

9th Edition

MANAGERS AND THE LEGAL ENVIRONMENT

STRATEGIES FOR BUSINESS



CONSTANCE E. BAGLEY

Ninth Edition

MANAGERS AND THE LEGAL ENVIRONMENT

STRATEGIES FOR BUSINESS

CONSTANCE E. BAGLEY

Yale University



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DEDICATION



*For my son Christoph, with all my love,
and for all of Team Bagley—Arleen, Bev, Bob, Christy,
David, Donna, Jeffrey, Kathleen, Liz, Mary, Nihal, Sheril, Shirley,
and Steve—with my deepest gratitude.*

We did it!

C.E.B.



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PREFACE

The importance of understanding the interplay of law, management, ethics, and strategy to successful and responsible management is greater than ever. It is therefore not surprising that the updated 2017 accreditation standards of The Association to Advance Collegiate Schools of Business (AACSB International), the premier accrediting body for business schools in the United States and abroad, require coverage of the “[e]conomic, political, regulatory, legal, technological, and social contexts of organizations in a global society” as well as “[s]ocial responsibility, including sustainability, diversity and ethical behavior and approaches to management.”¹

Effective management requires legal literacy as well as the ability to think critically and to integrate multiple seemingly discrete bodies of knowledge. Managers need practice identifying and assessing threats and opportunities and exercising good judgment in the face of uncertainty. At a minimum, it is critical for managers to know where the lines are on the field—what is legal, what is not, and what is in a gray area. It is also important to understand how firms can responsibly change the “rules of the game.”

Scandals involving major corporations around the world abound. Since the 2007–2008 financial crisis, banks have paid more than \$320 billion in fines,² with one trader posting on social media, “If you aint cheating, you aint trying.”³ Former Uber engineer Susan Fowler’s blog describing how she and other female engineers were treated at Uber resulted in the replacement of the founder and CEO and underscored the importance of the “tone at the top.” In September 2017 London announced it would not renew Uber’s license to operate, declaring that the company did not meet the designation of “fit and proper.”⁴

The use by Volkswagen AG (VW) of “cheat” software to pass diesel emissions control standards tarnished the brand and cost the company billions in criminal penalties, civil fines, and settlements. In addition, at least eight VW executives have been criminally charged and face possible prison time.

Wells Fargo Bank agreed in 2016 to pay \$185 million in fines to settle claims that its employees had opened 2.1 million unauthorized accounts to meet unrealistic sales goals. After the bank revealed in August 2017 that an additional 1.4 million unauthorized accounts may have been opened, Congresswoman Maxine Waters, the ranking Democrat on the House Financial Services Committee, called for the break-up of Wells Fargo and accused it of engaging in “a routine practice of ripping off and preying on their customers, in a seemingly never-ending avalanche of scandals.”⁵

A massive data breach in 2017 at Equifax, one of the three major credit reporting agencies in the United States, imperiled the personal data of more than 140 million Americans. Senator Elizabeth Warren faulted Equifax for its “delayed and lackluster response” and called for an expanded government investigation of its data protection systems.⁶ Adding fuel to customers’ ire, *Business Insider* reported that the firm’s chief financial officer and two other executives had cashed in almost \$2 million of Equifax stock after the breach was discovered.⁷ Equifax’s CEO and the heads of information technology and security retired shortly after the firm announced that it had been hacked.⁸

Climate change is another area of management concern. Although President Donald Trump withdrew in June 2017

1. AACSB INT’L, ELIGIBILITY PROCEDURES AND ACCREDITATION STANDARDS FOR BUSINESS ACCREDITATION 35 (Apr. 8, 2013, updated July 1, 2017), <http://www.aacsb.edu/-/media/aacsb/docs/accreditation/standards/business-2017-update.ashx?la=en>.
2. Reuters, *Banks Have Paid \$321 Billion in Fines Since the Financial Crisis*, FORTUNE (Mar. 2, 2017), <http://fortune.com/2017/03/03/bank-fines-2008-financial-crisis/>.
3. James Titcomb, *Barclays Handed Biggest Bank Fine in UK History over ‘Brazen’ Currency Rigging*, TELEGRAPH (May 20, 2015), <http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/11619188/Barclays-handed-biggest-bank-fine-in-UK-history-over-brazen-currency-rigging.html>.
4. In determining whether Uber was “fit and proper,” officials reviewed how Uber handled “serious criminal offenses, how it conducted background checks on drivers and its justification for a software program called Greyball, which ‘could be used to block regulatory bodies from gaining full access to the app.’” Prashant S. Rao & Mike Isaac, *Uber Lamenting Cost of ‘Bad Reputation,’ Loses London License*, N.Y. TIMES, Sept. 23, 2017, at A1.

5. Samantha Masunaga & James Rufus Koren, *Wells Fargo’s Estimate for Unauthorized Accounts Jumps 67%, to 3.5 Million*, L.A. TIMES (Aug. 31, 2017), <http://www.latimes.com/business/la-fi-wells-fargo-accounts-20170831-story.html>.
6. Roger Yu, *Equifax Data Breach: Elizabeth Warren Calls for Probe of Hack, Consumer Data Security*, USA TODAY (Sept. 15, 2017), <https://www.usatoday.com/story/money/2017/09/15/warren-d-mass-called-friday-more-thorough-investigation-recent-data-breach-credit-reporting-agency-al669299001/>; *The Equifax Data Breach: What to Do*, FED. TRADE COMM’N, (Sept. 8, 2017), <https://www.consumer.ftc.gov/blog/2017/09/equifax-data-breach-what-do>.
7. Lauren Lyons Cole, *The Equifax Breach May Have Exposed 143 Million People’s Social Security Numbers—But Here’s Why You Shouldn’t Freak Out*, BUS. INSIDER (Sept. 13, 2017), <http://www.businessinsider.com/equifax-hack-dont-freak-out-2017-9>.
8. Jennifer Surane & Anders Melin, *Equifax CEO Richard Smith Resigns After Uproar Over Massive Hack*, BLOOMBERG.COM (Sept. 26, 2017), <https://www.bloomberg.com/news/articles/2017-09-26/equifax-ceo-smith-resigns-barros-named-interim-chief-after-hack>.

from the Paris Climate Accord, citing the “draconian financial and economic burdens the agreement imposes” on this country,⁹ other nations and state governments are stepping into the breach to address climate change. Private firms are adding sustainability to their goals as a differentiating factor and as a matter of enlightened self-interest.

The topics discussed in the ninth edition of *Managers and the Legal Environment: Strategies for Business* are on the leading edge of business regulation and strategy. They include the standards for judicial review of decisions by administrative agencies, including the views of President Trump’s appointee U.S. Supreme Court Justice Neil M. Gorsuch;¹⁰ the extraterritorial reach of the Alien Torts Statute and other U.S. laws;¹¹ corporate criminal liability in the United States and other parts of the world;¹² liability of tippees for insider trading;¹³ whether the offer and sale of Bitcoin and other virtual coins and tokens constitute the offer and sale of securities; raising money on the Internet through crowdfunding and other techniques; when a broker recommending the purchase of securities has an obligation to update warnings about possible market risks that could render the securities illiquid;¹⁴ the ability of a patent holder to control the reuse of a product after it has been sold overseas;¹⁵ whether a gun manufacturer can be held liable for a mass school shooting under the negligent entrustment exception to the Protection of Lawful Commerce in Arms Act;¹⁶ whether a whistleblower is protected under the Dodd–Frank Wall Street Reform and Consumer Protection Act when the person reports a securities violation internally and not to the Securities and Exchange Commission;¹⁷ the classification of an individual working as an Uber driver as an employee or an independent contractor;¹⁸ whether undergraduate and graduate student assistants who perform teaching and research services are employees eligible to unionize¹⁹; whether requiring employees to sign agreements precluding them from bringing group arbitration

and class actions concerning their working conditions violates the National Labor Relations Act;²⁰ whether a university admissions policy that included race as a factor can withstand strict scrutiny;²¹ the religious accommodation responsibilities of a potential employer to a job applicant;²² whether the religious beliefs of the owner of a company permit the company to fire an employee going through sex reassignment surgery without violating Title VII;²³ and when government restrictions on development constitute a taking requiring just compensation.²⁴

The text addresses not only traditional business law topics, such as agency, contracts, torts, criminal law, anti-trust, and employment law, but also other topics of vital concern to business managers, such as privacy protections, constitutional law, intellectual property, corporate governance, securities regulation, bankruptcy, and environmental law and sustainability.

Managers and the Legal Environment: Strategies for Business is a comprehensive and challenging, yet approachable and understandable, text that is suitable both for those with substantial work experience and for those who are studying business for the first time. It includes an extensive glossary providing clear definitions of all key terms, thereby enhancing students’ legal literacy and facilitating their future interactions with counsel. Professors at more than 100 colleges and universities have successfully used the text in legal environment of business courses and in business law courses at the undergraduate, M.B.A., executive M.B.A., and executive education levels.

As its title implies, the text is designed as a “hands-on,” transactional guide for current and future business managers and leaders, including entrepreneurs.²⁵ It provides a comprehensive discussion of how law affects daily management decisions and business strategies, and it offers tools that managers can use to manage more effectively. The text also highlights traps for the unwary so managers not only can spot legal issues before they become legal problems but also can effectively handle the inevitable legal disputes that will arise in the course of doing business. No manager operating in the complex and ever-changing global business environment of the twenty-first century can compete successfully without this knowledge. Yet staying out of trouble is only part of the picture. Law does not just constrain and regulate; it also enables and

9. Statement, Office of the White House Press Secretary, Statement by President Trump on the Paris Climate Accord (June 1, 2017), <https://www.whitehouse.gov/the-press-office/2017/06/01/statement-president-trump-paris-climate-accord>.

10. *Gutierrez-Brizuela v. Lynch*, 834 F.3d 1142 (10th Cir. 2016) (Case 6.1).

11. *Morrison v. Nat’l Austrl. Bank Ltd.*, 561 U.S. 247 (2010) (Case 24.2); *In re S. African Apartheid Litig.*, 15 F. Supp. 3d 454 (S.D.N.Y. 2014); *Kiobel v. Royal Dutch Petroleum Co.*, 569 U.S. 108 (2013).

12. See the “Global View” in Chapter 24.

13. *Salman v. United States*, 137 S. Ct. 420 (2016) (Case 22.4); *United States v. Martoma*, 869 F.3d 58 (2d Cir. 2017).

14. *Tutor Perini Corp. v. Banc of Am. Sec. LLC*, 842 F.3d 71 (1st Cir. 2016) (Case 22.2).

15. *Impression Prods., Inc. v. Lexmark Int’l, Inc.*, 137 S. Ct. 1523 (2017).

16. *Soto v. Bushmaster Firearms, Int’l, LLC*, 2016 WL 8115354 (Conn. Super. Ct. Oct. 14, 2016) (Case 10.5).

17. *Somers v. Digital Realty Trust Inc.*, 850 F.3d 1045 (9th Cir. 2017), *cert. granted*, 137 S. Ct. 2300 (2017) (Case 22.5).

18. *Jane Doe 1 v. Uber Techs. Inc.*, 184 F. Supp. 3d 774 (N.D. Cal. 2016) (Case 5.1).

19. *Trs. of Columbia Univ. in the City of N.Y. & Graduate Workers of Columbia—GWC, UAW*, 364 N.L.R.B. No. 90 (2016) (Case 12.2).

20. *Morris v. Ernst & Young, LLP*, 834 F.3d 975 (9th Cir. 2016), *cert. granted*, 137 S. Ct. 809 (2017) (Case 3.2).

21. *Fisher v. Univ. of Texas at Austin*, 136 S. Ct. 2198 (2016) (Case 4.4).

22. *EEOC v. Abercrombie & Fitch Stores, Inc.*, 135 S. Ct. 2028 (2015) (Case 13.2).

23. *EEOC v. R.G. & G.R. Harris Funeral Homes, Inc.*, 201 F. Supp. 3d 837 (E.D. Mich. 2016), *appeal filed*, No. 16-2424 (6th Cir. Oct. 13, 2016) (Case 13.1).

24. *Koontz v. St. Johns River Mgmt. Dist.*, 133 S. Ct. 2586 (2013) (Case 18.2).

25. Additional readings on the legal aspects of entrepreneurship can be found in CONSTANCE E. BAGLEY & CRAIG E. DAUCHY, *THE ENTREPRENEUR’S GUIDE TO LAW AND STRATEGY* (5th ed. 2018).

facilitates.²⁶ For example, contracts can create options, allocate risk, and enhance trust.

A key objective of *Managers and the Legal Environment: Strategies for Business* is to reframe students' understanding of the relationship of law and ethics to business. Rather than focusing solely on regulation and viewing law and ethics purely as constraints to be complied with and reacted to, this text teaches future managers the value of *legal astuteness*—the ability to practice strategic compliance management and to use the law and legal tools proactively to increase both the total value created and the share of that value captured by the firm.²⁷

Legal astuteness requires a set of value-laden attitudes, a proactive approach, the ability to exercise informed judgment, context-specific knowledge of the law and the application of legal tools, and the ability to partner with strategically astute counsel.²⁸ This text helps managers bridge the communication gaps that can occur when they work with attorneys and enhances their ability to address the legal aspects of business with confidence.

The text tightly integrates the treatment of law, management, and ethics, thereby helping students develop the ability to exercise informed judgment when managing the legal dimensions of business. Law is not presented in a vacuum. Instead, its relevance to management is made explicit at the beginning and end of every chapter. Court cases are chosen for their managerial relevance. Each chapter ends not with a summary of black-letter law but with a discussion of ways managers can use the laws and legal tools discussed in the chapter to create value, marshal resources, and manage risk by being proactive and exercising informed judgment. For example, the chapter on intellectual property (Chapter 11) explains how firms can use copyrights, patents, and trade secret protection to capture the value of their intellectual capital. It also discusses the use of trademarks to protect brand equity. The antitrust chapter (Chapter 16) makes it clear that firms can compete hard but must be able to justify their actions by articulating a valid business purpose for their behavior.

The topics covered in *Managers and the Legal Environment: Strategies for Business* demonstrate its focus on meeting the ever-changing needs of business managers and leaders. The chapter on international business transactions (Chapter 24) illustrates the overall approach of the text. It includes not only a discussion of the Foreign Corrupt Practices Act and such key legal concepts as

sovereign immunity and extraterritorial application of domestic law, but also a detailed examination of the blend of legal, financial, operational, and logistical issues that often determine the success or failure of an international investment transaction or joint venture. Chapter 24 also discusses the European Union's "right to be forgotten" and how that right impacts businesses such as Google.

PEDAGOGICAL FEATURES

Each chapter of *Managers and the Legal Environment: Strategies for Business* employs a wide array of proven teaching devices that reinforce the goals of the text.

Conceptual Frameworks

The ninth edition presents various conceptual frameworks to help students better understand the intersection of law, management, and ethics. Exhibit 1.1 presents the systems approach to law, business and society. The model explains how public law and societal expectations affect a firm's competitive environment and the value and uniqueness of its resources and capabilities as well as its value proposition and the activities in its value chain. It also shows how a firm's actions prompt changes in the public rules and how managers can use the law and the tools it offers to pursue opportunity, marshal resources, and capture value while managing the attendant risks. Exhibit 1.2 shows how legal considerations affect each activity in the value chain. Based on the author's analysis of literally thousands of cases, statutes, and regulations, Exhibits 1.3 through 1.7 present a typology of the underlying rationales of the U.S. public law governing businesses. As Chapter 1 points out, other countries tend to have laws that further many of these same objectives, albeit with varying degrees of emphasis on the different objectives and varying ways of furthering them.

Exhibit 1.8 then summarizes a variety of legal tools available at various stages of business development (ranging from evaluating the opportunity and defining the value proposition to harvesting) to further the managerial objectives of creating realizable value and managing risk. By mapping legal tools against these key managerial objectives, Exhibit 1.8 makes the legal aspects of business more readily accessible to students of business. Exhibit 2.1 presents the Ethical Business Leader's Decision Tree,²⁹ which is a tool that managers and their counsel can use to evaluate the legal and ethical aspects of their strategy and its implementation. The "In Brief" in Chapter 7 presents a decision tree for contract analysis. Chapter 20 includes a decision tree for understanding how the business judgment rule is applied to board decisions. Finally, the insider

26. M.C. Suchman, D.J. Steward & C.A. Westfall, *The Legal Environment of Entrepreneurship: Observations on the Legitimation of Venture Finance in Silicon Valley*, in *THE ENTREPRENEURSHIP DYNAMIC: ORIGINS OF ENTREPRENEURSHIP AND THE EVOLUTION OF INDUSTRIES* (C.B. Schoonhoven & E. Romanelli eds., 2001).

27. Constance E. Bagley, *Winning Legally: The Value of Legal Astuteness*, 33 *ACAD. MGMT. REV.* 378 (2008).

28. See Constance E. Bagley, *The Value of a Legally Astute Top Management Team: A Dynamic Capabilities Approach* in *THE OXFORD HANDBOOK OF DYNAMIC CAPABILITIES* (David J. Teece & Sohvi Leih eds., 2016).

29. This first appeared in Constance E. Bagley, *The Ethical Leader's Decision Tree*, 81 *HARV. BUS. REV.* 18 (Feb. 2003).

trading decision tree in Chapter 22 shows when trades based on material nonpublic information violate the securities and mail and wire fraud laws.

“A Case in Point”

Each chapter presents relevant cases, set off from the body of the text, that illustrate business law in action. These cases represent crucial court decisions that have shaped important business law concepts or present key legal conflicts that managers will address in their careers. Included are many modern cases that represent the most current statements of the law. They include *United States v. DeCoster*,³⁰ in which the U.S. Court of Appeals for the Eighth Circuit examined the circumstances under which the owner and operator of a food production company could be held criminally liable for violations of the Federal Food, Drug and Cosmetic Act under the responsible corporate officer doctrine; *Trump v. International Refugee Assistance Project*,³¹ in which the U.S. Supreme Court examined whether an injunction staying the enforcement of an executive order suspending immigration from six Muslim-majority countries should be stayed pending a decision on the merits (after that executive order expired on September 24, 2017, President Trump issued a Proclamation banning or limiting entry from eight countries, including North Korea and Venezuela³²); *Morris v. Ernst & Young, LLP*,³³ in which the U.S. Court of Appeals for the Ninth Circuit held that including concerted action waivers in employment agreements violated the National Labor Relations Act, an issue the U.S. Supreme Court agreed to hear during its 2017–2018 term; and *United States v. Nosal*,³⁴ in which the U.S. Court of Appeals for the Ninth Circuit examined whether certain types of behavior by employees and former employees involving the use of passwords to access an employer’s computer system violated the Computer Fraud and Abuse Act. Classic cases, such as *Meinhard v. Salmon* (Case 2.1) and *MacPherson v. Buick Motor Co.* (Case 10.1), are used to show early developments in the law that remain applicable today. The selection of and approach to cases are guided by the author’s goals of teaching students how to think critically so they can identify legal issues before they become legal problems and use the law strategically to create realizable value with honesty and integrity.

30. 828 F.3d 626 (8th Cir. 2016), *cert. denied*, 137 S. Ct. 2160 (2017) (Case 17.1).

31. 137 S. Ct. 2080 (2017) (Case 4.1).

32. Office of the White House Press Secretary, Proclamation, Presidential Proclamation Vetting Capabilities and Processes for Detecting Attempted Entry Into the United States by Terrorists or Other Public-Safety Threats (Sept. 24, 2017), <https://www.whitehouse.gov/the-press-office/2017/09/24/enhancing-vetting-capabilities-and-processes-detecting-attempted-entry>.

33. 834 F.3d 975 (9th Cir. 2016), *cert. granted*, 137 S. Ct. 809 (2017) (Case 3.2)

34. 844 F.3d 1024 (9th Cir. 2016), *cert. denied*, 2017 WL 1807382 (U.S. Oct. 10, 2017) (Case 14.3).

The format of each “A Case in Point” is designed to convey a nuanced understanding of the case while simultaneously covering a wide range of material. The case citation and facts are followed by a statement of the issue presented, which reinforces the legal principle illustrated by the case. Each case discussion then presents the court’s decision and concludes with a description of the result.

In many chapters, at least one case opinion is presented in the language of the court, edited for clarity and brevity. Excerpts from dissenting opinions are used occasionally to demonstrate how reasonable people can come to different conclusions about the same facts. This is important for two reasons. First, today’s dissent may be tomorrow’s majority opinion. Second, comparing the arguments raised in the opinion with those of the dissent requires, and strengthens the student’s ability to engage in, critical analysis. Each edited case is followed by two thought-provoking critical thinking questions that challenge the student’s understanding of the court’s language and reasoning and encourage the student to consider the ramifications of the decision for future cases and managerial decisions.

The opinions in the remaining cases are summarized, thereby permitting the coverage of more cases and concepts than would be feasible if all cases were presented in the language of the court. The author believes that students benefit from reading a more rigorous treatment of cases than is provided by the short briefs found in many texts. Thus, students are provided with a detailed recitation of the facts, the issues, the court’s reasoning, and the result.

Many cases also include comments that place the case in its proper legal and managerial context. A comment might explain why the case is important, why the court decided it the way it did, or what the ramifications are for business actors. This helps students understand how an individual case can affect the legal environment as a whole. In addition, the comments encourage students to think critically about court decisions and the conduct of the managers involved.

International Coverage, “Global View,” and “International Snapshot”

The ninth edition includes one of the most expansive integrated treatments of international business regulation available in a general legal environment or business law textbook. The text addresses the international aspects of the legal environment in three ways. First, the chapter on international law and transactions (Chapter 24) provides a transactional, integrated discussion of international business, including the use of letters of credit, sovereign immunity, compliance with anti-bribery statutes and local labor laws, and the economic sanctions against North Korea. Second, most chapters include a boxed feature

entitled “Global View,” which discusses key differences between U.S. law and the laws applied in the European Union, Japan, Canada, and other countries. For example, the consumer protection chapter (Chapter 17) describes the approaches taken by the European Union and China to genetically modified foods. The chapter on civil rights and employment discrimination (Chapter 13) discusses European, Indian, and Japanese discrimination law. The chapter on securities fraud (Chapter 22) examines the rules surrounding insider trading in the European Union and China. Global efforts to address climate change and sustainability are included in the environmental law and sustainability chapter (Chapter 15). Finally, a number of chapters also highlight international considerations in short boxed features called “International Snapshot.” For example, certain changes to the trademark law of Canada are discussed in the intellectual property chapter (Chapter 11).

Focus on Ethics, Integrity, and Social Responsibility

This text places great emphasis on ethical concerns, stimulating students to consider how their actions as managers and business leaders must incorporate considerations of ethics and social responsibility. Ethical considerations are emphasized in four ways. First, Chapter 2, “Ethics and the Law,” includes topics such as accounting fraud by companies intent on managing their earnings to meet analyst expectations, allegations of bribery and kickbacks, overseas working conditions, and conflicts of interest in the securities, insurance brokerage, and mutual fund industries. Second, ethical considerations are highlighted throughout the text in separate boxed features entitled “Ethical Consideration.” Third, each chapter includes a section entitled “A Manager’s Dilemma: Putting It into Practice,” which often requires students to consider how ethics factor into managerial decisions and business strategy. Finally, ethical considerations are raised in many of the end-of-chapter “Questions and Case Problems.”

These ethical considerations are commentaries on how standards of ethics and social responsibility do (and sometimes do not) inform the process of lawmaking. The text discusses the ethical implications of business decisions made in response to legal rules, as well as the moral boundaries of the legal regime.

“Economic Perspective,” “Historical Perspective,” and “Political Perspective”

Many chapters contain a separate boxed feature that puts the law in that chapter into economic, historical, or political perspective. For example, the employment agreement chapter (Chapter 12) looks at whether raising the minimum wage in Seattle, Washington, is good economic

policy; and the securities fraud and insider trading chapter (Chapter 22) explains the differences between the efficient capital markets hypothesis and market bubbles and the impact of these competing theories on the fraud-on-the-market doctrine. The environmental law and sustainability chapter (Chapter 15) explains the tragedy of the commons and the concept of externalities.

The “Perspective” features add a real-world dimension to the material and foster interdisciplinary analysis. Too often, law is presented in a vacuum, divorced from the larger historical, political, and economic context in which the law is created, applied, and changed. The goal of these sections is to heighten students’ awareness of these larger forces and the complicated interplay between economics and politics and the law. That interplay is crucial to the operation of a business, but it is often less than predictable.

“In Brief”

To provide a visual aid for the student, most chapters contain at least one boxed summary, the “In Brief,” which breaks down into digestible pieces the key elements of material presented in that chapter. In some cases, this may be presented in the form of a flow chart; in others, it may appear in the form of a decision tree or matrix.

“The Responsible Manager”

Each chapter includes a feature entitled “The Responsible Manager” at the end of the chapter material. This feature presents an in-depth discussion of the crucial legal considerations that the successful manager must take into account in a particular situation. “The Responsible Manager” sections summarize key takeaways from each chapter, but they are far more than mere summaries of legal rules. In a concise yet nuanced manner, they alert managers to the legal issues they must spot in order to avoid violating the law or plunging the company into expensive, time-consuming litigation. In addition, these sections highlight the ethical concerns managers need to confront to adequately serve their company and all its stakeholders.

As examples, “The Responsible Manager” section for the chapter on courts and dispute resolution (Chapter 3) includes points to consider when deciding whether to sue or pursue an alternative dispute resolution vehicle and provides a guide for setting up an effective alternative dispute resolution procedure. The administrative law chapter (Chapter 6) outlines steps managers can take to work more effectively with administrative agencies. The employment agreement chapter (Chapter 12) discusses ways to minimize wrongful discharge suits. The international law and transactions chapter (Chapter 24) highlights the issues likely to arise in transactions involving more than one country and suggests strategies for managing successfully in a global setting.

“A Manager’s Dilemma: Putting It into Practice”

Following “The Responsible Manager” in each chapter is a feature entitled “A Manager’s Dilemma: Putting It Into Practice,” which requires students to analyze the legal, business, and ethical aspects of a managerial decision and to make a recommendation for action. Many of these sections are based on recent cases or news accounts. For example, the chapter on sales, licensing, and e-commerce (Chapter 8) asks whether nondisparagement clauses help or hurt retailers, and the chapter on privacy protection (Chapter 9) questions whether national security should take precedence over consumer privacy and whether a corporation has a moral obligation to help the government at the expense of its customers’ privacy.

“Inside Story”

Each chapter concludes with a feature called “Inside Story.” These mini-cases present fascinating and detailed descriptions of real-world business situations, many of which highlight up-to-the-minute, cutting-edge business transactions. For example, the constitutional law chapter (Chapter 4) highlights the effect of politics on the appointment of justices to the U.S. Supreme Court, including the refusal by the Republican members of the Senate to hold hearings on President Barack Obama’s nomination of Judge Merrick B. Garland to succeed Justice Antonin Scalia on the Court. Other “Inside Story” topics include the contaminated water supply in Flint, Michigan (Chapter 18); the rise and fall of Takata Corporation as a result of the defective airbag debacle (Chapter 10); the dangers of the Samsung Galaxy Note 7 Smartphone (Chapter 17); and an overview of how bilateral no-poaching and wage-fixing agreements between firms may violate antitrust laws (Chapter 16). Classic battles are also included. For example, the *Pennzoil v. Texaco* case study, the “Inside Story” for the contracts chapter (Chapter 7), includes excerpts from the court’s opinion and the legal documents so that students can have the experience of seeing such material firsthand. These “Inside Story” examples bring legal conflicts and developments to life and reinforce students’ appreciation for how such conflicts are played out in the real world.

Defined Terms, “Key Words and Phrases,” and Glossary

Throughout the text, all crucial legal terms are printed in italics and defined immediately. A list of key terms appears in the “Key Words and Phrases” listing at the end of each chapter, with a page reference to the definition of each term. In addition, a comprehensive glossary at the end of the text defines all key terms. These features improve students’ legal and business vocabulary and enhance their legal literacy.

End-of-Chapter “Questions and Case Problems”

Each chapter is followed by eight thought-provoking “Questions and Case Problems,” which require students to synthesize, review, and apply the material. The questions are diverse. Some are mini-cases that require students to identify the legal and business issues and make a managerial decision. Others are based directly on specific cases, presenting real-world legal conflicts or decisions as opportunities for students to apply the appropriate law and engage in critical thinking. For example, the sources of law, courts, and dispute resolution chapter (Chapter 3) includes a question about the enforceability of consumer credit card agreements requiring card holders to arbitrate all claims and banning group arbitration;³⁵ the constitutional law chapter (Chapter 4) includes a question about the constitutionality of a state law requiring individuals to use the bathrooms and changing facilities corresponding to their biological sex at birth; it also asks what factors a company should consider when deciding whether to curtail activities in states with such laws;³⁶ and the consumer protection chapter (Chapter 17) includes a question about whether an administrative agency’s decision not to promulgate a rule on airline seat size and spacing was arbitrary and capricious in light of a consumer group’s assertion that shrinking seat size and increasing passenger girth imperiled safety by “slowing emergency egress.”³⁷ In most chapters, more than half the questions are based on actual cases, with the citation provided for enterprising students who want to look up the case in preparation for class.

CHANGES IN THE NINTH EDITION

Each chapter of *Managers and the Legal Environment: Strategies for Business* begins with a pithy quote, in most instances from a judge, capturing a key concept in the chapter. The ninth edition provides a cutting-edge analysis of recent key developments that have dramatically altered the legal landscape, including the Trump administration’s reassessment of the proper role of federal and state government in business (the topic of the “Inside Story” in Chapter 6, the administrative law chapter) as well as the abandonment of the Trans-Pacific Partnership and efforts to renegotiate the North American Free Trade Agreement. A number of opinions presented as “A Case in Point” are from the U.S. Supreme Court’s 2014–2016 terms. They include the Court’s rulings on the constitutionality of President Trump’s ban on immigrants from seven (then six) Muslim-majority countries;³⁸ the proper standard

35. *McGill v. Citibank, N.A.*, 393 P.3d 85 (Cal. 2017).

36. *Caracaño v. McCrory*, 203 F. Supp. 3d 615 (M.D.N.C. 2016).

37. *Flyers Rights Educ. Fund, Inc. v. FAA*, 864 F.3d 738 (D.C. Cir. 2017).

38. As noted earlier, this so-called travel ban expired on September 24, 2017, and was replaced by a revised travel ban that was issued via a presidential Proclamation.

for determining whether a university may take race into account when making admissions decisions; whether a job applicant must have initially informed a prospective employer of her need for a religious accommodation to prevail in a Title VII discrimination suit; whether a scheme to fraudulently obtain funds from a bank customer's account was a scheme to fraudulently obtain property from a "financial institution"; whether submitting a claim for government reimbursement of a health care claim without disclosing violations of statutory, regulatory, or contractual requirements is an actionable misrepresentation under the False Claims Act; and the circumstances under which a remote tippee may be guilty of illegal insider trading when no pecuniary benefit is received.

Key decisions from other courts include the factors used to determine whether individuals in the "gig" economy are employees or independent contractors; whether an employee was on a frolic or a detour when he was involved in a car accident during his workday and the potential liability of his employer; whether an individual can rely on an existing judicial interpretation of a statute before the court abandons its own judicial interpretation in deference to a subsequent different interpretation by an administrative agency; the constitutionality under the First Amendment of a "posting rule" for federal contractors requiring them to notify their employees of their collective bargaining rights; a gun manufacturer's potential liability, in the wake of a mass shooting on school grounds, under the Protection of Lawful Commerce in Arms Act; whether Google's library scanning project, in which millions of copyrighted books were scanned in their entirety, constituted fair use; whether the owner of a corporation may fire an employee undergoing sex reassignment surgery based on the owner's religious beliefs; whether certain claims about the safety of Uber drivers are false and misleading under the Lanham Act or just "puffery"; and whether an employee is protected under the Dodd–Frank Wall Street Reform and Consumer Protection Act's whistleblowing provision when a securities violation is reported only internally. When an earlier case remains the best pedagogical tool to illustrate a principle, it has been retained.

The ninth edition incorporates the provisions of recent federal legislation, such as the Defend Trade Secrets Act of 2016, and regulatory changes to certain Securities and Exchange Commission registration requirements and exemptions pursuant to the JOBS Act and FAST Act. It also discusses enforcement actions taken by various agencies in response to breaches of consumer privacy ranging from unauthorized releases of health information to the publication of data retained by a dating site for married individuals seeking new sexual partners. Recent rules promulgated and proposed under the Dodd–Frank Act by the Consumer Financial Protection Bureau are also included, along with a discussion of net neutrality and the fiduciary duties of certain brokers to act in the best interests of their clients when advising on pension plan investments.

The text includes updated guidance from the National Labor Relations Board on when employees' use of social media to criticize their employer constitutes protected concerted action under the National Labor Relations Act. It also discusses recent international developments, including Britain's withdrawal from the European Union ("Brexit"), developments in the euro zone, and the ultimate resolution of Chevron's dispute with Ecuador concerning a massive judgment awarded by an Ecuadorian court for environmental damage to the rain forests.³⁹

Many of the end-of-chapter "Questions and Case Problems" are new. For example, the constitutional chapter (Chapter 4) includes a question about whether the Patent and Trademark Office could refuse to register an Asian band's name, "The Slants," as a federal trademark pursuant to the clause of the Lanham Act that prohibits registration for disparaging marks without running afoul of the First Amendment.⁴⁰ The intellectual property chapter (Chapter 11) includes a question on the patentability of diagnostic medical tests,⁴¹ and the employment discrimination chapter (Chapter 13) includes a question about whether an employer's behavior constituted religious discrimination in violation of Title VII when it fired two employees for missing work on their Sabbath.⁴²

Most of the "Inside Story" and "Economic/Historical/Political Perspective" features are also new or have been substantially revised to reflect the latest developments. For example, the "Inside Story" in the employment discrimination chapter (Chapter 13) discusses the treatment of female engineers at Uber and the associated corporate culture. The "Political Perspective" in the international chapter (Chapter 24) has been updated to reflect economic trade sanction activity between the United States and Russia, and the "Historical Perspective" in the ethics chapter (Chapter 2) includes Pope Francis's encyclical on the environment.

ANCILLARY COMPONENTS

Instructor Resources

The ninth edition of *Managers and the Legal Environment: Strategies for Business* provides instructors with the following supplements: Answer Manual prepared by the author, Instructor's Manual, Test Bank in Cognero, and PowerPoint® slides. All supplements for the ninth edition can be found on the text's companion site. Available at login.cengage.com, the companion website offers an array of teaching and learning resources.

39. *Chevron Corp. v. Donziger*, 833 F.3d 74 (2d Cir. 2016), cert. denied, 137 S. Ct. 2268 (2017); *Chevron Corp. v. Ecuador*, 795 F.3d 200 (D.C. Cir. 2015), cert. denied, 136 S. Ct. 2410 (2016).

40. *Matal v. Tam*, 137 S. Ct. 1744 (2017).

41. *Cleveland Clinic Found. v. True Health Diagnostics LLC*, 859 F.3d 1352 (Fed. Cir. 2017).

42. *Tabura v. Kellogg USA, Inc.*, 194 F. Supp. 3d 1188 (D. Utah 2016), appeal filed, No. 16-4135 (10th Cir. July 29, 2016).

Answer Manual for End-of-Chapter “Questions and Case Problems” and “A Manager’s Dilemma”

A complete and separate Answer Manual, prepared by the author, identifies the issues presented in each “A Manager’s Dilemma” and in the end-of-chapter “Questions and Case Problems.” It provides thorough, cogent model essay answers to facilitate teaching by the Socratic and case methods.

Instructor’s Manual

The Instructor’s Manual includes chapter outlines, case summaries, and teaching suggestions.

Test Bank

The Test Bank contains true/false, multiple-choice, and essay test questions. The questions vary in levels of difficulty and meet a full range of tagging requirements so that instructors can tailor their testing to meet their specific needs.

Cognero

Cengage Learning Testing Powered by Cognero is a flexible, online system that allows instructors to:

- Author, edit, and manage test bank content from multiple Cengage Learning solutions.
- Create multiple test versions quickly.
- Deliver tests from the LMS, the classroom, or wherever the instructor prefers.

PowerPoint® Slides

A set of PowerPoint® slides provides outlines of topics covered in each chapter, which can be used for lecture or review.

ADDITIONAL COURSE TOOLS

Business School Teaching Cases Prepared by the Author

Professor Bagley has authored or coauthored a variety of business school teaching cases that can be purchased separately and used together with *Managers and the Legal Environment: Strategies for Business* in both business law and legal environment classes. They promote critical thinking and require interdisciplinary analysis.

Her Yale cases include:

- BP in Russia* (ethics and international business transactions)
- Delhi Metro Railway Corporation* (international joint ventures and financings, corruption, and leadership)
- From Politics to Law: U.S. Healthcare Reform 2011* (sources of law, constitutional law, and healthcare reform)

- Jim Flores, ControlTrix* (employment discrimination and wrongful termination)
- Kirkwood* (contracts and ethics)
- Morgan Life Sciences* (securities regulation and insider trading)
- PrimeSense and PrimeSense and Microsoft* (entrepreneurship, nondisclosure agreements, patents, and trade secrets)
- Research in Motion’s BlackBerry: Balancing Privacy Rights and National Security* (coauthored with Professor Sally Gunz of the University of Waterloo) (privacy)
- South Africa’s Energy Crisis: Reconciling Economic Growth with Environmental Protection* (environmental protection and economic development)

For a complete list, please go to the entrepreneurship law site powered by the Kauffman Foundation and the University of Missouri at Kansas City at <http://entrepreneurship.org> and search under Entrepreneurship Law, Business School Teaching Cases.

The author’s Harvard Business School cases include:

- BitTorrent and BitTorrent and Warner Bros.* (copyrights and licensing agreements)
- Priceline versus Microsoft* (patents and nondisclosure agreements)
- Richard Spellman (A) and (B)* (employment and stock purchase agreements and executive compensation)
- USG Corporation (A), (B), and (C)* (litigation, lobbying, product liability, and bankruptcy)
- X-IT and Kidde* (entrepreneurship, ethics, copyrights, trade secrets, and patents)

For a complete list, please go to <https://cb.hbsp.harvard.edu/cbmp/pages/home> and search for “Bagley.”

Cengage’s MindTap

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Each and every item in the Learning Path is assignable and gradable. This gives instructors information on class standings and flags concepts that may be difficult. Additionally, students gain knowledge about where they stand—both individually and compared with the highest performers in class.

To view a demo video and learn more about MindTap, please visit www.cengage.com/mindtap.

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A FINAL WORD

Managers and the Legal Environment: Strategies for Business, ninth edition, contains information on a wide range of legal topics but should not be relied upon as legal advice. Instead, a lawyer should be consulted before action is taken in any specific case. Hopefully, this text will facilitate meaningful dialogues with counsel and make its readers more informed consumers of legal services. Legally astute managers work with strategically astute counsel as partners to create value, marshal resources, and manage risks, to win with integrity.

Constance E. Bagley
Yale University

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UNIT

1

FOUNDATIONS OF THE LEGAL AND REGULATORY ENVIRONMENT

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LAW, VALUE CREATION, AND RISK MANAGEMENT

"[L]awyers and corporate leaders who understand the law and the structures of power in the U.S.A. have a unique capacity to protect and enhance share-owners wealth."¹

—Tom Hinthorne

INTRODUCTION

WINNING LEGALLY

Governments immerse modern organizations "in a sea of law."² Public law provides the rules of the game³ within which firms compete to create and capture value. Law does more than regulate and constrain, however. It also enables and facilitates.⁴ Indeed, multiple-country studies reveal that the efficiency of a country's capital markets is directly related to the country's legal environment.⁵ Researchers found a statistically significant relationship between a country's economic prosperity, as measured by the per capita gross domestic product, and each of the following:

- Judicial independence.
- Adequacy of legal recourse.
- Police protection of business.
- Demanding product standards.

- Stringent environmental regulations.
- Quality laws relating to information technology.
- Extent of intellectual property protection.
- Effectiveness of antitrust laws.⁶

For example, adequate protection of minority shareholder rights increases investment in new ventures.⁷ Conversely, excessive regulation, including burdensome licensing requirements and filing fees, can hamper new venture formation.⁸

"Legally astute" managers who work with strategically astute counsel to proactively manage the legal aspects of business can use the law to increase both the total value created and the share of that value captured by the firm.⁹ Managers can also make their own "private law" by entering into contracts and crafting certain governance structures, such as public-private partnerships.¹⁰ Firms can use a variety of legal tools, ranging from insurance policies to contractual indemnification provisions and limitations on liability, to allocate and manage risk. Finally, managers can lobby and work with regulators to change the rules of the game.

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8. S. Djankov, R. La Porta, F. Lopez-de-Silanes & A. Shleifer, *The Regulation of Entry*, 117 Q. J. ECON. 1 (2002).

9. See Constance E. Bagley, *Winning Legally: The Value of Legal Astuteness*, 33 ACAD. MGMT. REV. 378 (2008).

10. See, e.g., Constance E. Bagley & Christina D. Tvarnø, *Promoting "Academic Entrepreneurship" in Europe and the United States: Creating an Intellectual Property Regime to Facilitate the Efficient Transfer of Knowledge from the Lab to the Patient*, 26 DUKE J. COMP. & INT'L L. 1 (2015); Constance E. Bagley & Christina D. Tvarnø, *Pharmaceutical Public-Private Partnerships: Moving from the Bench to the Bedside*, 4 HARV. BUS. L. REV. 373 (2014).

CHAPTER OVERVIEW

The purpose of this chapter is to provide a framework for analyzing the intersection of law and management. It introduces the *systems approach to law, business and society*, a descriptive framework that integrates legal and societal considerations with mainstream theories of competitive advantage and social responsibility. The chapter then outlines the four primary public policies furthered by business regulation in the United States. It concludes with a discussion of why legal astuteness is a valuable dynamic capability.¹¹

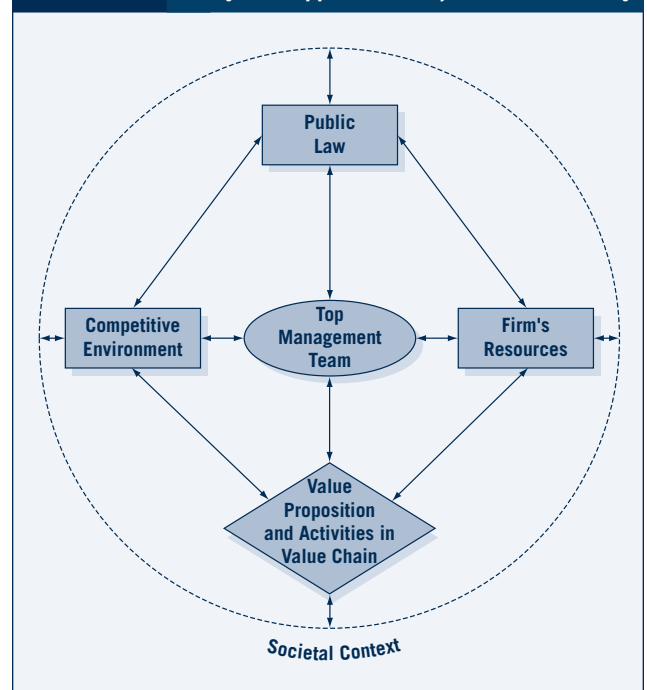
1-1 THE SYSTEMS APPROACH TO LAW, BUSINESS AND SOCIETY

Society grants rights and powers to business, which society can revoke if firms do not act responsibly.¹² As Tom Stephens, CEO of Manville Corporation, put it when Manville decided to add labels to its fiberglass products warning of possible carcinogenic risks, “The laws of society are more powerful than any law that Congress can put on the books. Woe be unto any businessman who doesn’t read the laws of society and understand them.”¹³ As a result, “the task of anticipating, understanding, evaluating, and responding to public policy developments within the host environment is itself a critical managerial task.”¹⁴

Laws enacted in response to corporate misdeeds often impose greater restrictions and costs on business than would have been imposed had firms acted more responsibly at the outset. A prime example is the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, which was enacted after widespread abuses in the subprime mortgage market led to near-global financial collapse.

As shown in Exhibit 1.1, firms operate within a broader societal context, which directly affects not only the public law but also the competitive environment and the value of firm resources.¹⁵ At the center is the top management team (TMT), which identifies opportunities for value creation and capture while managing the attendant risks. Given the attributes of the members of the TMT and their values,¹⁶

EXHIBIT 1.1 The Systems Approach to Law, Business and Society



the parameters set by the public law, the firm’s position within the competitive environment, and the nature and uniqueness of the firm’s resources, the TMT defines the value proposition and selects and performs the activities in the value chain.

1-1a Meeting Societal Expectations

The systems approach recognizes that “business decisions consist of continuous, interrelated economic and moral components”¹⁷ and that law and legal institutions are part of each firm’s “ecosystem.”¹⁸ It also builds on stakeholder theory’s insight that firms have relationships with many constituent groups, which both affect and are affected by the actions of the firm.¹⁹ As Michael C. Jensen explained, “In order to maximize value, corporate managers must not only satisfy, but enlist the support of, all corporate stakeholders—customers, employees, managers, suppliers, local communities.”²⁰

11. Constance E. Bagley, *The Value of a Legally Astute Top Management Team: A Dynamic Capabilities Approach*, in *THE OXFORD HANDBOOK OF DYNAMIC CAPABILITIES* (David J. Teece & Sohvi Leih eds., 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2811424.
12. D.J. Wood, *Corporate Social Performance Revisited*, 16 *ACAD. MGMT. REV.* 691 (1991).
13. William Glaberson, *Of Manville, Morals and Mortality*, *N.Y. TIMES*, Oct. 9, 1988.
14. LEE E. PRESTON & JAMES E. POST, *PRIVATE MANAGEMENT AND PUBLIC POLICY: THE PRINCIPLE OF PUBLIC RESPONSIBILITY* 4 (1975).
15. See generally Constance E. Bagley, *What’s Law Got to Do with It?: Integrating Law and Strategy*, 47 *AM. BUS. L. J.* 587 (2010).
16. D.C. Hambrick & P.A. Mason, *Upper Echelons: The Organization as a Reflection of its Top Managers*, 9 *ACAD. MGMT. REV.* 193 (1984).

17. D.L. Swanson, *Addressing a Theoretical Problem by Reorienting the Corporate Social Performance Model*, 20 *ACAD. MGMT. REV.* 43 (1995).
18. See David J. Teece, *Explicating Dynamic Capabilities: The Nature and Microfoundations of (Sustainable) Enterprise Performance*, 28 *STRATEGIC MGMT. J.* 1319 (2007).
19. Thomas Donaldson & Lee E. Preston, *The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications*, 20 *ACAD. MGMT. REV.* 65 (1995).
20. Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, *J. APPLIED CORP. FIN.*, Fall 2001, at 8, 19. See also LYNN A. STOUT, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC* (2012).

1-1b Effect of Law on the Competitive Environment and the Firm's Resources

Law helps shape the competitive environment and affects each of the *five forces*, identified by Michael Porter, that determine the attractiveness of an industry: buyer power, supplier power, the competitive threat posed by current rivals, the availability of substitutes, and the threat of new entrants.²¹ For example, companies can use patents, copyrights, trademarks, and trade secrets to differentiate their products, command premium prices, erect barriers to entry, sustain first-mover advantage, and reduce costs. Incumbents can promote regulatory burdens, such as licensing requirements, to keep out new rivals, as taxi companies have done to try to curtail ride-sharing firms such as Uber.

Law also affects the allocation, marshaling, value, and distinctiveness of the firm's resources. Under the *resource-based view (RBV)* of the firm, a firm's resources can be a source of sustained competitive advantage if they are valuable, rare, and imperfectly imitable by competitors and have no strategically equivalent substitutes.²² *Legal astuteness*—the ability of managers to communicate effectively and work with counsel to solve complex problems and to marshal, deploy, leverage, and redeploy resources—is a valuable managerial capability that may be a source of sustained competitive advantage.²³

Conversely, noncompliance destroys value. In addition to the penalties, fines, and legal costs associated with noncompliance, illegal behavior diverts funds from strategic investments, tarnishes the firm's image with customers and other stakeholders, raises capital costs, and reduces sales volume.²⁴ In the case of WorldCom's collapse in the wake of massive accounting fraud, \$200 billion of shareholder value was lost in less than a year, making it the largest corporate fraud in history.²⁵

After regulators discovered that Volkswagen had installed software on millions of diesel-powered cars for the sole purpose of cheating on Environmental Protection Agency (EPA) emissions tests, the company pleaded guilty and paid \$4.3 billion in U.S. criminal and civil penalties.²⁶

This was in addition to the nearly \$15 billion the firm agreed to pay affected customers and certain environmental programs in a settlement reached in 2016.²⁷ In January 2017, the U.S. government indicted six German executives, including the company's chief compliance officer, on charges of conspiring to violate the Clean Air Act and to defraud the United States and American customers.²⁸

In contrast, at least under certain circumstances, the ability to proactively go beyond the letter of the law can result in competitive advantage.²⁹ As discussed further in Chapter 14, legally astute management teams practice *strategic compliance management*.³⁰ They identify and embrace operational changes that will enable them to convert regulatory constraints into opportunities for innovation.³¹ For example, proactive strategies for dealing with the interface between a firm's business and the natural environment have been associated with improved financial performance.³² Yet firms' ability to reduce pollution became a source of competitive advantage only after managers replaced the mindset of reducing pollution to meet government end-pipe restrictions with a search for ways to use environment-friendly processes to create value.³³

1-1c Law and the Value Chain

As shown in Exhibit 1.2, there are legal aspects of every activity in the value chain. From a firm's choice of business entity to the warranties it offers and the contracts it negotiates, law pervades the activities of the firm, affecting both its internal organization and its external relationships with customers, suppliers, and competitors.

1-1d Law Is Dynamic

Both public and market players affect the law and the way it is interpreted, applied, and changed over time. Thus, law is not just a static external force acting upon managers and their firms. Instead, law and organizations are "endogenously coevolutionary."³⁴ By lobbying legislators

21. Michael E. Porter, *How Competitive Forces Shape Strategy*, in ON COMPETITION 21–22 (1998). See also G. RICHARD SHELL, MAKE THE RULES OR YOUR RIVALS WILL (2004).

22. Margaret A. Peteraf & Jay B. Barney, *Unraveling the Resource-Based Tangle*, 24 MANAGERIAL & DECISION ECON. 309 (2003). See also GEORGE J. SIEDEL, USING THE LAW FOR COMPETITIVE ADVANTAGE (2002).

23. Bagley, *supra* note 15.

24. Melissa S. Baucus & David A. Baucus, *Paying the Piper: An Empirical Examination of Longer-Term Financial Consequences of Illegal Corporate Behavior*, 40 ACAD. MGMT. J. 129 (1997) (finding that Fortune 500 firms convicted of illegal conduct earned significantly lower returns on assets than unconvicted firms).

25. See RICHARD BREEDEN, RESTORING TRUST: REPORT TO THE HON. JED S. RAKOFF, UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK, ON CORPORATE GOVERNANCE FOR THE FUTURE OF MCI, INC. (AUG. 2003).

26. Jackie Wattles, *Six Volkswagen Execs Indicted over Emissions Scandal*, CNN MONEY (Jan. 11, 2017), <http://money.cnn.com/2017/01/11/news/companies/volkswagen-emissions-indictment/>. See also Chris Matthews, *The 5 Biggest Corporate Scandals of 2015*, FORTUNE (Dec. 27, 2015), <http://fortune.com/2015/12/27/biggest-corporate-scandals-2015/>.

27. Wattles, *supra* note 26.

28. *Id.*

29. Bagley, *supra* note 9.

30. CONSTANCE E. BAGLEY, WINNING LEGALLY: HOW TO USE THE LAW TO CREATE VALUE, MARSHAL RESOURCES, AND MANAGE RISK (2005).

31. Barry M. Mitnick, *The Strategic Uses of Regulation—and Deregulation*, in CORPORATE POLITICAL AGENCY: THE CONSTRUCTION OF COMPETITION IN PUBLIC AFFAIRS (Barry M. Mitnick ed., 1993); Michael E. Porter & Claas van der Linde, *Green and Competitive: Ending the Stalemate*, HARV. BUS. REV., Sept.–Oct. 1995, at 120.

32. See William Q. Judge & Thomas J. Douglas, *Performance Implications of Incorporating Natural Environmental Issues into the Strategic Planning Process: An Empirical Assessment*, 35 J. MGMT. STUD. 241 (1998); Robert D. Klassen & D. Clay Whybark, *The Impact of Environmental Technologies on Manufacturing Performance*, 42 ACAD. MGMT. J. 599 (1999).

33. Chad Nehrt, *Maintainability of First Mover Advantages When Environmental Regulations Differ Between Countries*, 23 ACAD. MGMT. REV. 77 (1998).

34. Edelman & Suchman, *supra* note 2, at 501.

EXHIBIT 1.2 Law and the Value Chain

Support Activities	Firm infrastructure	<i>Limited liability, corporate governance, choice of business entity, tax planning, and securities regulation</i>				
	Human resource management	<i>Employment contracts, at-will employment, wrongful termination, bans on discrimination, equity compensation, Fair Labor Standards Act, National Labor Relations Act, workers' compensation, and Employee Retirement Income Security Act</i>				
	Technology development	<i>Intellectual property protection, nondisclosure agreements, assignments of inventions, covenants not to compete, licensing agreements, and product liability</i>				
	Procurement	<i>Contracts, Uniform Commercial Code, Convention on the International Sale of Goods, bankruptcy laws, securities regulation, and Foreign Corrupt Practices Act</i>				
	Inbound logistics	Operations	Outbound logistics	Marketing and sales	Service	Margin
	<i>Contracts Antitrust limits on exclusive dealing contracts Environmental compliance</i>	<i>Workplace safety and labor relations Environmental compliance Consumer privacy Strict product liability Process patents and trade secrets</i>	<i>Contracts Environmental compliance</i>	<i>Contracts Uniform Commercial Code Convention on the International Sale of Goods Consumer protection laws, including privacy protection Bans on deceptive or misleading advertising or sales practices Antitrust limits on vertical and horizontal market division, tying and predatory pricing Import/export controls World Trade Organization</i>	<i>Strict product liability Warranties Waivers and limitations of liability Doctrine of unconscionability Customer privacy</i>	
	Primary Activities					

SOURCES: Diagram and text in roman type from MICHAEL E. PORTER, *COMPETITIVE ADVANTAGE: CREATING AND SUSTAINING SUPERIOR PERFORMANCE* (1985); text in italic type adapted from CONSTANCE E. BAGLEY, *WINNING LEGALLY: HOW TO USE THE LAW TO CREATE VALUE, MARSHAL RESOURCES, AND MANAGE RISK* (2005), and M.E. Porter & M.R. Kramer, *Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility*, *HARV. BUS. REV.*, Dec. 1, 2006, at 78.

and members of the executive branch, forming coalitions, and working directly with regulatory bodies, managers can help shape the environment in which they do business.³⁵ As with any other activity, managers engaged in lobbying and other political activities must be mindful of the ethical aspects of their actions.

The Limits of Self-Regulation

Unfortunately, enlightened self-interest is not always a substitute for government regulation. Paul Krugman criticized former Federal Reserve Board Chair Alan Greenspan and other banking regulators for ignoring warnings about the predatory lending practices³⁶ that ultimately contributed to the subprime mortgage crisis in 2007–2008. Krugman quoted a 1963 essay in which Greenspan dismissed as a “collectivist myth” the idea that business leaders, left to their own devices, would “attempt to sell unsafe food and drugs, fraudulent securities and shoddy buildings”; instead, Greenspan asserted that “it is in the self-interest of

every businessman to have a reputation for honest dealings and a quality product.”³⁷ Krugman faulted Greenspan for putting “ideology above public protection.”³⁸ Greenspan himself subsequently remarked: “Those of us who look to the self-interest of lending institutions to protect shareholder equity have to be in a state of shocked disbelief.”³⁹

1-2 LAW AND PUBLIC POLICY

Public law—the formal rules embodied in constitutions, statutes enacted by legislatures, judicial decisions rendered by courts, and regulations promulgated by administrative agencies—both reflects and helps shape societal expectations. The laws and regulations applicable to business conducted in the United States further four primary public policy objectives: promoting economic growth, protecting workers, promoting consumer welfare, and promoting public welfare. This typology is depicted in Exhibit 1.3.

35. See L.G. Weber, *Citizenship and Democracy: The Ethics of Corporate Lobbying*, 6 BUS. ETHICS Q. 253 (1996).

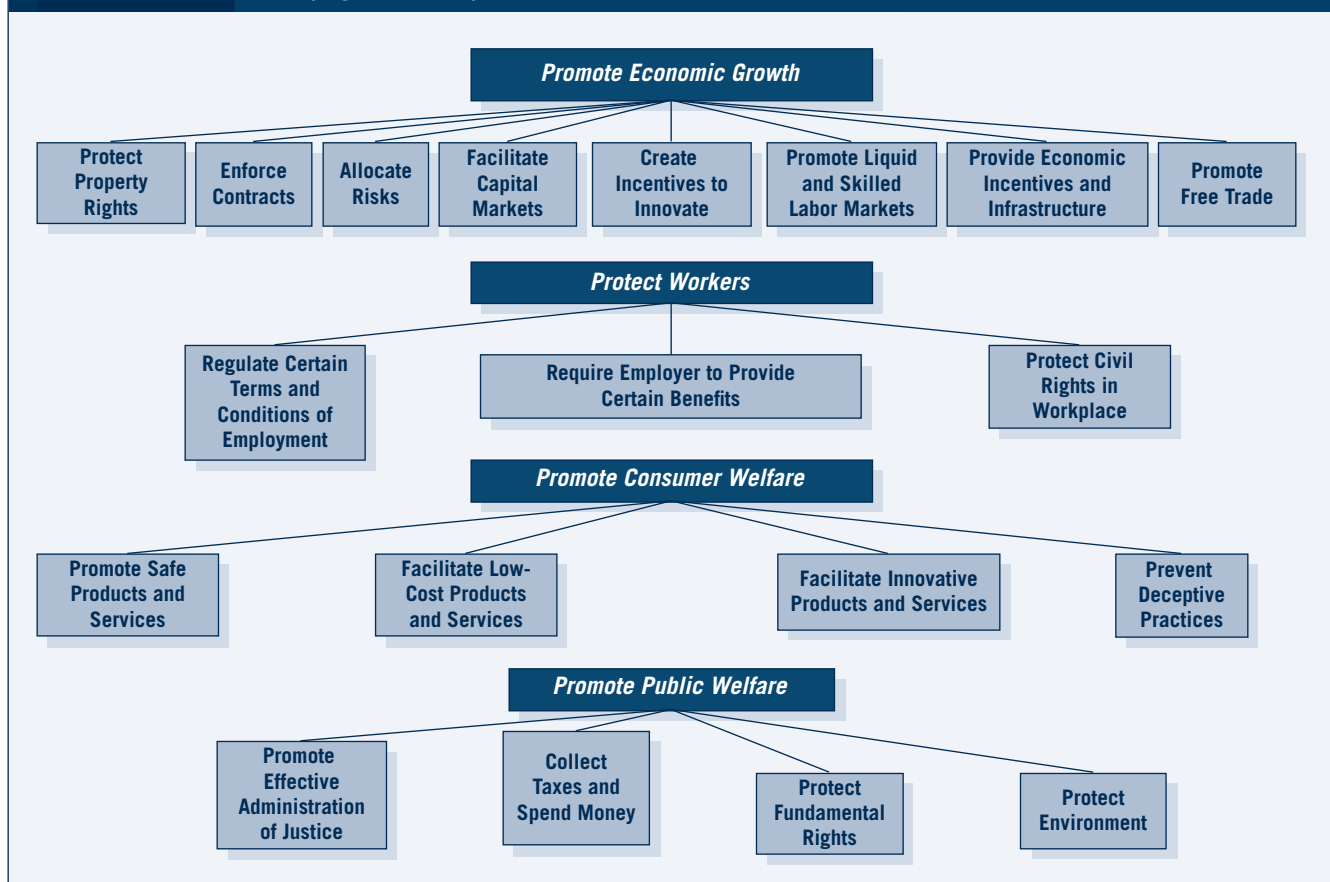
36. Opinion, Paul Krugman, *Blindly into the Bubble*, N.Y. TIMES (Dec. 21, 2007), <http://www.nytimes.com/2007/12/21/opinion/21krugman.html>.

37. *Id.*

38. *Id.*

39. Alan Greenspan, *We Will Never Have a Perfect Model of Risk*, FIN. TIMES, Mar. 17, 2008, at 13.

EXHIBIT 1.3 Underlying Public Policy Rationales of U.S. Laws



Other major economic powers tend to have laws that further these same objectives, albeit with varying degrees of emphasis on the different objectives and varying ways of furthering them.⁴⁰ Indeed, much of the current debate on what constitutes good corporate governance turns on how much weight each country gives to the interests of shareholders, debt holders, employees, customers, and suppliers and to the protection of the environment.

1-2a Promoting Economic Growth

Various laws and regulations promote economic growth. As seen in Exhibit 1.4, the law protects private property rights; enforces private agreements; allocates risks;⁴¹ facilitates the raising of capital; creates incentives to innovate; promotes liquid and skilled labor markets; provides subsidies, tax incentives, and infrastructure; and promotes free trade in the global markets.

40. For example, Germany seeks to promote economic growth by facilitating the capital markets, but its goal of protecting workers has led to the system of codetermination whereby half of the members of the supervisory boards of large German corporations are elected by the workers and unions, and half are elected by the shareholders.

41. For an excellent discussion of government's role in allocating risk, see DAVID A. MOSS, *WHEN ALL ELSE FAILS: GOVERNMENT AS THE ULTIMATE RISK MANAGER* (2002).

1-2b Protecting Workers

Worker protection constitutes a second major public policy underlying U.S. business law. This is accomplished by regulating certain terms and conditions of employment, requiring the employer to provide certain benefits, and protecting workers' civil rights, as outlined in Exhibit 1.5. Complying with these requirements imposes costs on employers that society, acting through the legislature and the courts, has deemed appropriate for employers to bear.

1-2c Promoting Consumer Welfare

Business regulation promotes consumer welfare by encouraging the sale of safe and innovative products and services at a fair price, preventing deceptive practices, and protecting consumer privacy, as shown in Exhibit 1.6.

1-2d Promoting Public Welfare

As depicted in Exhibit 1.7, business regulation promotes public welfare by ensuring the effective administration of justice, collecting taxes and spending money, protecting fundamental rights, and protecting the environment.

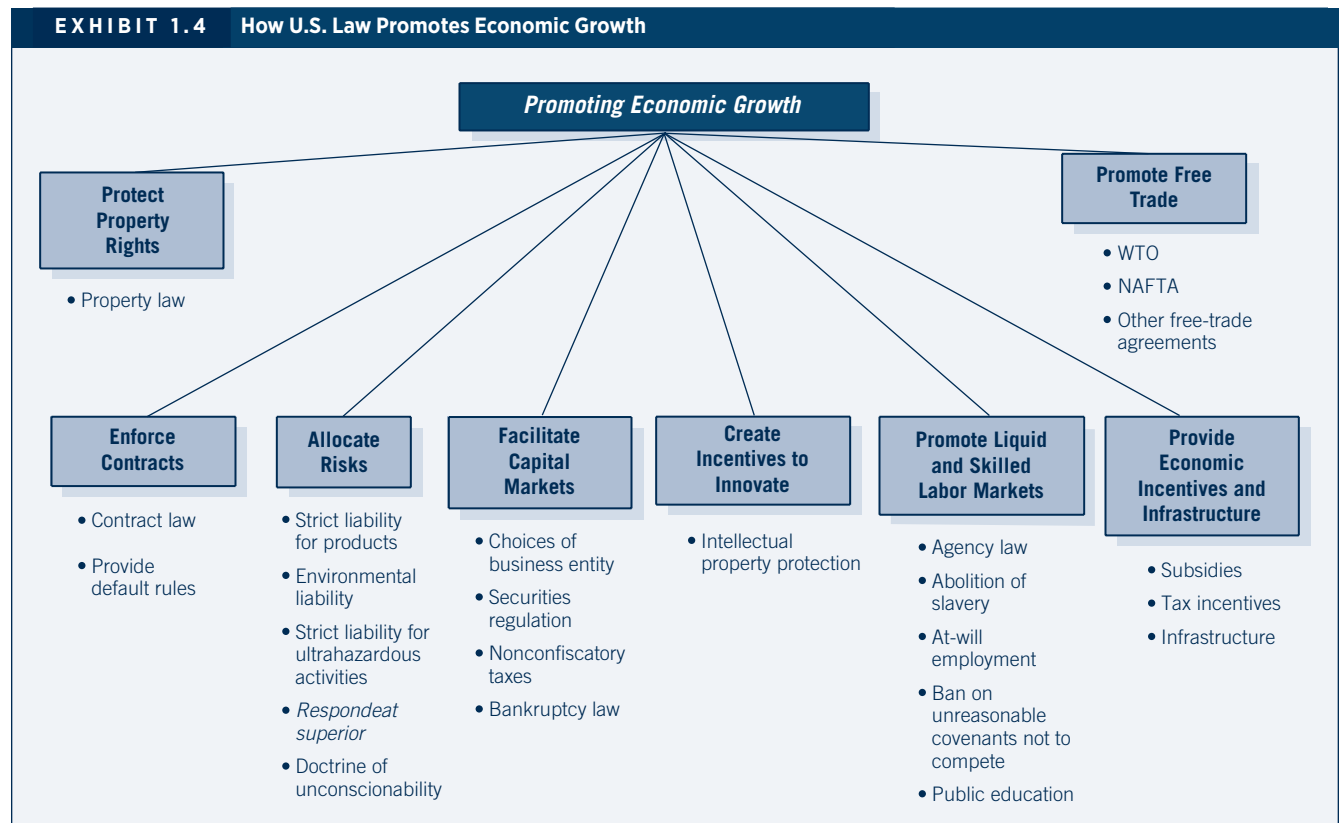
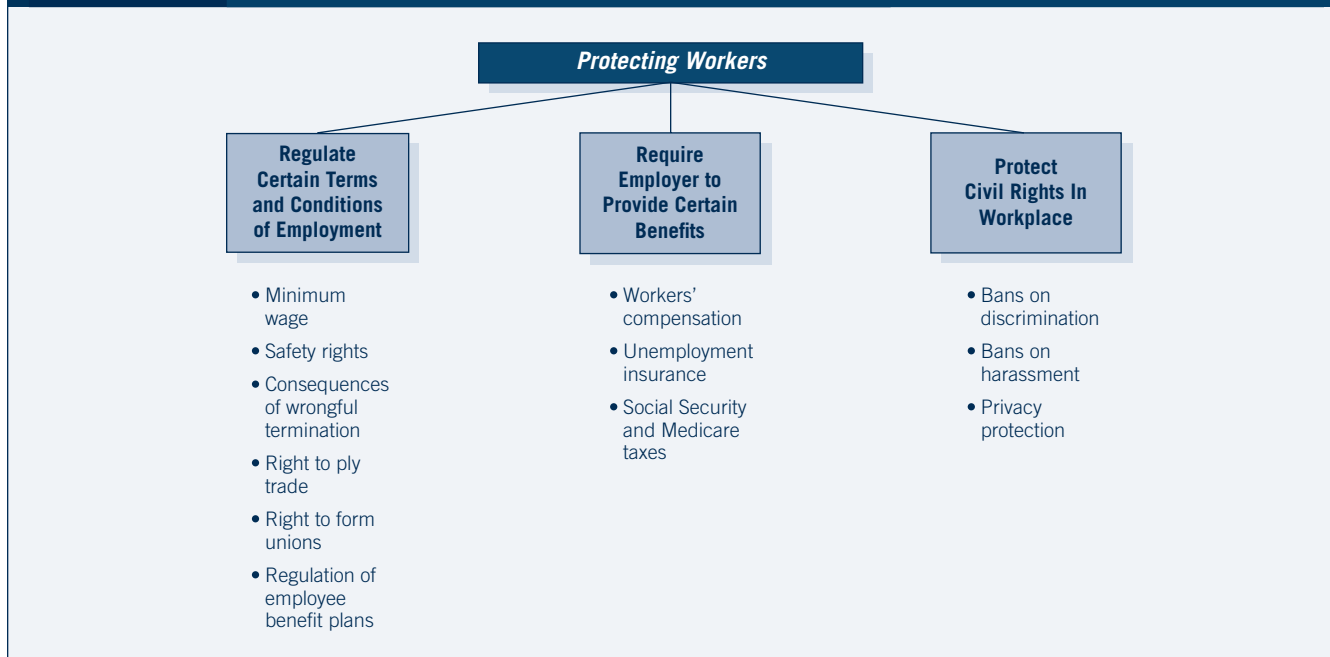
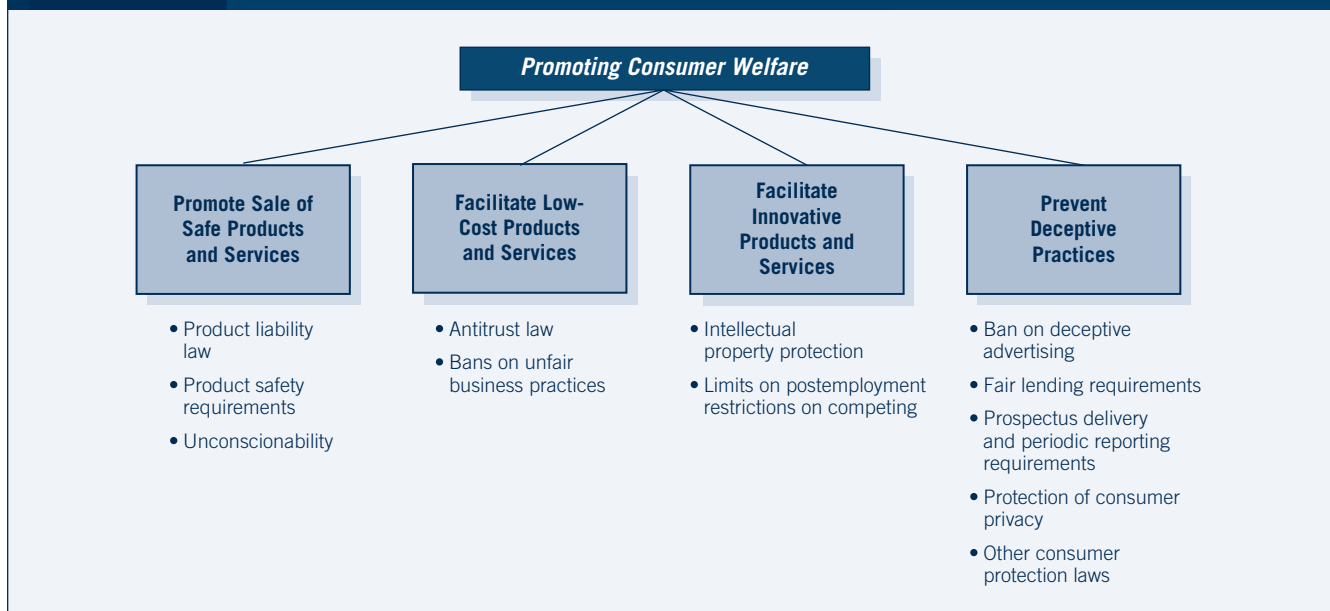
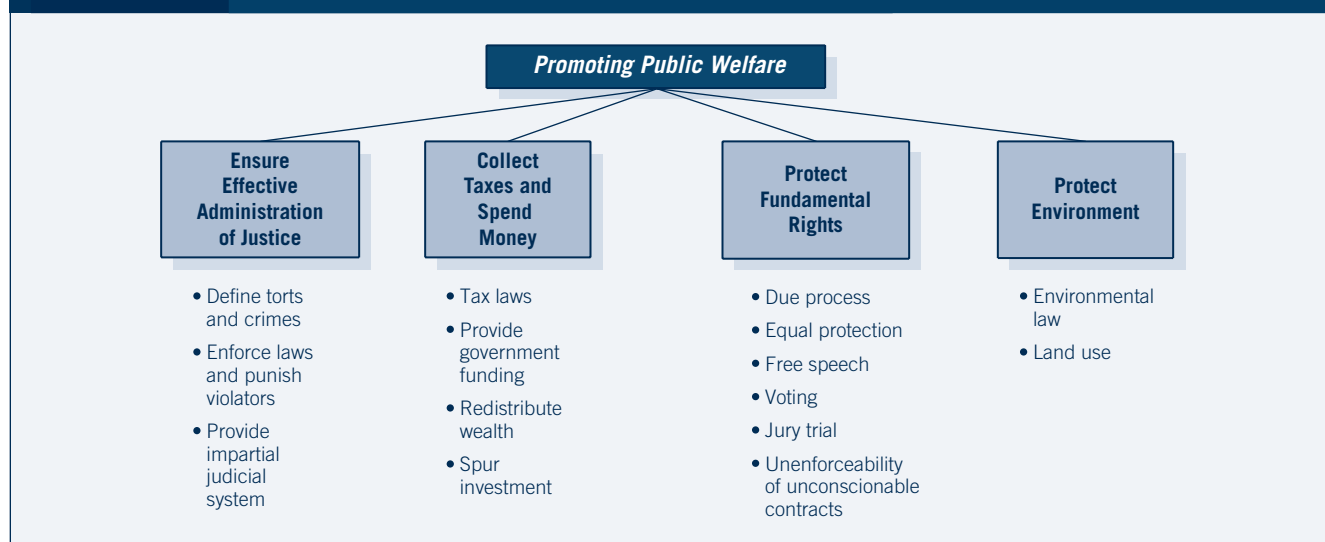


EXHIBIT 1.5 How U.S. Law Protects Workers**EXHIBIT 1.6** How U.S. Law Promotes Consumer Welfare**1-2e Policy Conflicts**

Sometimes, these public policies conflict. In the case following Exhibit 1.7, the U.S. Supreme Court considered

whether the public policy of ensuring freedom of expression outweighed the interest of physicians in keeping their prescribing practices private and the interest of the state in reducing health-care expenses.

EXHIBIT 1.7 How U.S. Law Promotes Public Welfare



A CASE IN POINT

SUMMARY

CASE 1.1

Sorrell v. IMS Health Inc.

Supreme Court of the United States

564 U.S. 552 (2011).

FACTS A Vermont statute prohibited pharmacies from selling prescriber-identifying information for marketing prescription drugs without the prescriber's consent. This information identifies the drugs and dosages that individual doctors prescribe for their patients. Data miners analyze such information and sell it to pharmaceutical manufacturers, which use the information to refine their sales pitches to physicians and thereby increase sales of brand-name drugs. Vermont data miners and an association of brand-name drug manufacturers challenged the statute as a violation of their free-speech rights under the First Amendment of the U.S. Constitution, as applied to the states by the Fourteenth Amendment.

ISSUE PRESENTED Is a state law banning the sale of prescriber-identifying information to pharmaceutical firms without the prescriber's consent constitutional?

SUMMARY OF OPINION The U.S. Supreme Court began by noting that speech in aid of drug manufacturing is protected by the Free Speech Clause of the First Amendment. The Vermont statute precluded detailers—drug reps who meet with physicians to provide details about brand-name drugs and offer free samples—from obtaining prescriber-identifying information but permitted its purchase by others. Because the statute disfavored speech with a particular content (marketing) and disfavored specific speakers (detailers), it was subject to “heightened judicial scrutiny.” For the statute to pass muster, Vermont had to show that it directly advanced a substantial government interest and that it was narrowly drawn to achieve that interest.

Vermont argued that the law was necessary to protect the privacy of prescribing physicians and to reduce the likelihood that physicians would prescribe expensive brand-name drugs that are not in the best interests of patients or the State. The legislature found that detailing “increases the cost of health care and health insurance; encourages hasty and excessive reliance on brand-name drugs, before the profession has

observed their effectiveness as compared with older and less expensive generic alternatives; and fosters disruptive and repeated marketing visits tantamount to harassment.” Although the Supreme Court agreed that these interests were “significant,” it concluded that they did not justify the burden the statute placed on protected expression. The statute banned the sale of prescribing information to “a narrow class of disfavored speakers” while making it available to researchers and health departments promoting the use of generic drugs. Even if pharmaceutical marketing efforts influence prescribing practices, “the State may not seek to remove a popular but disfavored product from the marketplace by prohibiting truthful, nonmisleading advertisements that contain impressive endorsements or catchy jingles.” As for disruptive visits, physicians are free not to meet with detailers.

The Court acknowledged that “[t]he capacity of technology to find and publish personal information . . . presents serious and unresolved issues with respect to personal privacy and the dignity it seeks to secure.” If Vermont banned the sale of

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