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The
LEGAL
ENVIRONMENT
of BUSINESS

TEXT AND CASES



ELEVENTH EDITION



The LEGAL ENVIRONMENT of BUSINESS

TEXT AND CASES

Eleventh 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 the legal environment in order to function in the real world. *The Legal Environment of Business*, Eleventh Edition, provides the information that students need in an interesting and contemporary way.

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

The Eleventh Edition of this text is more modern, exciting, and visually appealing than ever before. We have added new features, cases, concept summaries, and exhibits. The text also contains hundreds of highlighted and numbered *Cases in Point* and *Examples*, as well as new case problems and unit-ending *Task-Based Simulations*. Special pedagogical elements within the text focus on legal, ethical, global, and corporate issues while addressing core curriculum requirements.

Highlights of the Eleventh 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 offer the following.

The IDDR Approach: A New Emphasis on Ethics

The ability of businesspersons to reason through ethical issues is now more important than ever. For the Eleventh Edition of *The Legal Environment of Business*, we have created a completely new framework for helping students

(and businesspersons) make ethical decisions. We present **The IDDR Approach** in Chapter 3 (Ethics in Business). This systematic approach provides students with a clear step-by-step process to analyze the legal and ethical implications of decisions that arise in everyday business operations.

The new IDDR Approach uses four logical steps:

- **STEP 1: Inquiry**
- **STEP 2: Discussion**
- **STEP 3: Decision**
- **STEP 4: Review**

Students can remember the first letter of each step easily by using the phrase: “I Desire to Do Right.”

Completely Revised Chapter 3 on Ethics in Business

A newly revised Chapter 3 details each IDDR step’s goals and then provides a Sample Scenario to help students apply this new approach to ethical decision making. In addition to introducing the IDDR Approach, we have made Chapter 3 more current and more practical, and reduced the amount of theoretical ethical principles it presents. The chapter now focuses on real-life application of ethical principles.

New A Question of Ethics Case Problems throughout Text

After Chapter 3, to reinforce the application of the IDDR Approach, students are asked to use its various steps when answering each chapter’s *A Question of Ethics*. To challenge students in analyzing the ethical angles in today’s business legal environment, we have replaced every *A Question of Ethics* problem throughout the text to be based on a 2017, 2018, or 2019 case.

A Variety of Exciting Features

The Eleventh Edition of *The Legal Environment of Business* is filled with numerous features specifically designed to cover current legal topics of high interest.

Each feature is related to a topic discussed in the text and ends with *Critical Thinking* or *Business Questions*. Suggested answers to all of the *Critical Thinking* and *Business Questions* are included in the *Answers Manual* for this text.

1. **Ethics Today.** These features focus on the ethical aspects of a topic discussed in the text to emphasize that ethics is an integral part of a legal environment of business course. Examples include the following:
 - Applying the IDDR Framework (Chapter 3)
 - Is It Ethical (and Legal) to Brew “Imported” Beer Brands Domestically? (Chapter 11)
 - Should There Be More Relief for Student Loan Defaults? (Chapter 15)
 - Is It Fair to Classify Uber and Lyft Drivers as Independent Contractors? (Chapter 19)
2. **Global Insight.** These features illustrate how other nations deal with specific legal concepts to give students a sense of the global legal environment. Subjects include the following:
 - Aleve versus Flanax—Same Pain Killer, but in Different Countries (Chapter 8)
 - Does Cloud Computing Have a Nationality? (Chapter 18)
 - Islamic Law and *Respondeat Superior* (Chapter 19)
 - Can a River Be a Legal Person? (Chapter 25)
3. **Digital Update.** These features are designed to examine cutting-edge cyberlaw topics, such as the following:
 - Does Everyone Have a Constitutional Right to Use Social Media? (Chapter 2)
 - Should Employees Have a “Right of Disconnecting”? (Chapter 3)
 - Revenge Porn and Invasion of Privacy (Chapter 6)
 - Riot Games, Inc., Protects Its Online Video Game Copyrights (Chapter 9)
 - Hiring Discrimination Based on Social Media Posts (Chapter 21)
4. **Managerial Strategy.** These features emphasize the management aspects of business law and the legal environment. Topics include the following:
 - Should You Consent to Have Your Business Case Decided by a U.S. Magistrate Judge? (Chapter 4)
 - When Is a Warning Legally Bulletproof? (Chapter 7)
 - The Criminalization of American Business (Chapter 10)
 - Commercial Use of Drones (Chapter 14)
 - The SEC’s Pay-Ratio Disclosure Rule (Chapter 28)

Entire Chapter on Internet Law, Social Media, and Privacy

The Eleventh Edition again includes a whole chapter (Chapter 9) on *Internet Law, Social Media, and Privacy*.

Social media have entered the mainstream and become a part of everyday life for many businesspersons. In this special chapter, we give particular emphasis to the legal issues surrounding the Internet, social media, and privacy. We also recognize this trend throughout the text by incorporating the Internet and social media as they relate to the topics under discussion.

Coverage of Topics on the Revised CPA Exam

In 2016, the American Institute of CPAs (AICPA) issued its final report on “Maintaining the Relevance of the Uniform CPA Exam.” In addition to more focus on critical thinking, authentic applications, and problem solving, the content of the exam has changed to some extent.

The Eleventh Edition of *The Legal Environment of Business* incorporates information on the new topics on the CPA exam, specifically addressing the following:

- Agency law (worker classification and duties of principals and agents)
- Employment law (Affordable Care Act)
- Business organizations (corporate governance issues, including Sarbanes-Oxley compliance and criminal liability for organizations and management)

In addition, the Eleventh Edition continues to cover topics that are essential to new CPAs who are working with sophisticated business clients, regardless of whether the CPA exam covers these topics.

We recognize that today’s business leaders must often think “outside the box” when making business decisions. For this reason, we strongly emphasize business and critical thinking elements throughout the text. We have carefully chosen cases, features, and problems that are relevant to business operations. Almost all of the features and cases conclude with some type of critical thinking question. For those teaching future CPAs, this is consistent with the new CPA exam’s focus on higher-order skills, such as critical thinking and problem solving.

Highlighted and Numbered Examples and Case in Point Illustrations

Many instructors use cases and examples to illustrate how the law applies to business. Students understand legal concepts better in the context of their real-world application. Therefore, for this edition of *The Legal Environment of Business*, we have expanded the number of highlighted numbered *Examples* and *Cases in Point* in every chapter.

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. These two features are uniquely designed and consecutively numbered throughout each chapter for easy reference. The *Examples* and *Cases in Point* are integrated throughout the text to help students better understand how courts apply legal principles in the real world.

Task-Based Simulations: A New Unit-Ending Feature

A new *Task-Based Simulation* feature concludes each of the five units in the Eleventh Edition. This feature presents a hypothetical business situation and then asks a series of questions about how the law applies to various actions taken by the firm. To answer the questions, the students must apply the laws discussed throughout the unit.

In addition, each unit ends with an *Application and Ethics* feature that provides additional analysis on a topic related to that unit and explores its ethics ramifications. Each of the features ends with two questions—a *Critical Thinking* question and an *Ethics Question*. Some topics covered include the following:

- One of the Biggest Data Breaches Ever (Unit 2)
- Nondisclosure Agreements (Unit 3)
- Health Insurance and Small Business (Unit 4)
- Climate Change (Unit 5)

Suggested answers to the questions in the new *Task-Based Simulation* features (and the *Application and Ethics* features) are included in the *Answers Manual* for this text.

New Cases and Case Problems

For the Eleventh Edition of *The Legal Environment of Business*, we have added thirty-one new cases, thirty-five new regular case problems, and twenty-eight new *A Question of Ethics* case problems from 2017, 2018, and 2019. The new cases and problems have been carefully selected to illustrate important points of law and to be of high interest to students and instructors. We have made it a point to find recent cases that enhance learning and are relatively easy to understand.

1. Spotlight Cases and Classic Cases. Certain cases and case problems that are exceptionally good teaching cases are labeled as *Spotlight Cases* and *Spotlight Case Problems*. Examples include *Spotlight on Beer Labels*, *Spotlight on Gucci*, *Spotlight on Nike*, *Spotlight on the Seattle Mariners* and *Spotlight on Verizon*. Instructors will find these *Spotlight*

Cases and *Spotlight Case Problems* useful to illustrate the legal concepts under discussion, and students will enjoy studying the cases because they involve interesting and memorable facts. Other cases have been chosen as *Classic Cases* because they establish a legal precedent in a particular area of law.

- 2. Critical Thinking Section.** Each case concludes with a *Critical Thinking* section, which normally includes two questions. The questions may address *Legal Environment*, *E-Commerce*, *Economic*, *Environmental*, *Ethical*, *Global*, *Political*, or *Technological* issues, or they may ask *What If the Facts Were Different?* Each *Classic Case* ends with an *Impact of This Case on Today's Law* discussion and a *Critical Thinking* question.
- 3. Longer Excerpts for Case Analysis.** We have also included one longer case excerpt in many chapters—labeled *Case Analysis*—followed by three *Legal Reasoning Questions*. The questions are designed to guide students' analysis of the case and build their legal reasoning skills. These *Case Analysis* features may be used for case-briefing assignments.

Suggested answers to all case-ending questions and case problems are included in the *Answers Manual* for this text.

Business Case Problem with Sample Answer

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 find a sample answer in Appendix C at the end of this text.

Exhibits and Concept Summaries

We have spent considerable effort developing and designing all of the exhibits and concept summaries in this text to achieve better clarity and more visual appeal.

Practice and Review

In the Eleventh Edition of *The Legal Environment of Business*, we offer a *Practice and Review* feature at the end of every chapter to help solidify students' understanding of the chapter materials. Each *Practice and Review* 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 *Practice and Review* features can be found in the *Answers Manual* for this text.

Issue Spotters

At the conclusion of each chapter, we have included a special section with two *Issue Spotters* related to the chapter's topics. These questions facilitate student learning and review of the chapter materials. Sample answers to the *Issue Spotters* in every chapter are provided in Appendix B and in the *Answers Manual* for this text.

Time-Limited Group Assignment

For instructors who want their students to engage in group projects, each chapter of the Eleventh Edition includes a special *Time-Limited Group Assignment*. Each activity begins by describing a business scenario and then poses several questions pertaining to the scenario. Each question is to be answered by a different group of students based on the information in the chapter. These projects may be used in class to spur discussion or as homework assignments. Suggested answers to the *Time-Limited Group Assignments* are included in the *Answers Manual* for this text.

Supplements/Digital Learning Systems

The Legal Environment of Business, Eleventh Edition, provides a comprehensive supplements package designed to make the tasks of teaching and learning more enjoyable and efficient. The following supplements and digital products are offered in conjunction with the text.

MindTap for The Legal Environment of Business

MindTap™ for *The Legal Environment of Business*, Eleventh Edition, is a fully online, highly personalized learning experience built upon Cengage Learning content. By combining readings, multimedia, activities,

and assessments into a singular Learning Path, *MindTap* guides students through their course with ease and engagement.

Instructors can personalize the experience by customizing Cengage Learning resources and adding their own content via apps that integrate into the *MindTap* framework seamlessly with Learning Management Systems (LMS).

The *MindTap* product provides a four-step Learning Path, Case Repository, Adaptive Test Prep, and an Interactive eBook designed to meet instructors' needs while also allowing instructors to measure skills and outcomes with ease. Each item is assignable and gradable. This gives instructors knowledge of class standings and students' mastery of concepts that may be difficult. Additionally, students gain knowledge about where they stand—both individually and compared to the highest performers in class.

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- *Cross-compatible capability.* Import and export content to and from other systems.

Instructor's Companion Website

The Instructor's Companion Website for the Eleventh Edition of *The Legal Environment of Business* 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 and feature, the *Practice and Review*, the *Issue Spotters*, the *Business Scenarios and Case Problems*, and the unit-ending *Task-Based Simulation* and *Application and Ethics* features.
- **Test Bank.** A comprehensive test bank that contains multiple-choice, true/false, and short essay questions.
- **Case-Problem Cases.**
- **Case Printouts.**
- **PowerPoint Slides.**
- **Lecture Outlines.**
- **MindTap Integrated Syllabus.**

For Users of the Previous Edition

First of all, we want to thank you for helping make *The Legal Environment of Business* one of the best-selling legal environment texts 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.

Every chapter of the Eleventh Edition has been revised as necessary to incorporate new developments in the law or to streamline the presentations. Other major changes and additions for this edition include the following:

- Chapter 2 (Business and the Constitution)—The chapter has been revised and updated to be more business oriented. It has a new case, two new case problems, and a new *Digital Update* feature on a United States Supreme Court decision concerning whether everyone has a constitutional right to use social media.
- Chapter 3 (Ethics in Business)—The chapter contents have been revised and updated to be more practical for businesspersons. A new section introduces a systematic approach to resolving ethical issues called the IDDR Approach. (“I Desire to Do Right” is a useful mnemonic device for remembering the individual steps:

Inquiry, Discussion, Decision, and Review.)

There is a new Exhibit and a new *Ethics Today* feature that illustrates how to apply the IDDR framework. The step-by-step IDDR Approach is then reiterated in the problems labeled *A Question of Ethics* that appear in every subsequent chapter. There are five new *Cases in Point*, seven new *Examples*, a new case, and four new case problems in the chapter. A *Digital Update* feature explores whether employees have a right to disconnect from their electronic devices after work hours. The chapter concludes with a new *Time-Limited Group Assignment* on corporate social responsibility.

- Chapter 8 (Intellectual Property Rights)—The materials on intellectual property rights have been thoroughly revised and updated to reflect the most current laws and trends. A new *Global Insight* feature discusses confusion in the context of trademark infringement. There is a new case, a new *Example*, and two new case problems.
- Chapter 9 (Internet Law, Social Media, and Privacy)— This chapter, which covers legal issues that are unique to the Internet, has been thoroughly revised and updated for the Eleventh Edition. It includes a new case, four new *Cases in Point*, and a new *Digital Update* feature on how copyright law applies to video games.
- Chapter 11 (International and Space Law)—The chapter now includes a section on space law—international and domestic. There are two new cases presented, as well as an updated discussion of NAFTA (now called USMCA) and of a United States Supreme Court decision concerning the Alien Tort Statute. The chapter also includes an updated *Ethics Today* feature on the domestic brewing of imported beer brands.
- Chapter 14 (Sales and Lease Contracts)—We have streamlined and simplified our coverage of the Uniform Commercial Code and added a new case, a new *Example*, six new *Cases in Point*, and one new case problem.
- Chapter 20 (Employment Law), Chapter 21 (Employment Discrimination), and Chapter 22 (Immigration and Labor Law)—These three chapters covering employment law have been thoroughly updated to include discussions of legal issues facing employers today. Chapter 20 a new case, three new *Cases in Point*, one new *Example*, and two new case problems. It also includes an *Ethics Today* feature on whether employees should receive paid bathroom breaks.

Chapter 21 has a new case, five new *Cases in Point*, a new concept summary, and two new case problems. A revised *Digital Update* feature discusses hiring discrimination based on social media posts. Chapter 22 includes a new case and a *Managerial Strategy* feature on union organizing using company e-mail systems. We discuss relevant United States Supreme Court decisions affecting employment issues throughout these chapters.

- Chapter 24 (Consumer Protection)—The chapter has been revised and updated and includes a new subsection on state laws concerning false

advertising. It has a new case, three new *Cases in Point*, and three new case problems.

- Chapter 28 (Investor Protection and Corporate Governance)—The contents of this chapter have been thoroughly revised and updated in light of the amendments to Regulation A (Regulation A+). There is a new *Digital Update* feature titled Investment Crowdfunding—Regulations and Restrictions, as well as a new example and a new exhibit on this topic. In addition, there is a new subsection, a new case, three new *Cases in Point*, and two new case problems.

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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 legal environment text that is best for you and best for your students.

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

*To my parents and sisters.
F.B.C.*

*For Vicky,
We've had so many years
working together, and they
have been wonderful,
productive, and exciting.
I have always valued
your professionalism.*

R.L.M.

The Foundations



- 1. Law and Legal Reasoning**
- 2. Business and the Constitution**
- 3. Ethics in Business**
- 4. Courts and Alternative Dispute Resolution**
- 5. Court Procedures**

Chapter 1

Law and Legal Reasoning

One of the most 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 all are based on the general observation that **law** consists of

enforceable rules governing relationships among individuals and between individuals and their society. In some societies, these enforceable rules may consist of unwritten principles of behavior. In other societies, they are set forth in ancient or contemporary law codes. In the United States, our rules consist of written laws and court decisions created by modern legislative and judicial bodies. Regardless of how such rules are created, they all have one feature 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 look at how business law and the legal environment affect business decisions. For instance, suppose that

Hellix Communications, Inc., wants to buy a competing cellular company. It also wants to offer unlimited data plans once it has acquired this competitor. Management fears that if the company does not expand, one of its bigger rivals will put it out of business. But Hellix Communications cannot simply buy its rivals. Nor can it just offer a low-cost cell-phone plan to its customers. It has to follow the laws pertaining to its proposed actions. Some of these laws (or regulations) depend on interpretations by those running various regulatory agencies. The rules that control Hellix Communications' actions reflect past and current thinking about how large telecommunications companies should and should not act.

1-1 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, knowing what conduct can lead to legal **liability** is not enough. Businesspersons must develop critical thinking and legal reasoning skills so that they can evaluate how various laws might apply to a given situation and determine the best course of action.

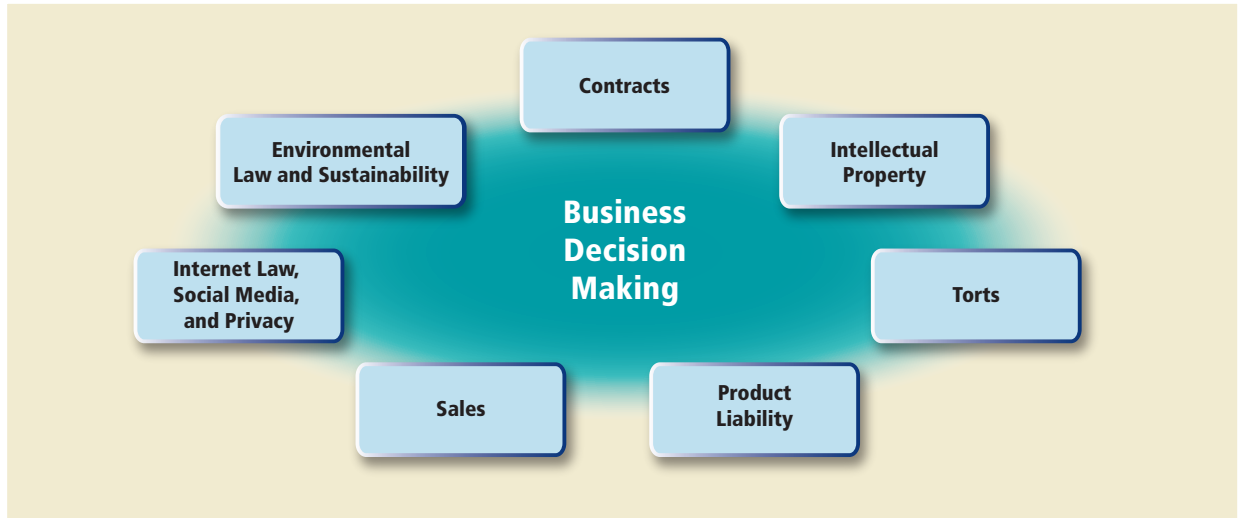
Our goal in this text is not only to teach you about specific laws, but also to teach you how to think about the law and the legal environment and to develop

your critical-thinking and legal-reasoning skills. The laws may change, but the ability to analyze and evaluate the legal (and ethical) ramifications of situations as they arise is an invaluable and lasting skill.

1-1a 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. Although 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. Exhibit 1-1 illustrates the various areas of the law that may influence business decision making.

■ **Example 1.1** When Mark Zuckerberg, as a Harvard student, first launched Facebook, others claimed that Zuckerberg had stolen their ideas for a social networking

Exhibit 1-1 Areas of the Law That Can Affect Business Decision Making

site. They filed a lawsuit against him alleging theft of intellectual property, fraudulent misrepresentation, and violations of partnership law and securities law. Facebook ultimately paid \$65 million to settle those claims out of court. Since then, Facebook has been sued repeatedly for violating users' privacy (and federal laws) by tracking their website usage and by scanning private messages for purposes of data mining and user profiling. Facebook's business decisions have also come under scrutiny by federal regulators, such as the Federal Trade Commission (FTC), and by international authorities, such as the European Union. The company settled a complaint filed by the FTC alleging that Facebook had failed to keep "friends" lists and other user information private. ■

1-1b 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. Today, business decision makers need to consider not just whether a decision is legal, but also whether it is ethical.

Ethics generally is defined as the principles governing what constitutes right or wrong behavior. Often, as in several of the claims against Facebook just discussed, 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 arise in business. For instance, all of the unit-ending *Application and Ethics* features include an *Ethical Connection* section that explores the ethical dimensions of a topic treated within the unit. We have also included *Ethical Questions* for each unit, as well as within many of the cases presented in this text. *Ethics Today* features, which focus on ethical considerations in today's business climate, appear in selected chapters, including this chapter. A *Question of Ethics* case problem is included at the end of every chapter to introduce you to the ethical aspects of specific cases involving real-life situations.

1-2 Sources of American Law

American law has numerous sources. Often, these sources of law are classified as either primary or secondary.

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 Federal Trade Commission.
4. Case law and common law doctrines.

Next, we will describe each of these important sources of law.

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 later). Courts often refer to secondary sources of law for guidance in interpreting and applying the primary sources of law discussed here.

1-2a 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.

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.

1-2b 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.

Statutory law also includes local **ordinances**—regulations passed by municipal or county governing units to deal with 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.

Statutory Conflicts Tension may sometimes arise between federal, state, and local laws. ■ **Example 1.2** This tension is evident in the national debate over so-called sanctuary cities—cities that limit their cooperation with federal immigration authorities. Normally, local law

enforcement officials are supposed to alert federal immigration authorities when they come into contact with undocumented immigrants, so that the immigrants can be detained for possible deportation. But a number of cities across the United States have adopted either local ordinances or explicit policies that do not follow this procedure. Police in these cities often do not ask or report the immigration status of individuals with whom they come into contact. Other places refuse to detain undocumented immigrants who are accused of low-level offenses. ■

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, or NCCUSL (www.uniformlaws.org), in 1892. The NCCUSL still exists today. Its object is to draft **uniform laws** (model statutes) for the states to consider adopting.

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, was 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.

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.

1-2c Administrative Law

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

1-2d 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 for a review of the sources of American law.

Concept Summary 1.1

Sources of American Law

Constitutional Law

- Law as expressed in the U.S. Constitution or 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 conflict with the U.S. Constitution.

Statutory Law

- Statutes (including uniform laws) and ordinances enacted by federal, state, and local legislatures.
- Federal statutes may not violate the U.S. Constitution.
- State statutes and local ordinances may not violate the U.S. Constitution or the relevant state constitution.

Administrative Law

- The rules, orders, and decisions of federal, state, and local 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.

1-3 The Common Law Tradition

Because of our colonial heritage, much of American law is based on the English legal system. Knowledge of this tradition is crucial to understanding our legal system today because judges in the United States still apply common law principles when deciding cases.

1-3a Early English Courts

After the Normans conquered England in 1066, 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 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. *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.

Remedies in Equity The remedies granted by the equity courts became known as **remedies in equity**, or equitable remedies. These remedies include specific performance, 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 in later chapters.

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 1.3** Ted forms a contract (a legally binding agreement) to purchase a parcel of land that he thinks will be perfect for his future home. The seller **breaches** (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 wants. What Ted wants is to have a court order the seller to perform the contract. In other words, Ted will seek 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 lists some important equitable maxims.

The last maxim listed in the 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

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.)

expired, no action (lawsuit) can be brought, no matter how strong the case was originally.

1-3b 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, you must know what remedies are available. Additionally, certain vestiges of the procedures used when there were separate courts of law and equity still exist. For instance, 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 summarizes the procedural differences (applicable in most states) between an action at law and an action in equity.

1-3c 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 they 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,

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
Decision	By jury or judge	By judge (no jury)
Result	Judgment	Decree
Remedy	Monetary damages or property	Injunction, specific performance, or rescission

and other forms of case publication became available. Today, cases are published, or “reported,” in volumes called **reporters**, or *reports*—and are also posted online. 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 the doctrine of *stare decisis*, 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. 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 Precedents that must be followed within a jurisdiction are called *controlling precedents*. Controlling precedents are a type of binding authority. 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, 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. See this chapter’s *Ethics Today*

feature for a discussion of how courts often defer to case precedent even when they disagree with the reasoning in the case.

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 1.4** 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 Supreme 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 a lower court will sometimes 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 Internet and certain other technologies have presented many new and challenging issues for the courts to decide.

In deciding cases of first impression, courts often look at **persuasive authorities**—legal authorities that a court may consult for guidance but that are not binding on the court. A court may consider precedents from other jurisdictions, for instance, although those precedents are not binding. A court may also consider legal principles and policies underlying previous court decisions or existing statutes. Additionally, a court might look at issues of fairness, social values and customs, and public policy (governmental policy based on widely held societal values). Today, federal courts can also look at unpublished opinions (those not intended for publication in a printed legal reporter) as sources of persuasive authority.⁶

4. 347 U.S. 483, 74 S.Ct. 686, 98 L.Ed. 873 (1954).

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

6. See Rule 32.1 of the Federal Rules of Appellate Procedure.

3. Pronounced *stahr-ee dih-si-sis*.

Ethics Today

Stare Decisis versus Spider-Man

Supreme Court Justice Elena Kagan, in a recent decision involving Marvel Comics' Spider-Man, ruled that, "What we can decide, we can undecide. But *stare decisis* teaches that we should exercise that authority sparingly." Citing a Spider-Man comic book, she went on to say that "in this world, with great power there must also come—great responsibility."^a In its decision in the case—*Kimble v. Marvel Entertainment, LLC*—the Supreme Court applied *stare decisis* and ruled against Stephen Kimble, the creator of a toy related to the Spider-Man figure.^b

Can a Patent Involving Spider-Man Last Super Long?

A patent is an exclusive right granted to the creator of an invention. Under U.S. law, patent owners generally possess that right for twenty years. Patent holders can license the use of their patents as they see fit during that period. In other words, they can allow others (called *licensees*) to use their invention in return for a fee (called *royalties*).

More than fifty years ago, the Supreme Court ruled in its *Brulotte* decision that a licensee cannot be forced to pay royalties to a patent holder after the patent has expired.^c So if a licensee signs a contract to continue to pay royalties after the patent has expired, the contract is invalid and thus unenforceable.

At issue in the *Kimble* case was a contract signed between Marvel Entertainment and Kimble, who had invented a toy made up of a glove equipped with a valve and a canister of pressurized foam. The patented toy allowed people to shoot fake webs intended to look like Spider-Man's. In 1990, Kimble tried to cut a deal with Marvel Entertainment concerning his toy, but he was unsuccessful. Then Marvel started selling its own version of the toy.

a. Lee, S., *Spider-Man: Amazing Fantasy*, No. 15 (New York: Marvel Comics, 1962).

b. 576 U.S. ___, 135 S.Ct. 2401, 192 L.Ed.2d 463 (2015). Also see *Nautilus, Inc. v. ICON Health & Fitness, Inc.*, 304 F.Supp.3d 552 (W.D.Texas—San Antonio 2018).

c. *Brulotte v. Thys Co.*, 379 U.S. 29, 85 S.Ct. 176 (1964).

When Kimble sued Marvel for patent infringement, he won. The result was a settlement that involved a licensing agreement between Kimble and Marvel with a lump-sum payment plus a royalty to Kimble of 3 percent of all sales of the toy. The agreement did not specify an end date for royalty payments to Kimble, and Marvel later sued to have the payments stop after the patent expired, consistent with the Court's earlier *Brulotte* decision.

A majority of the Supreme Court justices agreed with Marvel. As Justice Kagan said in the opinion, "Patents endow their holders with certain super powers, but only for a limited time." The court further noted that the fifty-year-old *Brulotte* decision was perhaps based on what today is an outmoded understanding of economics. That decision, according to some, may even hinder competition and innovation. But "respecting *stare decisis* means sticking to some wrong decisions."

The Ethical Side

In a dissenting opinion, Supreme Court Justice Samuel A. Alito, Jr., said, "The decision interferes with the ability of parties to negotiate licensing agreements that reflect the true value of a patent, and it disrupts contractual expectations. *Stare decisis* does not require us to retain this baseless and damaging precedent. . . . *Stare decisis* is important to the rule of law, but so are correct judicial decisions."

In other words, *stare decisis* holds that courts should adhere to precedent in order to promote predictability and consistency. But in the business world, shouldn't parties to contracts be able to, for example, allow a patent licensee to make smaller royalty payments that exceed the life of the patent? Isn't that a way to reduce the yearly costs to the licensee? After all, the licensee may be cash-strapped in its initial use of the patent. Shouldn't the parties to a contract be the ones to decide how long the contract should last?

Critical Thinking *When is the Supreme Court justified in not following the doctrine of stare decisis?*

1-3d 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. You may be asked to provide answers for some of the case problems that appear