

Seventeenth Edition

THE LEGAL AND REGULATORY ENVIRONMENT OF BUSINESS

Marisa Anne Pagnattaro

Daniel R. Cahoy

Julie Manning Magid

O. Lee Reed

Peter J. Shedd

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The Legal and Regulatory Environment of **BUSINESS**

Seventeenth Edition

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THE LEGAL AND REGULATORY ENVIRONMENT OF BUSINESS, SEVENTEENTH EDITION

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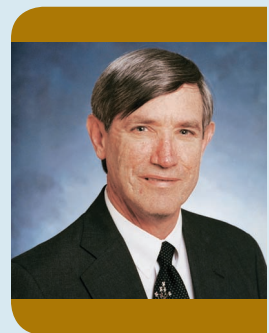
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Julie Manning Magid is an Associate Professor of Business Law and a Kelley Venture Fellow in the Kelley School of Business at Indiana University. She received her J.D. from the University of Michigan Law School and her A.B. from Georgetown University. Prior to joining the Kelley School faculty, Professor Magid was a litigation attorney specializing in employment and business litigation. Professor Magid is recognized for her teaching in the undergraduate,

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Lee Reed retired in 2010 as the Scherer Chair in Public Affairs and Josiah Meigs Distinguished Teaching Professor in the Terry College of Business at the University of Georgia. He continues to be active at UGA as Emeritus Professor of Legal Studies in Business. He received his Doctor of Law degree at the University of Chicago and a B.A. degree at Birmingham-Southern College. Professor Reed holds a J.D. degree from the University of Chicago. A former president of the Academy in Legal Studies in Business, he has received five national research awards for his scholarly articles and is former Editor in Chief of the *American Business Law Journal*. He has also testified before the Federal Trade Commission and has twice written invited introductions for *The Advertising Law Anthology*. Professor Reed is a frequent speaker to trade and scholarly groups on the fundamental importance of the rule of law and property to the private market system.



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This seventeenth edition continues the long, rich tradition of our commitment to presenting timely examples and cases that underscore the relevance of the law for business. We are passionate about helping students understand the importance of the legal and regulatory environment of business. Our goal is to make this text accessible, and we hope that they will embrace the study of the law with enthusiasm. In this preface, we strive to highlight themes, additions, and pedagogical devices—including important electronic features—that are key to this edition.

The Seventeenth Edition: Themes and New Additions

With each new edition, we endeavor to maintain the reputation of this text as being the most up-to-date on the latest important developments in the law for business. As we prepare each new edition, we consider the events that affect the business environment and discuss how to incorporate them into the text. Because of the ongoing fallout from the 2008 financial crisis, we continue to highlight the regulatory responses in this edition. Other additions to the seventeenth edition include the Affordable Care Act, focusing on *National Federation of Independent Business v. Sebelius* as the lead case, an elaborated discussion about fraud, and a new section on privacy. We also added a number of recent federal cases and Supreme Court decisions from the 2013–2014 term.

Each chapter includes a range of relevant examples and case opinions, with key points noted for each case. Sidebars within each chapter provide students and instructors with opportunities to learn about topics that illustrate the principles discussed within the text. Marginal comments also reinforce key themes and points of emphasis. We hope that that this layering of the law with examples reinforces each student’s understanding of the law for business.

We believe that this text is well suited for both legal environment and business law classes. The fundamental message we wish our readers to grasp is that the law is at the core of the private market. The law determines ownership and protects owners. Based on this knowledge, individuals can make informed decisions about how the law can be strategically used to protect their rights.

Overall, it is important for our readers—primarily business students—to appreciate the crucial role of the law for business and to consider how it can be used for strategic advantage in the market.

Organization of the Seventeenth Edition

This edition consists of 22 chapters, divided into four parts. Part One introduces students to the legal foundations for business. The first chapter in this section underscores the importance of the legal environment of business to appreciate the role of law as the foundation for business in the private market system. This

section also includes a chapter on ethics, as well as three chapters pertaining to dispute resolution: courts, litigation, and alternative dispute resolution. Lastly, this first part includes a chapter on the U.S. Constitution (including the Commerce Clause) and its fundamental role in the legal system for business.

Part Two consists of basic legal principles, incorporating eight chapters: property, contract formation, contractual performance, torts, intellectual property, international law, criminal law, and corporate governance/business organizations. These chapters are designed to help students learn basic legal principles, as well as how to identify them in business contexts.

Part Three details the regulatory landscape for business. Five chapters cover essential regulatory aspects of business: the regulatory process, anti-trust, financial and securities regulation, privacy and consumer protection, and environmental regulation.

The final section, Part Four, contains three chapters pertaining to the employer–employee relationship: discrimination, employment laws (including agency), and the labor–management relationship.

Taken together, these chapters should provide students with a comprehensive, yet accessible, sense of the laws and regulations crucial for companies doing business in the United States.

Authorship Team

One of the strengths of this text is its continuity of authorship and the coordination among the authorship team. Marisa Pagnattaro, who joined the team on the fourteenth edition, has undertaken the lead role on this edition. Dan Cahoy, who began on the sixteenth edition, has played a significant role in shaping this edition. Lee Reed joined the team in 1977 on the fourth edition. His legal philosophy continues to influence the text. Peter Shedd, who has long been, and continues to be, a steward of the text, joined the book as a co-author on the eighth edition in 1990. We are all very pleased to welcome Julie Manning Magid to the seventeenth edition. Her legal expertise and demonstrated teaching excellence enrich this edition.

Pedagogy

This seventeenth edition continues the reputation of our prior editions for having many valuable teaching elements. The following list highlights the various pedagogical tools in this edition:

- **Learning Objectives**—each chapter begins with a list that guides the students reading, studying, and learning. These learning objectives were designed with AACSB guidelines in mind.
- **Marginalia**—in the margins, each chapter includes notes, points of emphasis, definitions, quotes, and recommendations about what to do and what to avoid. These notations emphasize key points throughout each chapter.

- **Sidebars**—examples or further descriptions are separated from the text into boxes labeled “sidebars.” As in the courtroom setting, when a judge calls for a conversation with the lawyers away from the jury, these boxes are sidebars to the overall discussion. Through these sidebars, we believe you will find the text is brought to life with business-related examples.
- **Cases**—except for the first two chapters, chapters include edited portions of actual court decisions. These cases contain the parties’ arguments and the judge’s decision of the issues. We have deleted most of the procedural aspects, citations, and footnotes. In addition to the edited cases, some of the sidebars contain references to cases that further illustrate points in the text.
- At the end of each case, **Key Points** are set forth to help students focus on the main points of each case.
- **Concept Summaries**—at appropriate points in each chapter, a summary of the preceding material appears. Through these summaries, complex and lengthy presentations are easily reviewable by the reader.
- **Key Terms**—a list of critical words or phrases is found at the end of each chapter. These terms are boldfaced in the text, and definitions are repeated in the glossary.
- **Review Questions and Problems**—following the text of each chapter is a series of questions and problems. These are tied to the various sections of each chapter and serve as an overview of the material covered.
- **Business Discussions**—the last item in each chapter is a factual situation designed to stimulate conversation among students causing them to review the material within the chapter.

Acknowledgments

We are all very proud to congratulate Jere Morehead on becoming the University of Georgia’s 22nd president. He undertook this role in 2013, having previously served as senior vice president for academic affairs and provost. Recognized as a Josiah Meigs Distinguished Teaching Professor, he has always been a dedicated member of the faculty, committed to excellence in student learning. He was part of the authorship team for the tenth through sixteenth editions of this text. Although he is not part of the authorship team on this edition, his valuable contributions over seven editions and his support for the authorship team continue to endure in this edition.

We also want to thank a number of people who contributed to the seventeenth edition. We greatly appreciate the efforts of our team at McGraw-Hill: Tim Vertovec, Kathleen Klehr, Jarek Szymanski and Jessica Portz. This is their first edition working on this text, and we greatly appreciate their support of the authorship team and the development of crucial new electronic features of the text. We are also grateful to all of the regional sales team representatives for their enthusiastic marketing support.

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Finally, we thank all of the professors and students who have used or are using our text. Your feedback continues to be important. Please feel free to share your thoughts with us. Your feedback also may be sent to The McGraw-Hill Companies.

Marisa Anne PAGNATTARO
Daniel R. CAHOY
Julie Manning MAGID
O. Lee REED
Peter J. SHEDD

This seventeenth continues the reputation of our prior editions for having many valuable teaching elements. In an effort to provide even more guidance and relevance for students, this edition introduces margin notes and comments and sidebars.

learning *objectives*

New to this edition are Learning Objectives at the beginning of each chapter. These objectives will act as a helpful road map of each chapter, narrowing the focus of each topic for both instructor and students. You will also find these Learning Objectives tagged for every test bank question to ensure that key points from each chapter are covered in every quiz and exam.



2

The Role of Ethics in Decision Making

Learning Objectives

In this chapter you will learn:

- 2-1. To compare the connection between law and ethical principles.
- 2-2. To analyze why ethical consequentialism and not ethical formalism has been the chief source of values for business ethics.
- 2-3. To generate an individual framework for ethical values in business.
- 2-4. To evaluate the obstacles and rewards of ethical business practice in our property-based legal system.

plant's profitability, yet the home office does not appreciate the difficulties under which the plant is operating. In such a situation the overemphasis on profit can easily lead to the manager's taking ethical and legal shortcuts to ensure profit.

An example of such shortcuts involved Columbia/HCA Healthcare Corporation, one of the major national hospital chains. Following a government investigation, many units of the company were accused of enhancing profits by improperly billing Medicare for laboratory tests and home health care services. It was also alleged that managers were "upcoding," or exaggerating patient illness, in order to get greater reimbursements from the Medicare system. Several managers were criminally indicted and convicted. The company's CEO resigned. To settle charges, the company agreed to pay the federal government \$745 million to resolve fraud allegations. As part of its response, the company also stationed ethics and compliance officers in nearly every hospital, in part to prevent managers from "looking good" by producing profits through improper billings.

Does the emphasis on profit in a property-based private market mean that *only* profit must be considered in business decision making? For an example of a nation where not only profit is important in business, see Sidebar 2.8.

sidebar 2.8

The Swedish Example of Lagom

The Swedes have a strong property-based private market, but the business emphasis in Sweden is not solely on profit making. Instead, the Swedes have a strong ethic of *lagom*, which means "not too much, not too little, but just enough."

As a result, the pay of corporate chief executive officers (CEOs) is only a small fraction of what it is in the United States and the average take-home pay of employees (excluding CEOs) varies from highest to lowest by a ratio of only 3 to 1. Sweden provides universal health care, public nursing homes, and subsidized child care

and parental leave-taking during a child's first year. When Swedish companies go overseas, they treat employees there with much of the same ethic as in Sweden.

Lagom means that there are few wealthy Swedes, and Sweden's social welfare system of "just enough" depends on a tax rate of approximately twice that in the United States. Note also that Sweden is a small, homogeneous country whose citizens share a common ethical culture that is often not found in larger nations. Source: Susan Winesinger, "Sweden: The Kindness Economy," *Business Ethics*, Fall 2003.

"I do not believe maximizing profits for the investors is the only acceptable justification for all corporate actions. The investors are not the only people who matter. Corporations can exist for purposes other than simply maximizing profits."

—John Mackey, CEO, Whole Foods Market

Don't forget that a nation is just a large group. This means that "culture matters" in the implementation (or not) of moral values.

marginalia

In the margins, each chapter includes notes, points of emphasis, definitions, quotes, and recommendations about what to do and what to avoid.

sidebar 2.5

Ethical Norms and Values for Marketers

PREAMBLE

The American Marketing Association commits itself to promoting the highest standard of professional ethical norms and values for its members. Norms are established standards of conduct that are expected and maintained by society and/or professional organizations. Values represent the collective conception of what people find desirable, important and morally proper. Values serve as the criteria for evaluating the actions of others. . . .

ETHICAL VALUES

Honesty—to be truthful and forthright in our dealings with customers and stakeholders.

- We will tell the truth in all situations and at all times.
- We will offer products of value that do what we claim in our communications.
- We will stand behind our products if they fail to deliver their claimed benefits.
- We will honor our explicit and implicit commitments and promises.

Responsibility—to accept the consequences of our marketing decisions and strategies.

- We will make strenuous efforts to serve the needs of our customers.
- We will avoid using coercion with all stakeholders.
- We will acknowledge the social obligations to stakeholders that come with increased marketing and economic power.
- We will recognize our special commitments to economically vulnerable segments of the market such as children, the elderly and others who may be substantially disadvantaged.

Fairness—to try to balance justly the needs of the buyer with the interests of the seller.

- We will represent our products in a clear way in selling, advertising and other forms of communication; this includes the avoidance of false, misleading and deceptive promotion.
- We will reject manipulations and sales tactics that harm customer trust.
- We will not engage in price fixing, predatory pricing, price gouging or "bait-and-switch" tactics.

- We will not knowingly participate in material conflicts of interest.

Respect—to acknowledge the basic human dignity of all stakeholders.

- We will value individual differences even as we avoid stereotyping customers or depicting demographic groups (e.g., gender, race, sexual orientation) in a negative or dehumanizing way in our promotions.
- We will listen to the needs of our customers and make all reasonable efforts to monitor and improve their satisfaction on an ongoing basis.
- We will make a special effort to understand suppliers, intermediaries and distributors from other cultures.
- We will appropriately acknowledge the contributions of others, such as consultants, employees and coworkers, to our marketing endeavors.

Openness—to create transparency in our marketing operations.

- We will strive to communicate clearly with all our constituencies.
- We will accept constructive criticism from our customers and other stakeholders.
- We will explain significant product or service risks, component substitutions or other foreseeable eventualities that could affect customers or their perception of the purchase decision.
- We will fully disclose list prices and terms of financing as well as available price deals and adjustments.

Citizenship—to fulfill the economic, legal, philanthropic and societal responsibilities that serve stakeholders in a strategic manner.

- We will strive to protect the natural environment in the execution of marketing campaigns.
- We will give back to the community through volunteerism and charitable donations.
- We will work to contribute to the overall betterment of marketing and its reputation.
- We will encourage supply chain members to ensure that trade is fair for all participants, including producers in developing countries.

sidebars

Examples or further descriptions are separated from the text into boxes labeled Sidebars. As in the courtroom setting, when a judge calls for a conversation with the lawyers away from the jury, these boxes are sidebars to the overall discussion. Through these sidebars, the text is explained in more detail or is brought to life with a business-related example.

concept *summary*

At appropriate points in each chapter, a summary of the preceding material appears. Through these summaries, complex and lengthy presentations are easily reviewable by the reader.

Conflicts of Interest Often embodied in business codes of ethics, avoiding conflicts of interest is a final ethical value flowing from the law, especially from agency law. A conflict of interest occurs when one attempts to "serve two masters," and no agent or employee of one principal can secretly work for another whose interest competes with that of the first principal. That is why a real estate agent may not represent both the seller and the buyer in a real estate transaction without permission from both parties.

Sometimes when corporations "go public" or otherwise sell new stock issues, they will give employees of their customers or suppliers the option of buying a number of the new stock shares at a special fixed price. If the market value of the stock rises, exercise of the stock options can be quite valuable to these employees as they resell the stock at market price. Is it a conflict of interest for employees of other companies to accept these stock options? Does it impair their objective judgment about continuing to do business with the corporation that has given them such a gift? Compaq Computer Corporation, Cisco Systems, and AT&T specifically forbid employees from accepting stock options from their suppliers or customers.

Conflicts of interest also arise in public service. For instance, it is a conflict of interest for a judge or administrative regulator to make a decision involving a company in which he or she owns stock. Note that in this instance the conflict of interest does not involve "serving two masters." The conflict arises because of the ownership interests that will make it difficult for the judge or regulator to make an unbiased decision. In terms of formalism and consequentialism, how do you evaluate the prohibition against conflicts of interest?

concept *summary*

Ethical Values from Legal Regulation

- Respect the liberty and rights of others.
- Act in good faith.
- Exercise due care.
- Honor confidentiality.
- Avoid conflicts of interest.

PROFESSIONAL CODES OF ETHICS

Another important source of business ethics comes from the historic tradition of the professional codes of ethics. Professions such as law and medicine have long traditions of codes of ethical conduct. Other professions, and more recently business and industry in general, have developed and adopted codes of ethical conduct. Here we use portions of professional codes to demonstrate sources of ethical values that come from the development of group standards for ethical conduct.

We begin with selected excerpts from codes of conduct for two professions: marketing and accounting. These codes are the Ethical Norms and Values for Marketers from the American Marketing Association, shown in Sidebar 2.5, and the American Institute of Certified Public Accountants Code

cases

Except for the first two chapters, chapters include edited portions of actual court decisions. These cases illustrate the parties' arguments and the judge's decision of the issues. We have deleted most of the procedural aspects, citations, and footnotes. An alternative to these edited cases appears in some sidebars; there a case may be explained in our own language.

case 4.1

MAYER v. BELICHICK 605 F.3d 223 (3rd Cir.)

Season ticket-holder brought action against the New England Patriots and league, alleging various causes of action arising out of the team's alleged practice of surreptitiously videotaping the signals of opposing teams.

COWEN, Circuit Judge

Plaintiff Carl J. Mayer appeals from the order of the United States District Court for the District of New Jersey granting the respective motions to dismiss filed by Defendants Bill Belichick and the New England Patriots ("Patriots") as well as by Defendant National Football League ("NFL"). We will affirm.

1. This highly unusual case was filed by a disappointed football fan and season ticket-holder in response to the so-called "Spygate" scandal. This scandal arose when it was discovered that the Patriots were surreptitiously videotaping the signals of their opponents. Mayer, a New Jersey resident and New York Jets season ticket-holder, initially filed his complaint on September 7, 2007. He named as Defendants the Patriots, headquartered in Massachusetts, as well as the team's head coach, Belichick, a Massachusetts resident. Mayer eventually filed an amended complaint on August 19, 2008, which added the NFL, with its headquarters in New York, as a Defendant. . . .
2. The core of this action is that the Defendants, during a game with the New York Jets on September 9, 2007, instructed an agent of the Defendants to surreptitiously videotape the New York Jets coaches and players on the field with the purpose of illegally recording, capturing and stealing the New York Jets signals and visual coaching instructions. The Defendants were in fact subsequently found by the National Football League ("NFL") to have improperly engaged in such conduct.
3. Plaintiffs contend that in purchasing tickets to watch the New York Jets that, as a matter of contract, the tickets imply that each game will be played in accordance with NFL rules and regulations as well as all applicable federal and state laws. . . .

At their most fundamental level, the various claims here arose out of the repeated and surreptitious violations of a specific NFL rule. This rule provides

that "no video recording devices of any kind are permitted to be in use in the coaches' booth, on the field, or in the locker room during the game" and that "all video for coaching purposes must be shot from locations enclosed on all sides with a roof overhead." . . .

On September 9, 2007, the Jets and the Patriots played the season opener in Giants Stadium, East Rutherford, New Jersey. Mayer possessed tickets and parking passes to this game, and the Patriots ultimately won, 38-14. ESPN.com then reported that the NFL was investigating accusations that an employee of the Patriots was actually videotaping the signals given by Jets coaches at this game. . . .

On September 13, 2007, "the NFL found the Defendants guilty of violating all applicable NFL rules by engaging in a surreptitious videotaping program." . . .

Mayer ultimately alleged nine separate counts in his amended complaint. He asserted, in order, the following causes of action against the Patriots and Belichick: (1) tortious interference with contractual relations; (2) common law fraud; (3) violations of the New Jersey Deceptive Business Practices Act; (4) violations of New Jersey's racketeering statutes; (5) violations of the Racketeer Influenced and Corrupt Organizations Act ("RICO"); (6) the infringement of the rights of ticket-holders as third-party beneficiaries; (7) breach of implied contract or quasi-contract; and (8) violations of the New Jersey Consumer Fraud Act ("NJCFRA"). Finally, he advanced a breach of contract claim against the NFL on account of its destruction of the videotapes. . . . After they were served with the amended complaint, the Patriots and Belichick filed a motion to dismiss for failure to state a claim pursuant to Federal Rule of Civil Procedure 12(b)(6). The NFL subsequently filed its own motion to dismiss as well. . . .

The District Court, while noting that Mayer alleged numerous theories of liability in this case, appropriately turned to the following dispositive question: namely, whether or not he stated an actionable injury (or, in other words, a legally protected right or interest) arising out of the alleged "dishonest" videotaping program undertaken by the Patriots and the NFL team's head coach. . . . we ultimately conclude that the District Court was correct to hold that Mayer failed to set forth a legally cognizable right, interest, or injury here. . . .

[continued]

Significantly, our ruling also does not leave Mayer and other ticket-holders without any recourse. Instead, fans could speak out against the Patriots, their coach, and the NFL itself. In fact, they could even go so far as to refuse to purchase tickets or NFL-related merchandise. . . .

However, the one thing they *cannot* do is bring a legal action in a court of law. For the foregoing reasons, we will affirm the District Court's order dismissing Mayer's amended complaint in its entirety.

KEY POINTS

- To maintain a lawsuit, a plaintiff must have standing or a legally cognizable claim.
- The Third Circuit found that, because the plaintiff did not have a legally protected right arising out of the alleged "dishonest" videotaping program, he did not state an actionable injury.
- Accordingly, defendant's motions to dismiss were granted.

a lawsuit. A plaintiff must have a legally cognizable claim to maintain a lawsuit. The case reinforces the rule that the courts are careful to avoid overstepping their constitutional role and will only rule on actual cases or controversies.

PERSONAL JURISDICTION

Power to hear a case means a court must have authority not only over the subject matter of the case but also over the parties to the case. This latter authority is called **personal jurisdiction**. Personal jurisdiction over the plaintiff is obtained when the plaintiff files the suit. Such action indicates voluntary submission to the court's power.

Personal jurisdiction over the defendant usually is obtained by the service of a **summons**, or notice to appear in court, although in some cases it is obtained by the publication of notice and mailing a summons to the last known address. This delivery of notice is referred to as **service of process**. Service of a summons on the defendant usually is valid if it is served upon any member of the household above a specified age and if another copy addressed to the defendant is mailed to the home.

For many years, a summons could not be properly served beyond the borders of the state in which it was issued. However, states now have what are called **long-arm statutes**, which provide for the service of process beyond their boundaries. Such statutes are valid and constitutional if they provide a defendant with due process of law. Under the Fifth Amendment to the Constitution, no person shall "be deprived of life, liberty, or property without due process of law." The Fourteenth Amendment provides that states must also guarantee due process protection. Due process requires that if a defendant is not present within the state where the lawsuit is filed, he or she must have certain minimum contacts with the state so that

No case can proceed forward without the existence of both subject matter and personal jurisdiction.

91

key points

At the end of each edited case, key points can be found. These key points help students grasp the essential elements and relevance of each case.

concept summary

Judicial Review

- Judicial review allows the courts to review actions taken by legislative and executive branches of government.
- The philosophy of judicial restraint is sometimes referred to as strict constructionism or a conservative approach.
- Supporters of judicial activism believe the courts are the appropriate body to bring about social, political, and economic change.
- The Supreme Court is deeply divided between these two competing views of judicial decision making.

Key Terms

Appeal 67	Judicial activism 74	Trial court 66
Appellate court 66	Judicial restraint 74	Writ of certiorari 67
Courts of appeal 67	Judicial review 73	
Diversity of citizenship 69	Petit jury 63	
Federal question cases 68	Small-claims court 67	
Federal Rules of Civil Procedure 69	Subject matter jurisdiction 66	
	Supreme court 67	

Review Questions and Problems

Personnel

- Judges and Justices**
What are the essential responsibilities of a trial judge?
- Jurors**
Why have several states eliminated the requirement of unanimity in jury trials?
- Lawyers**
Name the three critical roles a lawyer serves in society. Why have many lawyers and their business clients had such conflict in recent years?

Organization of the Court System

- Subject Matter Jurisdiction**
Mark, a citizen of Georgia, was crossing a street in Atlanta when he was struck by a car driven by David, a citizen of New York visiting Atlanta. The car was owned by David's employer, a Delaware corporation that has its principal place of business in Atlanta, Georgia. Mark sues both David and the corporation in federal district court in Atlanta alleging damages in the amount of \$500,000. Does the court have subject matter jurisdiction? Why or why not?
- State Courts**
What role do reviewing or appellate courts play in the judicial process? How do they differ from trial courts?

review questions and problems

Following the text of each chapter is a series of questions and problems. These are tied to the sections of each chapter and serve as an overview of the material covered.

6. Federal Courts

XYZ makes and markets a product that it believes will help control weight by blocking the human body's digestion of starch. The Food and Drug Administration (FDA) has classified the product as a drug and orders it removed from the market until it can evaluate its use through testing. XYZ disputes the FDA's action and seeks to bring suit in the federal courts. Will the federal courts have jurisdiction to hear the case? Why or why not?

7. Decisions by the U.S. Supreme Court

Susan files a petition for certiorari in the U.S. Supreme Court following an adverse decision in the Illinois Supreme Court on a claim arising under a breach of contract. What chance does Susan have of the Supreme Court granting the petition? What special circumstances would she need to show?

The Power of Judicial Review

- Judicial Restraint**
Define the power of judicial review. How do advocates of judicial restraint exercise that power?
- Judicial Activism**
Define judicial activism. Compare and contrast judicial restraint and judicial activism.
- A Sample U.S. Supreme Court Case**
Why are concurring and dissenting opinions important?
- The Nature of the Judicial Process**
What are the forces that Justice Cardozo says shape the judicial process? How is the law made? In light of the liberal versus conservative divisions in the courts, are Cardozo's observations still relevant?

business discussion

1. You have spent the past four weeks away from work serving as a juror in a case deciding whether a pharmaceutical company should be held liable for the heart attack of a woman who took its painkiller, Oxyo-1. The lengthy case has taken a toll on your professional career, and you have many unanswered questions as jury deliberations begin.

- Where does your duty lie in serving on a jury?
- Are you protected against adverse employment action by your firm for missing work to serve on a jury?
- How do you reconcile the woman's prior heart palpitations from years ago with her recent attack? Was her heart already compromised before she began taking the painkiller Oxyo-1?
- Why didn't the pharmaceutical company withdraw the painkiller from the market at the first sign of a problem?

2. You are the president of a large corporation which is in the business of manufacturing, among other things, chemical products used to eradicate termites. You have just reviewed a confidential report, prepared by one of your top scientists, questioning the effectiveness of the product and the claims your business has been making to homeowners, pesticide treatment firms, and the general public. You have heard rumors that a lawsuit will be filed shortly against your corporation claiming that this product is ineffective.

- Who should you turn to for advice?
- Should you destroy the report?
- In which court can a lawsuit be filed?
- If you lose the lawsuit at trial, can you appeal?

expanded business discussions

The last item in each chapter are scenarios designed to stimulate conversation among students allowing them to review and apply the material within the chapter.

Instructor's Resource Manual

This manual consists of the teaching outline section, transparency masters, a case brief supplement, and video guide. The teaching outline section makes up the bulk of this Instructor's Manual, which is organized by text chapter. This section corresponds with the headings in the text, and typically includes suggestions on points of emphasis, answers to the case questions that appear within each chapter of the text, cases for discussion, and additional matters for discussion. Each chapter of this manual also includes a list of references that might be useful secondary sources of information; and suggested answers to all case questions and responses to the end-of-chapter review questions. The Case Brief section of the Instructor's Manual contains a brief of each edited case found in the text. For ease of use, the briefs are numbered by chapter in the order they appear in the text. There is a reference to the page in the text where the edited case appears. The tear-out format of this supplement allows instructors to remove any material and incorporate it into their lecture notes.

Test Bank

Instructors can test students' mastery of concepts as the instructors create exams with the use of this Test Bank. Organized by chapter, the Test Bank contains multiple choice, true/false, and essay questions. Many of the questions have been modified to correspond with the text's revision. Answers immediately follow each question, along with page references and corresponding Learning Objectives.

EZ Test

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 the 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. The test bank includes true/false, multiple choice, and essay questions, with answers, page references, and level coding.

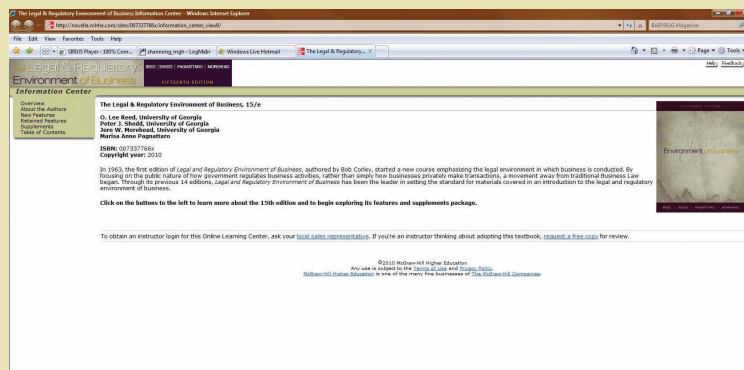
PowerPoint Presentation

The PowerPoint Presentation provides detailed lecture outlines for discussing key points and figures from the book.

Online Learning Center

www.mhhe.com/reed17e

The Online Learning Center (OLC) is a website that follows the text chapter by chapter. OLC content is designed to reinforce and build on the text content. As students read the book, they can go online to take self-grading quizzes and read chapter review material.



You Be the Judge Online

This interactive product features case videos that showcase courtroom arguments of business law cases. These case videos give students the opportunity to watch profile interviews of the plaintiff and defendant, read background information, hear each case, review the evidence, make their decisions, and then access an actual, unscripted judge's decision and reasoning. There are also instructor's notes available with each video to help prepare you for classroom discussion.



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PartONE Introduction: Legal Foundations for Business 1

- 1 Law as a Foundation for Business 4
- 2 The Role of Ethics in Decision Making 26
- 3 The Court System 60
- 4 Litigation 86
- 5 Alternative Dispute Resolution 118
- 6 The Constitution 152

PartTWO Basic Legal Principles 183

- 7 The Property System 186
- 8 Contract Formation 226
- 9 Contractual Performance and Breach 258
- 10 Torts Affecting Business 280
- 11 Intellectual Property 312
- 12 International Law 350
- 13 Criminal Law and Business 378
- 14 Business Organizations 412

PartTHREE The Regulatory Landscape for Business 441

- 15 The Regulatory Process 444
- 16 Regulating Competition—Antitrust Laws 472
- 17 Financial and Securities Regulations 506
- 18 Regulations Protecting Consumer Purchases, Privacy, and Financial Activities 546
- 19 Environmental Regulation 578

PartFOUR The Employer–Employee Relationship 613

- 20 Discrimination in Employment 614
- 21 Employment Laws 652
- 22 Labor–Management Relationship 686

Appendix I: Case Briefing and Legal Study Tips 711
Appendix II: Sample Complaint 713
Appendix III: The Constitution of the United States of America 717
Appendix IV: Selected Sections of Article 2 of Uniform Commercial Code 726
Appendix V: Selected Sections of the Sarbanes-Oxley Act of 2002 732
Appendix VI: Selected Sections of Securities Act of 1933 737
Appendix VII: Selected Sections of Securities Exchange Act of 1934 739
Glossary 741
Photo Credits 769
Index 771

PartONE Introduction: Legal Foundations for Business 1

1 Law as a Foundation for Business 4

sidebar 1.1 JPMorgan Chase & Co.'s Massive Legal Liability 6

WHY LAW AND REGULATIONS ARE FUNDAMENTAL FOUNDATIONS FOR BUSINESS 6

Law, the Rule of Law, and Property 7

LAW 7

THE RULE OF LAW 7

sidebar 1.2 The Chief Justice and the Rule of Law 8

PROPERTY 8

PROPERTY IN ITS BROADEST SENSE 9

sidebar 1.3 Russia's Property Problems 11

JURISPRUDENCE 11

Classifications of Law 12

COMMON LAW AND CIVIL LAW 12

PUBLIC AND PRIVATE LAW 13

CIVIL LAW AND CRIMINAL LAW 13

sidebar 1.4 Bank of America's Ongoing Post-Financial Crisis Legal Woes 14

SUBSTANTIVE LAW AND PROCEDURAL LAW 14

Sources of Law 14

FEDERAL LAW 14

STATE LAW 15

JUDICIAL DECISIONS OR CASE LAW 15

Advantages 16

Disadvantages 16

SOURCES OF LAW HIERARCHY IN REVIEW 17

LEGAL SANCTIONS 17

SANCTIONS FOR CRIMINAL CONDUCT 18

SANCTIONS FOR BREACH OF CONTRACT 18

SANCTIONS FOR TORTIOUS CONDUCT 19

SANCTIONS FOR VIOLATING STATUTES AND REGULATIONS 19



A Property-Based Legal System and Corporate Governance 20

THE SPECIFIC SENSE OF CORPORATE GOVERNANCE 20

THE GENERAL SENSE OF CORPORATE GOVERNANCE 21

2 The Role of Ethics in Decision Making 26

Contemporary Business Ethics 28

ETHICS AND SOCIETY 29

Changing Normative Values 29

Economic Interdependence 30

News Media and the Internet 30

sidebar 2.1 High School Dishonesty Predicts Dishonesty in the
Workplace 31

ETHICS AND GOVERNMENT 31

The Nature of Ethics 31

ETHICS AND MORALITY 32

ETHICS AND LAW 33

sidebar 2.2 Price Gouging after Hurricane Katrina 33

Two Systems of Ethics 34

FORMALISM 34

Kant and Formalism 35

The Social Contract 36

CONSEQUENTIALISM 36

sidebar 2.3 Virtual Morality 38

The Protestant Ethic 38

COMPARING THE TWO ETHICAL SYSTEMS 38

sidebar 2.4 Tobacco Facts 40

Sources of Values for Business Ethics 40

LEGAL REGULATION 40

Liberty and Rights 41

Good Faith 41

Due Care 42

Confidentiality 42

Conflicts of Interest 43

PROFESSIONAL CODES OF ETHICS 43

sidebar 2.5 Ethical Norms and Values for Marketers 44

sidebar 2.6 American Institute of Certified Public Accountants
Code of Professional Conduct 45



ORGANIZATIONAL CODES OF ETHICS 45*Different Approaches to Ethical Codes* 46*sidebar 2.7* Boeing Code of Conduct 47**INDIVIDUAL VALUES 47****Achieving an Ethical Business Corporation 50****THE OBSTACLES 50***The Emphasis on Profit* 50*sidebar 2.8* The Swedish Example of *Lagom* 51*The Effect of the Group* 51*The Control of Resources by Nonowners* 52*sidebar 2.9* Failure and Collapse 52**THE STEPS 53***Involvement of Top Management* 53*Openness in Communication* 53*Consideration of All Stakeholders* 54*sidebar 2.10* The Demise of Arthur Andersen 55**THE REWARDS 55****CAN A BUSINESS HAVE A CONSCIENCE? 56***sidebar 2.11* Same-Sex Marriage Debate and
"Kiss-Ins". 57**3 The Court System 60***sidebar 3.1* The Soaring Cost of Legal Representation 62**Personnel 62****JUDGES AND JUSTICES 62****JURORS 63***sidebar 3.2* Jury Consultants and Technical Support: Other Key
Parties in Litigation 64**LAWYERS 65****Organization of the Court System 66****SUBJECT MATTER JURISDICTION 66****STATE COURTS 66***Trial Courts* 66*Appellate Courts* 67*sidebar 3.3* Small-Claims Courts 67**FEDERAL COURTS 68***District Courts* 69*Appellate Courts* 69

sidebar 3.4 Circuit Scorecard 71

DECISIONS BY THE U.S. SUPREME COURT 71

sidebar 3.5 Very Slim Odds 72

sidebar 3.6 The Role of the Reviewing Court 73

The Power of Judicial Review 73

JUDICIAL RESTRAINT 74

sidebar 3.7 Choosing a Supreme Court Justice 75

sidebar 3.8 The First Five Years of the Roberts Court 75

JUDICIAL ACTIVISM 76

sidebar 3.9 Typical Alignment of Justices 77

A SAMPLE U.S. SUPREME COURT CASE 77

sidebar 3.10 Labeling Judges as Liberal or Conservative 78

case 3.1 NATIONAL FEDERATION OF INDEPENDENT BUSINESS v. SEBELIUS 80

THE NATURE OF THE JUDICIAL PROCESS 81

sidebar 3.11 U.S. Supreme Court Justices 82

sidebar 3.12 The Nature of the Judicial Process (1921) 83

4 Litigation 86

Litigation—An Overview 88

sidebar 4.1 The High Cost of Litigation 88

PARTIES 88

STANDING TO SUE 89

case 4.1 MAYER v. BELICHICK 90

PERSONAL JURISDICTION 91

sidebar 4.2 Personal Jurisdiction: Minimum Contacts 92

sidebar 4.3 Where Does Mark Zuckerberg Reside? 93

CLASS-ACTION SUITS 93

sidebar 4.4 Class-Actions in Federal Court 94

sidebar 4.5 Major Class-Action Lawsuits 95

Pretrial Procedures 95

sidebar 4.6 Understanding the Sample Complaint 96

PLEADINGS 96

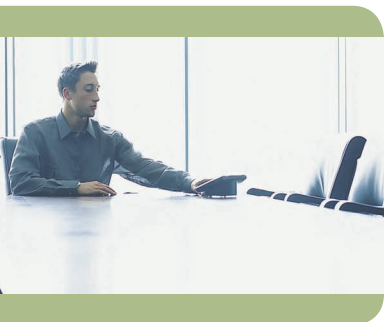
STEPS IN DISCOVERY 97

Purpose 97

Methods 97

sidebar 4.7 Discovery and Massive Client Data: Are Clouds the Answer? 98



SCOPE OF DISCOVERY 99*sidebar 4.8* Costs of Discovery 99*sidebar 4.9* Litigation Holds and E-Discovery 100**MOTIONS 100***sidebar 4.10* Frivolous Lawsuits against Ringling Brothers 102**FRIVOLOUS CASES 102****The Trial 103***sidebar 4.11* The Intersection of the Internet and Juries 103**JURY SELECTION 103***sidebar 4.12* The Jury and Constitutional Limits on Peremptory Challenges 104**case 4.2** WAL-MART STORES, INC. v. DUKES 105*sidebar 4.13* Religion and Peremptory Challenges 107**OTHER STEPS DURING A TRIAL 107***sidebar 4.14* Technology in the Courtroom: The “OpenCourt” Project 108**BURDEN OF PROOF 108***Criminal Cases 108**Civil Cases 109**sidebar 4.15* Televising Jury Deliberations 110**DECIDING THE CASE 110****Posttrial Issues 111****APPEALS 111***sidebar 4.16* Qualcomm and Posttrial Sanctions 112*Appellate Procedures 112**Deference to Trial Courts 113**sidebar 4.17* Appealing an Evidentiary Ruling 114**ENFORCEMENT OF JUDGMENTS AND DECREES 114***sidebar 4.18* Discovery of Misconduct Causes Lockheed to Lose Its \$37 Million Verdict 114**RES JUDICATA 115***sidebar 4.19* How Do You Prevent a Lawsuit in Your Firm? 115**5 Alternative Dispute Resolution 118****Conflicts and Negotiation 120****CONFLICTS AND DISPUTES 120****STYLES AND METHODS OF NEGOTIATION 121***sidebar 5.1* Negotiation Styles 121*sidebar 5.2* A Business Dispute 122

POSITIONAL NEGOTIATION 122**PRINCIPLED NEGOTIATION 123***Communication 123**Relationship 123**Interests 124**Options 124**Legitimacy 124**Alternatives 124**Commitment 124***Alternative Dispute Resolution
(ADR) Systems 125****RANGE OF OPTIONS 125****SETTLEMENTS 126****FOCUS GROUPS 126****Arbitration 127***sidebar 5.3* Examples of Contracts with Arbitration

Clauses 128

sidebar 5.4 Trends in Arbitration 129**SUBMISSIONS 129***sidebar 5.5* Sample Arbitration Clause 130*sidebar 5.6* To Arbitrate or Litigate 130**ARBITRATORS 131***Expertise 131**Number Chosen 131**Authority over Certain Matters 131***case 5.1** RENT-A-CENTER, WEST, INC., v. ANTONIO JACKSON 132**AWARDS 133****THE FEDERAL ARBITRATION ACT 134***Impact on Policy 134**Impact on State Laws 134***case 5.2** 14 PENN PLAZA LLC. v. PYETT 135*sidebar 5.7* Do Agreements to Arbitrate Limit the EEOC's Remedies? 136*sidebar 5.8* Strict Enforcement of a Class Action Waiver in an Arbitration Agreement 137**STATUTORILY MANDATED ARBITRATION 137***Types of Cases 137**Procedures 137***VOLUNTARY/CONTRACT-BASED ARBITRATION 138**

sidebar 5.9 Arbitration Agreements 139

JUDICIAL REVIEW 139

Review of Voluntary/Contract-Based Arbitration Awards 139

Single Claims v. Class Actions 139

sidebar 5.10 Judicial Review of Arbitrator's Award 140

Review of Statutorily Mandated Arbitration 140

Review under the Federal Arbitration Act 141

sidebar 5.11 Standard of Review of Arbitrator's Decision—Can Parties Expand the Statute? 143

Mediation 144

sidebar 5.12 Bill's and M&N Revisited 144

PROCEDURES 145

sidebar 5.13 Steps in the Mediation Process 145

ADVANTAGES/DISADVANTAGES 146

LACK OF JUDICIAL INVOLVEMENT 147

COMBINATION OF ADR SYSTEMS 147

6 The Constitution 152

Basic Concepts 155

SEPARATION OF POWERS 155

SUPREMACY CLAUSE 155

Preemption 156

sidebar 6.1 Examples of State Laws Preempted by Federal Law 156

Federal Government's Authority to Regulate Business—The Commerce Clause 157

REGULATION OF FOREIGN COMMERCE 157

REGULATION OF INTERSTATE COMMERCE 157

IMPACT ON INTERSTATE COMMERCE 158

LIMITATION ON FEDERAL AUTHORITY 158

CONTRACT CLAUSE 158

Amendments and Basic Protections 159

FIRST AMENDMENT PROTECTIONS 160

Freedom of Religion 160

sidebar 6.2 How Does the IRS Define "Churches"? 160

Freedom of Speech 161

sidebar 6.3 Business and the Religious Freedom Restoration Act 161

sidebar 6.4 Art and Obscenity 162



<i>sidebar 6.5</i> The FCC Is Not Amused	163
<i>sidebar 6.6</i> Picketing as Free Speech	163
case 6.1 SNYDER v. PHELPS	164
<i>sidebar 6.7</i> Free Speech versus an Individual's Right of Privacy	166
<i>Commercial Speech</i>	166
<i>sidebar 6.8</i> The Controversy Over Cigarette Warning Labels	167
case 6.2 BROWN v. ENTERTAINMENT MERCHANTS ASSOCIATION	167
<i>Freedom of the Press</i>	169
<i>Second Amendment: The Right to Possess Guns</i>	169
<i>sidebar 6.9</i> WikiLeaks, Edward Snowden, and Freedom of the Press	170
<i>sidebar 6.10</i> The Second Amendment After the Heller Case	171
<i>The Fifth Amendment: Takings Clause</i>	171
<i>Eminent Domain and the Common Good</i>	171
<i>Public Use</i>	172
case 6.3 KELO v. CITY OF NEW LONDON, CONNECTICUT	172
<i>Just Compensation</i>	175
<i>The Fourteenth Amendment: Equal Protection and Due Process of Law</i>	175
DUE PROCESS OF LAW	175
<i>Incorporation Doctrine</i>	176
EQUAL PROTECTION	176
<i>Minimum Rationality</i>	176
<i>sidebar 6.11</i> Economic Regulations and the Rational-Basis Test	177
<i>Strict Scrutiny</i>	177
<i>sidebar 6.12</i> Same-Sex Marriage and the Constitution	178
<i>Quasi-Strict Scrutiny</i>	178
<i>sidebar 6.13</i> Analysis of Equal Protection	179

Part TWO Basic Legal Principles 183

7 The Property System 186

Introduction to the Property-Based Legal System 188

sidebar 7.1 Property as the Foundation of the Private Market 189

Rationale for the Property System 190

THE PROBLEM OF LIMITED RESOURCES 190

sidebar 7.2 The Three Faces of Property 191

PROPERTY AND PROSPERITY 191

sidebar 7.3 The Mystery of Capital 192



Defining Property in the Legal System 193

TWO BASIC DIVISIONS OF PROPERTY 193

PROPERTY BOUNDARIES IN THE PHYSICAL WORLD 194

sidebar 7.4 Defining Intangible Property 195

Defining Land 195

Air Rights 195

Subsurface Rights 196

case 7.1 COASTAL OIL & GAS CORP. v. GARZA ENERGY TRUST
ET AL. 196

Fixtures on Land 198

Interests in Property with Respect to Others and Time 198

TYPES OF OWNERSHIP 198

Fee simple 199

Life estate 199

Leasehold estate 199

Concurrent ownership 199

Specialty Applications of Property 200

EASEMENTS 200

BAILMENTS 201

sidebar 7.5 Follow Instructions or Else 202

case 7.2 SEMOON v. THE WOOSTER SCHOOL CORP. 202

Acquiring Resources in a Property System 204

ACQUIRING RESOURCES THROUGH EXCHANGE 204

ACQUIRING RESOURCES THROUGH POSSESSION 205

Lost Items 205

sidebar 7.6 Barry Bonds' Home-Run Ball 206

Adverse Possession 206

sidebar 7.7 Curing Blight through Adverse Possession? 207

ACQUIRING RESOURCES THROUGH CONFUSION 207

ACQUIRING RESOURCES THROUGH ACCESSION 208

ACQUIRING RESOURCES THROUGH GIFT 208

TITLE AND PROPERTY REGISTRATION 209

Property and Security Interests 209

SECURITY INTERESTS IN LAND 210

Recording Statutes 210

Foreclosure, Deficiency, and Redemption 210

sidebar 7.8 Financial Collapse and Recession 211

SECURED TRANSACTIONS 211*Perfection 212***PRIORITY PROBLEMS AND EXAMPLES 212***sidebar 7.9 Artisan's Liens and Mechanic's Liens 214***Limitations on Property and the Common Good 214****PROPERTY, THE USE OF RESOURCES,
AND THE EQUAL RIGHT OF OTHERS 215***sidebar 7.10 The Property System and Corporate Governance 216***NUISANCE AND ZONING 216***sidebar 7.11 Hot Sauce or Fresh Air? 217***case 7.3 COOK v. SULLIVAN 218****PROPERTY LIMITATIONS AND THE COMMON GOOD 220***Duration Limitations on Property 220**Taxation 220***PROPERTY: A CONCLUSION AND COMMENT 221****8 Contract Formation 226****Basic Concepts 228****CONTRACT LAW IN PRIVATE ENTERPRISE 228***sidebar 8.1 The Confidentiality Agreement 229***SOURCES OF CONTRACT LAW 229****Contractual Classifications and Terminology 230****BILATERAL AND UNILATERAL CONTRACTS 230****EXPRESS AND IMPLIED-IN-FACT CONTRACTS 231****case 8.1 MONTZ v. PILGRIM FILMS & TELEVISION, INC. 232***sidebar 8.2 Unsolicited Ideas 234**sidebar 8.3 Implied Warranties 234***IMPLIED-IN-LAW OR QUASI-CONTRACTS 234****CONTRACTUAL ENFORCEMENT TERMINOLOGY 235****CONTRACTUAL PERFORMANCE TERMINOLOGY 235****Contract Formation 236****OFFER TO CONTRACT 237***Definite Terms 237**sidebar 8.4 Is There a Definite Offer? 237**Termination of Offer 238***ACCEPTANCE OF OFFER 238***Mirror Image Rule 239**UCC Battle of the Forms 239*

case 8.2 GOTTLIB & CO., INC. v. ALPS SOUTH CORPORATION	239
<i>Silence Not Acceptance</i>	241
<i>Mailbox Rule</i>	241
<i>sidebar 8.5</i> Is the Mailbox Rule Still Relevant?	242
CONSIDERATION	242
<i>Agreement Not to Sue</i>	242
case 8.3 VASSILKOVSKA v. WOODFIELD NISSAN, INC.	243
<i>Preexisting Obligation</i>	245
<i>sidebar 8.6</i> Consideration Not Necessary	245
<i>Prior Consideration</i>	245
<i>Promise to Make a Gift</i>	245
<i>Option Contract</i>	246
<i>Promissory Estoppel</i>	246
CAPACITY OF PARTIES TO CONTRACT	246
<i>Minors</i>	246
<i>Intoxicated and Mentally Incompetent Persons</i>	247
LAWFUL PURPOSE	247
<i>sidebar 8.7</i> Unconscionable Contracts	248
<i>Contracts That Restrain Trade</i>	248
When a “Meeting of the Minds” Is Lacking	248
FRAUD OR INNOCENT MISREPRESENTATION	249
<i>sidebar 8.8</i> Deceptive Advertising and the FTC	249
MISTAKE	250
DURESS OR UNDUE INFLUENCE	250
Contract Form	250
ORAL CONTRACTS	251
STATUTE OF FRAUDS	251
<i>sidebar 8.9</i> Types of Contracts Required to Be Evidenced by a Signed Writing	251
<i>Sale of an Interest in Land</i>	252
<i>Collateral Promise to Pay Another’s Debt</i>	252
<i>Cannot Be Performed within One Year</i>	252
<i>Sale of Goods of \$500 or More</i>	252
<i>Others Contracts</i>	253
<i>sidebar 8.10</i> Are Electronic Contracts Considered Writings?	253
EXCEPTIONS TO THE WRITING REQUIREMENT	253
<i>Part Performance</i>	254

Rules Involving Goods 254

sidebar 8.11 Exceptions to Statute-of-Frauds Requirement That
Sale-of-Goods Contracts Be in Writing 254

Judicial Admissions 255

9 Contractual Performance and Breach 258

Interpretation of Contracts 260

RULES OF INTERPRETATION 260

sidebar 9.1 *Macy's v. Martha Stewart and J.C. Penney*: What Is a
Stand-Alone Store? 261

THE PAROL EVIDENCE RULE 261

Performance 262

CONDITIONS OF PERFORMANCE 262

case 9.1 ST. LOUIS PRODUCE MARKET v. HUGHES 264

PAYMENT, DELIVERY, SERVICES TENDERED IN GOODS CONTRACTS 265

sidebar 9.2 Terms of Delivery in the UCC 266

SUBSTANTIAL PERFORMANCE 266

sidebar 9.3 Levels of Performance 266

DIVISIBILITY OF PERFORMANCE 267

Excuses for Nonperformance 267

IMPOSSIBILITY OF PERFORMANCE 268

case 9.2 EAST CAPITOL VIEW COMMUNITY DEVELOPMENT
CORP. v. ROBINSON 268

COMMERCIAL IMPRACTICABILITY 269

WAIVER OR RELEASE 269

Breach of Contract 270

sidebar 9.4 Opening the Door to Related Liability 272

case 9.3 RHODES v. DAVIS 272

Efficient Breach 273

sidebar 9.5 Walking Away from a Mortgage 274

Third Parties' Rights 274

BENEFICIARIES 274

ASSIGNMENT OF CONTRACTS 275

Notice of Assignment 276

Contracts That Cannot Be Assigned 276

NOVATIONS 276



Practical Perspective on Contracts 277

sidebar 9.6 Suggestions for Businessperson/Lawyer Relationship on the Drafting of Contracts 277

10 Torts Affecting Business 280

Intentional Torts 282

sidebar 10.1 Types of Intentional Torts 282

ASSAULT AND BATTERY 282

case 10.1 HARPER v. WINSTON COUNTY 283

INTENTIONAL INFLICTION OF MENTAL DISTRESS 284

INVASION OF PRIVACY 285

case 10.2 EHLING v. MONMOUTH-OCEAN HOSPITAL SERVICE CORP. 285

FALSE IMPRISONMENT AND MALICIOUS PROSECUTION 287

TRESPASS 287

CONVERSION 288

DEFAMATION 288

Defamation and the First Amendment 289

sidebar 10.2 Football Coaches as Public Figures 289

FRAUD 290

sidebar 10.3 Tort or Crime? Or Both? 291

INTERFERENCE WITH BUSINESS RELATIONS 291

Injurious Falsehood 291

sidebar 10.4 One Set of Facts But Several Tort Claims? 292

Intentional Interference with Contractual Relations 292

NEGLIGENCE 293

sidebar 10.5 Elements of Negligence 293

DUTY OF CARE 293

case 10.3 IANNELLI v. BURGER KING CORP. 294

UNREASONABLE BEHAVIOR—BREACH OF DUTY 295

sidebar 10.6 Medical Malpractice Crisis 296

Examples of Negligence 296

Willful and Wanton Negligence 297

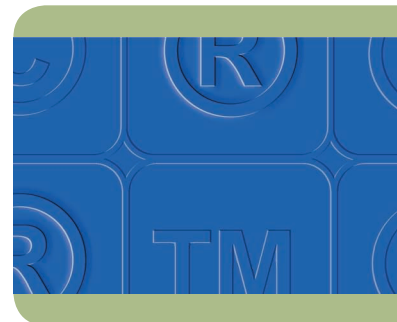
sidebar 10.7 Strip Search Hoax Costs McDonald's \$6.1 Million 297

CAUSATION IN FACT 298

PROXIMATE CAUSATION 298

sidebar 10.8 Explosion on the Long Island Railroad 299



DEFENSES TO NEGLIGENCE 299*Contributory Negligence* 299*Assumption of Risk* 300**Strict Liability in Tort 300****STRICT PRODUCTS LIABILITY 301***sidebar 10.9* Tort Reform 302**case 10.4** BRANHAM v. FORD MOTOR CO. 302**ULTRAHAZARDOUS ACTIVITY 304****OTHER STRICT LIABILITY TORTS 304***sidebar 10.10* The Great Molasses Flood 305**Damages 305****COMPENSATORY DAMAGES 305***sidebar 10.11* Highest Jury Tort Awards of 2010 306**PUNITIVE DAMAGES 307***sidebar 10.12* Punitive Damage Guidelines 308**11 Intellectual Property 312***sidebar 11.1* The Increasing Importance of Intellectual Property 314**THE JUSTIFICATION FOR INTELLECTUAL PROPERTY 315****INTELLECTUAL PROPERTY AND COMPETITION 315***sidebar 11.2* The Open Source Alternative 316**CAPTURING INTELLECTUAL PROPERTY 316****Trade Secrets 317****ESTABLISHING THE EXISTENCE
OF A TRADE SECRET 317****case 11.1** AL MINOR & ASSOCIATES, INC. v. MARTIN 318**DEMONSTRATING MISAPPROPRIATION 320***Employee Mobility and Trade Secrets* 320**CIVIL ENFORCEMENT OF TRADE SECRETS 321****CRIMINAL ENFORCEMENT OF TRADE SECRETS 321***sidebar 11.3* Soda Secrets 322*sidebar 11.4* Federal Government Intellectual Property Enforcement 322**Patent Law 323****OBTAINING A PATENT 323***Patent Type* 323*sidebar 11.5* Should Utility Patents Always Be Presumed Valid? 324

PATENTABLE SUBJECT MATTER 325

case 11.2 ASSOCIATION FOR MOLECULAR PATHOLOGY v. MYRIAD GENETICS, INC. 326

NOVELTY, NONOBVIOUSNESS, AND UTILITY 327

sidebar 11.6 Is Software Patentable? Maybe. 328

PATENT ENFORCEMENT 329

sidebar 11.7 The Determination of Obviousness 329

PATENT TROLLS AND THE LITIGATION THREAT 330**Trademark Law 331****TYPES OF TRADEMARKS 332**

Trade Dress 333

TRADEMARK REGISTRATION 333

sidebar 11.8 Brands vs. Trademarks 333

sidebar 11.9 “Washington Redskins” Is a Disparaging Name 334

TRADEMARK ENFORCEMENT 335

case 11.3 KRAFT FOODS GROUP BRANDS LLC. v. CRACKER BARREL OLD COUNTRY STORE, INC. 336

Trademarks and the Internet 339

TRADEMARK DILUTION 339**Copyright Law 340****COPYRIGHT OWNERSHIP 340****COPYRIGHT INFRINGEMENT 341****COPYRIGHT FAIR USE 342**

case 11.4 CAMPBELL v. ACUFF-ROSE MUSIC, INC. 342

COPYRIGHT IN THE DIGITAL AGE 343

sidebar 11.10 Is Copyright Law Too Inflexible for the Modern World? 344

Digital Millennium Copyright Act 344

sidebar 11.11 Knowledge of Users’ Infringing Activity 345

International Intellectual Property Rights 345**A Conclusion about Intellectual Property 346****12 International Law 350****Risks Involved in International Trade 353**

sidebar 12.1 Problems with Outsourcing in China: Mattel’s Massive Toy Recall 353

PRESSURES FOR BRIBES 353

sidebar 12.2 Turning Back the Tide of Corruption 354



sidebar 12.3 FCPA Prosecutions: U.S. Government Success Stories 356

EXPROPRIATION AND NATIONALIZATION 356

EXPORT CONTROLS 357

sidebar 12.4 Export Control Reform 358

sidebar 12.5 Twenty-First-Century Pirates 359

International Law and Organizations 359

sidebar 12.6 What Are Corporate Codes of Conduct? 360

SOURCES OF INTERNATIONAL LAW 360

Public International Law 360

sidebar 12.7 *Medellin v. Texas* (2008): The U.S. Supreme Court and the International Court of Justice (ICJ) 361

Private International Law 362

INTERNATIONAL ORGANIZATIONS 362

United Nations 362

World Trade Organization 363

The European Union 364

MAJOR AGREEMENTS AFFECTING TRADE 365

Convention on the International Sale of Goods 366

North American Free Trade Agreement 366

Central America-Dominican Republic Free Trade Agreement 366

Recent Free Trade Agreements 367

sidebar 12.8 Philip Morris: Restrictions Affecting Their Global Business 367

Methods of Transacting International Business 368

FOREIGN SALES 368

LICENSES OR FRANCHISES 368

sidebar 12.9 Successful International Franchising Ventures 369

DIRECT FOREIGN INVESTMENT 369

sidebar 12.10 Chiquita Brands International: Payments to Death Squads for “Protection” 370

Resolving International Disputes 370

ALIEN TORT STATUTE 370

case 12.1 *KIOBEL v. ROYAL DUTCH PETROLEUM, CO.* 371

SUING FOREIGN GOVERNMENTS IN THE UNITED STATES 372

SUING FOREIGN FIRMS IN THE UNITED STATES 373

sidebar 12.11 The Reach of U.S. Law: *Spector v. Norwegian Cruise Line, Ltd.* 545 U.S. 119 (2005) 373

INTERNATIONAL ARBITRATION 373

sidebar 12.12 Chevron and Texaco in Ecuador: \$18 Billion Judgment 374

China International Economic and Trade Arbitration Commission 375

The World Intellectual Property Organization: Arbitration and Mediation Center 375

13 Criminal Law and Business 378

sidebar 13.1 Handcuffs and Jail Time 381

Terms and Procedures 382**CLASSIFICATIONS OF CRIMINAL CONDUCT 382****BASIC CONCEPTS 382**

sidebar 13.2 The Price of the \$11 Billion Accounting Fraud at WorldCom 383

THE GRAND JURY 383**Constitutional Issues 384**

sidebar 13.3 The Fourth Amendment: Exigent Circumstances and Warrantless Searches 384

THE FOURTH AMENDMENT: ILLEGAL SEARCH AND SEIZURE 385

case 13.1 RILEY v. CALIFORNIA 386

sidebar 13.4 Know Your *Miranda* Rights 387

THE FIFTH AMENDMENT: PROTECTION AGAINST SELF-INCRIMINATION 388

sidebar 13.5 Fifth Amendment Rights: Mere Silence Does Not Invoke *Miranda* 388

THE FIFTH AMENDMENT: DOUBLE JEOPARDY 389**THE SIXTH AMENDMENT: RIGHTS IN A CRIMINAL CASE 389****Specific Crimes 390****FRAUD 390**

sidebar 13.6 Madoff's Multi-Billion-Dollar Ponzi Scheme 391

sidebar 13.7 FBI (Federal Bureau of Investigation) Report: Common Fraud Schemes 392

Mail and Wire Fraud 392

case 13.2 SKILLING v. UNITED STATES 393

Securities Fraud 395

sidebar 13.8 Preventing Identity Theft 395

Health Care Fraud 396

Counterfeiting 396

sidebar 13.9 False Claims Act and Whistleblower Lawsuits 396

Bankruptcy Fraud 397



CONSPIRACY 397*sidebar 13.10* Anatomy of a Prosecution: The Fall of Enron 398**OBSTRUCTION OF JUSTICE 398***sidebar 13.11* Think Before You Act: Examples of Obstruction of Justice 399**FALSE STATEMENT TO A BANK 400****FALSE STATEMENT TO A FEDERAL AGENCY 400***sidebar 13.12* Massey Energy Co. Explosion: Multiple Charges 401**LARCENY 401****RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT (RICO) 402***sidebar 13.13* Major RICO Prosecutions 403**CYBER CRIME 404****ENDANGERING WORKERS 404***sidebar 13.14* HACKED! Examples of Cyber Crimes 405**AIDING AND ABETTING 405****BRIBERY AND KICKBACKS 406***sidebar 13.15* Bribery Prosecutions 406**SENTENCING GUIDELINES 407****TRENDS 408****14 Business Organizations 412****FORMS OF BUSINESS ORGANIZATIONS 414***sidebar 14.1* Possible Forms of Business Organizations 414**Factors to Consider When Selecting a Business's Organizational Form 415****CREATION 415****CONTINUITY 415****MANAGERIAL CONTROL 415****LIABILITY 416****TAXATION 416****Selecting the Best Organizational Form 416****SOLE PROPRIETORSHIPS 416****PARTNERSHIPS 418***Creation 418**sidebar 14.2* Formation and Naming of a Partnership 419*Continuity 419**sidebar 14.3* Anticipating a Partnership's Dissolution—Buy and Sell Agreements 420

Managerial Control 420

Liability 420

Taxation 420

CORPORATIONS 421

Creation 422

sidebar 14.4 Steps in Creation of a Corporation 422

Continuity 422

Managerial Control 423

sidebar 14.5 Why Are So Many Companies Incorporated in Delaware? 423

Liability 424

case 14.1 ALLI v. U.S. 425

Taxation 427

sidebar 14.6 Corporate Tax Rates* 427

LIMITED PARTNERSHIPS 429

Creation 429

Continuity 430

Managerial Control 430

Liability 430

sidebar 14.7 Actions by Limited Partner

S CORPORATIONS 431

sidebar 14.8 Nonprofit Corporations 431

LIMITED LIABILITY ORGANIZATIONS 432

Creation 432

Continuity 432

Managerial Control 433

sidebar 14.9 Fiduciary Duties in LLCs 433

Liability 433

Taxation 433

Operating the Organization 434

MAKING THE DECISION 434

TRENDS IN MANAGING THE ORGANIZATION 434

case 14.2 FEDERAL COMMUNICATIONS COMMISSION v. AT&T INC. 436

PartTHREE The Regulatory Landscape for Business 441

15 The Regulatory Process 444

Regulatory Process—Administrative Agencies 446



REASONS FOR AGENCIES 446*sidebar 15.1* Major Federal Agencies 447*Providing Specificity* 447*Providing Expertise* 448*Providing Protection* 448*Providing Regulation* 448*Providing Services* 448**FUNCTIONS OF AGENCIES 449***Rule Making* 449*Adjudicating* 450*Advising* 450*Investigating* 450**ORGANIZATION OF AGENCIES 451****case 15.1** FREE ENTERPRISE FUND v. PUBLIC COMPANY
ACCOUNTING OVERSIGHT BOARD 451*In General* 453*Quasi-Judicial Staff* 455*sidebar 15.2* Procedures Followed in Quasi-Judicial
Proceedings 455**INFLUENCING AGENCY DECISIONS 456****Judicial Review of Agency Decisions 456****STANDING TO SUE 457***Reviewability* 457*Aggrieved Party* 457*sidebar 15.3* Standing to Sue or Who May Challenge an
Administrative Policy 457**REVIEW OF RULE MAKING 457***Is Delegation Valid?* 458*sidebar 15.4* Standard of Review of Agency Actions 459*Authority Exceeded?* 459**case 15.2** FOOD AND DRUG ADMINISTRATION v. BROWN &
WILLIAMSON TOBACCO CORPORATION 459**REVIEW OF ADJUDICATIONS: PROCEDURAL
ASPECTS 462***Exhaustion of Remedies* 462*sidebar 15.5* Exceptions to Requirement of Exhaustion 463*Primary Jurisdiction* 463**REVIEW OF FACTUAL DETERMINATIONS 464****Criticism of Administrative Agencies 465***sidebar 15.6* Criticisms of Administrative Process 465

THE COSTS TO BUSINESS 466

THE COSTS TO SOCIETY 466

CONCLUSION 467

sidebar 15.7 Trends in Regulations: Growth of Government in the Twentieth Century 468

16 Regulating Competition—Antitrust Laws 472

HISTORICAL DEVELOPMENT 474

The Sherman Act, Section 1—Agreements in Restraint of Trade 475

ANALYSIS IN ANTITRUST LAW 477

THE RULE OF REASON 477

Per Se Illegality 477

HORIZONTAL PRICE FIXING 478

case 16.1 UNITED STATES OF AMERICA v. APPLE INC. 478

VERTICAL PRICE FIXING 481

INDIRECT PRICE FIXING 482

TERRITORIAL AGREEMENTS 482

CONCERTED ACTIVITIES 483

case 16.2 AMERICAN NEEDLE, INC. v. NATIONAL FOOTBALL LEAGUE 483

sidebar 16.1 Basic Provisions of National Cooperative Production Amendment Act 486

The Sherman Act, Section 2—Monopolization 486

sidebar 16.2 Example of Monopoly 487

case 16.3 KOLON INDUSTRIES, INC. v. E.I. DUPONT DE NEMOURS & CO. 488

sidebar 16.3 Proving an Illegal Monopoly Exists 490

Sherman Act Sanctions and Exceptions 491

SANCTIONS 491

EXEMPTIONS 492

sidebar 16.4 Antitrust vs. Securities Regulation 494

The Clayton Act 494

INTRODUCTION 494

PRICE DISCRIMINATION 495

SPECIAL ARRANGEMENTS 497

sidebar 16.5 Tying Contracts, Patents, and Standard of Review 497



MERGERS AND ACQUISITIONS 498*sidebar 16.6* American Airlines Merges with a Rival 500**The Federal Trade Commission Act—Unfair Competition 500****INTERNATIONAL ANTITRUST ENFORCEMENT 501****17 Financial and Securities Regulations 506****WHAT IS A SECURITY? 509****SECURITIES AND EXCHANGE COMMISSION 510****The Securities Act of 1933: Going Public 510****PARTIES REGULATED 511****DOCUMENTS INVOLVED 511***Registration Statement 511**Prospectus 512***LIABILITY 513***Section 11: Registration Statement 513**Section 12: Prospectus and Other Communications 514**Section 17: Fraudulent Transactions 514***DEFENSES 515***Materiality 515**Statute of Limitations 515**Due Diligence 515***Securities Exchange Act of 1934: Being Public 516****SECTION 10(b) AND RULE 10b-5 517***sidebar 17.1* Language of Section 10(b) of the 1934 Act and SEC's Rule 10b-5 517*Liability 518***case 17.1** STONERIDGE INVESTMENT PARTNERS, LLC, PETITIONER v. SCIENTIFIC-ATLANTA, INC., ET AL. 518*Damages 520**sidebar 17.2* Proof of Loss Due to Fraud 521*sidebar 17.3* Right to Contribution from Others 521*Materiality 521**sidebar 17.4* Statute of Limitations for Fraud Claims 522*International Application 522***case 17.2** MORRISON v. NATIONAL AUSTRALIA BANK LTD. 523

INSIDER TRANSACTIONS	525
NONPUBLIC INFORMATION	525
case 17.3 UNITED STATES v. O'HAGAN	526
ADDITIONAL CIVIL LIABILITY	529
CRIMINAL LIABILITY	530
Other Considerations	531
PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995	531
case 17.4 HALLIBURTON CO. v. ERICA P. JOHN FUND, INC.	533
STATE BLUE SKY LAWS	535
<i>Registration Requirements</i>	535
<i>Exemptions</i>	536
Sarbanes-Oxley Act of 2002	537
REVITALIZATION OF SEC	537
ACCOUNTING REFORMS	537
CORPORATE GOVERNANCE	538
FINANCIAL STATEMENTS AND CONTROLS	539
WHISTLEBLOWER PROTECTION	539
<i>sidebar 17.5 Extending Whistleblower Protection</i>	540
Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010	541
Jumpstart Our Business Startups (JOBS) Act of 2012	542
18 Regulations Protecting Consumer Purchases, Privacy, and Financial Activities	546
The Federal Trade Commission	548
THE FTC AND TRADE PRACTICE REGULATION	548
FTC PENALTIES AND REMEDIES	550
<i>Civil Fines</i>	550
<i>Other Remedies</i>	550
<i>sidebar 18.1 Keeping Promises</i>	551
POLITICS, ECONOMICS, AND THE LAW: THE FTC TODAY	551
FALSE ADVERTISING	552
Consumer Privacy	553
LIMITATIONS ON GOVERNMENT INTRUSIONS	554



TRADITIONAL BUSINESS PRIVACY 554**ELECTRONIC AND ONLINE PRIVACY PROTECTION 555**

case 18.1 IN RE: ZYNGA & IN RE: FACEBOOK PRIVACY
LITIGATIONS 556

INTERNATIONAL PRIVACY PROTECTION 559

Sidebar 18.2 The Right to Be Forgotten 560

Federal Credit Regulations 561**THE EQUAL CREDIT OPPORTUNITY ACT 561**

ECOA Prohibitions 561

Responsibilities of the Credit Extender 561

ECOA Remedies and Penalties 562

THE FAIR CREDIT REPORTING ACT 562

Consumer Rights under FCRA 563

Investigative Consumer Reports 563

Observing Reasonable Procedures 563

FCRA Penalties and Remedies 564

case 18.2 SAFECO INSURANCE CO. v. BURR 564

Fair and Accurate Credit Transactions Act Amendments 565

THE TRUTH-IN-LENDING ACT 565

Truth-in-Lending Coverage 566

Finance Charge and Annual Percentage Rate 566

Financing Statement 566

Penalties and Remedies under Truth-in-Lending 567

sidebar 18.3 Truth-in-Lending and the Subprime Mortgage
Mess 567

Truth-in-Lending Trends 568

Debt Collection and Consumer Protection 568**THE FAIR DEBT COLLECTION PRACTICES ACT 568**

FDCPA Remedies and Enforcement 569

case 18.3 JERMAN v. CARLISLE, MCNELLIE, RINI, KRAMER &
ULRICH LPA 569

State Laws Regulating Debt Collection 571

CONSUMER FINANCIAL PROTECTION ACT 571**BANKRUPTCY 572**

Bankruptcy Proceedings 572

Trustee in Bankruptcy 572

Creditor Priority 573

Discharge 573

ADDITIONAL CONSUMER PROTECTION 574



19 Environmental Regulation 578

sidebar 19.1 Categories of Environmental and Pollution-Control Laws 580

Government's Regulation of Itself 581

THE NATIONAL ENVIRONMENTAL POLICY ACT 581

NEPA Basics 581

EVALUATION OF ENVIRONMENTAL IMPACT STATEMENTS 582

case 19.1 SIERRA FOREST LEGACY v. SHERMAN 582

NEPA Trends 584

Government's Regulation of Business 584

THE ENVIRONMENTAL PROTECTION AGENCY 585

sidebar 19.2 Responsibilities of the EPA 585

AIR POLLUTION 585

Clean Air Act and Amendments 585

Clean Air Act Enforcement 586

Air Pollution Sources 586

CLEAN AIR ACT TODAY 587

Emissions Reduction Banking 587

Prevention of Significant Deterioration 588

The Permitting Process 588

sidebar 19.3 Beyond the Clean Air Act 588

Indoor Pollution 589

Conclusion 589

case 19.2 ENVIRONMENTAL PROTECTION AGENCY v. EME HOMER CITY GENERATION L.P. 589

WATER POLLUTION 591

Goals and Enforcement 592

ENDANGERED SPECIES ACT 593

Application of the ESA 593

PESTICIDE CONTROL 594

The Federal Pesticide Acts 594

Enforcement 595

SOLID WASTE 595

The Solid Waste Disposal Act 595

TOXIC AND HAZARDOUS SUBSTANCES 596

The Problem 597

Toxic Substances Control Act 597

Resource Conservation and Recovery Act 598

The Superfund 598

case 19.3 BURLINGTON NORTHERN AND SANTA FE RAILWAY
CO. v. UNITED STATES 599

Radiation 602

Suits by Private Individuals 603

CITIZEN ENFORCEMENT 603

TORT THEORIES 603

Nuisance 604

Other Tort Doctrines 604

Trends in Environmental Regulation 605

AREAS OF ENVIRONMENTAL CONCERN 605

Loss of Natural Ecosystems 605

Ozone 606

Greenhouse Effect 606

sidebar 19.4 Mass Extinction and Its Consequences 606

Population Growth 607

CORPORATE GOVERNANCE AND THE ENVIRONMENT 607

sidebar 19.5 Sustainability Reporting 608

PRIVATE PROPERTY AND THE ENVIRONMENT 608

PartFOUR The Employer–Employee Relationship 613

20 Discrimination in Employment 614

The Civil Rights Act of 1964 616

GENERAL PROVISIONS 616

ENFORCEMENT PROCEDURES 617

The 1991 Amendments 618

Winning a Title VII Civil Action 618

case 20.1 THOMPSON v. NORTH AMERICAN STAINLESS, LP 620

DISCRIMINATION ON THE BASIS OF RACE OR COLOR 621

sidebar 20.1 *Hithon v. Tyson Foods, Inc.*: The Use of the Word
“Boy” 622

case 20.2 RICCI v. DESTEFANO 623

sidebar 20.2 Abercrombie & Fitch’s \$40 Million Diversity
Lesson 625

sidebar 20.3 National Origin Discrimination: Problematic Ethnic
Slurs 626

DISCRIMINATION ON THE BASIS OF NATIONAL ORIGIN 626



DISCRIMINATION ON THE BASIS OF RELIGION 626*sidebar 20.4* Workplace Discrimination against Muslims 627**DISCRIMINATION ON THE BASIS OF SEX 628***sidebar 20.5* Women in Business: A Tough Go for Many 629*Sexual Harassment 629**sidebar 20.6* Vulgar Workplace Language & Sexual Harassment 630*Pregnancy Discrimination Act 631**sidebar 20.7* Pregnancy Discrimination: Claims on the Rise 631*Equal Pay Act 632**sidebar 20.8* Did the Supreme Court Get It Wrong? Legislative Action Post-Ledbetter 633*Sexual Orientation Discrimination 633**sidebar 20.9* Sexual Orientation Discrimination: State and Local Laws 634**Employment Practices That May Be Challenged 634****QUESTIONNAIRES, INTERVIEWS, TESTING, AND EDUCATIONAL REQUIREMENTS 634****HEIGHT AND WEIGHT REQUIREMENTS 635****APPEARANCE REQUIREMENTS 636****AFFIRMATIVE ACTION PROGRAMS AND REVERSE DISCRIMINATION 636***Private Employer Affirmative Action 637***SENIORITY SYSTEMS 638****Other Statutes and Discrimination in Employment 638****CIVIL RIGHTS ACT OF 1866 638***Unlimited Damages 639***DISCRIMINATION ON THE BASIS OF AGE 639***Types of Age Discrimination 640**Employer Defenses in ADEA Cases 640**sidebar 20.10* Did You Read the Law? A Law Firm Runs Afoul of the ADEA 641*Remedies under the ADEA 641***DISCRIMINATION ON THE BASIS OF DISABILITIES 641***Reasonable Accommodation under the ADA 642**sidebar 20.11* Chipotle Mexican Grill: Must Accommodate Disabled Patrons 643*Remedies under the ADA 643*

GENETIC DISCRIMINATION 644

sidebar 20.12 Protecting against Inadvertent Acquisition of Medical Information in Violation of GINA 645

DISCRIMINATION IN GETTING AND KEEPING HEALTH INSURANCE 645**OTHER FEDERAL LEGISLATION 645****STATE ANTIDISCRIMINATION LAWS 646****TRENDS IN EMPLOYMENT DISCRIMINATION AND LITIGATION 647**

Surge in Private Lawsuits 647

Arbitration in Employment Discrimination Disputes 647

sidebar 20.13 Is It Important to Investors if the CEO Is a Man or a Woman? 647

Insuring against Employment Discrimination Claims 648

21 Employment Laws 652

sidebar 21.1 Fair Labor Standards Act: To Pay or Not to Pay Overtime? 654

Employment Laws 654**MINIMUM WAGES AND MAXIMUM HOURS 654**

sidebar 21.2 Internship Programs under the FLSA 656

case 21.1 SANDIFER v. UNITED STATES STEEL CORP. 656

sidebar 21.3 Break Time for Nursing Moms 658

case 21.2 KASTEN v. SAINT-GOBAIN PERFORMANCE PLASTICS CORP. 658

THE WARN ACT 660**THE FAMILY AND MEDICAL LEAVE ACT 661**

sidebar 21.4 FMLA: Facts and Statistics 662

sidebar 21.5 EEOC: Best Practices Recommendations on Work/Family Balance 662

sidebar 21.6 States Are Immune from FMLA Self-Care Claims 663

FMLA and Military Families 663

UNIFORMED SERVICES EMPLOYMENT AND REEMPLOYMENT RIGHTS ACT 664

sidebar 21.7 Rand Study: Invisible Wounds of War 665

case 21.3 STAUB v. PROCTOR HOSPITAL 665

OCCUPATIONAL SAFETY AND HEALTH ADMINISTRATION 667

sidebar 21.8 New OSHA Crowd Management Safety Guidelines 668

sidebar 21.9 OSHA's Severe Violator Enforcement Program 668

PENSION PLANS 669

HEALTH CARE 669

sidebar 21.10 Business Size and the Affordable Care Act 670

LIMITATIONS ON EMPLOYMENT AT WILL 670

sidebar 21.11 IRS Whistleblowers Rewards Program 671

sidebar 21.12 Privacy, Technology and Social Media 672

WORKERS' PRIVACY 672

sidebar 21.13 Is There Any Reasonable Expectation of Privacy in the Workplace? 673

WORKERS' COMPENSATION ACTS 673

History 673

The System 674

Tests for Determining Compensation 675

Exclusive Remedy Rule 676

The Future of State Workers' Compensation 676

EMPLOYMENT ELIGIBILITY VERIFICATION 676

sidebar 21.14 Arizona Law on Hiring Foreign Workers Is Upheld 677

Agency Law in Contracts and Other Contexts 678**TERMINOLOGY 678****CONTRACTUAL LIABILITY FROM AN AGENT'S ACTS 679**

Actual Authority 679

Implied Authority 679

Apparent Authority 680

Ratification 680

TORT LIABILITY FROM AN AGENT'S ACTS 680**CRIMINAL LIABILITY 681****EMPLOYEE LAWSUITS 682**

sidebar 21.16 What Can Employers Do to Avoid Employment Litigation? 683

22 Labor–Management Relationship 686**Labor Laws 688**

sidebar 22.1 2013 Statistics on Union Membership 689

LAWS BEFORE 1935 689

The Clayton Act 689

The Railway Labor Act 690

The Norris-LaGuardia Act 691

sidebar 22.2 Three Pro-Union Executive Orders 692



The Wagner Act 692

THE NATIONAL LABOR RELATIONS BOARD 693

NLRB Organization 693

Jurisdiction 693

sidebar 22.3 Are College Football Players Employees? 694

case 22.1 HISPANICS UNITED OF BUFFALO, INC.
AND CARLOS ORTIZ 694

Quasi-Judicial Authority 695

CERTIFICATION OF UNIONS 695

sidebar 22.4 Limitation of NLRB's Remedies 696

Certification Elections 696

Certification through Cards 696

sidebar 22.5 Unfair Labor Practice? *The NLRB v. Boeing* 697

UNFAIR LABOR PRACTICES BY MANAGEMENT 697

Interfering with Unionization 698

Dominating a Labor Organization 698

Discriminating Based on Union Affiliation 699

Discriminating as a Result of NLRB Proceedings 699

Refusing to Bargain in Good Faith 699

sidebar 22.6 This Was No Joke: The Writers Guild of America
Strike 700

sidebar 22.7 Fired! Venting About the Boss on
Facebook 701

The Taft-Hartley Act 702

EIGHTY-DAY COOLING-OFF PERIOD 702

sidebar 22.8 Tweeting His Way to Termination 703

FREE SPEECH 703

UNION SHOP—MEMBERSHIPS AND FEES 704

sidebar 22.9 Restricting Workplace Speech: Setting the
Parameters 704

SUITS AGAINST UNIONS 705

sidebar 22.10 Making a Point: Union Protests with Giant Inflatable
Rats 705

UNFAIR LABOR PRACTICES BY UNIONS 706

Restraining or Coercing an Employee into Joining a Union 706

*Causing an Employer to Discriminate against a Nonunion
Member* 706

*Striking or Picketing for Illegal Purposes or Engaging in Secondary
Boycotts* 707

AMENDMENTS 707

Agreeing to Engage in a Secondary Boycott 707

Picketing When Not Certified 708

Appendix I: Case Briefing and Legal Study Tips 711

Appendix II: Sample Complaint 713

Appendix III: The Constitution of the United States of America 717

Appendix IV: Selected Sections of Article 2 of Uniform Commercial Code 726

Appendix V: Selected Sections of the Sarbanes-Oxley Act of 2002 732

Appendix VI: Selected Sections of Securities Act of 1933 737

Appendix VII: Selected Sections of Securities Exchange Act of 1934 739

Glossary 741

Photo Credits 769

Index 771

Part ONE

Introduction: Legal Foundations for Business

In the twenty-first century, business managers who understand how to handle legal challenges will be in a position to use law to their strategic advantage. As President John Adams said that the United States is a nation “of law.” Certainly, law is all around us. The news media are full of stories about law, and many of our most popular television programs concern lawyers, courts, and law enforcement. Law surrounds how we buy and sell things, when we can drive a car and vote, and who we can see for many licensed services. Law taxes and punishes us as well as grants rights and privileges. Marriage and divorce apply rules of law, and even birth and death have legal significance. The conduct of modern business is hardly possible without the support of law, and everything you own is yours because of law. Part One of this book helps you understand the legal foundations for business.

Chapter 1 emphasizes the importance of understanding the fundamental role of law for business. The chapter explains that there are understandable organizing principles to the legal system, and it asserts that these principles—law, the rule of law, and property—provide a necessary foundation for successful modern business. Chapter 1 also covers the concepts of jurisprudence, explains the sources of law, sets out various classifications of law,

identifies legal sanctions, and introduces the concept of corporate governance. A good part of what you do in this course is to learn a legal vocabulary. Even more important, you must then learn to apply it. Chapter 1 gets this important process under way.

Chapter 2 emphasizes that the social basis of legal rules in a democracy are the traditional values, morals, and ethics of society. In a democracy, law is a very significant expression of society’s moral beliefs and concerns. Law often prohibits behavior that we consider morally wrong and permits or tolerates customary behaviors. In business, ethical issues frequently concern property relationships between employees and employers, between management and business owners, and between businesses and society. Chapter 2 looks at two ethical systems: formalism and consequentialism. It then examines various sources of values for business ethics, including legal regulation, professional and organizational codes of ethics, and individual values. It also suggests an approach to individual ethics in business organizations.

The next three chapters address dispute resolution, by explaining the U.S. court system, as well as the process of litigation and alternative dispute resolution mechanisms. Learning about the court system and ways to resolve disputes will help you understand how business can use

the law strategically. Also, as you read law-related news, these basic concepts are fundamental to grasp how and why a company resolves disputes.

Chapter 3 explains the court system, identifying key players: judges, jurors, and lawyers. Each plays a distinct and important role. This chapter also sets forth the organization of the state and federal court systems, including the appellate courts. This chapter also includes a guided reading of the text's first court opinion, the U.S. Supreme Court case *National Federation of Independent Business v. Sebelius*, which decided the constitutionality of the Patient Protection and Affordable Care Act.

Chapter 4 focuses on how civil cases move through the court system in a process known as *litigation*. This chapter describes how the filing of a complaint commences cases and then explains all of the other pleadings that can be filed, as well as all of the pretrial discovery procedures and motions. The chapter concludes with information about the stages of a trial and any posttrial appeals.

There are many drawbacks to litigation, and Chapter 5 illustrates alternative ways to resolve disputes. This chapter explains different negotiating techniques to settle disputes. It also demonstrates the key differences between mediation and arbitration. Although both use a neutral third party to assist in resolving the dispute, they have significantly different features, which are important to know before agreeing to resolve a dispute.

Chapter 6, the final chapter in Part One, discusses the U.S. Constitution and constitutional guarantees relevant to business, including First Amendment protections, due process, and equal protection. This chapter also explains the significance of the Commerce Clause. Decisions involving the Commerce Clause have played a major role in defining how business works in the United States. This clause has a rich history of empowering the federal government's authority to regulate business. As such, understanding the role of administrative agencies in carrying out that will is critical.

Taken together, these chapters introduce readers to the legal foundations for business. The following section makes suggestions about the best way to read and study *The Legal and Regulatory Environment of Business*.

How to Study This Textbook

To read this textbook we highly recommend a certain method called Survey, Question, Read, Recite, Review (SQ3R). SQ3R is much more effective than simply starting at the beginning of a chapter and reading straight through to the end. But it should not take much longer than reading straight through.

If you are allowing two hours for the reading of a chapter, first take no more than five or six minutes and “survey” the chapter. Flip through the chapter and look at all of the main headings and subheadings of the sections, perhaps also looking at the first sentences of several paragraphs in each section. In surveying you are not trying to learn or even understand the material but rather to get an idea of what the chapter is about.

After surveying the material, develop a “question” for each section as you read. If the section heading says “Why Nations Are Economically Weak or Strong,” turn the heading into a question, like “Why are some nations economically weak and others economically strong?” Then “read” the section with the purpose of answering your question. When you finish reading, “recite” aloud or silently to yourself the answer to the question.

The last “R” refers to “review.” Spend the last 10 minutes of your study time reviewing the chapter. A good way to do this is to go back to your questions and answer them again. If you will study by this method, we guarantee more effective results than if you simply read the chapter straight through. We have included a longer explanation of SQ3R as Appendix 1 in the back of the book, along with an explanation of the case briefing system, which you may need beginning with Chapter 3. •



1 Law as a Foundation for Business

■ Learning Objectives

In this chapter you will learn:

- 1-1. To understand that laws and regulations are fundamental foundations for business.
- 1-2. To explain that “property” in the law refers not to something that is owned but to the right of ownership itself, which gives incentive for wealth creation.
- 1-3. To analyze why *stare decisis* is different in common law nations than in civil law nations.
- 1-4. To classify what legal sources lawyers turn to in answering legal questions from their clients and the hierarchy of those sources.



Introduction

An understanding of the importance of the legal environment of business is essential to appreciate the role of law as the foundation for business practice in a private market system. Learning about the law is essential to understanding how the law can be used for strategic advantage and to developing sustainable business practices. This text and its accompanying electronic features are designed

with a number of objectives in mind, including creating a learning environment in which you will gain:

- The legal vocabulary to communicate with lawyers and business colleagues about areas of the law in a sophisticated manner.
- The ability to identify legal issues potentially relevant to a particular business situation.
- The judgment to make sound business decisions to prevent legal disputes.

- The knowledge to determine legal issues that require advice from counsel.
- The foundation to act as a sophisticated consumer of legal services.

As you read this book, consider the impact of the law on business. This chapter provides a basic overview of the law, helping you understand the common classifications and sources of law. Many examples are provided throughout the chapters to underscore the relevance of the law for business.

sidebar 1.1

JPMorgan Chase & Co.'s Massive Legal Liability

If there was ever a question about the toll that wrongdoing can take on a company, it was addressed by Jamie Dimon, CEO of JPMorgan Chase & Co. In a 30-page letter to shareholders in 2014, Dimon addressed the ramifications of the bank's legal cases with multiple government agencies, stating that the previous year was "the most painful, difficult, and nerve wracking experience that I have ever dealt with professionally." At that time, the company had already spent more than \$20 billion to settle a range of cases.

JPMorgan is in the process of adding more than 13,000 employees to handle regulatory compliance

and risk control, including approximately 8,000 employees whose primary responsibility is to combat money laundering. The company is spending \$2 billion to comply with new rules and regulations.

In the same letter to shareholders, Dimon acknowledged that the company was too self-assured when they saw regulators investigating their competitors and that they need to be "better listeners and do a better job at examining critiques of others so [they] can learn from other people's mistakes, too."

Source: David Henry, "JPMorgan's Dimon Calls Settling Legal Issues 'Nerve Wracking,'" *Reuters* (April 9, 2014).

LO 1-1

WHY LAW AND REGULATIONS ARE FUNDAMENTAL FOUNDATIONS FOR BUSINESS

In the twenty-first century, it is crucial for companies doing business in the United States to be aware of the legal and regulatory landscape. As vividly evidenced by the experience of JPMorgan Chase & Co. in Sidebar 1.1, companies must take steps to ensure that they are in full compliance with the law to avoid a range of civil and criminal liability. By studying the legal and regulatory environment of business, you will gain an understanding of basic legal vocabulary and gain the ability to identify problematic situations that could result in liability. Moreover, whether you are involved in contract negotiations, the development of intellectual property, or dealing with employees, learning the fundamentals of the law will not only help you make informed decisions, but also to know when to call an attorney for advice.

In fact, because of the positive role lawyers can play, they are increasingly being asked to join corporate boards. In 2000, only 24 percent of U.S. companies had lawyer directors on their boards, but by 2009, 43 percent did. A recent study demonstrated that having lawyer-directors resulted in an average 9.5 percent increase in firm value. Without question, lawyers on boards can help companies navigate a myriad of issues and help manage risk.¹

"Privatization without necessary institutional infrastructure [such as law] in the transition countries led to asset stripping rather than wealth creation."

—Joseph E. Stiglitz,
economist

¹See Lubormi Litov, Simone Sepe and Charles Whitehead, "Lawyers and Fools: Lawyer Directors in Public Corporations," http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2218855 (January 14, 2014).

Law, the Rule of Law, and Property

Three concepts establish a necessary framework for the most effectively functioning market in the modern nation: law, the rule of law, and property. Note how they connect to each other.

LAW

In the last 10,000 years, human society has moved from roving bands of hunter-gatherers to large modern nations with populations in the hundreds of millions. The social forces that hold together societies range from custom and religion to law and economic ties. In the modern nation, however, the most significant of the social forces is **law** because law can glue together diverse peoples of different backgrounds into very large, organized groups. Law is known by everyone as being intended to tell members of society what they can or cannot do. Strangers to a society may not understand or appreciate complex and subtle customs of behavior, but they can observe the formal laws governing what kinds of activities are permitted and prohibited in society. Lawyers, judges, and other trained interpreters of the rules can help them in this process.

A simple definition of law follows:

- Law is made up of rules.
- These rules are laid down by the state and backed up by enforcement.

Law is a formal social force, meaning that laws come from the state and are usually written down and accessible so those who need to understand and obey them can. To maintain order in society, adequate enforcement institutions such as courts and the police are a necessary part of the legal system. As countries such as China are finding out, written laws mean little unless they can be promptly and fairly enforced. Without adequate enforcement, resources can be taken from those who have them, and agreements can be disregarded. The certainty and trust necessary to make complex, long-term business arrangements are absent. People must spend much of their time guarding their resources rather than developing them.

THE RULE OF LAW

In a modern nation, law is important to implement either the commands of a dictator or the will of the people in a democracy. However, only in democracies is there true concern for the rule of law, which goes beyond merely thinking of law as governmental commands backed up by force. Under the **rule of law**, laws that are made are *generally* and *equally* applicable. They apply to all or most members of society and they apply to various groups in the same way.

Under the rule of law, law applies to lawmakers as well as to the rest of society. Thus, lawmakers have an incentive to make laws that benefit everyone. Rule-of-law nations adopt laws supporting the private market because it is in everyone's interest, including the lawmakers'.

In today's international business environment, more and more voices are calling for the rule of law. The secretary-general of the United Nations says that "without confidence based on the rule of law; without trust and transparency—there could be no well-functioning markets." The managing director of the

The first known written set of laws was the Code of Hammurabi, named after the Babylonian king of the eighteenth century BC.

"Without the rule of law, major economic institutions such as corporations, banks, and labor unions would not function, and the government's many involvements in the economy—regulatory mechanisms, tax systems, customs structure, monetary policy, and the like—would be unfair, inefficient, and opaque."

—Thomas Carothers,
Director, Democracy
and Rule of Law Project,
Carnegie Endowment
for International
Peace

“While economic growth can occur in the short run with autocratic regimes, long-run economic growth entails the development of the rule of law.”

—Douglas C. North,
acceptance speech
for the Nobel Prize in
Economics, 1993

International Monetary Fund asserts that “high quality” economic growth depends “in particular on the rule of law” which is a “lodestar for all countries.” Observes the managing director of JPMorgan Chase: “An environment in which courts cannot be relied upon to adhere to the rule of law is an environment in which businesses will be reluctant to invest and in which development will be stunted.” He calls the rule of law “a cornerstone of free trade.”

Unfortunately, the rule of law is an ideal rather than a complete fact in even the most democratic nation. Special interest groups attempt to persuade lawmakers to benefit these groups at the expense of others. And it is not always clear what it means to apply laws generally and equally. Still, in a democracy well-educated voters who understand the importance of the rule of law can hold to account lawmakers who excessively favor special interests. Judges also play a vital role in maintaining the rule of law. (See Sidebar 1.2.)

Almost all wealthy countries embrace the rule of law; for example, most European countries. Article 6 of the Treaty on European Union, called the Maastricht Treaty, says the EU is “founded” on “the rule of law.” There are no countries with strong, diverse economies that do not have the rule of law. As former President Eisenhower warned, “The clearest way to show what the rule of law means to us in everyday life is to recall what has happened when there is no rule of law.”

sidebar 1.2

The Chief Justice and the Rule of Law

Before someone can become a justice of the U.S. Supreme Court, the president must nominate and the U.S. Senate must confirm that person. The Senate must also confirm the president’s choice to be chief justice. During the confirmation, the senators always ask questions about the rule of law. Here is how Chief Justice John Roberts responded to a confirmation question about the rule of law.

Somebody asked me . . . , “Are you going to be on the side of the little guy,” he said. And you obviously want to give an

immediate answer, but, as you reflect on it, if the Constitution says that the little guy should win, the little guy’s going to win in court before me. But if the Constitution says that the big guy should win, well, then the big guy’s going to win, because my obligation is to the Constitution.

Compare Chief Justice Roberts’ statement to a similar observation made by former Chief Justice Warren E. Burger: “Judges rule on the basis of law, and not public opinion, and they should be totally indifferent to the pressures of the times.”

LO 1-2

PROPERTY

Property is a legal right that allows you to exclude others from your resources.

The third concept necessary for a successful private market in the modern nation is **property**. In a dictionary, property has two common meanings: (1) something that is owned, and (2) ownership. We will be using the word in its second definition as “**ownership**.” In law the word “property” (or “ownership”) means the right to turn to public authorities like the police or the courts to help you keep others from interfering with what you own. Property is a legal fence that keeps others out without your permission. It allows you to exclude others from something without your permission.

Three types of ownership fences are

- Public property, which applies to public resources owned by the government (or “state”) like roads, public buildings, public lands, and monuments.
- Private property, which applies to resources that you own as an individual.
- Common property, which applies to resources like land that more than one individual owns jointly.

So important is the right of private property that in this book we often just refer to private property as “property.” We will specifically say “public property” or “common property” if we mean those applications of exclusionary right.

It is through the law of property that individuals and business organizations can possess, use, and transfer their private resources. The enforcement of the property right under the rule of law gives people incentive to develop the resources they own and a property-based legal system that enables such control by allowing people to exclude others from interfering with what their efforts produce. The exclusionary right of property provides a basis for the private market and modern business. Scholars have traced the economic flourishing of Western civilization during the last several hundred years to the increasing recognition of the right of property in the nations of the West.

PROPERTY IN ITS BROADEST SENSE

Property can be thought of as the central concept underlying Western legal systems. (See Figure 1.1.) Most of the topics discussed in this book relate to the exclusionary right of property. Contract law enables an owner to exchange resources (Chapters 8 and 9), especially at a future date. Tort law compensates owners whose resources are wrongfully harmed by the actions of others (Chapter 10). Criminal law punishes those who harm an owner’s resources in particular ways, for example, by theft (Chapter 13). The law of corporate governance and business organizations identifies how individuals can own and use private resources in groups (Chapter 14).

Regulatory law both protects ownership and sets limits on private resource use (Chapter 15). Antitrust law forbids owners from monopolizing classes of resources and sets rules for how businesses can compete to acquire ownership in new resources (Chapter 16). Securities laws regulate the transfer of ownership in certain profit-making opportunities (Chapter 17). Environmental law controls how owners can use their resources when creating pollution (Chapter 19). Even labor laws and antidiscrimination laws involve property in the sense they protect the employees’ right to exclude employers from interfering with certain self-ownership interests of the employees (Chapters 20, 21, and 22). Finally, a theme of the entire book, corporate governance, specifically concerns the law protecting the owners of a business organization from the managers who run it for them. Generally speaking, corporate governance also refers to any law regulating and limiting private owners’ productive resources and their use.

In its broadest sense, property includes an ownership of individual constitutional and human rights in ourselves that excludes the state from interfering with these rights. Today, we usually call our relationship to these rights

Do remember that the property right gives a major incentive to develop resources.

Property is the central concept of Western legal systems.

To say that you have a “right” means that legally you can keep others from interfering with that right. To be able to exclude others is the essence of property.