



CONSTANCE E. BAGLEY

EIGHTH EDITION

MANAGERS AND THE LEGAL ENVIRONMENT

Strategies for the 21st Century



Eighth Edition

MANAGERS AND THE LEGAL ENVIRONMENT

STRATEGIES FOR THE 21ST CENTURY

CONSTANCE E. BAGLEY

Yale University



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**Managers and the Legal Environment:
Strategies for the 21st Century
Eighth Edition**

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DEDICATION

*For my son Christoph,
with all my love.
C.E.B.*



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PREFACE



It is hard to imagine a time when understanding the interplay of law, business, ethics, and society was more important to successful and responsible management. It is, therefore, not surprising that the Association to Advance the Collegiate Schools of Business International, the premier accrediting body for business schools in the United States and abroad, amended its accreditation standards in April 2013 to 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, and ethical behavior and approaches to management.”¹

Law both reflects societal expectations and changes in response to them. The subprime mortgage crisis of 2008 led predictably to the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 and the creation of the Consumer Financial Protection Bureau. Banks and other financial institutions have already paid more than \$100 billion in fines and settlements arising out of the origination and sale of toxic mortgages and mortgage-backed securities, and numerous cases are still ongoing. The U.S. Supreme Court continues to wrestle with how to apply Fourth Amendment search and seizure requirements adopted in the eighteenth century to twenty-first century technology, holding most recently that the police may not search the contents of a cell phone on an arrestee’s person without a warrant.² After the Supreme Court opened the floodgates for direct corporate electioneering in *Citizens United v. Federal Election Commission*,³ shareholders began demanding that firms be more transparent about their political activities. The Court extended the right to religious freedom to closely held corporations in *Burwell v. Hobby Lobby Stores, Inc.*,⁴ raising questions about when the personal beliefs of shareholders can relieve the corporations they own of the obligation to comply with various laws of general application.

The legal topics discussed in the eighth edition of *Managers and the Legal Environment: Strategies for the 21st Century* are on the leading edge of business regulation. They include the validity of rules issued by

the EPA to regulate greenhouse gases⁵; the regulation of transmission speeds on the Internet and the arguments for and against “net neutrality”⁶; the protection of whistleblowers under the Dodd–Frank Wall Street Reform and Consumer Protection Act; the JOBS Act, which permits crowdfunding of new businesses and makes it easier for emerging growth companies to tap the public markets; the patentability of isolated DNA and synthetically created DNA⁷; the application of copyright law to products lawfully produced abroad then sold in the United States⁸; the constitutionality of the individual insurance mandate⁹ and the obligation to provide contraceptives under the Patient Protection and Affordable Care Act¹⁰; the regulation of virtual currencies, such as Bitcoin; the power of bankruptcy courts to hear certain bankruptcy-related claims;¹¹ federal preemption of state-law product liability claims involving generic drugs¹²; mandatory arbitration of customer disputes¹³; and employers’ obligations to accommodate certain religious dress¹⁴ and leaves of absence.¹⁵ The text addresses not only traditional business law topics, such as agency, contracts, torts, criminal law, antitrust, 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.

Managers and the Legal Environment: Strategies for the 21st Century 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. Professors at more than one hundred colleges and universities have successfully used the text in legal environment of business courses and business law courses at the undergraduate, M.B.A., executive M.B.A., and executive education levels.

1. ASS’N TO ADVANCE COLLEGIATE SCHOOLS OF BUSINESS, ELIGIBILITY PROCEDURES AND ACCREDITATION STANDARDS FOR BUSINESS ACCREDITATION 31 (Apr. 8, 2013), available at <http://www.aacsb.edu/-/media/AACSB/Docs/Accreditation/Standards/2013-business-standards.ashx>.

2. *Riley v. California*, 134 S. Ct. 2473 (2014) (Case 14.1).

3. 558 U.S. 310 (2010).

4. 134 S. Ct. 2751 (2014) (Case 19.3).

5. *Util. Air Regulatory Grp. v. EPA*, 134 S. Ct. 2427 (2014) (Case 15.1).

6. *Verizon v. FCC*, 740 F.3d 623 (D.C. Cir. 2014).

7. *Assoc. for Molecular Pathology v. Myriad Genetics, Inc.*, 133 S. Ct. 2107 (2013) (Case 11.1).

8. *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351 (2013) (Case 11.3).

9. *Nat’l Fed’n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566 (2012) (Case 4.1).

10. *Burwell v. Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751 (Case 19.3).

11. *Exec. Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165 (2014) (Case 23.2).

12. *Mut. Pharm. Co., Inc. v. Bartlett*, 133 S. Ct. 2466 (2013) (Case 10.4).

13. *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304 (2013) (Case 3.2).

14. *EEOC v. Abercrombie & Fitch Stores, Inc.*, 731 F.3d 1106 (10th Cir. 2013), cert. granted, 2014 WL 3702553 (U.S. Oct. 2, 2014) (Case 13.2).

15. *Adeyeye v. Heartland Sweeteners, LLC*, 721 F.3d 444 (7th Cir. 2013).

As its title implies, the text is designed as a “hands-on,” transactional guide for current and future business managers and leaders, including entrepreneurs.¹⁶ It provides a broad and detailed understanding 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 can not only spot legal issues before they become legal problems but also 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.

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. The conviction in 2012 of the former CEO of McKinsey & Co. for insider trading is just another recent reminder of the personal perils of not complying with the law.

Yet staying out of trouble is only part of the picture. Law does not just constrain and regulate; it also enables and facilitates.¹⁷

A key objective of *Managers and the Legal Environment: Strategies for the 21st Century* 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.¹⁸

To achieve legal astuteness, managers must learn to bridge the communication gaps that can occur when they work with attorneys. They need to develop a common language. This book helps future managers develop legal literacy and an appreciation of the role of law in the effective and ethical management of their businesses.

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 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 the 21st Century* 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, 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. The discussion of the case against Shell under the Alien Tort Statute for alleged human rights violations in Nigeria¹⁹ requires students to think critically about the legal and social responsibilities of business and highlights concerns about the presumption against the extraterritorial application of U.S. laws. The dispute also raises the issue of whether a corporation can be a person entitled to engage in political speech under the First Amendment, but not a person for purposes of liability for violations of international law. The “Inside Story” in that chapter discusses the 2014 case against Google in which the European Court of Justice set forth for the first time an individual’s “right to be forgotten.”

PEDAGOGICAL FEATURES

Each chapter of *Managers and the Legal Environment: Strategies for the 21st Century* employs a wide array of proven teaching devices that reinforce the goals of the text.

Conceptual Frameworks

The eighth 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 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. It also shows how a firm’s action prompts changes in the public rules

16. Additional readings on the legal aspects of entrepreneurship can be found in CONSTANCE E. BAGLEY & CRAIG E. DAUCHY, *THE ENTREPRENEUR’S GUIDE TO BUSINESS LAW* (4th ed. 2011).

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

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

19. *Kiobel v. Royal Dutch Petroleum Co.*, 133 S. Ct. 1659 (2013) (Case 24.3).

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 managers can use the law to affect the competitive environment, and Exhibit 1.3 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 1.4 through 1.8 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 1.9 then summarizes a variety of legal tools available during various stages of business development (ranging from evaluating the opportunity and defining the value proposition to harvest) to further the managerial objectives of creating realizable value and managing risk. By mapping legal tools against these key managerial objectives, Exhibit 1.9 seeks to frame the legal aspects of management in terms more readily accessible to students of business. Exhibit 2.1 presents the Ethical Business Leader's Decision Tree,²⁰ 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 trading decision tree in Chapter 22 shows when trades based on material non-public information violate the securities and mail and wire fraud laws.

"A Case in Point"

Each chapter presents a number of cases, set off from the body of the text, as examples of 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 statement of the law. These include *United States v. Windsor*,²¹ in which the U.S. Supreme Court held that section 3 of the Defense of Marriage Act violated the Fifth Amendment by denying equal protection to lawfully married same-sex couples; *American Broadcasting Companies, Inc. v. Aereo, Inc.*,²² in which the Supreme Court held that a company that retransmitted broadcast television, without paying a licensing fee, violated the Transmit Clause of the Copyright Act of 1976; and *Third*

Point LLC v. Ruprecht,²³ in which the Delaware Court of Chancery examined the use of shareholder rights plans, also known as poison pills, to thwart activist investors. Other traditional cases, such as *Meinhard v. Salmon* (Case 5.1) and *MacPherson v. Buick Motor Co.* (Case 10.1), are used to show early developments in the law that remain applicable today. The selection 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.

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 being illustrated by the case. Each case discussion then proceeds with a presentation of the court's decision and concludes with a description of the result.

In most 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 in each chapter 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.

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

21. 133 S. Ct. 2675 (2013) (Case 4.4).

22. 134 S. Ct. 2498 (2014) (Case 11.2).

23. 2014 WL 1922029 (Del. Ch. May 2, 2014) (Case 20.5).

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

The eighth 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, and compliance with anti-bribery statutes and local labor laws. Second, many 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 product liability and consumer protection chapters (Chapters 10 and 17) describe the relevant European Union Directives. The chapter on civil rights and employment discrimination (Chapter 13) discusses European, Japanese, and Indian discrimination law. The chapter on directors, officers, and controlling shareholders (Chapter 20) discusses corporate takeovers in Europe. Finally, a number of chapters also highlight international considerations in short boxed features called “International Snapshot.” For example, pollution in China is discussed in the “International Snapshot” in the environmental law chapter (Chapter 15).

Focus on Ethics 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. 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) includes a discussion of the economic implications of raising the federal minimum wage, 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 chapter (Chapter 15) explains the economic 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 and changed. The goal of these sections is to heighten students’ awareness of these larger forces. In addition, business managers should be made aware of 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, an “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 sophisticated 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) provides a guide for setting up an effective alternative dispute resolution procedure. The torts chapter (Chapter 9) provides a manager’s guide to reducing tort risks and

protecting privacy. 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 ethics (Chapter 2) asks whether tax avoidance by multinational companies is ethical, and the bankruptcy chapter (Chapter 23) asks whether General Motors should assert the shield of bankruptcy to preclude liability for suits related to faulty ignition switches in cars sold before the “new GM” emerged from bankruptcy.

“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. The “Inside Story” topics include manufacturer responses to deadly factory fires in Bangladesh and worker suicides in China (Chapter 2), the impact of government surveillance programs such as PRISM (Chapter 9), and the e-book price-fixing conspiracy involving Apple Inc. (Chapter 16). Contemporary 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 bold type 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. The definitions in the “Glossary” and the “Key Words and Phrases” 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 constitutional law chapter (Chapter 4) includes a question about whether a state can amend its constitution to eliminate the use of race in state college admissions,²⁴ and the employment agreement chapter (Chapter 12) includes a question addressing the right of college football players to unionize.²⁵ 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 EIGHTH EDITION

The eighth edition of *Managers and the Legal Environment: Strategies for the 21st Century* provides a cutting-edge analysis of recent key developments that have dramatically altered the legal landscape. A number of opinions presented as “A Case in Point” are from the U.S. Supreme Court’s 2013–2014 term. They include the Court’s rulings on whether a family-owned corporation can invoke the protection of the Religious Freedom Restoration Act of 1993 to avoid providing its employees with certain contraceptive coverage required by the Affordable Care Act; whether police may access data from a cell phone that is on an arrestee’s person without a warrant; whether the Environmental Protection Agency permissibly determined that its regulation of greenhouse gas emissions from new motor vehicles triggered permitting requirements under the Clean Air Act for stationary sources that emit greenhouse gases; and whether the fraud-on-the-market theory of reliance in a securities fraud suit should be overruled, as well as whether a defendant in a class-action suit could present price impact evidence to defeat the presumption of reliance at the class certification stage. Key decisions from

24. *Schutte v. Coalition to Defend Affirmative Action*, 134 S. Ct. 1623 (2014).

25. *Northwestern University, Employer and College Athletes Player Assoc. (CAPA)*, Petitioner, 2014 WL 1246914, Case 13-RC-121359 (N.L.R.B. Mar. 26, 2014), *review granted*, 2014 WL 1653118 (N.L.R.B. Apr. 24, 2014).

other courts include the legality of the “posting rule” promulgated by the National Labor Relations Board under the National Labor Relations Act; the conditions under which a covenant to negotiate in good faith is enforceable; whether an individual who is texting from a location remote from the driver of a car can be liable in tort to persons injured by the driver, who was distracted because of the texts; and whether a board may amend the corporate bylaws to require shareholders to bring all suits relating to the internal affairs of the corporation in the state in which the corporation is domiciled. When an earlier case remains the best pedagogical tool to illustrate a principle, it has been retained.

The eighth edition embeds the provisions of recent federal legislation, such as the Dodd–Frank Act and the Patient Protection and Affordable Care Act, in the relevant chapters. The text includes new 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 Chevron’s attempt to use a New York court to enjoin the enforcement outside of Ecuador of a massive judgment awarded by an Ecuadorian court for environmental damage to the rain forests²⁶ as well as Chevron’s settlement in 2014 with one of the legal and lobbying firms involved in the litigation. Also discussed is the status of ongoing global climate talks, including efforts to extend the Kyoto protocol and the Obama administration’s 2013 Climate Action Plan.

Many of the end-of-chapter “Questions and Case Problems” are new. For example, the constitutional chapter (Chapter 4) includes a question involving First Amendment rights and campaign contribution limits,²⁷ the chapter on civil rights and employment discrimination (Chapter 13) includes a question on sexual harassment in the workplace,²⁸ and the consumer protection chapter (Chapter 17) includes a question about whether a food manufacturer’s use of the phrase “100% natural” is false or misleading.²⁹

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 bankruptcy chapter (Chapter 23) discusses the Detroit bankruptcy, including the challenges of addressing underfunded public pension plans. The “Political Perspective” in the chapter on civil rights and employment discrimination (Chapter 13)

provides insight into the manner in which sexual assaults are handled in the military.

ANCILLARY COMPONENTS

Instructor Resources

The eighth edition of *Managers and the Legal Environment: Strategies for the 21st Century* provides instructors with the following supplements: Answer Manual, Instructor’s Manual, Test Bank in Cognero, and PowerPoint® slides. All supplements for the eighth edition were prepared by Joseph A. Zavaletta, Jr., J.D., and 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.

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.

26. *Chevron Corp. v. Naranjo*, 667 F.3d 232 (2d Cir. 2012).

27. *McCutcheon v. Fed. Election Comm’n*, 134 S. Ct. 1434 (2014).

28. *Stevens v. Saint Elizabeth Med. Ctr.*, 533 F. App’x 624 (6th Cir. 2013).

29. *Janney v. General Mills, Inc.*, 2014 WL 1266299 (N.D. Cal. Mar. 26, 2014).

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 the 21st Century* 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, and patents)
- 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 Kauffman Foundation site 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)
- 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 <http://hbsp.harvard.edu> and search the author field for "Bagley."

Cengage's CourseMate

Cengage's CourseMate brings course concepts to life with interactive learning, study, and exam preparation tools—including an e-book—that support the printed textbook. Revised for this edition, student study materials and a set of auto-gradable, interactive quizzes allow students to instantly gauge their comprehension of the material. Built-in engagement tracking tools allow instructors to follow students' study activities and assess their progress. Available to instructors and students within CourseMate is the KnowNOW! blog for Business Law, which provides

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A FINAL WORD

Managers and the Legal Environment: Strategies for the 21st Century, eighth 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 counsel as partners to create value, marshal resources, and manage risks.

Constance E. Bagley
Yale University

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UNIT

I

FOUNDATIONS OF THE LEGAL AND REGULATORY ENVIRONMENT

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LAW, VALUE CREATION, AND RISK MANAGEMENT

INTRODUCTION

WINNING LEGALLY¹

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 understand and proactively manage the legal aspects of business can use the law and the legal system to increase both the total value created and the share of that value captured by the firm.⁹ As Tom Hinthorne remarked, “[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-owner wealth.”¹⁰ 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. Managers can also make their own “private law” by entering into contracts and crafting certain governance structures. A variety of legal tools, ranging from insurance policies to contractual indemnification provisions and limitations on liability, can help firms allocate and manage risk. Finally, managers can lobby and work with regulators to change the rules of the game.

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 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 how legally astute managers can enhance realizable firm value.

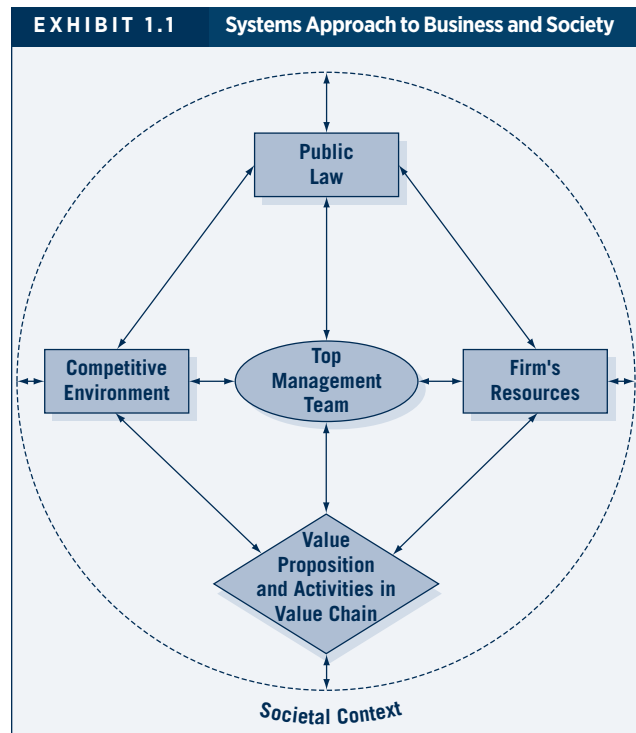
1. See generally CONSTANCE E. BAGLEY, *WINNING LEGALLY: HOW TO USE THE LAW TO CREATE VALUE, MARSHAL RESOURCES, AND MANAGE RISK* (2005).
 2. Lauren B. Edelman & Mark C. Suchman, *The Legal Environments of Organizations*, 23 ANN. REV. SOC. 479 (1997).
 3. DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 3–4 (1990).
 4. Mark C. Suchman, D.J. Steward & C.A. Westfall, *The Legal Environment of Entrepreneurship: Observations on the Legitimization of Venture Finance in Silicon Valley*, in THE ENTREPRENEURSHIP DYNAMIC: ORIGINS OF ENTREPRENEURSHIP AND THE EVOLUTION OF INDUSTRIES (C.B. Schoonhoven & E. Romanell, eds., 2001).
 5. R. La Porta, F. Lopez-de-Silanes, A. Shleifer & R.W. Vishny, *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997).
 6. Michael E. Porter, *Enhancing the Microeconomic Foundations of Prosperity: The Current Competitiveness Index*, in WORLD ECONOMIC FORUM, THE GLOBAL COMPETITIVENESS REPORT 2001–2002 (2002).
 7. S. Johnson, R. La Porta, F. Lopez-de-Silanes & A. Shleifer, *Tunneling*, 90 AM. ECON. REV. 22 (2000).

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. Tom Hinthorne, *Predatory Capitalism, Pragmatism, and Legal Positivism in the Airlines Industry*, 18 STRATEGIC MGMT. J. 509 (1996). See also George J. Siedel, *Six Forces and the Legal Environment of Business: The Relative Value of Business Law Among Business School Core Courses*, 37 AM. BUS. L.J. 37 (2000).

1-1 THE SYSTEMS APPROACH TO BUSINESS AND SOCIETY

Society grants rights and powers to business, but society can revoke those rights and powers if firms do not act responsibly.¹¹ 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 to any businessman who doesn’t read the laws of society and understand them.”¹² 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.”¹³

As shown in Exhibit 1.1, firms operate within a broader societal context, which directly affects the competitive environment and the value of firm resources.¹⁴ At the center is the top management team (TMT), which evaluates and pursues opportunities for value creation and capture while managing the attendant risks. Given the characteristics of the members of the TMT and their values, 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.



11. D.J. Wood, *Corporate Social Performance Revisited*, 16 ACAD. MGMT. REV. 691 (1991).
12. William Glaberson, *Of Manville, Morals and Mortality*, N.Y. TIMES, Oct. 9, 1988.
13. LEE E. PRESTON & JAMES E. POST, PRIVATE MANAGEMENT AND PUBLIC POLICY: THE PRINCIPLE OF PUBLIC RESPONSIBILITY 4 (1975).
14. See generally Constance E. Bagley, *What’s Law Got to Do with It?: Integrating Law and Strategy*, 47 AM. BUS. L.J. 587 (2010).

1-1a Meeting Societal Expectations

The systems approach recognizes that “business decisions consist of continuous, interrelated economic and moral components.”¹⁵ 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.¹⁶

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.¹⁷ Exhibit 1.2 shows how managers can use law to affect these forces and also indicates the public policies behind the relevant laws.

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.¹⁸ Legal astuteness is a valuable managerial capability that may be a source of sustained competitive advantage.¹⁹ Conversely, failure to integrate law into the development of strategy and of action plans can place a firm at a competitive disadvantage and imperil its economic viability.²⁰

Consider the fall of Enron and its once venerable accounting firm Arthur Andersen (described in Chapter 2) and the collapse of WorldCom in the wake of massive accounting fraud; the implosion of Barings, England’s oldest merchant bank, after illegal trades by Nick Leeson; and the collapse of mortgage brokerage firms implicated in predatory lending (described further in the “Inside Story” in Chapter 18). Violation of criminal laws can also land an executive in prison, as happened to Jeffrey Skilling, former CEO of Enron, who was convicted of fraud and originally sentenced to more than twenty-four years in prison. (His sentence was reduced to fourteen years in June 2013 as part of a court-ordered reduction and plea bargain.)

15. D.L. Swanson, *Addressing a Theoretical Problem by Reorienting the Corporate Social Performance Model*, 20 ACAD. MGMT. REV. 43 (1995).
16. Thomas Donaldson & Lee E. Preston, *The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications*, 20 ACAD. MGMT. REV. 65 (1995).
17. Michael E. Porter, *How Competitive Forces Shape Strategy*, in ON COMPETITION 21–22 (1996). See also RICHARD G. SHELL, MAKE THE RULES OR YOUR RIVALS WILL (2004).
18. Margaret A. Peteraf & Jay B. Barney, *Unraveling the Resource-Based Tangle*, 24 MANAGERIAL & DECISION ECON. 309 (2003). See also GEORGE J. SIEDEL, USING LAW FOR COMPETITIVE ADVANTAGE (2002).
19. Bagley, *supra* note 14.
20. Bagley, *supra* note 9.

EXHIBIT 1.2		Using Law to Affect the Competitive Environment			
Public Policy Objectives	Porter's Five Forces				
	Direct Competition	Threat of Entry	Substitution	Supplier Power	Buyer Power
Promote economic growth	Obtain development subsidies, tax breaks for domestic firms. Litigate application of antitrust laws.	Secure patents and other IP rights. Lobby for protectionist tariffs to advantage domestic firms.	Secure trademarks. Bundle products.	Enter into long-term supply contracts.	Secure cost-plus government contracts and no-bid contracts from Department of Defense. Enter into exclusive dealing contracts. Use contracts or intellectual property rights to bundle products.
Protect worker interests	Restrict availability of visas needed by rivals. Lobby for tighter worker safety regulations to detriment of lesser rivals.	Seek limits on overseas outsourcing.	Enter into employment agreements with covenants not to compete. Subject stock to vesting.	Litigate definition of "employee."	Lobby for ban on products made with child or slave labor.
Promote consumer welfare	Seek to outlaw competing products on safety grounds. Promote expedited regulatory approval of generic drugs and biologics. Disclose product ingredients and place of manufacture.	Impose licensing regime. Demand posting of bond by service providers.	Seek to outlaw substitute products on safety grounds.	Require labeling of "foreign" parts.	Require purchasers to buy services from state-licensed providers.
Promote public welfare	Obtain ethanol-style subsidies for firm's product. Lobby for tougher environmental standards.	Resist reforms designed to reduce the costs of incorporating, obtaining licenses, and issuing securities.	Seek to grandfather existing products and facilities from new taxes and regulatory requirements.	Lobby for reduced import duties on foreign suppliers.	Lobby for domestic content requirements and higher transportation taxes. Promote bans on the payment of bribes.

SOURCE: Bagley, *supra* note 14, at 599.

Even if the firm survives, noncompliance destroys value. Illegal conduct can put a firm at a competitive disadvantage by diverting funds from strategic investments, tarnishing the firm's image with customers and other stakeholders, raising capital costs, and reducing sales volume.²¹ Researchers found that Fortune 500 firms convicted of illegal conduct earned significantly lower returns on assets than unconvicted firms. In the case of WorldCom, \$200 billion of shareholder value

was lost in less than a year, making it the largest corporate fraud in history.²²

More recently, JPMorgan Chase, the largest U.S. bank based on assets, agreed during one three-month period in 2013 to pay billions of dollars in fines and settlements. They included a \$13 billion settlement with the Justice Department stemming from its subprime mortgage business,²³ penalties of \$920 million to settle charges relating to \$6.2 billion of losses from risky trading (the

21. Melissa S. Baucus & David A. Baucus, *Paying the Piper: An Empirical Examination of Long-Term Financial Consequences of Illegal Corporate Behavior*, 40 ACAD. MGMT. J. 129 (1997).

22. See Richard Breeden, *Restoring Trust*, filed with the WorldCom bankruptcy court on August 26, 2003.

23. Jessica Silver-Greenberg & Ben Protess, *JP Morgan Reveals How It Formed Mortgages*, N.Y. TIMES, Nov. 20, 2013, at B1.

so-called London Whale trades),²⁴ and an additional fine of \$100 million by the U.S. Commodity Futures Trading Commission after admitting that reckless behavior had led to the London Whale debacle.²⁵

In contrast, at least under certain circumstances, the ability to proactively go beyond the letter of the law can result in competitive advantage.²⁶ Legally astute management teams practice **strategic compliance management**.²⁷ They view the cost of complying with government regulations as an investment, not an expense. Instead of just complying with the letter of the law, they seek out and embrace operational changes that will enable them to convert regulatory constraints into innovation opportunities.²⁸

Proactive strategies for dealing with the interface between a firm's business and the natural environment that go beyond environmental regulatory compliance have been associated with improved financial performance.²⁹ 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.³⁰

1-1c Law and the Value Chain

As shown in Exhibit 1.3, each activity in the value chain has legal aspects. 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

The systems approach recognizes the dynamic nature of law. Law affects the market and market players, but market players also 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.”³¹ By lobbying legislators 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.³² As with any other activity, managers engaged in lobbying and other political activities must be mindful of the ethical aspects of their actions.

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 predatory lending practices,³³ which 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.” Krugman faulted Greenspan for putting “ideology above public protection.”³⁴ 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.”³⁵

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 (discussed in Chapters 6, 17, 18, 21, and 23), which was enacted after widespread abuses in the subprime mortgage market led to near-global financial collapse.

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 U.S. business further four primary public policy objectives: promoting economic growth, protecting workers, promoting consumer welfare, and promoting public welfare. This typology is depicted in Exhibit 1.4.

24. Jill Treanor, *JP Morgan Boss in Talks Over Fine for Sub-Prime Bond Sales; Bank May Have to Settle on Record \$11bn Penalty*, THE GUARDIAN (U.K.), Sept. 27, 2013, at 37.

25. Virginia Harrison, *JP Morgan to Pay Fresh \$100M London Whale Fine*, CNNMONEY (Oct. 16, 2013), <http://money.cnn.com/2013/10/16/news/companies/jpmorgan-whale-settlement>.

26. Bagley, *supra* note 9.

27. Bagley, *supra* note 1.

28. Regulation may prompt firms to innovate, making them more competitive. 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 & C. van der Linde, *Green and Competitive*, HARV. BUS. REV., May 1995, at 120.

29. 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 in Manufacturing Performance*, 42 ACAD. MGMT. J. 599 (1999).

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

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

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

33. *Id.*

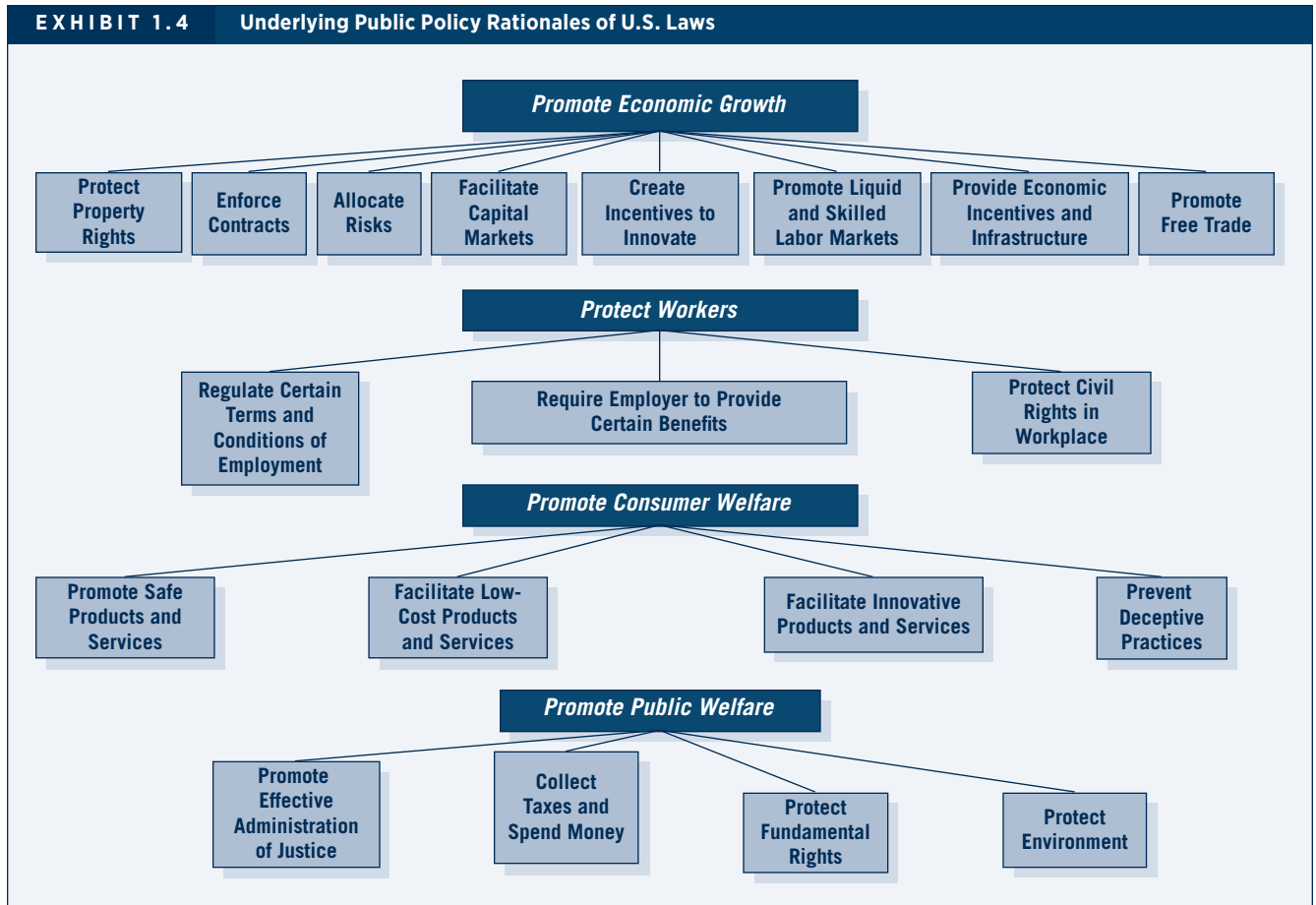
34. Paul Krugman, *Disastrous De-Regulation: For Greenspan and Bush, Ideology Trumps Oversight*, PITTSBURGH POST-GAZETTE, Dec. 22, 2007, at B7.

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

EXHIBIT 1.3 Law and the Value Chain

Support Activities						Margin
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 Practices 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	
	<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 BAGLEY, *supra* note 1, 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.



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.³⁶ 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 Exhibit 1.5 shows, this is done by protecting private property rights; enforcing private agreements; allocating risks;³⁷ facilitating the raising of capital; creating incentives to innovate; promoting liquid and skilled labor markets; providing subsidies, tax incentives, and infrastructure; and promoting free trade in the global markets.

36. 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.

37. 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* (2001).

1-2b Protecting Workers

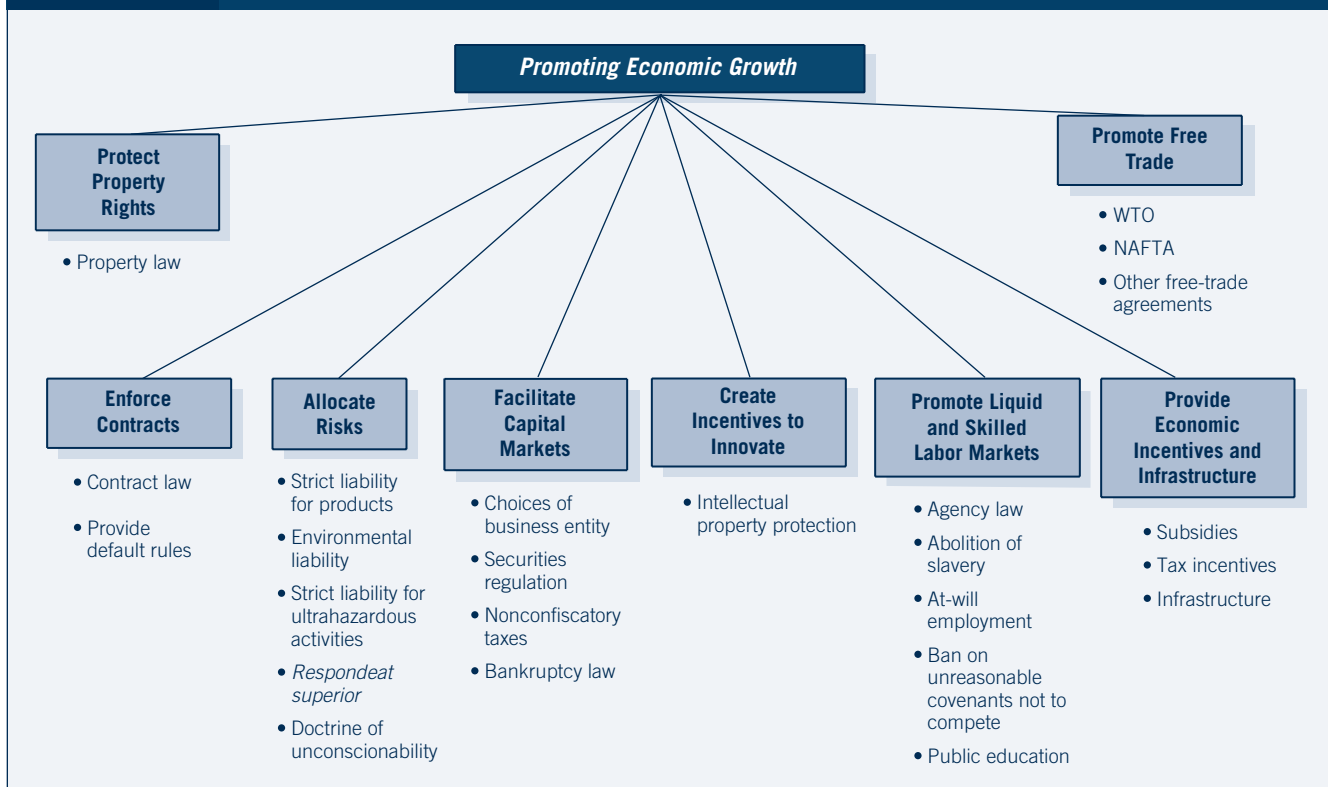
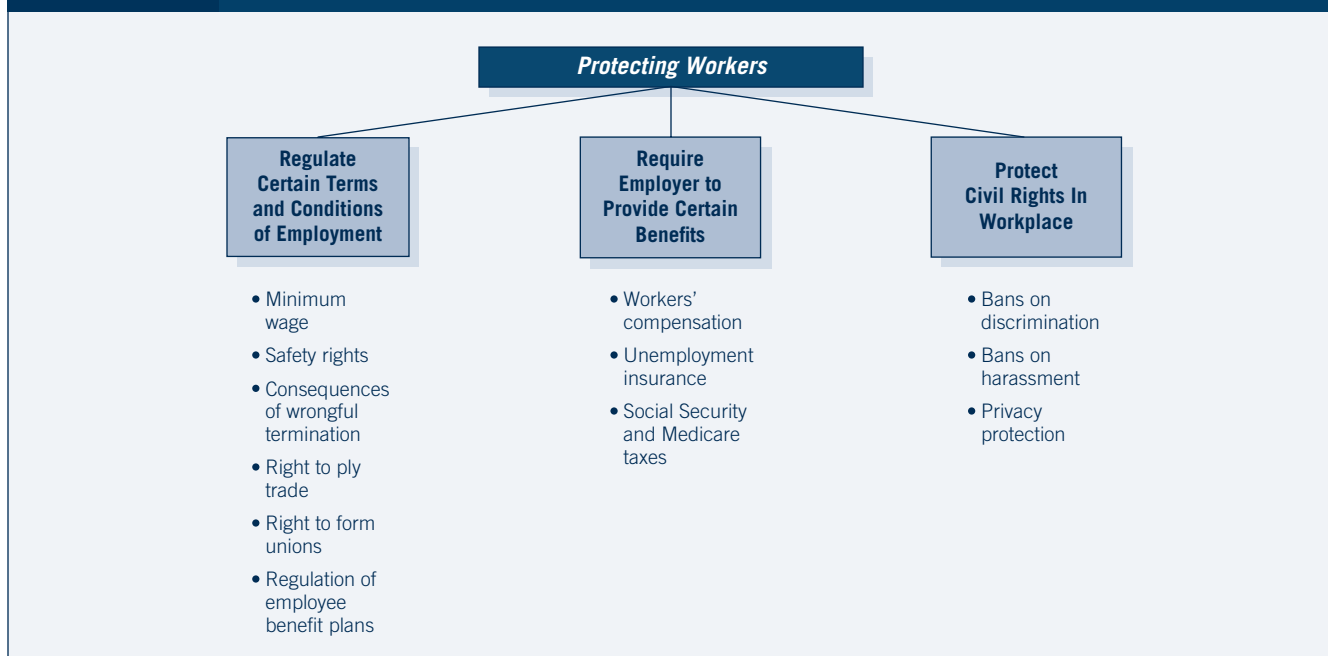
Worker protection constitutes a second major public policy underlying U.S. business law. This is accomplished by regulating certain terms and conditions of employment, requiring the employer to provide certain benefits, and protecting workers' civil rights, as outlined in Exhibit 1.6. Complying with these requirements imposes costs on employers that society, acting through the legislature and the courts, has deemed appropriate for employers to bear.

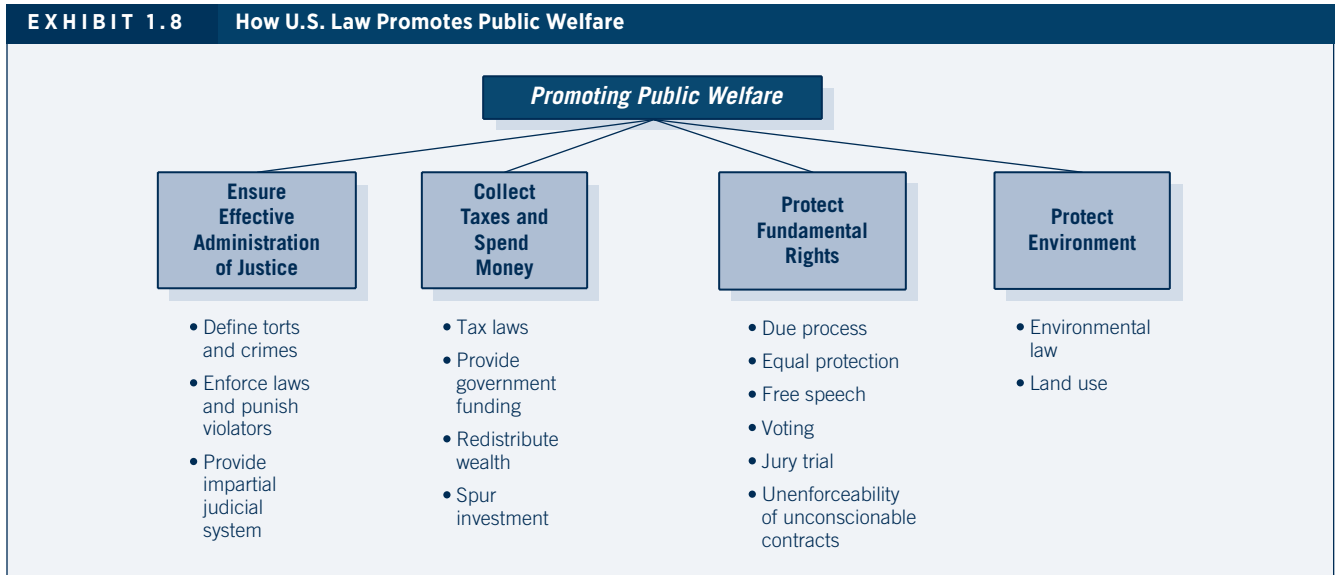
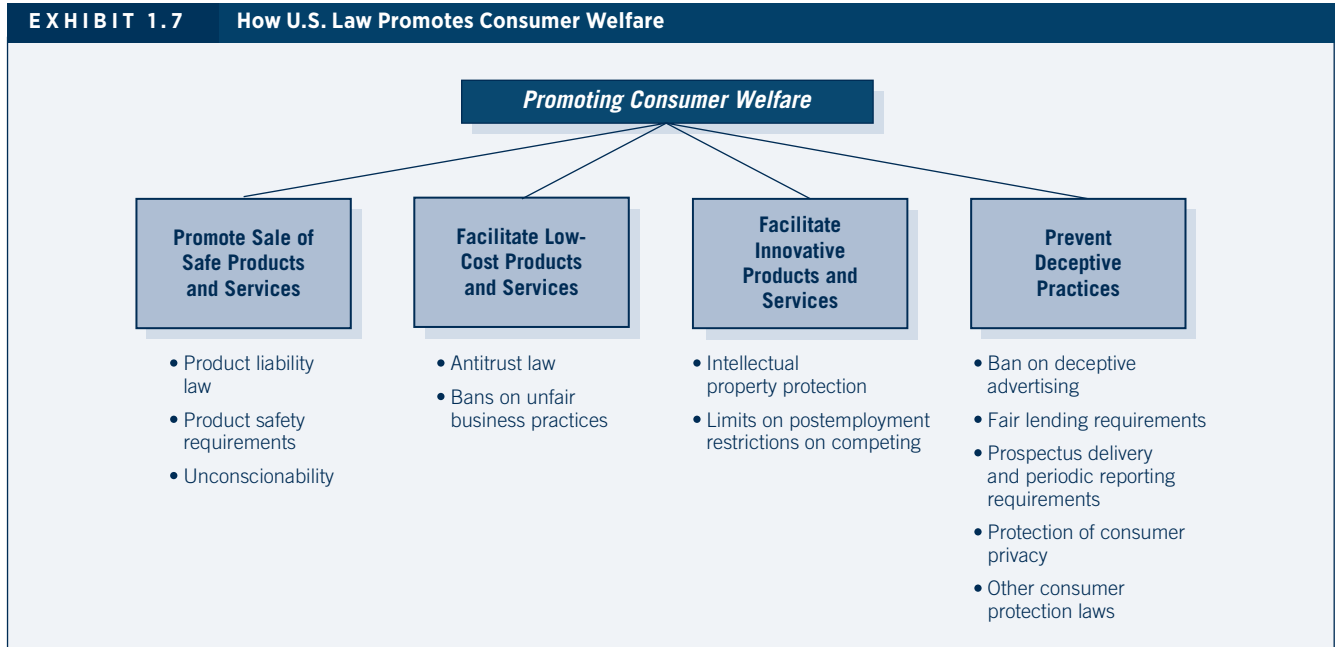
1-2c Promoting Consumer Welfare

Business regulation is designed to promote 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 1.7.

1-2d Promoting Public Welfare

As depicted in Exhibit 1.8, 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 Promotes Economic Growth**EXHIBIT 1.6 How U.S. Law Protects Workers**



1-2e Policy Conflicts

Sometimes, these public policies conflict. In the following case, the 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.