanded Concept Summary for Structure and Nature of the Constitution: Federal Powers
- Expanded First Amendment section
- New Case 2.5
- Expanded Other Amendments section
- Expanded Fourteenth Amendment section
- Expanded Equal Protection section
- Updated Concept Summary for Constitutional Protections
- Case Summary 2.1 replaced
- Two new Case Summaries added
- Key Terms added

Chapter 3

- Updated State versus Federal Courts section
- Expanded State Trial Courts section
- Expanded State Appellate Courts section

- Updated U.S. District Courts section
- Table 3.1 data updated
- Figure 3.2
- Expanded How the Law Develops section
- Expanded Subject Matter Jurisdiction:
- Expanded In-State Defendants
- Expanded Out-of-State Defendants section
- Expanded Venue section
- New Case Summary

Chapter 4

- New Key Point added to Prolawsuit: Demand and Prelitigation Settlement Negotiations section
- Updated Statutes of Limitations with new Key Point added
- Expanded Answer section
- Expanded Depositions section
- Expanded Interrogatories section
- New Legal Speak added
- New Legal/Ethical Reflection and Discussion feature added
- Expanded Requests for Production section
- New Case 4.1
- Updated Self-Check
- Updated Trial section
- Updated Jury Selection and Opening section
- New Legal Speak added to Deliberations and Verdict section
- Expanded Posttrial Motions and Appeals section
- Expanded Concept Summary Stages of Litigation
- Expanded Expertise section
- Expanded Formal ADR section
- New Case 4.3
- Expanded Federal Arbitration Act section
- Expanded Mediation section

- Expanded Hybrid Forms of ADR section
- Two new Case Summaries added
- Key Terms added

Chapter 5

- Updated Learning Objective
- Expanded Business Ethics Defined section
- Expanded Primary and Secondary Stakeholders section
- Expanded Principles-Based Approach section
- New Self-Check added
- New Concept Summary added
- Expanded Values Management and Challenges to Business Ethics section
- Expanded Strategic Advantages of Values Management section
- New Case 5.1
- New Legal/Ethical Reflection and Discussion feature added
- Expanded Common Traits of Effective Ethical Programs in Business section
- New Case 5.2
- New Concept Summary added to Corporate Social Responsibility section
- New Key Terms added
- Two new Case Summaries added

Chapter 6

- Chapter 6 was split into two chapters.
- Learning Objectives
- Expanded Elements of a Contract section
- New Concept Summary added
- Categories of Contracts section
- New Key Point added
- Expanded Bilateral or Unilateral section
- Expanded Express, Implied or Quasi-Contracts section
- New Case 6.1
- Expanded Valid, Void, Voidable, or Unenforceable section
- New Legal Speak
- New Case 6.2
- New subheadings in Categories of Contracts section

- New Case 6.3
- Two new Self-Checks
- New Concept Summary added
- New Theory to Practice added
- New Manager's Challenge added
- All new Case Summaries
- Key Terms added

Chapter 7

- This is a chapter split from first edition's Chapter 6
- Learning Objectives
- New introduction
- Agreement Part 1: Offer section
- Advertisements as an Offer section
- Updated example in Option Contract section
- Expanded Death, Incapacity, or Destruction section
- Concept Summary title changed from Agreement to Mutual Assent and content added
- Expanded Silence as an Acceptance section
- Expanded Indefinite Terms section
- Expanded Consideration section
- Expanded Amount and Type of Consideration section
- New Legal/Ethical Reflection and Discussion feature added following Preexisting Duty Rule
- Expanded Bargained-for Exchange section
- Expanded Past Consideration section
- New Case 7.4
- Expanded Minors section
- New Key Point added
- Expanded Mental Incompetents section
- Expanded Concept Summary for Contract Formation
- Expanded Fraudulent Misrepresentation section
- New Self-Check, Fraud and Misrepresentation, added
- New Case 7.5
- Expanded Statute of Frauds section
- Expanded Enforceability of Contracts under the Statute of Frauds section
- Two new case Summaries added
- Answers added for new Self-Check content

Chapter 8

- Updated Learning Objectives
- Expanded Categories of Conditions section
- Update Substantial Performance section
- Expanded Mutual Consent section
- Expanded Impossibility section
- Expanded Impracticability section
- Expanded Concept Summary for Performance and Discharge
- Expanded Anticipatory Repudiation section
- New content added to Remedies section
- New Case 8.2
- Expanded Clean Hands and Tender of Performance section
- New Case 8.3
- New Key Terms added
- Two new Case Summaries added

Chapter 9

- Updated Learning Objectives
- Expanded Introduction to Article 2 of the UCC section
- Expanded UCC Coverage and Definitions section
- Expanded Merchant Transactions section
- Legal Speak added to Consideration section
- Expanded Risk of Loss section
- Expanded Goods Picked Up by the Buyer section
- Expanded Cure section
- New Case 9.3
- Updated Concept Summary for Performance of Sales Contracts
- Expanded Goods in Hands of Seller section
- Expanded Cover section
- Updated Concept Summary for Contracts for International Sales of Goods
- New Key Terms added
- Two new Case Summaries added

Chapter 10

- New Learning Objective Added
- Updated Categories of Torts section

- Updated Defamation section
- Updated Qualified Privilege section
- Expanded Fraudulent Misrepresentation section
- False Imprisonment section
- Updated Table 9.1
- Key Point added
- Expanded Intentional Torts section
- Expanded No General Duty to Act section
- Expanded *Res Ipsa Loquitur* section
- Expanded Closest-in-Proximity section
- Expanded Actual Damages section
- Expanded Defenses to Negligence Claims section
- Expanded Abnormally Dangerous Activities section
- Expanded Warranty section
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UNIT ONE

Fundamentals of the Legal Environment of Business

CHAPTER 1 Legal Foundations

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1

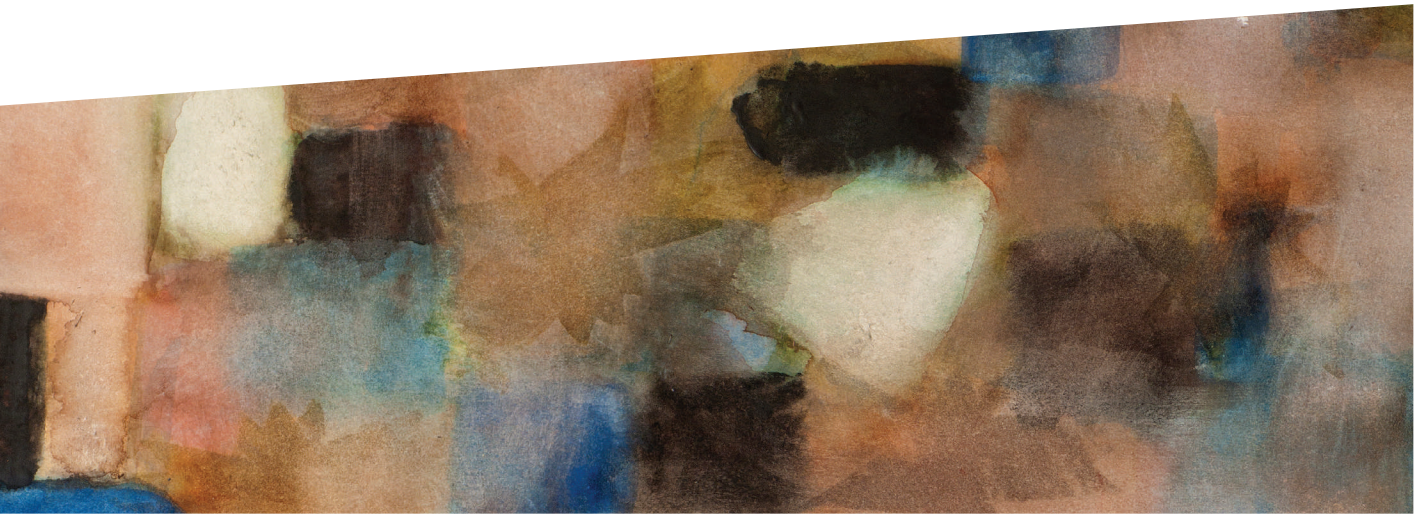
CHAPTER

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 law.
- 1-3** Explain the importance and benefits of legal awareness for business owners and managers in creating 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 LO 1-1

What Is 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 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, but 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* or certain laws that regulate certain rights of employees as *employment law*.

Jurisprudence

Jurisprudence, roughly defined as the science and philosophy of law, defines several schools of

¹*Black's Law Dictionary.*

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. *Natural law* proponents argue that a system of moral values, which are inherent in humankind, form the basis for all law and those certain principles are of a *higher* authority than national laws (laws defined by a governing body).² *Positivists* believe in a specific set of agreed-upon laws that are enforced *uniformly* and strictly unless the law is changed expressly via the government. They reject the natural law notion of a higher authority that surpasses national law. *Legal realism* began to take shape in the United States after World War I and is based on the concept that law is a *social institution* that should be used to promote fairness by taking into account social and economic realities when arriving at legal conclusions. Perhaps the most dramatic example of the legal realism school of thought in practice was the U.S. Supreme Court's formal recognition during the civil rights era of its role in achieving equality for all Americans by interpreting the Constitution as protecting certain rights that courts had previously never recognized.

LO 1-2 Purposes of Law

Although the most visible function of the law on a day-to-day basis is to provide for some system of order that defines crimes and levies punishment for violation of the crimes, 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 domination and power of their authority with little consideration for 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 and especially in education and in the workplace. The law also sets out a system 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* that 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., financial, operations, 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.

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



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²Aristotle was perhaps the most famous advocate of the natural law theory.

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.

LEGAL DECISIONS IN A BUSINESS ENVIRONMENT: THEORY TO PRACTICE

LO 1-3

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 both 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 attorney, the results contribute to better strategic business decisions that add value to the business. For example,

KEY POINT

Learning to apply legal awareness in practice involves recognizing opportunities for proactive business planning, limiting liability, gaining a competitive edge, and adding value to the business.



Management teams with legal insight add value to their company by limiting liability and identifying opportunities.

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 limits liability and maximizes business opportunities.

LO 1-4 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 considers 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.

Legal Speak >))

Retainer Fee Some law firms handle certain legal matters on a retainer-fee basis. Although the practice is becoming increasingly rare, a retainer fee is an advanced payment by a client that ensures the availability of an attorney to handle general legal matters. If a business owner or manager has legal questions or requires representation, the attorney's charges are deducted from the retainer fee. While costs exceeding the retainer are due from the client, any unused retainer-fee balance is either rolled over into the next billing cycle or forfeited according to the initial fee agreement.

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 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, who is responsible for record keeping and complying with notice and voting requirements for the board of directors.³ 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 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

³The legal structure of corporations and other business entities is discussed in detail in Unit Three.

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	■ 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.
	■ 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 laws.
	■ 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 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 did the previous business model.
	■ International law	■ IPC may be subject to international agreements and treaties regarding sales and intellectual property.

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.

LO 1-5 **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** (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 secrets⁴ 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 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 court case history (called *common law*, discussed later) that 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.

Legal Speak >>)

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*.

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 of 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

⁴Trade secret law, which is covered in detail in Chapter 25, “Intellectual Property,” is the legal protection of certain confidential business information.

this context means that constitutional law is supreme over all other sources of law such as federal and state statutes, treaties, and common law. The Constitution further grants federal law supremacy over conflicting state 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; creation of legal protections for intellectual property (such as patents and copyrights); 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."

Statutory Law

Statutes are written laws that are passed by the federal or a state legislature and are 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's concurrence, it is known as a *bill*. On the *federal level*, the president is the executive and may sign a bill into law (thereby adopting it as a statute), or the president may veto (reject) the bill 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. The governor (as executive) has authority to sign a state bill into law or to exercise other rights as laid out in the state constitution. Written laws at the *local level* are called **ordinances** (sometimes referred to as *local regulations*). Ordinances generally regulate issues such as zoning (regulating where certain businesses, such as factories, may be located) or impose health and safety regulations on local merchants such as restaurants.

Interpreting Statutes When interpreting statutes, courts initially apply the **plain meaning rule**. This means that if the words in the statute have clear and widely understood meanings, the court applies the statute in accordance with the rule. However, more complex statutes require further analysis, and courts look to two sources for guidance. The structure of the statute itself generally provides some indication of how the legislature intended it to be applied. The structure of the statute and the format of its mandates in a law are referred to as its **statutory scheme**. When interpreting statutes, courts also look to the records kept by the legislature, including the debates, committee and conference reports, and legislative findings of fact. These records are known as the statute's **legislative history** and may provide some indication of the intent of the legislative body that passed the statute. For example, in Chapter 2, "Business and the Constitution," we discuss the U.S.



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.

KEY POINT
Clear and unambiguous language does not mean that everyone who reads the statute will understand it perfectly. For example, the Internal Revenue Code is a federal statute that to the average person may be extremely confusing; however, it makes sense to a person with a background in accounting.