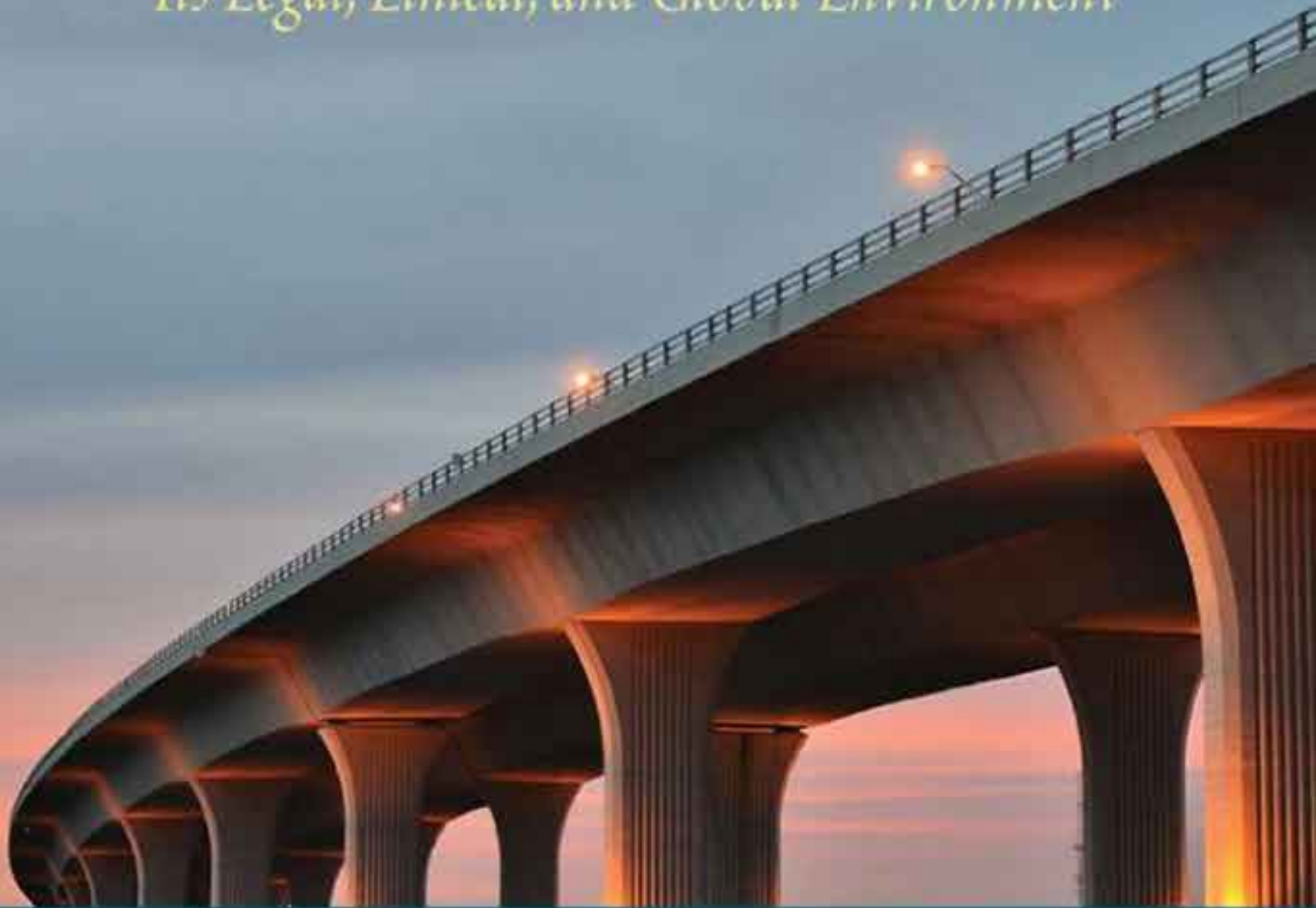




MARIANNE M. JENNINGS

BUSINESS

Its Legal, Ethical, and Global Environment



Tenth Edition

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A Different World, but the Same Issues

The seventh edition was published amidst the fallout from the legal, ethical, and, too often, financial collapses of Enron, WorldCom, Adelphia, HealthSouth, Parmalat, Arthur Andersen, Kmart, and others. With Sarbanes–Oxley on the books and new regulatory demands on corporations, we thought perhaps we had turned the corner. But the eighth edition was published as Wall Street and the economy were reeling from the fallout of a subprime mortgage market operating under regulatory radar without a great deal of disclosure on portfolio risk. When the ninth edition was published, the SEC had just settled a civil suit it brought against Goldman Sachs for allegedly selling securities to clients it was betting against as a short-seller in a scheme that saw its profits reach double-digit billions. Goldman paid a fine of \$550 million. In late 2009, Goldman’s CEO, Lloyd Blankfein, uttered the same words that Jeffrey Skilling did in 2000: “We are doing God’s work.” Now, as the tenth edition goes to press, there are questions about the fairness of the scrutiny of taxpayers by an administrative agency, the Internal Revenue Service, and the Justice Department’s tapping of phones of news corporations. Book publishers signed antitrust consent decrees for agreeing to fix prices in order to compete with Amazon. JPMorgan Chase lost \$6 billion because a London trader exceeded the bank’s risk limits and the bank’s reporting requirements were modified. A factory in Bangladesh, that produced clothing for U.S. retailers, collapsed, killing over 600 employees, a collapse that was caused by noncompliance with safety and code standards.

The patterns of business behavior that push the envelope of law and ethics continue. A good portion of the members of the New York legislature were indicted on corruption charges, companies from Ralph Lauren to Avon paid fines for violations of the Foreign Corrupt Practices Act, and BP paid the largest fines in U.S. history for the safety and environmental violations that resulted from the explosion of its Deepwater Horizon oil rig in the Gulf. Colleges and universities struggled with terminations of coaches for everything from losing to the failure to supervise the criminal activity of assistant coaches. The issues of law and ethics are still at the forefront of business, sports, and government. It has become a tall order just to keep up with all the events!

These companies and organizations and their employees and executives certainly could have benefited from understanding and keeping at the forefront of their decision processes the basics of law and ethics! The legal and ethical environments of business are center stage. Several editions ago, Congress made massive regulatory reform a reality with the passage of the Sarbanes–Oxley legislation on corporate governance, accounting regulation, and criminal penalties. But the SEC missed Bernie Madoff’s \$50 billion Ponzi scheme for 18 years and Congress passed additional reforms for financial market regulation in 2010. Credit card solicitations, billing, and terms have changed completely and are now under a new Consumer Protection

Bureau housed within the Federal Reserve so that all aspects of credit cards are now consolidated and regulated in one place. Business is even more international, and we are witnessing the need for thoughtful legal and ethical analysis as companies enter new markets. Even Apple struggled with backlash from conditions in its supplier's factories. Suicides and child labor at Foxconn damaged the Apple brand. There were so many FCPA cases that the Justice Department issued new guidelines to help companies better construct their compliance programs for controlling bribes in international operations.

The world and business continue to change and grow, but law and ethics have retained their role and importance. In fact, now more than ever, we need to understand the legal and ethical issues that affect our businesses and our lives. The knowledge base and even the questions in law and ethics remain the same, but the underlying facts have changed. For example, we still debate the social responsibility role of business. Now we raise that issue in the context of whether Apple and Google should take advantage of offshore tax loopholes. We continue to delve into the pros and cons of sending production to other countries. We still have the question of when a contract is formed, but now we face that question with "point and click" technology rather than faxes and letters. We continue to be concerned about our privacy as consumers, but now we wonder who really has access to our Facebook page. We still wonder about the extent of copyright law. The file-sharing programs have never quite gone away and the film industry now litigates the downloading of copyrighted films. The world is different, but law and ethics form the constant framework into which we fit the issues of the day. In the materials that follow, you have the chance to understand the marvelous stability of this framework and the ease with which you can apply it to this very different world. Be sure to look for descriptions of the new structure as well as the continuing features in the book, such as the "Consider..." tutorials, the ethics issues, and the "Business Strategy" application exercises.

Building the Bridge: Applying Legal and Ethical Reasoning to Business Analysis

I gave my students a midterm exam—a review of Apple and its various business issues, including the conditions in its supplier factories in China. These students are in the second year of their master's degree studies. They have been trained in economics, marketing, management, and finance. But as they completed their analysis of what went wrong with the world's most admired and emulated company, they had an epiphany. A company can get the finance issues right (Apple saves about 30 percent in production costs by outsourcing to China), have the right brand appeal and great products, and even yield terrific sales figures. However, it can all fall apart over the legal issues. China's standards for plant safety, wages, and working hours are different from those of the United States—and regulatory oversight is spotty. When suicides among plant workers were being covered internationally and child labor issues emerged, there was a chilling effect on Apple and Apple sales. The differing legal standards in international business were at the heart of this major setback for a company, one that would cause a drop in its stock. And when it comes to problems with factory standards and safety, the protests and boycotts follow. They are very capable *business* students. However, they did not realize until this midterm exam how much of business turns on anticipating the legal issues and getting them resolved correctly. And they also realized that all of our discussions of ethics and social responsibility had a role in doing business.

TANSTAAFL—“there ain’t no such thing as a free lunch” when it comes to international outsourcing. There are costs associated with using the much cheaper labor and factories in other countries. And those costs come from legal issues, which, if handled poorly, can affect a company’s value and tarnish its brand name.

Why couldn’t these students see the interconnection and critical roles of law and ethics in business until this case for their midterm? It was not for lack of exposure to the law. I taught my course “by the book,” so to speak. Students could recite the components of a valid contract, rattle off the requirements for bankruptcy, and recall from memory the antitrust statutes. Yet, I was coming to realize, this rote knowledge was not enough. One of my best former students, who had gone on to medical school, came to me perplexed about her office lease. She said that the complex in which she wanted to open her practice had a “no advertising” policy. In fact, she said that when she toured the premises with a leasing agent, the leasing agent turned to her and said, “You’re not one of those doctors who advertises, are you? Because if you are, we can’t lease to you. We have a policy against it.” One of my best students, who knew the antitrust statutes well, could not apply them to her everyday business. Worse, perhaps, she could not *recognize* when to apply these statutes: She did not see the antitrust implications of the agent’s statements nor the problems with the physicians in the complex taking such an approach to screening tenants.

I have reached the conclusion that there have always been shortcomings in the standard approach to teaching business students law and ethics. Students were not ignorant of the law; rather, they simply lacked the necessary skills to recognize legal and ethical issues and to apply their knowledge of law and ethics to business decision making. As instructors, we were not integrating legal and ethical reasoning with business analysis. My conclusion led me to develop my own materials for classroom use and eventually led to the publication of the first edition of this book. Now in its tenth edition, *Business: Its Legal, Ethical, and Global Environment* brings to the classroom the most integrated approach to learning law and ethics available in the market today. Throughout every chapter and in every feature, students and instructors are continually reminded of how various legal and ethical principles apply in business contexts. For all areas of law and ethics, this book answers the question: How does this concept affect a business? This book builds a bridge for the student between knowledge of law and ethics and application of both in business. My 37 years of teaching law and ethics finally brought this realization: Business ethics is not easily grasped nor practiced in business because we depersonalize ethical issues. If we just allow the company or organization to make the decision, our ethics are not in question; the company’s are. The ethical issues in the book require students to bring ethical issues into their lives, their circumstances, their world. This feature also forces them to answer this question in a wide variety of contexts: “If it were you, and you were faced with the dilemma and required to make a decision, what would you do?”

Strengthening the Bridge: New Content, Business Applications, and Learning Aids

For the tenth edition, *Business: Its Legal, Ethical, and Global Environment* has undergone further refinement. New content has been added, new business applications have been integrated into every chapter, and the learning aids have been modified and refocused to help students understand and apply legal and ethical concepts.

NEW CONTENT

The tenth edition of *Business: Its Legal, Ethical, and Global Environment* continues to meet its goal of helping students with their understanding of how law and ethics apply to the business world. The organizational structure, based on feedback from those who use the text, has been changed. The four parts remain, but there is a new mix of topics in those four parts. Part 1 offers the student an overview of the legal, ethical, and judicial environments of business. Part 2 covers the regulatory environments of business, including environmental regulation and sustainability as well as a new chapter on cyberlaw. Part 3 has been reorganized to provide a more logical flow of material and covers all aspects of sales and competition. Part 4 has also been reorganized and covers business management and corporate governance. This newly restructured section covers all issues related to employees, boards, agents, and how to keep all of these groups coordinated while taking legal and ethical actions.

ETHICS

Chapter 2: Business Ethics and Social Responsibility offers new examples and insights on the application of ethics to business decision making. Chapter 2 is chock full of the examples the last two years have netted—including Dr. Drew’s conflict of interest and a note from the jurors about the ethics of Wall Street executives in their acquittal verdict of one of them. Ethics coverage is also integrated throughout all chapters.

Business Applications

BIOGRAPHY

A “Biography” feature appears at the end of each chapter. These biographies provide students with business history through the study of individuals and companies involved with the area of law and ethics covered in the chapter. For example, Chapter 10 has a biography of Kim Dotcom, the man responsible for a high percentage of movie copyright infringement who awaits trial on an international level. Chapter 13 provides the story of Charlie Sheen’s contract dispute following his termination from his popular television series. Chapter 15 gives a biography of Mattel and its Bratz dolls and its long intellectual property battle over who had the idea for the dolls.

FOR THE MANAGER’S DESK

Each chapter also contains at least one “For the Manager’s Desk” feature. These readings provide students the opportunity to see how business interrelates with ethics and law. Some of the readings are excerpts from business publications, such as the *Wall Street Journal*, while other excerpts from the *Harvard Business Review*, *Corporate Finance Review*, and the *American Business Law Journal* offer the latest in academic studies and insights.

Learning Aids

... AND THE LAW

Each chapter contains a popular feature to further integrate law and ethics with the other “silos” of business. The “... and the Law” feature puts law and ethics in

the context of economics, human resources, public policy, strategy, finance, and other areas to illustrate the ways knowledge of the where and how for the fit of law and ethics can help make better managers and better decisions. For example, Chapter 18 presents the pros and cons of giving shareholders a say on CEO compensation packages. Chapter 17 includes a discussion of the organizational behavior lessons learned from the legal problem Penn State experienced as a result of a former assistant football coach molesting children in the facilities of the school's football program. Chapter 5's "Economics and the Law" takes a look at the issue in increasing eminent domain proceedings. These features apply the principles from business disciplines to understand more fully the depth and breadth of management issues.

CASE HEADLINES

Every court case has a case headline that summarizes what issues are involved in the case. In Chapter 12, students read *Paramount Contracting Co. v DPS Industries, Inc.*, a case that addresses the issue of what constitutes the sales of goods and what constitutes the sale of services. The case title is memorable: "Dirt Is Cheap, But It Is Still a Good." In Chapter 6, the case *Hornbeck Offshore Services, L.L.C. et al. v Salazar* deals with an issue of whether agency action was arbitrary and capricious in issuing a moratorium on offshore drilling, and the case title is "Drilling Down to the Facts Supporting a Rule." The vivid one-line description and colorful facts of the case, a common thread throughout the case choices in the text, help students internalize the rules and lessons about not destroying evidence for a potential lawsuit.

CHAPTER OPENERS

Chapters begin with an opening problem, titled "Consider..." which presents a legal dilemma relevant to the chapter's discussion and similar to those business managers need to handle. These are revisited and answered in the body of the chapter. For example, Chapter 6 has a new chapter opening on a proposed regulation on food calorie content disclosure that would affect movie theater popcorn. Chapter 20 has a new opening on Boeing's battle to open a new plant for the production of its new 787 in South Carolina that would be nonunion. Moreover, answers to these opening "Consider..." features are referenced in the text and clearly marked. In Chapter 6, the chapter opening scenario is woven throughout the chapter to explain the rulemaking process and business interaction with that process. Next, opening statements discuss the major topics of the chapter and present the general goals for the chapter in the form of questions to be answered. Finally, quotations, often humorous, pique students' interest and focus the chapter on the major issues.

CHAPTER SUMMARY

Each chapter concludes with a summary that reinforces the major concepts of the chapter. Each summary is constructed around the key questions introduced at the start of the chapter and key terms presented throughout the chapter.

BUSINESS STRATEGY APPLICATIONS

Each chapter has a business strategy connection designed to help students understand where law and ethics fit in developing effective business strategies. For example in Chapter 5, the "Business Strategy" feature deals with how companies

are coping with Internet sales tax issues. This feature shows how important legal issues are in determining costs and margins in business. The Chapter 13 “Business Strategy” deals with how restaurants are coping with no-shows in their reservations and their contract rights when someone makes a reservation but never shows up.

Organization and Features: A Structure to Guide Students to Reasoning and Analysis

The classic features have been updated and strengthened. The organization has been retained to continue to meet student needs in the classroom.

ORGANIZATION

As noted, there are now four parts in the book, which serve to organize the materials around four basic areas: (1) understanding the legal environment, (2) understanding the regulatory environment, (3) dealing with sales, contracts and competition, and (4) management and governance. Every chapter integrates international and ethical topics.

PART 1

In four chapters, Part 1 offers an introduction to law, an introduction to business ethics and the judicial system, and a discussion of litigation and alternative dispute resolution. Part 1 provides students with a foundation in law and ethics as well as legal and ethical reasoning, necessary for the areas of law in the chapters that follow. By being brief (four chapters), Part 1 offers instructors an early and logical break for exams.

PART 2

In seven chapters, Part 2 covers the regulatory environment of business, including the following topics: constitutional law, administrative and international law, business crimes and business torts, cyberlaw, and environmental regulation. The new cyberlaw chapter, Chapter 10: Cyberlaw, Social Media, and Privacy, deals with what may be one of the law’s fastest growing areas. What are my rights when it comes to posting information online? And, what are the rights of my employer or college admission officer to see that information? At the completion of Parts 1 and 2, students have a grasp of the legal system, ethical boundaries, and the laws that affect business operational decisions, even those in cyberspace.

PART 3

The five chapters in Part 3 present students with the legal and ethical issues surrounding contracts, sales, and competition. Part 3 includes the following topics: contract formation and performance (including coverage of consumer issues); product liability; intellectual property; trade restraints; and business competition and antitrust. From the negotiation of price to the collection of accounts, this segment of the book covers all aspects of selling business products and services. This section is structured so that the contracts discussion precedes the complexities of property and competition.

PART 4

The five chapters in Part 4 discuss business management and governance. Topics include the management of employees, from agency law to employment

regulation to employee rights to issues in discrimination. However, Part 4 now includes the governance issues of business structure and management, including financing and securities law issues. This section covers the issues of running, managing, and financing a business.

FEATURES

COURT CASES

Edited court language cases provide in-depth points of law, and many cases include dissenting and concurring opinions. Case questions follow to help students understand the points of law in the case and think critically about the decision. The courts have been active since the last edition, and many 2011–2013 case decisions are presented throughout the book. Students will be able to study Donald Trump’s claim for defamation when a writer misstated his net worth. Can a company avoid Foreign Corrupt Practices Act violations when it has its agent appointed a government official in another country? What happens when a young man saves his Pepsi points to claim a Harrier Jet that he sees in a Pepsi spoof ad for “Pepsi stuff”? Does he get his jet?

CONSIDER...

“Consider...” problems, along with “Ethical Issues” and “Business Planning Tips,” have been a part of every chapter since the first edition. The “Consider...” features, often based on real court cases, ask students to evaluate and analyze the legal and ethical issues discussed in the preceding text. Because these issues are integrated into the text, students must address and think critically about these issues as they encounter them. Through interactive problems, students learn to judge case facts and determine the consequences. “Consider...” brings the most current topics into the book and the classroom. Students can think about fracking and environmental law and issues of sustainability. The issues of privacy and professionalism arise in a “Consider...” on a wet t-shirt contest that results in an embarrassing moment for a television news anchor.

THINKING, APPLYING, AND ANSWERING: “CONSIDER...” TUTORIALS—A GUIDE FOR REASONING

One “Consider...” per chapter is solved for the students in a methodical walk-through that helps them understand how to apply the legal principles or case precedent that they have just studied. The facts of the case or hypothetical are presented and the students are asked to recall what they have just learned. Next, students are walked through applying those principles to the current facts. Finally, they are given the answer and the reason that answer is consistent with their thinking and applying.

ETHICAL ISSUES

The “Ethical Issues” feature appears in every chapter and presents students real-world ethical problems to grapple with. “Ethical Issues” help integrate coverage of ethics into every chapter. These ethical issues include personal and real-life examples that help students relate to the pervasive nature of ethical dilemmas that they do and will continue to face. For example, the release of 9-1-1 calls as public records raises issues about an individual’s privacy as students examine the content of the Demi Moore 9-1-1 call and the issues about her condition released during the call in Chapter 6.

BUSINESS PLANNING TIPS

Students are given sound business and legal advice through “Business Planning Tips.” With these tips, students not only know the law but also know how to anticipate issues and ensure compliance.

CYBERLAW

In addition to the new cyberlaw chapter (Chapter 10: Cyberlaw, Social Media, and Privacy), most chapters also include a segment on cyberlaw. These chapter-by-chapter materials, marked by an icon, give students the chance to see how new technology fits into the existing legal framework.

EXHIBITS

Exhibits include charts, figures, and business and legal documents that help highlight or summarize legal and ethical issues from the chapter. With the credit and financial market reforms and the changes in criminal penalties, many of the charts are either new or updated.

END-OF-CHAPTER PROBLEMS

Many end-of-chapter problems have been updated and now focus more on actual cases. There are new chapter problems throughout the book of varied lengths for different instructor needs.

The Informed Manager: Who Should Use This Book?

With its comprehensive treatment of the law, integrated business applications, and full-color design, *Business: Its Legal, Ethical, and Global Environment* is well suited for both undergraduate and MBA students. The book is used extensively in undergraduate education programs around the country. In addition, this edition has been class-tested with MBA students, and it is appropriate for MBA and executive education programs.

A NOTE ON AACSB STANDARDS

The strong presence of ethics, social responsibility, international law and issues, and the integration of other business disciplines make the book an ideal fit for meeting AACSB standards and curriculum requirements. The AACSB standards emphasize the need for students to have an understanding of ethical and global issues. The tenth edition continues with its separate chapter on ethics as well as ethical issues and dilemmas for student discussion and resolution in every chapter. The separate chapter on international law continues its expanded coverage from the last edition, and each chapter has a segment devoted to international law issues. The tenth edition includes readings on office romance, the challenges of ethics and law in international business, the role of lawyers in other countries, and attitudes outside the United States on insider trading and antitrust laws.

This edition presents students with the legal foundation necessary for business operations and sales but also affords the students the opportunities to analyze critically the social and political environments in which the laws are made and in which businesses must operate. An examination of the lists of companies and

individuals covered in the biographies, and of the publications from which the “For the Manager’s Desk” readings are taken, demonstrates the depth of background the tenth edition offers in those areas noted as critical by the AACSB. The materials provide a balanced look at regulation, free enterprise, and the new global economy.

Supplements

Business: Its Legal, Ethical, and Global Environment offers a comprehensive and well-crafted supplements package for both students and instructors.

Weekly Ethics and Law Updates. Available at mariannejennings.com, the weekly updates contributed by the author offer at least 12 current events per month for discussion and analysis. The update features new decisions, new statutes, new regulations, new ethical dilemmas, and a host of examples and cites to current periodicals. The tenth edition includes references to these updates in the text.

Instructor’s Manual. The *Instructor’s Manual*, written by the author, provides the following for each chapter: a detailed outline; answers to “Considers...,” “Ethical Issues,” case problems, and the end-of-chapter Questions and Problems; briefs of all cases; summaries of key features; supplemental readings; and interactive/cooperative learning exercises.

PowerPoint® Lecture Review Slides. Developed by the author, these PowerPoint slides consist of lecture outlines and select tables and figures used in the book. The slides are available for use by students as an aid to note taking, and by instructors for enhancing their lectures.

Test Bank. The Test Bank for instructors includes more than 2,000 questions in true/false, multiple-choice, and essay format. The questions vary in levels of difficulty, and meet a full range of tagging requirements, including AACSB standards.

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Business Law Digital Video Library. The Digital Library offers more than 90 videos and helps your students link their everyday experiences to legal ideas, spark classroom discussion, and reinforce core concepts. The Business Law Digital Video Library is organized into six series: Legal Conflicts in Business (includes specific modern business and e-commerce scenarios); Ask the Instructor (presents straightforward explanations of concepts for student review); Drama of the Law (features classic business scenarios that spark classroom participation); LawFlix (contains clips from many popular films); Real World Legal (presents legal scenarios encountered in real businesses); and Business Ethics in Action (presents ethical dilemmas in business scenarios). For more information about the Digital Video Library, visit www.cengage.com/blaw/dvl. Access for students is free when bundled with a new textbook or can be purchased separately. Students must register for and purchase access to the Digital Video Library at www.cengagebrain.com.

KnowNOW Blog. A professor's dream—a daily blog, written by the author and other professors, on eye-catching legal issues that allows students the opportunity to engage in discussion and really master concepts because of the nature of the subject matter. Insider trading is something that may not grab their attention until you share with them the story of the famous Notre Dame football player, Rudy, who settled pump-and-dump charges by the SEC. And a breached sale-of-fabric contract sounds like a dull session unless you are able to use the Lululemon problem—the company made thousands of yoga pants with the fabric only to discover through customer complaints that the fabric was see-through and those customers wanted their money back. Even antitrust law comes to life when you use the merger of Corona with Bud Light to cover market share and monopoly power.

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ABOUT THE AUTHOR

Professor Marianne Jennings is an emeritus professor of legal and ethical studies in business from the W. P. Carey School of Business at Arizona State University, having retired in 2011 after 35 years of teaching there. She returned to part-time teaching there in 2013, and continues to teach graduate courses in business ethics at colleges around the country.

During her tenure at ASU, she served in many different capacities: director of the Joan and David Lincoln Center for Applied Ethics (1995–1999); faculty director for the MBA Executive Program (2006–2007); associate dean (1986–1987); chair of the University Hearing Board (1995–2011); and faculty athletic representative to the NCAA and PAC-10 (1986–1987).

Professor Jennings earned her undergraduate degree in finance and her J. D. from Brigham Young University. Her internships were with the Federal Public Defender and U.S. Attorney in Nevada, and she has done consulting work for law firms and businesses and professional groups, including AES, Boeing, Dial Corporation, Mattel, Motorola, CFA Institute, Southern California Edison, the Arizona Auditor General, the Cities of Phoenix, Mesa, and Tucson, the Institute of Internal Auditors, Coca-Cola, DuPont, Blue Cross Blue Shield, Motorola, Mattel, Pepsi, Hy-Vee Foods, IBM, Bell Helicopter, Amgen, Raytheon, and VIAD.

Professor Jennings has authored hundreds of articles in academic, professional, and trade journals. Currently, she has six textbooks and monographs in circulation. The eighth edition of her textbook, *Case Studies in Business Ethics*, and the tenth edition of her textbook, *Business: Its Legal, Ethical and Global Environment*, will be published in January 2014. Her first textbook, *Real Estate Law*, had its tenth edition published in January 2013. She was added as a co-author to *Anderson's Business and the Legal Environment* in 1997, a text whose 22nd edition was published in January 2013. Her book, *Business Strategy for the Political Arena*, was selected in 1985 by *Library Journal* as one of its recommended books in business/government relations. *A Business Tale: A Story of Ethics, Choices, Success, and a Very Large Rabbit*, a fable about business ethics, was chosen by *Library Journal* in 2004 as its business book of the year. *A Business Tale* was also a finalist for two other literary awards in 2004. In 2000, her book on corporate governance was published by the *New York Times* MBA Pocket Series. Professor Jennings' book on long-term success, *Building a Business Through Good Times and Bad: Lessons from Fifteen Companies, Each With a Century of Dividends*, was published in October 2002 and has been used by Booz, Allen, Hamilton for its work on business longevity. Her book on organizational ethical culture, *The Seven Signs of Ethical Collapse*, was published by St. Martin's Press and continues to be used by many organizations as a framework for assessing culture. Her books have been translated into five languages. Her latest book, *Somewhere Between Ezekiel and Miss Havisham*, a book of essays on grief, was published in 2012.

Her columns have been syndicated around the country, and her work has appeared in the *Wall Street Journal*, *Chicago Tribune*, *New York Times*, *Washington Post*, and *Reader's Digest*. A collection of her essays, *Nobody Fixes Real Carrot Sticks Anymore*, first published in 1994, is still being published. She was given an Arizona Press Club award in 1994 for her work as a feature columnist. She has been a commentator on business issues on *All Things Considered* for National Public Radio.

She has conducted more than 500 workshops and seminars in the areas of business, personal, government, legal, academic, and professional ethics. She was named professor of the year in the College of Business in 1981, 1987, 2000, and 2010 and was the recipient of a Burlington Northern teaching excellence award in 1985. In 1999, she was given best article awards by the Academy of Legal Studies in Business and the Association for Government Accountants. She was given best article awards by the Institute of Internal Auditors and Association of Government Accountants in 2001 and 2004. She was a Dean's Council of 100 Distinguished Scholar from 1995–2011. In 2000, the Association of Government Accountants inducted her into its Speakers Hall of Fame. In 2005, she was named an All-Star Speaker by the Institute of Internal Auditors. In 2006, her article, "Ethics and Investment Management: True Reform," was selected by the United Kingdom's *Emerald Management Review* from 15,000 articles in 400 journals as one of the top 50 articles in 2005. She was named one of the Top 100 Thought Leaders by Trust Across America in 2010. In 2012, she was named one of the 100 Most Influential People in Business Ethics by *Ethisphere* magazine.

She is a contributing editor for the *Real Estate Law Journal*, *New Perspectives*, *The Smart Manager*, and *Corporate Finance Review*. She served on the Board of Editors for the *Financial Analysts Journal* from 2007–2012. She served as editor-in-chief of the *Journal of Legal Studies Education* during 2003–2004. During 1984–1985, she served as then-Governor Bruce Babbitt's appointee to the Arizona Corporation Commission. In 1999, she was appointed by Governor Jane Dee Hull to the Arizona Commission on Character. From 1986–1987, she served as ASU's faculty athletic representative to the NCAA and PAC-10. From 1999–2009, she served as president of the Arizona Association of Scholars.

She is a member of twelve professional organizations, including the State Bar of Arizona, and has served on four boards of directors, including Arizona Public Service (now Pinnacle West Capital) from 1987–2000, Zealous Capital Corporation, and the Center for Children with Chronic Illness and Disability at the University of Minnesota. She served as chair of the Bonneville International Advisory Board for KHTC/KIDR from 1994–1997 and was a weekly commentator on KGLE during 1998. She was appointed to the board of advisers for the Institute of Nuclear Power Operators in 2004. She has appeared on *CNBC*, *CBS This Morning*, the *Today Show*, and *CBS Evening News*.

Personal: Married since 1976 to Terry H. Jennings, Maricopa County Attorney's Office Deputy County Attorney; five children: Sarah, Sam, and John, and the late Claire and Hannah Jennings.

ACKNOWLEDGMENTS

By its tenth edition, a book has evolved to a point of trademark characteristics. This book is known for its hands-on examples and readings for business managers. That trademark evolves because of the efforts of many. They are the reviewers and adopters of the text who provide ideas, cases, and suggestions for improvement and inclusion. For this edition, the following colleagues offered their seasoned advice:

Shawn Abbott (*College of the Siskiyous*)
Suzanne Bechtel (*State College of Florida*)
Robert H. Breakfield (*Winthrop University*)
Leslee Brock (*Southwest Mississippi Community College*)
Emmy Buboltz (*Minnesota State University Mankato*)
Linda Christiansen (*Indiana University Southeast*)
Robert H. Doud (*Adelphi University*)
Dr. Christopher C. Esgar (*Penn State University*)
Peter Fagan (*Embry-Riddle Aeronautical University*)
M. M. Forsyth (*University of Southern Mississippi*)
Andy Garcia (*Bowling Green State University*)
Brian Gardner (*Transylvania University*)
Yolande Gardner (*Lawson State Community College*)
Richard R. Gerken (*Plymouth State University*)
Ilene Goldberg (*Rider University*)
Arlene M. Hibscheiler (*University at Buffalo*)
Robert Kenny, Esq. (*Rider University*)
Lora Koretz (*Arizona State University*)
Gail Petravick (*Bradley University*)
Leslie Sekerka (*Menlo College*)
Jeannine Shafer (*Western Michigan University*)
Wayne Tanna (*Chaminade University of Honolulu*)
Regina Webb (*Southern University at Shreveport*)
Russell Welch (*University of North Texas*)

Any edition of a book bears the mark of the editors who work to design, refine, market, and produce it. Seven editions ago, Rob Dewey saw potential for the book and applied his enthusiasm and market insights to mold a somewhat ugly duckling into a four-color swan. The book also carries the imprimatur of Steve Silverstein, who confronted me with a profound question, "Why can't those in business see these ethical dilemmas when they are in the midst of them?" His question forced me back to the drawing board and resulted in the more personal ethical dilemmas. Vicky True, now in Rob's role, understands the needs of instructors because of her intense road schedule, holds a keen sense of market direction, and offers the insights of both to help to shape this new edition. Sarah Blasco,

new as the editor for this edition, gives new meaning to “supportive editor” and “organized.” She applies a steady hand as she watches for consistencies, dates, and clarity. Tristann Jones serves as a patient administrator and coordinator for all of us. Tamborah Moore, the production editor, once again brought her eye for detail, her experience, and her insightful questions to the long haul of copyedit and page proofs. Kris Tabor has been with me since the first edition, helping with word processing, IMs, study guides, test banks, and venting. We mark 26 years of a terrific partnership with this edition.

This book also carries the unmistakable liveliness of an author who shares her life with helpful and delightful children and one tolerant husband. Since the first edition of this book, I have added four children to our first, witnessed two graduate from college, one from law school, grieved over the loss of two, and seen the others grow up all too quickly in a household in which “Mom, the UPS guy is here with page proofs” was their first spoken sentence. They now simply witness me hovering over my computer from dawn’s light until I fall asleep on the keyboard. My children and my husband, collectively my family, are the most charming people I know. They have brought me stories, pop culture, and good sense with their, “Uh-oh, here we go!” Even from their now–globally dispersed positions, they call and ask, “How’s the writing going?” Their vibrancy is found in the color and charm of these pages. I am grateful for their unanimous and unwavering support for my work. Finally, I am grateful to my parents who taught me through their words and examples of the importance and rewards of ethics and hard work.

Marianne Moody Jennings



Part 1

BUSINESS: ITS LEGAL, ETHICAL, AND JUDICIAL ENVIRONMENT

Simply stated, you cannot run a successful business without knowing the law. What is legal? Where can I find the laws I need to know? How do I make decisions about legal conduct that is ethically troublesome to me? What if I have a disagreement with a customer, employee, or shareholder? How and where can I resolve our differences?

This portion of the book explains what law is, where it can be found, how it is applied, and how legal disputes are resolved. But beyond the legal environment of a business, there are the ethical issues. Just because what you are doing is legal does not mean it is ethical. And why should a manager make ethical choices and behave honorably in business? Law and ethics are inextricably intertwined. A commitment to both is part of a sustainable business model.

Most people understand the law through personal experiences. Some are exposed to law through traffic tickets. Others encounter the law when a problem arises with a landlord or lease. Many wonder about their rights when search engines and other Internet companies gather information about them without their realizing such efforts were ongoing. Since 2008, many have come to understand the law as they faced foreclosures on their homes and needed to know their rights. Their understanding of the law may be limited by the anger they feel about having their email scanned or getting a traffic ticket. However, without traffic laws, the roads would be a study in survival of the fittest. The law is your source of assurance that if you face a foreclosure, you will have not only rights but also time to respond to your lender's actions. Each day businesses find and face legal and ethical issues in everything from privacy rights on Facebook to proper documentation of employees' citizenship.

The types of laws and the penalties for violating them vary from state to state and from city to city but, however much they vary, laws exist everywhere and at every level of government. Indeed, law is a universal, necessary foundation of an orderly society. Law helps maintain order, imposing on us certain minimum standards of conduct. When we fall short of those standards, we risk penalties. Law is made up of rules that control people's conduct and their interrelationships. Traffic laws control not only our conduct when we are driving but also our relationships with other drivers using the roads. In some instances, traffic laws give other drivers a right-of-way and we are liable to them for any injuries we cause by not following those laws.

This chapter offers an introduction to law. How is law defined? What types of laws are there? What are the purposes and characteristics of law? Where are laws found, and who enacts them?

UPDATE 

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*This country's planted
thick with laws from
coast to coast . . . and if
you cut them down . . .
d'you really think you
could stand upright in
the winds that would
blow then?*

A Man for All Seasons, Act I

Consider...

YouTube was founded in February 2005 by three former employees of Paypal. When YouTube was launched in December 2005, a press release described it as a “consumer media company” that “allows people to watch, upload, and share personal video clips.” YouTube achieved rapid prominence and profitability, eclipsing competitors such as Google Video and Yahoo Video by wide margins. In November 2006, Google acquired YouTube for \$1.65 billion. By March 2010, site traffic on YouTube had soared to more than 1 billion daily video views, with

more than 24 hours of new video uploaded to the site every minute.

Viacom, other film companies, and copyright holders discovered that their films and other video materials were posted on YouTube and filed suit against YouTube and Google for copyright infringement. Google and YouTube maintained that those who posted the videos were responsible for infringement and that they only provided an Internet site and service. Are YouTube and Google responsible for the copyright infringement of others?

1-1 Definition of Law

Philosophers and scholars throughout history have offered definitions of law. Aristotle, the early Greek philosopher, wrote that “the law is reason unaffected by desire” and “law is a form of order, and good law must necessarily mean good order.” Oliver Wendell Holmes Jr., a U.S. Supreme Court justice of the early twentieth century, said, “[L]aw embodies the story of a nation’s development through many centuries.” Sir William Blackstone, the English philosopher and legal scholar, observed that law was “that rule of action which is prescribed by some superior and which the inferior is bound to obey.” *Black’s Law Dictionary* defines law as “a body of rules of action or conduct prescribed by the controlling authority, and having legal binding force.”¹ Law has been defined at least once by every philosopher, statesman, and police officer.

Law is simply the body of rules governing individuals and their relationships. Most of these rules become law through a recognized governmental authority. Laws give us basic freedoms, rights, and protections. Law also offers a model of conduct for members of society in their business and personal lives and gives them certainty of expectation. Plans, businesses, contracts, and property ownership are based on the expectation that the law will provide consistent protection of rights. Without such constancy in legal boundaries, society would be a mass of chaos and confusion.

1-2 Classifications of Law

1-2a PUBLIC VERSUS PRIVATE LAW

Public law includes those laws enacted by some authorized governmental body. State and federal constitutions and statutes are all examples of public laws, as are the state incorporation and partnership procedures, county taxation statutes, and local zoning laws.

Private law, on the other hand, is developed between two individuals. For example, landlords usually have regulations for their tenants, and these regulations are private laws. Homeowners' associations have developed an important body of private law that regulates everything from the type of landscaping for homes in a subdivision to whether homeowners can erect basketball hoops in their driveways. The terms of a contract are a form of private law for the contracting parties. Although the requirements for forming and the means for enforcing that contract may be a matter of public law, the terms for performance are the private law the parties agree to as the rules for governing their relationships. Employer rules in a corporation are also examples of private law; as long as those rules do not infringe any public rights or violate any statutory or constitutional protections, those rules define a private law relationship between employer and employee. For example, most companies now have Twitter and Facebook policies that limit the type of information and comments employees can post about their employers in social media outlets. Interestingly, both state legislatures and the U.S. Congress have proposed legislation that would control employer restrictions on employees' posts. Public law is being changed to reflect technological areas that are not yet addressed in employment law.

1-2b CRIMINAL VERSUS CIVIL LAW

A violation of a **criminal law** is a wrong against society. A violation of a **civil law** is a wrong against another person or persons. Criminal violations have penalties such as fines and imprisonment. When you run a red light, you have committed a criminal violation and owe society a penalty, such as a fine or imprisonment. Violations of civil laws, on the other hand, require restitution: Someone who violates a civil law must compensate the harmed party. If you do run a red light and strike and injure a pedestrian, your criminal case is society's remedy. The civil wrong in the same action requires you to pay damages to that pedestrian.

If you drive while intoxicated, you are breaking a criminal law and are subject to a fine, jail term, or license suspension. If you have an accident while driving intoxicated, you commit a civil wrong against anyone you injure. People who are injured as a result of your driving while intoxicated can file a civil suit against you to recover for injuries to their persons and property (cars).

Other differences also distinguish civil laws from criminal laws and their enforcement. For example, different rights and procedures are used in the trials of criminal cases (see Chapter 8 for more details).

1-2c SUBSTANTIVE VERSUS PROCEDURAL LAW

Substantive laws are those that give rights and responsibilities. **Procedural laws** provide the means for enforcing substantive rights. For example, if Zeta Corporation has breached its contract to buy 3,000 microchips from Yerba Corporation, Yerba has the substantive right to expect performance and may be able to collect damages for breach of contract by bringing suit. The laws governing how Yerba's

suit is brought and the trial process are procedural laws. Procedural laws are also used in criminal cases, such as grand jury proceedings or arraignments and pleas (see Chapter 8 for more information).

1-2d COMMON VERSUS STATUTORY LAW

The term **common law** has been in existence since 1066, when the Normans conquered England and William the Conqueror sought one common set of laws for governing a then-divided England. The various customs of each locality were conglomeraed so that all fiefdoms could operate under a “common” system of law. The common law came about as judges in different areas settled disputes in similar ways by consulting their fellow judges on their previous decisions before making decisions. This principle of following other decisions is referred to as *stare decisis*, meaning “let the decision stand.” This process of legal reasoning is still followed today. The courts use the judicial decisions of the past in making their judgments in order to provide the consistency and constancy of the law.

As much of an improvement as it was, the common law was still just uncodified law. Because of increased trade, population, and complexities, the common law needed to be supplemented. As a result, **statutory law**, which is passed by some governmental body and written in some form, was created.

Today, in the United States, we have common law and statutory law. Some of our common law still consists of principles from the original English common law. For example, how we own and pass title to real property are areas largely developed from English common law. The body of common law continues to grow, however: the judicial system’s decisions constitute a form of common law that is used in the process of *stare decisis*. Courts throughout the country look to other courts’ decisions when confronted with similar cases.

Statutory law exists at all levels of government—federal, state, county, city, borough, and town. Our statutory law varies throughout our nation because of the cultural heritages of various regions. For example, the southwestern states have marital property rights statutes—often referred to as community property laws—that were influenced by the Spanish legal system implemented in Mexico. The northeastern states have different marital property laws that were influenced by English laws on property ownership. Louisiana’s contract laws are based on French principles because of the early French settlements there.

1-2e LAW VERSUS EQUITY

Equity is a body of law that attempts to do justice when the law does not provide a remedy, when the remedy is inadequate, or when the application of the law is terribly unfair. Equity, which originated in England, came into being because the technicalities of the common law often resulted in unresolved disputes or unfair resolutions. The monarchy allowed its chancellor to hear those cases that could not be resolved in the common law courts; eventually, a separate set of equity courts developed that were not bound by rigid common law rules. These courts could get more easily to the heart of a dispute. Over time, they developed remedies not available under common law. Common law, for example, usually permitted only the recovery of monetary damages. Courts of equity, on the other hand, could issue orders, known as **injunctions**, prohibiting certain conduct or ordering certain acts. The equitable remedies available in the **courts of chancery** were gradually combined with the legal remedies of the common law courts so that now parties can have their legal and equitable remedies determined by the same court.

Today's courts award equitable remedies when the legal remedy of money damages would be inadequate. For example, the copyright infringement cases brought by the recording and motion picture industries sought against the individuals and companies that provided the technological means for making individual copies of movies and songs (the file-sharing programs). The record companies, the movie producers, and the artists could never be adequately compensated with money for these forms of infringement because the continued activity caused the loss of their exclusive copyrights. The remedy that they sought and were given were injunctions that, within certain parameters, ordered a halt to the sites and programs that facilitated the unauthorized downloading of copyrighted materials.

1-3 Purposes of Law

1-3a KEEPING ORDER

Laws carry some form of penalty for their violation. Antitrust violations carry a fine or imprisonment or both. Violations of civil laws also carry sanctions. If an employer discriminates against you by refusing to give you a raise or promotion because of your age, gender, or race, you can seek money damages. A driver who injures another while driving intoxicated can be prosecuted but must also pay for the damages and the costs of the injuries the other person experiences. These civil and criminal penalties for violations of laws prevent feuds and the use of primitive methods for settling disputes, such as force.

The USA Patriot Act addresses a variety of legal issues, from search warrants to reporting requirements for banks and others engaged in high-dollar transactions (see Chapters 8, 12, and 9). The Patriot Act was passed for the purpose of preventing terrorist activities through early detection of plots and the control of funds used for financing terrorist activities.

1-3b INFLUENCING CONDUCT

Laws also influence conduct in a society. For example, securities laws require companies to make certain disclosures about those securities before they can be sold to the public. The antitrust laws passed in the early twentieth century prohibited some methods of competition, such as price fixing, and limited others, such as mergers (see Chapter 16). These types of laws continue to change the way businesses operate. For example, Google recently agreed to stop restricting its advertisers from working with other search engines.

1-3c HONORING EXPECTATIONS

Businesses commit resources, people, and time to ventures, expansion, and product development with the expectation that the contracts for those commitments will be honored and enforced according to existing law. Investors buy stock with the knowledge that they will enjoy some protection of that investment through the laws that regulate both the securities themselves and the companies in which they have invested. Laws allow prior planning based on the protections inherent in the law.

1-3d PROMOTING EQUALITY

Laws have been used to achieve equality in those aspects of life in which equality is not a reality. For example, the equal-right-to-employment acts (see Chapter 21) were passed to bring greater equality to the job market. The social welfare programs of state and federal governments were created to further the cause of economic

justice. The antitrust laws attempt to level the playing field for the free enterprise system to operate efficiently.

1-3e LAW AS THE GREAT COMPROMISER

A final and important purpose of law is to act as the great compromiser. Few people, groups, or businesses agree philosophically on how society, business, or government should be run. Law serves to mesh different views into one united view so that all parties are at least partially satisfied. When disputes occur, the courts apply the law to the parties' situation in an attempt to strike a compromise between two opposing views. The U.S. Supreme Court has provided compromises for the rights of businesses to be involved in the political process and make donations to candidates (see Chapter 5). In the relationship between freedom of speech and advertising regulation, the law serves as the mediator.

1-4 Characteristics of Law

1-4a FLEXIBILITY

As society changes, the law must change with it. When the United States was an agricultural nation, the issues of antitrust, employment discrimination, and securities fraud rarely arose. However, as the United States became an industrialized nation, those areas of law expanded, and they continue to expand today. As the United States further evolves into a technological and information-based society, still more areas of law will be created and developed. Computer fraud and identity theft, for example, were unknown issues 35 years ago; today, both state and federal laws address these issues through criminal statutes (see Chapter 10). The introduction of the fax machine required courts to reexamine how offers and acceptances of contracts are made, and the Internet has resulted in legislation allowing electronic signatures to have the same force and effect as signatures on paper (see Chapter 12).

Circumstances change through technology, sociology, and even biology. The law must address those changes. The "Consider..." at the beginning of the chapter demonstrates how the development of new technology presented new legal issues. What are the rights of copyright holders when an Internet company creates a system that allows users to post videos that are copyrighted? With billions of users and millions of videos, how do we protect copyrighted materials?

1-4b CONSISTENCY

Although the law must be flexible, it still must be predictable. Law cannot change so suddenly that parties cannot rely on its existence or protection. Being able to predict the outcome of a course of conduct allows a party to rely on a contract or dissuades a party from the commission of a crime. For a contract, a judicial remedy can be ordered for breach or nonperformance; for a crime, a prescribed punishment is the result.

1-4c PERVASIVENESS

The law must be pervasive and cover all necessary areas, but at the same time, it cannot infringe on individual freedoms or become so complex that it is difficult to enforce. For example, laws cover the formation, operation, and dissolution of corporations. Laws govern corporate management decisions on expanding, developing, and changing the nature of the corporation. Laws also ensure that shareholders' rights are protected. The corporation has great flexibility in management, as long as it stays within these legal boundaries.



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In the two following cases, the courts struggle as they try to honor the law's purposes of keeping order and honoring expectations while also grappling with the unique issues raised by modern technology and its applications and use in the context of balancing those purposes. The principle of *stare decisis* is at work in these two cases (see Chapter 3). You will be able to see how the law has evolved to address new issues that have resulted from technological developments. Case 1.1, the *Grokster* case, is briefed in Exhibit 1.1. A **brief** is a tool used by lawyers, law students, and judges to help them summarize a case and focus on its facts and the key points of the decision by the court. Case 1.2, the *Viacom* case, answers the questions posed in the "Consider..." problem at the beginning of the chapter.

CASE 1.1

Metro-Goldwyn-Mayer Studios Inc. v Grokster, Ltd.
545 U.S. 913 (2005)²

Copyright Infringement? Really, It's Just a Little Peer-to-Peer File Sharing

FACTS

Grokster, Ltd., and StreamCast Networks, Inc. (respondents/defendants) distribute free software products that allow computer users to share electronic files through peer-to-peer networks. With no central computer server required in these networks, the issue of storage space for high-bandwidth-capacity servers disappears. Because copies of a file (particularly a popular one) are available on many users' computers, file requests and retrievals move faster than on other types of networks, and can take place between any computers that remain connected to the network without risk of a server glitch. Peer-to-peer networks are used by universities, government agencies, corporations, and libraries to store and distribute electronic files.

Grokster and StreamCast software users have generally used the software networks for sharing copyrighted music and video files without authorization. A group of copyright holders (MGM for short, but including motion picture studios, recording companies, songwriters, and music publishers—petitioners) sued Grokster and StreamCast for their users' copyright infringements through the distribution of their software that allows users to reproduce and distribute copyrighted works in violation of the Copyright Act.

Grokster and StreamCast do not know when files are copied, but MGM commissioned a statistician to conduct a systematic search, and his study showed that nearly 90 percent of the files available for download were copyrighted works. Grokster and StreamCast dispute this figure and argue that free copying even of copyrighted works may be authorized by the rightholders. They also argue that potential noninfringing uses

of their software are significant, although infrequent in use. Some musical performers have gained new audiences by distributing their copyrighted works for free across peer-to-peer networks, and some distributors of unprotected content have used peer-to-peer networks to disseminate files, Shakespeare being an example. StreamCast has given Morpheus users the opportunity to download the briefs in this very case, though their popularity has not been quantified.

StreamCast gave away a software program of a kind known as OpenNap, designed as compatible with the Napster program. The OpenNap program was engineered "to leverage Napster's 50 million user base."

One StreamCast proposed ad read: "Napster Inc. has announced that it will soon begin charging you a fee. That's if the courts don't order it shut down first. What will you do to get around it?" Another proposed ad touted StreamCast's software as the "#1 alternative to Napster" and asked "[w]hen the lights went off at Napster ... where did the users go?" StreamCast even planned to flaunt the illegal uses of its software; when it launched the OpenNap network, the chief technology officer of the company averred that "[t]he goal is to get in trouble with the law and get sued. It's the best way to get in the new[s]." Grokster launched its own OpenNap system called Swaptor and inserted digital codes into its website so that computer users using Web search engines to look for "Napster" or "[f]ree filesharing" would be directed to the Grokster website, where they could download the Grokster software.

Grokster and StreamCast receive no revenue from users, who obtain the software itself for nothing. Instead, both companies generate income by selling advertising space, and they stream the advertising to

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Grokster and Morpheus users while they are employing the programs. As the number of users of each program increases, advertising opportunities become worth more. While there is doubtless some demand for free Shakespeare, the evidence shows that free access to copyrighted work is most important to users.

The District Court held that those who used the Grokster and Morpheus software to download copyrighted media files directly infringed MGM's copyrights, but granted summary judgment in favor of Grokster and StreamCast as to any liability arising from distribution of the then current versions of their software. The Court of Appeals affirmed. MGM appealed.

JUDICIAL OPINION

SOUTER, Justice

The question is under what circumstances the distributor of a product capable of both lawful and unlawful use is liable for acts of copyright infringement by third parties using the product....

Digital distribution of copyrighted material threatens copyright holders as never before, because every copy is identical to the original, copying is easy, and many people (especially the young) use file-sharing software to download copyrighted works. As the case has been presented to us, these fears are said to be offset by the different concern that imposing liability, not only on infringers but on distributors of software based on its potential for unlawful use, could limit further development of beneficial technologies.

The argument for imposing indirect liability in this case is, however, a powerful one, given the number of infringing downloads that occur every day using StreamCast's and Grokster's software. When a widely shared service or product is used to commit infringement, it may be impossible to enforce rights in the protected work effectively against all direct infringers, the only practical alternative being to go against the distributor of the copying device for secondary liability on a theory of contributory or vicarious infringement.

In *Sony Corp. v Universal City Studios*, 464 U.S. at 434, this Court addressed a claim that secondary liability for infringement can arise from the very distribution of a commercial product.... Because the VCR was "capable of commercially significant noninfringing uses," we held the manufacturer could not be faulted solely on the basis of its distribution.

In sum, where an article is "good for nothing else" but infringement, there is no legitimate public interest in its unlicensed availability, and there is no injustice in presuming or imputing an intent to infringe.... Conversely, the doctrine absolves the equivocal conduct of selling an item with substantial lawful as well as unlawful uses, and limits liability to instances of more acute fault than the mere understanding that some

of one's products will be misused. It leaves breathing room for innovation and a vigorous commerce.

Grokster and StreamCast reply by citing evidence that their software can be used to reproduce public domain works, and they point to copyright holders who actually encourage copying. Even if infringement is the principal practice with their software today, they argue, the noninfringing uses are significant and will grow.

Because the Circuit found the StreamCast and Grokster software capable of substantial lawful use, it concluded on the basis of its reading of *Sony* that neither company could be held liable, since there was no showing that their software, being without any central server, afforded them knowledge of specific unlawful uses.

This view of *Sony*, however, was in error, converting the case from one about liability resting on imputed intent to one about liability on any theory.

...Nothing in *Sony* requires courts to ignore evidence of intent if there is such evidence, and the case was never meant to foreclose rules of fault-based liability derived from the common law.

The classic case of direct evidence of unlawful purpose occurs when one induces commission of infringement by another, or "entic[es] or persuad[es] another" to infringe, *Black's Law Dictionary* 790 (8th ed. 2004), as by advertising. Thus at common law a copyright or patent defendant who "not only expected but invoked [infringing use] by advertisement" was liable for infringement "on principles recognized in every part of the law."

For the same reasons that *Sony* took the staple-article doctrine of patent law as a model for its copyright safe-harbor rule, the inducement rule, too, is a sensible one for copyright. We adopt it here, holding that one who distributes a device with the object of promoting its use to infringe copyright, as shown by clear expression or other affirmative steps taken to foster infringement, is liable for the resulting acts of infringement by third parties. We are, of course, mindful of the need to keep from trenching on regular commerce or discouraging the development of technologies with lawful and unlawful potential. The inducement rule, instead, premises liability on purposeful, culpable expression and conduct, and thus does nothing to compromise legitimate commerce or discourage innovation having a lawful promise.

Here, the summary judgment record is replete with other evidence that Grokster and StreamCast, unlike the manufacturer and distributor in *Sony*, acted with a purpose to cause copyright violations by use of software suitable for illegal use.

...[e]ach company showed itself to be aiming to satisfy a known source of demand for copyright infringement, the market comprising former Napster users. StreamCast's internal documents made constant reference to Napster, it initially distributed its Morpheus software through an OpenNap program compatible

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