

THE LEGAL ENVIRONMENT OF BUSINESS

TEXT AND CASES

Ninth Edition



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FEATURES THAT ADD INSIGHT AND DEPTH



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THE LEGAL ENVIRONMENT OF BUSINESS

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NINTH EDITION

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PREFACE

The study of the legal environment of business has universal applicability. A student entering any field of business must have at least a passing understanding of business law in order to function in the real world.

Additionally, students preparing for a career in accounting, government and political science, economics, and even medicine can use much of the information that they learn in a legal environment of business course. In fact, every individual throughout his or her lifetime can benefit from a knowledge of contracts, employment relationships, real property law, land-use control, and other legal topics. Consequently, we have fashioned this text as a useful “tool for living” for all of your students (including those taking the CPA exam).

For the Ninth Edition, we have spent a great deal of effort making this book more contemporary, exciting, and visually appealing than ever before. We have also added many new features and special pedagogical devices that focus on legal, ethical, global, and corporate issues, while addressing core curriculum requirements.

UNIQUE NEW DIGITAL LEARNING SYSTEMS

Before we discuss the many new aspects of this text, however, we wish to point out the exciting new digital products offered in conjunction with the text.

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 - Video Activities—Real-world video exercises make business law engaging and relevant.
 - Brief Hypotheticals—These applications provide students practice in spotting the issue and applying the law in the context of a short, factual scenario.
 - Case Problem Blueprints—Promote deeper critical thinking and legal reasoning by guiding students step-by-step through a case problem, building on acquired knowledge to truly assess their understanding of legal principles.
- **Personalized Student Plan** with multimedia study tools and videos.
- **Test Bank.**
- **Reporting and Assessment** options.

By using the optional CengageNOW system, students can complete the assignments online and can receive instant feedback on their answers.

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WHAT IS NEW IN THE NINTH EDITION

Instructors have come to rely on the coverage, accuracy, and applicability of *The Legal Environment of Business*. To make sure that our text engages your students, solidifies their understanding of legal concepts, and provides the best teaching tools available, we now offer the following items in the text.

New Chapter on Internet Law, Social Media, and Privacy

For the Ninth Edition, we have included an entirely new chapter (Chapter 15) entitled **Internet Law, Social Media, and Privacy**. Social media have entered the mainstream and become a part of everyday life for many businesspersons. Throughout the text, we recognize this trend by incorporating the Internet and social media as they relate to the topics under discussion.

We also give the legal issues surrounding the Internet, social media, and privacy special emphasis in this new chapter. This chapter examines some of the laws pertaining to the Internet, intellectual property, and privacy. It also discusses recent legal developments concerning the protection of social media passwords and the use of social media by employers and law enforcement.

New Managerial Strategy Features

For the Ninth Edition, we have created a new feature entitled **Managerial Strategy** that focuses on the management aspects of business law. Special emphasis is given to sustainability, ethical trends, and changing managerial responsibilities.

Each feature includes a short section entitled **Managerial Implications** that provides concrete information for managers and connects the topic under discussion to operating a business. Each feature also concludes with two **Business Questions** that prompt students to further exam-

ine the issues discussed. **Suggested answers to all the Business Questions are included in both the Instructor's Manual and the Answers Manual for this text.**

Topics examined in these features include:

- Budget Cuts for State Courts Can Affect Businesses (Chapter 2).
- Many Companies Have to Revise Their Social Media Policies (Chapter 23).

New Appendix to Chapter 10 Focuses on Reading and Analyzing Contracts

Because reading and analyzing contracts is such a crucial skill for businesspersons, a special **new Appendix to Chapter 10** has been added. This appendix follows the second contracts chapter and explains how to read and analyze a contract. Then, it presents an example of an employee noncompetition and nondisclosure agreement. The sample contract is annotated so that students can quickly see what each contract provision means.

New Highlighted and Numbered Examples and Case in Point Illustrations

Many instructors use cases and examples to illustrate how the law applies to business. For this edition, we have expanded both our in-text examples and our discussion of case law by adding highlighted numbered **Examples** and **Cases in Point** in every chapter.

These two features are uniquely designed and consecutively numbered throughout each chapter for easy reference. *Examples* illustrate how the law applies in a specific situation. *Cases in Point* present the facts and issues of an actual case and then describe the court's decision and rationale. The numbered *Examples* and *Cases in Point* features are integrated throughout the text to help students better understand how courts apply the principles in the real world.

New Spotlight Cases and Spotlight Case Problems

For the Ninth Edition of *The Legal Environment of Business*, certain cases and case problems have been carefully chosen as exceptionally good teach-

ing cases. **Spotlight Cases** and **Spotlight Case Problems** are labeled either by the name of one of the parties or by the subject involved. Some examples include *Spotlight on Amazon.com*, *Spotlight on Apple*, *Spotlight on Beer Labels*, *Spotlight on Macy's*, *Spotlight on the Seattle Mariners*, and *Spotlight on Verizon*.

Instructors will find these *Spotlight Cases* useful to illustrate the legal concepts under discussion. Students will enjoy studying these cases because the parties are often familiar and the cases involve interesting and memorable facts. **Suggested answers to all case-ending questions and case problems are included in both the Instructor's Manual and the Answers Manual for this text.**

New ExamPrep Section with Two Issue Spotters

For this edition, we have added a new section called *ExamPrep* at the conclusion of each chapter. The section includes **two new Issue Spotters related to the chapter's topics** that facilitate student learning and review of the materials. **Suggested answers to the Issue Spotters in every chapter are provided in Appendix E at the end of the text.**

New Legal Reasoning Group Activities

For instructors who want their students to engage in group projects, each chapter of the Ninth Edition includes a **special new Legal Reasoning Group Activity**. Each activity begins by describing a business scenario and then requires each group of students to answer a specific question pertaining to the scenario based on the information that they learned in the chapter. These projects may be used in class to spur discussion or as homework assignments. **Suggested answers to the Legal Reasoning Group Activities are included in both the Instructor's Manual and the Answers Manual for this text.**

New Insight Features

For the Ninth Edition, we have created **new Insight into [E-Commerce, Ethics, the Global Environment, or Social Media]** features that appear in selected chapters. These features provide

valuable insights into how the courts and the law are dealing with specific issues. Each of these features ends with a **Legal Critical Thinking** question that explores some cultural, environmental, or technological aspect of the issue. The following are some of the topics explored in these features:

- **Insight into E-Commerce**—Do Computers Have Free Speech Rights? (Chapter 5).
- **Insight into Social Media**—“Catfishing”: Is That Online “Friend” Who You Think It Is? (Chapter 10).
- **Insight into Ethics**—Warning Labels for Video Games (Chapter 13).
- **Insight into the Global Environment**—Is It Legal to Resell Textbooks Purchased Abroad? (Chapter 14).

Suggested answers to the Legal Critical Thinking questions are included in both the Instructor’s Manual and the Answers Manual for this text.

New Case Analysis Cases with Four Legal Reasoning Questions

In every chapter of the Ninth Edition of *The Legal Environment of Business*, we have included one longer case excerpt—labeled **Case Analysis Case**—followed by **four Legal Reasoning Questions**. The questions are designed to guide students’ analysis of the case and build their legal reasoning skills.

These *Case Analysis Cases* may be used for case-briefing assignments and are also tied to the *Special Case Analysis* questions found in nearly every unit of the text (one per unit). **Suggested answers to the Legal Reasoning Questions are included in both the Instructor’s Manual and the Answers Manual for this text.**

Improved Ethics Coverage

For the Ninth Edition of *The Legal Environment of Business*, we have significantly revised and updated the chapter on ethics and business decision making (Chapter 4). The chapter now presents a more practical, realistic, case-study approach to business ethics and the dilemmas facing businesspersons today. It also provides step-by-step guidance for making ethical business decisions.

The emphasis on ethics is reiterated in materials throughout the text, particularly the *Insight into Ethics* features, the *Focus on Ethics* features that conclude every unit, and the pedagogy that accompanies selected cases and features. We also discuss **corporate governance issues** in Chapter 28 and in the *Focus on Ethics* feature concluding Unit Four on the business environment. Finally, each chapter in the text includes **A Question of Ethics** case problem that provides a modern-day example of the kinds of ethical issues faced by businesspersons and explores the ways that courts can resolve them.

ADDITIONAL FEATURES OF THIS TEXT

The Legal Environment of Business, Ninth Edition, includes a number of pedagogical devices and special features, including those discussed here.

Emphasis on Business and on Critical Thinking

For the Ninth Edition, we have focused on making the text more business related. To that end, we have carefully chosen cases, features, and problems that are relevant to operating a business.

In addition, we recognize that today’s business leaders must often think “outside the box” when making business decisions. For this reason, we have included numerous critical thinking and legal reasoning elements in this text. Almost all of the features and cases presented in the text conclude with some type of critical thinking question.

Cases may include one or more of the following critical thinking questions:

- *What If the Facts Were Different?*
- *The Ethical Dimension*
- *The E-Commerce Dimension*
- *The Global Dimension*
- *The Legal Environment Dimension*
- *The Social Dimension*

Suggested answers to all questions following cases can be found in both the Instructor’s Manual and the Answers Manual for this text.

Managerial Implications in Selected Cases

In addition to the critical thinking questions, we have included special case pedagogy at the end of selected cases that have particular importance for business managers. This section, called *Managerial Implications*, points out the significance of the court's ruling in the case for business owners and managers.

Special Case Analysis Questions

For nearly every unit in the text, we also provide a *Special Case Analysis* question that is based on the *Case Analysis Case* excerpt in that chapter. The *Special Case Analysis* questions are designed to build students' analytical skills and appear in the *Business Case Problems* at the end of selected chapters.

The *Special Case Analysis* questions test students' ability to perform IRAC (which stands for Issue, Rule, Application, and Conclusion) case analysis. Students must identify the legal issue presented in the chapter's *Case Analysis Case*, understand the rule of law, determine how the rule applies to the facts of the case, and describe the court's conclusion. Instructors can assign these questions as homework or use them in class to elicit student participation and teach case analysis. **Suggested answers to the *Special Case Analysis* questions can be found in both the *Instructor's Manual* and the *Answers Manual* for this text.**

Reviewing Features in Every Chapter

In the Ninth Edition of *The Legal Environment of Business*, we continue to offer a *Reviewing* feature at the end of every chapter to help solidify students' understanding of the chapter materials. Each *Reviewing* feature presents a hypothetical scenario and then asks a series of questions that require students to identify the issues and apply the legal concepts discussed in the chapter.

These features are designed to help students review the chapter topics in a simple and interesting way and see how the legal principles discussed in the chapter affect the world in which they live. An instructor can use these features as the basis for in-class discussion or encourage students to use

them for self-study prior to completing homework assignments. **Suggested answers to the questions posed in the *Reviewing* features can be found in both the *Instructor's Manual* and the *Answers Manual* for this text.**

Concept Summaries

When key areas of the law need additional emphasis, we provide a *Concept Summary*. These summaries have always been a popular pedagogical tool in this text. It now includes nineteen of these summaries, many of which have been expanded or revised.

Exhibits

When appropriate, we also illustrate important aspects of the law in graphic form in exhibits. In all, fifty exhibits are featured in *The Legal Environment of Business*, Ninth Edition. Several of these exhibits are new, and we have modified existing exhibits to achieve better clarity.

Case Problems

Every chapter includes a 2012 or 2013 case problem in the *Business Case Problems* that appear at the end of the chapter. These problems are designed to clarify how modern courts deal with the business issues discussed in the chapter.

At the request of instructors, we have given every business scenario and case problem a label that identifies the chapter topic to which the question relates. These labels make it easier for instructors who wish to assign only certain questions to their students. In addition, for this edition, we have added page references to the text where the problem's answer can be found.

We have also included two special problems—the *Spotlight Case Problems* (in selected chapters, as mentioned earlier), which are based on good teaching cases with interesting facts, and the *Business Case Problem with Sample Answer* (discussed next).

Suggested answers to all chapter-ending business scenarios and case problems are included in both the *Instructor's Manual* and the *Answers Manual* for this text.

Business Case Problem with Sample Answer in Each Chapter

In response to those instructors who would like students to have sample answers available for some of the questions and case problems, we include a *Business Case Problem with Sample Answer* in each chapter. The *Business Case Problem with Sample Answer* is based on an actual case, and students can access a sample answer in Appendix F at the end of the text.

THE LEGAL ENVIRONMENT OF BUSINESS ON THE WEB

The Web site for the Ninth Edition of *The Legal Environment of Business* can be found by going to www.cengagebrain.com and entering ISBN 9781285428949. The Web site offers a broad array of teaching/learning resources, including the following:

- **Practice quizzes** for every chapter in this text.
- **Flashcards** and a **Glossary** for every chapter in this text.
- **Appendix A: How to Brief Cases and Analyze Case Problems** that appears in the book is also posted on the Web site.
- **Legal reference materials** including a “Statutes” page that offers links to the full text of selected statutes referenced in the text, a Spanish glossary, and other important legal resources.
- **CourseMate**, which students can purchase access to, provides additional study tools, including an e-book, additional quizzes, flashcards, key terms, and PowerPoint slides.

THE MOST COMPLETE SUPPLEMENTS PACKAGE AVAILABLE TODAY

This edition of *The Legal Environment of Business* is accompanied by many teaching and learning supplements, which are available on the password-

protected portion of the Instructor’s Companion Web Site.

The complete teaching/learning package for the Ninth Edition includes the supplements listed next. For further information on *The Legal Environment of Business* teaching/learning package, contact your local sales representative or visit *The Legal Environment of Business* Web site.

Instructor’s Companion Web Site

The Instructor’s Companion Web Site contains the following supplements:

- **Instructor’s Manual.** Includes sections entitled “Additional Cases Addressing This Issue” at the end of selected case synopses.
- **Answers Manual.** Provides answers to all questions presented in the text, including the questions in each case, feature, and unit-ending feature.
- **Test Bank.** A comprehensive test bank that contains multiple choice, true/false, and short essay questions.
- **Case-Problem Cases.**
- **Case Printouts.**
- **PowerPoint slides.**
- **Instructor’s Manual** for the *Drama of the Law* video series.

Software, Video, and Multimedia Supplements

- **Business Law Digital Video Library**— Provides access to ninety videos, including the *Drama of the Law* videos and video clips from actual Hollywood movies. Access to our Digital Library is available in an optional package with each new text at no additional cost. You can access the Business Law Digital Video Library, along with corresponding *Video Questions* that are related to specific chapters in the text, at www.cengagebrain.com.
- **CengageNow** (described on the first page of this preface).
- **MindTap** (described on the first page of this preface).
- **CourseMate** (described on the second page of this preface).

- **Westlaw®** (ten free hours for qualified adopters).

FOR USERS OF THE EIGHTH EDITION

First of all, we want to thank you for helping make *The Legal Environment of Business* the best-selling legal environment text in America today. Second, we want to make you aware of the numerous additions and changes that we have made in this edition—many in response to comments from reviewers.

New Chapter and Special Pedagogy

For this edition, we have added more material on Internet law and social media throughout the text. We have also created an entire chapter (Chapter 15) on Internet law, social media, and privacy.

We have also added the following entirely new elements for the Ninth Edition:

- New highlighted and numbered *Examples* and *Cases in Point*.
- New *Managerial Strategy* features.
- New *Insight into Social Media* features.
- New *Spotlight Cases and Spotlight Case Problems*.
- *Classic Cases*.
- Four *Legal Reasoning Questions* at the conclusion of *Case Analysis Cases*.
- *Appendix to Chapter 10: Reading and Analyzing Contracts*.
- *Issue Spotters* in every chapter.
- *Legal Reasoning Group Activities* in every chapter.
- *Appendix E* (Answers to the *Issue Spotters*), *Appendix F* (Sample Answers for *Business Case Problems with Sample Answer*).

Significantly Revised Chapters

Every chapter of the Ninth Edition has been revised as necessary to incorporate new developments in the law or to streamline the presenta-

tions. Other major changes and additions for this edition include the following:

- **Chapter 4 (Business Ethics)**—This chapter has been thoroughly revised with all new cases, business scenarios, and many new case problems. It includes a new section on business ethics and social media, as well as an in-depth discussion of stakeholders and corporate social responsibility. The chapter also provides step-by-step guidance on making ethical business decisions and includes materials on global business ethics. An *Insight into the Global Environment* feature examines bribery and the Foreign Corrupt Practices Act.
- **Chapter 5 (Business and the Constitution)**—The chapter has been revised and updated to be more business oriented. It has numerous new *Examples* and *Cases in Point*, many of which are based on United States Supreme Court decisions.
- **Chapter 8 (International Law in a Global Economy)**—This chapter has been thoroughly revised and updated. It now discusses international dispute resolution and includes a feature on border searches of electronic devices. All three cases presented in Chapter 8 are new, and an important 2013 United States Supreme Court decision has been selected as a *Spotlight on International Torts*.
- **Chapters 9 through 10 (the contracts materials)**—We have added many highlighted and numbered *Examples*, *Cases in Point*, and updates to clarify and enhance our already superb contract law coverage. The discussion of online contracting and electronic signatures has been merged with the coverage of traditional contracts. Chapter 9 presents a *Spotlight on Amazon.com* case and includes a *Spotlight on Taco Bell* case problem.
- **Chapter 11 (Sales and Lease Contracts)**—We have streamlined and simplified our coverage of the Uniform Commercial Code. We have added numerous new *Examples* and *Cases in Point* throughout the chapter to increase student comprehension. The chapter includes an *Insight into E-Commerce* on Taxing Web Purchases and a *Spotlight on Apple* case problem. It also contains a classic case and a 2013 *Case Analysis Case*.

- **Chapter 12 (Torts) and Chapter 13 (Strict Liability and Product Liability)**—Our torts coverage has been substantially revised, reorganized, and streamlined. The materials are up to date and business oriented. Intentional torts and negligence are covered in one chapter, and strict liability and product liability are covered in the next. Each chapter includes a *Spotlight Case*, and Chapter 13 presents an *Insight into Ethics* feature discussing warning labels for video games.
- **Chapter 14 (Intellectual Property Rights)**—The materials on intellectual property rights have been thoroughly revised and updated to reflect the most current laws and trends. There is a discussion of the dispute between Apple, Inc., and Samsung Electronics Company over smartphones. A feature discusses a 2013 United States Supreme Court decision on the resale on eBay of textbooks purchased abroad. The case problems include a *Spotlight on Macy's*.
- **Chapter 15 (Internet Law, Social Media, and Privacy)**—This chapter is all new and was created for the Ninth Edition to explore timely topics. It discusses legal issues that are unique to the Internet, such as spam, domain name disputes, cybersquatting, digital copyright laws, and file-sharing. It also discusses social media, company-wide social media networks, state legislation on social media, the Electronic Communications Privacy Act, and password protection. The chapter also covers online defamation, data collection and cookies, and online privacy.
- **Chapter 16 (Creditor-Debtor Relations and Bankruptcy)**—This chapter has been revised to be more up to date and comprehensible. We have streamlined the materials to focus on those concepts that students need to know, and included updated dollar amounts of various provisions of the Bankruptcy Code. An *Insight into Social Media* feature is included.
- **Chapters 17 through 19 (the Business Environment unit)**—This unit has been revised and updated to improve the flow and clarity. We provide more practical information and recent examples. Small-business organizational forms, including sole proprietorships and partnerships—as well as issues affecting owners of small businesses—are covered in Chapter 17. Limited liability forms of business are covered in Chapter 18, and corporations are discussed in Chapter 19. A new case and a new *Case Analysis Case* have been added in the corporate law chapter.
- **Chapter 21 (Employment Relationships)**—This chapter discusses many legal issues facing employers today and includes updated minimum wage figures and Social Security and Medicare percentages. We have also included a discussion of the Affordable Care Act (Obamacare).
- **Chapter 22 (Employment Discrimination)**—We have added *Examples* and *Cases in Point* throughout this chapter, as well as new numbered lists of elements, and two new cases. A new *Insight into Ethics* feature examines appearance-based discrimination. We discuss relevant United States Supreme Court decisions affecting employment issues throughout both Chapter 21 and this chapter.
- **Chapter 23 (Immigration and Labor Law)**—The materials on immigration law have been streamlined and updated and include a discussion of state immigration legislation and its constitutionality. A *Managerial Strategy* feature covers changing social media policies, and there is a new *Cases Analysis Case* on labor law.
- **Chapter 24 (Consumer Protection)**—This chapter has been streamlined and updated. The chapter also includes a *Spotlight on Honda* case and a *Spotlight on McDonald's* case problem.
- **Chapter 25 (Environmental Law)**—The materials on air pollution and water pollution have been updated, and a recent decision from the United States Supreme Court decision is presented.
- **Chapter 26 (Real Property and Land-Use Control)**—Parts of this chapter have been significantly revised. Several new terms were added. The discussion of eminent domain for economic development was updated. A *Spotlight Case* covers whether the buyer of an allegedly haunted house can seek rescission of the sale. The *Case Analysis Case* is on whether

a town can use a condemnation action to acquire rights-of-way for a natural gas pipeline that is not being built to furnish natural gas to the residents of that town. The discussion of zoning laws has been reworked, and several numbered lists explain permissible uses of land and requirements for variances.

- **Chapter 27 (Antitrust Law)**—We have added several new examples and expanded

coverage of leading cases, including a discussion of price fixing and e-books. Updated thresholds for interlocking directorates have been incorporated.

- **Chapter 28 (Investor Protection and Corporate Governance)**—This chapter has been substantially revised, updated, and simplified. It includes new numbered lists of elements, two new cases, and a *Classic Case*.

ACKNOWLEDGMENTS FOR PREVIOUS EDITIONS

Since we began this project many years ago, a sizable number of legal environment of business professors and others have helped us in various phases of the undertaking. The following reviewers offered numerous constructive criticisms, comments, and suggestions during the preparation of the previous editions.

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As in all past editions, we owe a debt of extreme gratitude to the numerous individuals who worked directly with us or at Cengage Learning. In particular, we wish to thank Vicky True-Baker, Rob Dewey, and Michael Worls for their helpful advice and guidance during all of the stages of this new edition. We extend our thanks to Jan Lamar, our longtime content developer, for her many useful suggestions and for her efforts in coordinating reviews and ensuring the timely and accurate publication of all supplemental materials. We are also indebted to Kristen Hurd for her excellent marketing advice and Mike Worls for his support.

Our content project manager, Ann Borman, and our art director, Michelle Kunkler, made sure that we came out with an error-free, visually attractive Ninth Edition. We appreciate their efforts. We are also indebted to the staff at Parkwood Composition, our compositor. Their ability to generate the pages for this text quickly and accurately made it possible for us to meet our ambitious printing schedule.

We especially wish to thank Katherine Marie Silsbee for her management of the entire project, as well as for the application of her superb research and editorial skills. We also wish to thank William Eric Hollowell, who co-authored the *Instructor's Manual* and the *Test Bank* for his excellent research efforts. We were fortunate enough to have the

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In addition, we would like to give special thanks to all of the individuals who were instrumental in developing and implementing the new CengageNOW for *The Legal Environment of Business: Interactive Assignment System*. These include Rob Dewey, Vicky True-Baker, Jan Lamar, Kristen Hurd, and Kristen Meere at Cengage, and Katherine Marie Silsbee, Roger Meiners, Lavina Leed Miller, William Eric Hollowell, Kimberly Wallan, Kristi Wiswell, and Joseph Zavaleta who helped develop the content for this unique Web-based product.

Through the years, we have enjoyed an ongoing correspondence with many of you who have found points on which you wish to comment. We continue to welcome all comments and promise to respond promptly. By incorporating your ideas, we can continue to write a business law text that is best for you and best for your students.

F.B.C.
R.L.M.

Dedication

To my parents and sisters.

F.B.C.

To Julian Kreeger,

Your professionalism only
gets better with time.

Thanks,

R.L.M.



UNIT ONE

THE FOUNDATIONS

CONTENTS

- 1 LAW AND LEGAL REASONING
- 2 THE COURT SYSTEM
- 3 ALTERNATIVE AND ONLINE DISPUTE RESOLUTION
- 4 BUSINESS ETHICS



CHAPTER 1

LAW AND LEGAL REASONING

One of the important functions of law in any society is to provide stability, predictability, and continuity so that people can know how to order their affairs. If any society is to survive, its citizens must be able to determine what is legally right and legally wrong. They must know what sanctions will be imposed on them if they commit wrongful acts. If they suffer harm as a result of others' wrongful acts, they must know how they can seek compensation. By setting forth the rights, obligations, and privileges of citizens, the law enables individuals to go about their business with confidence and a certain degree of predictability.

Although law has various definitions, they are all based on the general observation that **law** consists of *enforceable rules governing relationships among individuals and between individuals and their society*. These “enforceable rules” may consist of unwritten principles of behavior established by a nomadic tribe. They may be set forth in a law code, such as the Code of Hammurabi in ancient Babylon (c. 1780 B.C.E.) or the law code of one of today's European nations. They may consist of written laws and court decisions created by modern legislative and judicial bodies, as in the United States. Regardless of how such rules are created, they all have one thing in common: they establish rights, duties, and

privileges that are consistent with the values and beliefs of their society or its ruling group.

In this introductory chapter, we first look at an important question for any student reading this text: How does the legal environment affect business decision making? We next describe the major sources of American law, the common law tradition, and some basic schools of legal thought. We conclude the chapter with sections offering practical guidance on several topics, including how to find the sources of law discussed in this chapter (and referred to throughout the text) and how to read and understand court opinions.

SECTION 1

BUSINESS ACTIVITIES AND THE LEGAL ENVIRONMENT

Laws and government regulations affect almost all business activities—from hiring and firing decisions to workplace safety, the manufacturing and marketing of products, business financing, and more. To make good business decisions, a basic knowledge of the laws and regulations governing these activities is beneficial—if not essential.

Realize also that in today's business world, a knowledge of “black-letter” law is not enough. Businesspersons are also pressured to make ethical decisions. Thus, the study of business law necessarily involves an ethical dimension.

Many Different Laws May Affect a Single Business Decision

As you will note, each chapter in this text covers specific areas of the law and shows how the legal rules in each area affect business activities. Though compartmentalizing the law in this fashion promotes conceptual clarity, it does not indicate the extent to which a number of different laws may apply to just one decision.

LESSONS FROM FACEBOOK When Mark Zuckerberg started Facebook as a Harvard student, he probably did not imagine all the legal challenges his company would face as a result of his business decisions.

- As you may know from the movie, *The Social Network*, shortly after Facebook was launched, others claimed that Zuckerberg had stolen their ideas for

a social networking site. Their claims involved alleged theft of intellectual property (see Chapter 14), fraudulent misrepresentation (see Chapter 10), partnership law (see Chapter 17), and securities law (see Chapter 28). Facebook ultimately paid a significant amount (\$65 million) to settle those claims out of court (see Chapter 3).

- Facebook has also been sued repeatedly for violating users' privacy (such as by disseminating private information to third parties for commercial purposes—see Chapters 5 and 15).
- In 2012, a *class-action* lawsuit was filed against Facebook that seeks damages of \$15 billion for violating users' privacy (and federal wiretapping law) by tracking their Web site usage.
- Facebook's business decisions have also come under scrutiny by federal regulators, such as the Federal Trade Commission (FTC) and the Securities and Exchange Commission (SEC).
- In 2011, the company settled a complaint filed by the FTC alleging that Facebook failed to keep "friends" lists and other user information private.
- In 2012, Facebook conducted a much-anticipated initial public offering (IPO) of its stock. The IPO did not go well, however, and many investors suffered losses. Facebook is facing dozens of lawsuits (including class actions) related to business decisions made with regard to the IPO and alleged violations of securities laws (see Chapter 28).
- The SEC is also investigating whether Facebook engaged in any wrongdoing with regard to its IPO and trading of stock (see Chapter 28).

POINTS TO CONSIDER A key to avoiding business disputes is to think ahead when starting or running a business or entering a contract. Learn what you can about the laws pertaining to that specific enterprise or transaction. Have some idea of the legal ramifications of your business decisions and seek the advice of counsel when in doubt. Exhibit 1–1 on the following page illustrates the various areas of law that may influence business decision making.

Ethics and Business Decision Making

Merely knowing the areas of law that may affect a business decision is not sufficient in today's business world. Businesspersons must also take ethics into account. As you will learn in Chapter 4, *ethics* generally is defined as the principles governing what constitutes right or wrong behavior.

Today, business decision makers need to consider not just whether a decision is legal, but also whether it is ethical. Often, as in several of the claims against Facebook discussed above, disputes arise in business because one party feels that he or she has been treated unfairly. Thus, the underlying reason for bringing some lawsuits is a breach of ethical duties (such as when a partner or employee attempts to secretly take advantage of a business opportunity).

Throughout this text, you will learn about the relationship between the law and ethics, as well as about some of the types of ethical questions that often arise in business. For example, the unit-ending *Focus on Ethics* features are devoted solely to the exploration of ethical questions pertaining to topics treated within the unit. We have also included *Ethical Dimension* questions for selected cases that focus on ethical considerations in today's business climate and *Insight into Ethics* features that appear in selected chapters. A *Question of Ethics* case problem is included at the conclusion of every chapter to introduce you to the ethical aspects of specific cases involving real-life situations. Additionally, Chapter 4 offers a detailed look at the importance of business ethics.

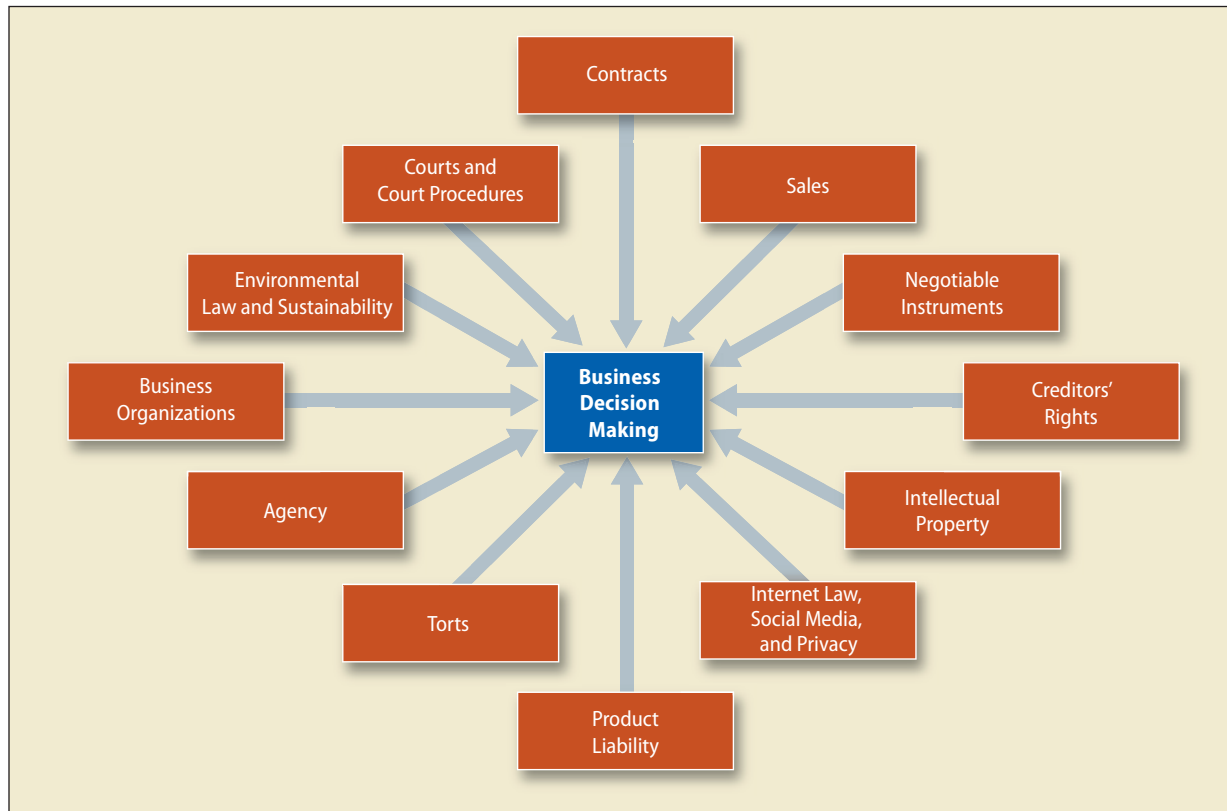
SECTION 2 SOURCES OF AMERICAN LAW

There are numerous sources of American law. *Primary sources of law*, or sources that establish the law, include the following:

1. The U.S. Constitution and the constitutions of the various states.
2. Statutory law—including laws passed by Congress, state legislatures, or local governing bodies.
3. Regulations created by administrative agencies, such as the Food and Drug Administration.
4. Case law and common law doctrines.

We describe each of these important sources of law in the following pages.

Secondary sources of law are books and articles that summarize and clarify the primary sources of law. Examples include legal encyclopedias, treatises, articles in law reviews, and compilations of law, such as the *Restatements of the Law* (which will be discussed shortly). Courts often refer to secondary sources of law for guidance in interpreting and applying the primary sources of law discussed here.

EXHIBIT 1-1 Areas of the Law That May Affect Business Decision Making**Constitutional Law**

The federal government and the states have separate written constitutions that set forth the general organization, powers, and limits of their respective governments. **Constitutional law** is the law as expressed in these constitutions.

According to Article VI of the U.S. Constitution, the Constitution is the supreme law of the land. As such, it is the basis of all law in the United States. A law in violation of the Constitution, if challenged, will be declared unconstitutional and will not be enforced, no matter what its source. Because of its importance in the American legal system, we present the complete text of the U.S. Constitution in Appendix B and discuss it in depth in Chapter 5.

The Tenth Amendment to the U.S. Constitution reserves to the states all powers not granted to the federal government. Each state in the union has its own constitution. Unless it conflicts with the U.S. Constitution or a federal law, a state constitution is supreme within the state's borders.

Statutory Law

Laws enacted by legislative bodies at any level of government, such as statutes passed by Congress or by state legislatures, make up the body of law known as **statutory law**. When a legislature passes a statute, that statute ultimately is included in the federal code of laws or the relevant state code of laws (discussed later in this chapter).

Statutory law also includes local **ordinances**—statutes (laws, rules, or orders) passed by municipal or county governing units to govern matters not covered by federal or state law. Ordinances commonly have to do with city or county land use (zoning ordinances), building and safety codes, and other matters affecting the local community.

A federal statute, of course, applies to all states. A state statute, in contrast, applies only within the state's borders. State laws thus may vary from state to state. No federal statute may violate the U.S. Constitution, and no state statute or local ordinance may violate the U.S. Constitution or the relevant state constitution.

UNIFORM LAWS During the 1800s, the differences among state laws frequently created difficulties for businesspersons conducting trade and commerce among the states. To counter these problems, a group of legal scholars and lawyers formed the National Conference of Commissioners on Uniform State Laws (NCCUSL, www.uniformlaws.org) in 1892 to draft **uniform laws** (model statutes) for the states to consider adopting. The NCCUSL still exists today and continues to issue uniform laws.

Each state has the option of adopting or rejecting a uniform law. *Only if a state legislature adopts a uniform law does that law become part of the statutory law of that state.* Note that a state legislature may adopt all or part of a uniform law as it is written, or the legislature may rewrite the law however the legislature wishes. Hence, even though many states may have adopted a uniform law, those states' laws may not be entirely "uniform."

The earliest uniform law, the Uniform Negotiable Instruments Law, was completed by 1896 and adopted in every state by the 1920s (although not all states used exactly the same wording). Over the following decades, other acts were drawn up in a similar manner. In all, more than two hundred uniform acts have been issued by the NCCUSL since its inception. The most ambitious uniform act of all, however, is the Uniform Commercial Code.

THE UNIFORM COMMERCIAL CODE One of the most important uniform acts is the Uniform Commercial Code (UCC), which was created through the joint efforts of the NCCUSL and the American Law Institute.¹ The UCC was first issued in 1952 and has been adopted in all fifty states,² the District of Columbia, and the Virgin Islands.

The UCC facilitates commerce among the states by providing a uniform, yet flexible, set of rules governing commercial transactions. Because of its importance in the area of commercial law, we cite the UCC frequently in this text. We also present Article 2 of the UCC in Appendix C. From time to time, the NCCUSL revises the articles contained in the UCC and submits the revised versions to the states for adoption.

Administrative Law

Another important source of American law is **administrative law**, which consists of the rules,

1. This institute was formed in the 1920s and consists of practicing attorneys, legal scholars, and judges.
2. Louisiana has not adopted Articles 2 and 2A (covering contracts for the sale and lease of goods), however.

orders, and decisions of administrative agencies. An **administrative agency** is a federal, state, or local government agency established to perform a specific function. Administrative law and procedures constitute a dominant element in the regulatory environment of business.

Rules issued by various administrative agencies now affect almost every aspect of a business's operations. Regulations govern a business's capital structure and financing, its hiring and firing procedures, its relations with employees and unions, and the way it manufactures and markets its products. Regulations enacted to protect the environment also often play a significant role in business operations.

FEDERAL AGENCIES At the national level, the cabinet departments of the executive branch include numerous **executive agencies**. The U.S. Food and Drug Administration, for example, is an agency within the U.S. Department of Health and Human Services. Executive agencies are subject to the authority of the president, who has the power to appoint and remove their officers.

There are also major **independent regulatory agencies** at the federal level, such as the Federal Trade Commission, the Securities and Exchange Commission, and the Federal Communications Commission. The president's power is less pronounced in regard to independent agencies, whose officers serve for fixed terms and cannot be removed without just cause.

STATE AND LOCAL AGENCIES There are administrative agencies at the state and local levels as well. Commonly, a state agency (such as a state pollution-control agency) is created as a parallel to a federal agency (such as the Environmental Protection Agency). Just as federal statutes take precedence over conflicting state statutes, federal agency regulations take precedence over conflicting state regulations.

Case Law and Common Law Doctrines

The rules of law announced in court decisions constitute another basic source of American law. These rules include interpretations of constitutional provisions, of statutes enacted by legislatures, and of regulations created by administrative agencies.

Today, this body of judge-made law is referred to as **case law**. Case law—the doctrines and principles announced in cases—governs all areas not covered by

statutory law or administrative law and is part of our common law tradition. We look at the origins and characteristics of the common law tradition in some detail in the pages that follow.

See *Concept Summary 1.1* below for a review of the sources of American law.

SECTION 3 THE COMMON LAW TRADITION

Because of our colonial heritage, much of American law is based on the English legal system, which originated in medieval England and continued to evolve in the following centuries. Knowledge of this system is necessary to understanding the American legal system today.

Early English Courts

The origins of the English legal system—and thus the U.S. legal system as well—date back to 1066, when the Normans conquered England. William the Conqueror and his successors began the process of unifying the country under their rule. One of the means they used to do this was the establishment of the king's courts, or *curiae regis*.

Before the Norman Conquest, disputes had been settled according to the local legal customs and traditions in various regions of the country. The king's courts sought to establish a uniform set of customs for the country as a whole. What evolved in these courts was the beginning of the **common law**—a body

of general rules that applied throughout the entire English realm. Eventually, the common law tradition became part of the heritage of all nations that were once British colonies, including the United States.

COURTS OF LAW AND REMEDIES AT LAW The early English king's courts could grant only very limited kinds of **remedies** (the legal means to enforce a right or redress a wrong). If one person wronged another in some way, the king's courts could award as compensation one or more of the following: (1) land, (2) items of value, or (3) money.

The courts that awarded this compensation became known as **courts of law**, and the three remedies were called **remedies at law**. (Today, the remedy at law normally takes the form of monetary **damages**—an amount given to a party whose legal interests have been injured.) This system made the procedure for settling disputes more uniform. When a complaining party wanted a remedy other than economic compensation, however, the courts of law could do nothing, so “no remedy, no right.”

COURTS OF EQUITY *Equity* is a branch of law—founded on notions of justice and fair dealing—that seeks to supply a remedy when no adequate remedy at law is available. When individuals could not obtain an adequate remedy in a court of law, they petitioned the king for relief. Most of these petitions were decided by an adviser to the king, called a **chancellor**, who had the power to grant new and unique remedies. Eventually, formal chancery courts, or **courts of equity**, were established.

CONCEPT SUMMARY 1.1

Sources of American Law

SOURCE	DESCRIPTION
Constitutional Law	The law as expressed in the U.S. Constitution and the state constitutions. The U.S. Constitution is the supreme law of the land. State constitutions are supreme within state borders to the extent that they do not violate a clause of the U.S. Constitution or a federal law.
Statutory Law	Laws (statutes and ordinances) enacted by federal, state, and local legislatures and governing bodies. None of these laws can violate the U.S. Constitution or the relevant state constitution. Uniform laws, when adopted by a state, become statutory law in that state.
Administrative Law	The rules, orders, and decisions of federal, state, and local government administrative agencies.
Case Law and Common Law Doctrines	Judge-made law, including interpretations of constitutional provisions, of statutes enacted by legislatures, and of regulations created by administrative agencies.

REMEDIES IN EQUITY The remedies granted by the equity courts became known as **remedies in equity**, or equitable remedies. These remedies include specific performance, an injunction, and rescission. *Specific performance* involves ordering a party to perform an agreement as promised. An *injunction* is an order to a party to cease engaging in a specific activity or to undo some wrong or injury. *Rescission* is the cancellation of a contractual obligation. We will discuss these and other equitable remedies in more detail at appropriate points in the chapters that follow, particularly in Chapter 10.

As a general rule, today's courts, like the early English courts, will not grant equitable remedies unless the remedy at law—monetary damages—is inadequate. ▶ **Example 1.1** Ted forms a contract (a legally binding agreement—see Chapter 9) to purchase a parcel of land that he thinks will be perfect for his future home. The seller **breaches**, or fails to fulfill, this agreement. Ted could sue the seller for the return of any deposits or down payment he might have made on the land, but this is not the remedy he really seeks. What Ted wants is to have the court order the seller to perform the contract. In other words, Ted wants the court to grant the equitable remedy of specific performance because monetary damages are inadequate in this situation. ◀

EQUITABLE MAXIMS In fashioning appropriate remedies, judges often were (and continue to be) guided by so-called **equitable maxims**—propositions or general statements of equitable rules. Exhibit 1–2 below lists some important equitable maxims.

The last maxim listed in that exhibit—“Equity aids the vigilant, not those who rest on their rights”—merits special attention. It has become known as the

equitable doctrine of **laches** (a term derived from the Latin *laxus*, meaning “lax” or “negligent”), and it can be used as a defense. A **defense** is an argument raised by the **defendant** (the party being sued) indicating why the **plaintiff** (the suing party) should not obtain the remedy sought. (Note that in equity proceedings, the party bringing a lawsuit is called the **petitioner**, and the party being sued is referred to as the **respondent**.)

The doctrine of laches arose to encourage people to bring lawsuits while the evidence was fresh. What constitutes a reasonable time, of course, varies according to the circumstances of the case. Time periods for different types of cases are now usually fixed by **statutes of limitations**. After the time allowed under a statute of limitations has expired, no action (lawsuit) can be brought, no matter how strong the case was originally.

Legal and Equitable Remedies Today

The establishment of courts of equity in medieval England resulted in two distinct court systems: courts of law and courts of equity. The courts had different sets of judges and granted different types of remedies. During the nineteenth century, however, most states in the United States adopted rules of procedure that resulted in the combining of courts of law and equity. A party now may request both legal and equitable remedies in the same action, and the trial court judge may grant either or both forms of relief.

The distinction between legal and equitable remedies remains relevant to students of business law, however, because these remedies differ. To seek the proper remedy for a wrong, one must know what

EXHIBIT 1–2 Equitable Maxims

1. *Whoever seeks equity must do equity.* (Anyone who wishes to be treated fairly must treat others fairly.)
2. *Where there is equal equity, the law must prevail.* (The law will determine the outcome of a controversy in which the merits of both sides are equal.)
3. *One seeking the aid of an equity court must come to the court with clean hands.* (The plaintiff must have acted fairly and honestly.)
4. *Equity will not suffer a wrong to be without a remedy.* (Equitable relief will be awarded when there is a right to relief and there is no adequate remedy at law.)
5. *Equity regards substance rather than form.* (Equity is more concerned with fairness and justice than with legal technicalities.)
6. *Equity aids the vigilant, not those who rest on their rights.* (Equity will not help those who neglect their rights for an unreasonable period of time.)

remedies are available. Additionally, certain vestiges of the procedures used when there were separate courts of law and equity still exist. For example, a party has the right to demand a jury trial in an action at law, but not in an action in equity. Exhibit 1–3 below summarizes the procedural differences (applicable in most states) between an action at law and an action in equity.

The Doctrine of *Stare Decisis*

One of the unique features of the common law is that it is *judge-made* law. The body of principles and doctrines that form the common law emerged over time as judges decided legal controversies.

CASE PRECEDENTS AND CASE REPORTERS When possible, judges attempted to be consistent and to base their decisions on the principles suggested by earlier cases. They sought to decide similar cases in a similar way and considered new cases with care because they knew that their decisions would make new law. Each interpretation became part of the law on the subject and thus served as a legal **precedent**. A precedent is a decision that furnishes an example or authority for deciding subsequent cases involving identical or similar legal principles or facts.

In the early years of the common law, there was no single place or publication where court opinions, or written decisions, could be found. By the fourteenth century, portions of the most important decisions from each year were being gathered together and recorded in *Year Books*, which became useful references for lawyers and judges. In the sixteenth century, the *Year Books* were discontinued, and other forms of case publication became available. Today, cases are published, or “reported,” in volumes called **reporters**, or *reports*. We describe today’s case reporting system in detail later in this chapter.

STARE DECISIS AND THE COMMON LAW TRADITION

The practice of deciding new cases with reference to former decisions, or precedents, became a cornerstone of the English and American judicial systems. The practice formed a doctrine known as ***stare decisis***³ (a Latin phrase meaning “to stand on decided cases”). Under this doctrine, judges are obligated to follow the precedents established within their jurisdictions. The term *jurisdiction* refers to a geographic area in which a court or courts have the power to apply the law—see Chapter 2.

Once a court has set forth a principle of law as being applicable to a certain set of facts, that court must apply the principle in future cases involving similar facts. Courts of lower rank (within the same jurisdiction) must do likewise. Thus, *stare decisis* has two aspects:

1. A court should not overturn its own precedents unless there is a compelling reason to do so.
2. Decisions made by a higher court are binding on lower courts.

CONTROLLING PRECEDENTS Controlling precedents in a jurisdiction are referred to as binding authorities. A **binding authority** is any source of law that a court must follow when deciding a case. Binding authorities include constitutions, statutes, and regulations that govern the issue being decided, as well as court decisions that are controlling precedents within the jurisdiction. United States Supreme Court case decisions, no matter how old, remain controlling until they are overruled by a subsequent decision of the Supreme Court or changed by further legislation or a constitutional amendment.

STARE DECISIS AND LEGAL STABILITY The doctrine of *stare decisis* helps the courts to be more efficient because, if other courts have analyzed a similar case,

3. Pronounced *ster-ay dih-si-ses*.

EXHIBIT 1–3 Procedural Differences between an Action at Law and an Action in Equity

Procedure	Action at Law	Action in Equity
Initiation of lawsuit	By filing a complaint	By filing a petition
Parties	Plaintiff and defendant	Petitioner and respondent
Decision	By jury or judge	By judge (no jury)
Result	Judgment	Decree
Remedy	Monetary damages	Injunction, specific performance, or rescission

their legal reasoning and opinions can serve as guides. *Stare decisis* also makes the law more stable and predictable. If the law on a subject is well settled, someone bringing a case can usually rely on the court to rule based on what the law has been in the past.

DEPARTURES FROM PRECEDENT Although courts are obligated to follow precedents, sometimes a court will depart from the rule of precedent if it decides that the precedent should no longer be followed. If a court decides that a ruling precedent is simply incorrect or that technological or social changes have rendered the precedent inapplicable, the court might rule contrary to the precedent. Cases that overturn precedent often receive a great deal of publicity.

► **Case in Point 1.2** The United States Supreme Court expressly overturned precedent in the case of *Brown v. Board of Education of Topeka*.⁴ The Court concluded that separate educational facilities for whites and blacks, which it had previously upheld as constitutional,⁵ were inherently unequal. The Court's departure from precedent in this case received a tremendous amount of publicity as people began to realize the ramifications of this change in the law. ◀

Note that judges do have some flexibility in applying precedents. For instance, a lower court may avoid applying a precedent set by a higher court in its jurisdiction by distinguishing the two cases based on their facts. When this happens, the lower court's ruling stands unless it is appealed to a higher court and that court overturns the decision.

WHEN THERE IS NO PRECEDENT Occasionally, courts must decide cases for which no precedents exist, called cases of *first impression*. For instance, as you will read throughout this text, the extensive use of the Internet has presented many new and challenging issues for the courts to decide.

In deciding cases of first impression, courts often look at **persuasive authorities** (precedents from other jurisdictions) for guidance. A court may also consider legal principles and policies underlying previous court decisions or existing statutes. Other factors that courts look at include fairness, social values and customs, and **public policy** (governmental policy based on widely held societal values).

4. 347 U.S. 483, 74 S.Ct. 686, 98 L.Ed. 873 (1954). A later section in this chapter explains how to read legal citations.

5. See *Plessy v. Ferguson*, 163 U.S. 537, 16 S.Ct. 1138, 41 L.Ed. 256 (1896).

Stare Decisis and Legal Reasoning

In deciding what law applies to a given dispute and then applying that law to the facts or circumstances of the case, judges rely on the process of **legal reasoning**. Through the use of legal reasoning, judges harmonize their decisions with those that have been made before, as the doctrine of *stare decisis* requires.

Students of business law and the legal environment also engage in legal reasoning. For example, you may be asked to provide answers for some of the case problems that appear at the end of every chapter in this text. Each problem describes the facts of a particular dispute and the legal question at issue. If you are assigned a case problem, you will be asked to determine how a court would answer that question, and why. In other words, you will need to give legal reasons for whatever conclusion you reach.⁶ We look here at the basic steps involved in legal reasoning and then describe some forms of reasoning commonly used by the courts in making their decisions.

BASIC STEPS IN LEGAL REASONING At times, the legal arguments set forth in court opinions are relatively simple and brief. At other times, the arguments are complex and lengthy. Regardless of the length of a legal argument, however, the basic steps of the legal reasoning process remain the same. These steps, which you can also follow when analyzing cases and case problems, form what is commonly referred to as the *IRAC method* of legal reasoning. IRAC is an acronym formed from the first letters of the following words: *Issue*, *Rule*, *Application*, and *Conclusion*. To apply the IRAC method, you would ask the following questions:

1. **Issue**—*What are the key facts and issues?* Suppose that a plaintiff comes before the court claiming *assault* (words or acts that wrongfully and intentionally make another person fearful of immediate physical harm—see Chapter 12). The plaintiff claims that the defendant threatened her while she was sleeping. Although the plaintiff was unaware that she was being threatened, her roommate heard the defendant make the threat. The legal issue is whether the defendant's action constitutes the tort (civil wrong) of assault, given that the plaintiff was unaware of that action at the time it occurred.

6. See Appendix A for further instructions on how to analyze case problems.