

EIGHTEENTH EDITION

# **BUSINESS LAW:**

The Ethical, Global, and  
Digital Environment



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# Business Law

The Ethical, Global, and Digital Environment

EIGHTEENTH EDITION  
*18e*

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## BUSINESS LAW

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# The Authors

**Jamie Darin Prenkert,** Professor of Business Law and the Charles M. Hewitt Professor, joined the faculty of Indiana University's Kelley School of Business in 2002. He is the Associate Dean of Academics for the Kelley School. He served as chair of the Department of Business Law and Ethics from 2014 to 2016 and from 2019 to 2020, having served as an Associate Vice Provost for Faculty and Academic Affairs for the Indiana University-Bloomington campus from 2016 to 2019. Professor Prenkert is a former editor in chief of the *American Business Law Journal* and is a member of the executive committee of the Academy of Legal Studies in Business. His research focuses on issues of employment discrimination and the human rights obligations of transnational corporations. He has published articles in the *American Business Law Journal*, the *North Carolina Law Review*, the *Berkeley Journal of Employment and Labor Law*, and the *University of Pennsylvania Journal of International Law*, among others. He also coedited a volume titled *Law, Business and Human Rights: Bridging the Gap*. Professor Prenkert has taught undergraduate and graduate courses, both in-residence and online, focusing on the legal environment of business, employment law, law for entrepreneurs, business and human rights, and critical thinking. He is a recipient of the Harry C. Sauvain Undergraduate Teaching Award and the Kelley Innovative Teaching Award.

Professor Prenkert earned a B.A. (*summa cum laude*) from Anderson University and a J.D. (*magna cum laude*) from Harvard Law School. Prior to joining the faculty of the Kelley School, he was a senior trial attorney for the U.S. Equal Employment Opportunity Commission.

**A. James Barnes,** Professor of Public and Environmental Affairs and Professor of Law at Indiana University-Bloomington (IU), previously served as Dean of IU's School of Public and Environmental Affairs and has taught business law at IU and Georgetown University. His teaching interests include commercial law, environmental law, alternative dispute resolution, law and public policy, and ethics and the public official. He is the co-author of several leading books on business law.

From 1985 to 1988, Professor Barnes served as the deputy administrator of the U.S. Environmental Protection Agency (EPA). From 1983 to 1985, he was the EPA general counsel and in the early 1970s served as chief of staff to the first administrator of EPA. Professor Barnes also served as a trial attorney in the U.S. Department of Justice and as general counsel of the U.S. Department of Agriculture. From 1975 to 1981, he had a commercial and environmental law practice with the firm of Beveridge and Diamond in Washington, D.C.

Professor Barnes is a Fellow of the National Academy of Public Administration, and a Fellow in the American College of Environmental Lawyers. He served as chair of the Environmental Protection Agency's Environmental Finance Advisory Board and as a member of the U.S. Department of Energy's Environmental Management Advisory Board. From 1992 to 1998,

he was a member of the Board of Directors of the Long Island Lighting Company (LILCO). Professor Barnes received his B.A. from Michigan State University and a J.D. (*cum laude*) from Harvard Law School.

**Joshua E. Perry,** Graf Family Professor and Associate Professor of Business Law and Ethics, joined the faculty of Indiana University's Kelley School of Business in 2009. He currently serves as chair of the Department of Business Law and Ethics, an appointment he has held since 2020. He was formerly the Faculty Chair for the Kelley School's Undergraduate Program. A three-time winner of the IU Trustees' Teaching Award and two-time winner of the Kelley Innovative Teaching Award, he teaches graduate and undergraduate courses on business ethics, critical thinking, and the legal environment of business. Professor Perry earned a B.A. (*summa cum laude*) from Lipscomb University, a Masters of Theological Studies from the Vanderbilt University Divinity School, and a J.D. from the Vanderbilt University Law School, where he was Senior Articles Editor on the *Law Review*. Prior to joining Kelley, he was on faculty at the Center for Biomedical Ethics and Society at Vanderbilt University Medical Center. In that role, he taught medical ethics in the School of Medicine and professional responsibility in the Law School, and served as a clinical ethicist in both the adult and children's hospitals at Vanderbilt. Before entering academe, he practiced law in Nashville, Tennessee, at a boutique litigation firm, where he specialized in dispute resolution and risk mitigation for clients in the health care, intellectual property, and entertainment industries.

Professor Perry's award-winning scholarship explores legal, ethical, and public policy issues in the life science, medical device, and health care industries, as well as in the business of medicine. He is the author of over 30 articles and essays that have appeared in a variety of journals, including the *American Business Law Journal*; the *Georgia Law Review*; the *Notre Dame Journal of Law, Ethics, and Public Policy*; the *Journal of Law, Medicine and Ethics*; and the *University of Pennsylvania Journal of Law and Social Change*, among others. His expertise has been featured in *The New York Times*, *USA Today*, *Wired*, *Fast Company*, *Huffington Post*, and *Salon*. Since 2015, he also has served on the editorial board for the *Journal of Business Ethics* as section editor for law, public policy, and ethics.

**Todd Haugh,** Associate Professor of Business Law and Ethics and Weimer Faculty Fellow at Indiana University's Kelley School of Business. His scholarship focuses on white-collar and corporate crime, business and behavioral ethics, and federal sentencing policy. His work has appeared in top law and business journals, including the *Northwestern University Law Review*, *Notre Dame Law Review*, *Vanderbilt Law Review*, and the *MIT-Sloan Management Review*. Prof. Haugh's expertise relating to the burgeoning field of behavioral compliance has led to frequent speaking and consulting engagements with major U.S.

companies and ethics organizations. He is also regularly quoted in national news publications such as *The New York Times*, *The Wall Street Journal*, *Forbes*, *Bloomberg News*, and *USA Today*.

A graduate of the University of Illinois College of Law and Brown University, Professor Haugh has extensive professional experience as a white-collar criminal defense attorney, a federal law clerk, and a member of the general counsel's office of the U.S. Sentencing Commission. In 2011, he was chosen as one of four Supreme Court Fellows of the Supreme Court of the United States to study the administrative machinery of the federal judiciary.

Prior to joining the Kelley School, where he teaches courses on business ethics, white-collar crime, and critical thinking, Professor Haugh taught at DePaul University College of Law and Chicago-Kent College of Law. He is a recipient of numerous teaching and scholarly awards, including a Trustees Teaching Award and multiple Innovative Teaching Awards, and a Jesse Fine Fellowship from the Poynter Center for the Study of Ethics and American Institutions, to which he now serves as a board member. In 2019 he was awarded the Distinguished Early Career Achievement Award by the Academy of Legal Studies in Business.

**Abbey R. Stemler,** Assistant Professor of Business Law and Ethics at Indiana University's Kelley School of Business.

She is a leading scholar on the sharing economy, and her scholarship and teaching have garnered many university and national awards. She is frequently sought out for her expertise on platform-based technology companies, such as Facebook, Uber, and Google.

Professor Stemler has published multiple articles in leading law journals such as the *Iowa Law Review*, *Emory Law Journal*, *Maryland Law Review*, *Georgia Law Review*, and *Harvard Journal on Legislation*. Her research explores the interesting spaces where law has yet to catch up with technology. In particular, her aim is to expose the evolving realities of Internet-based innovations and platforms and to find ways to effectively regulate them without hindering their beneficial uses. As she sees it, many modern firms inhabit a world that operates under alien physics—where free is often costly and “smart” is not always wise. She employs tools and insights from economics, behavioral science, regulatory theory, and rhetoric to understand how we, as a society, can better protect consumers, privacy, and democracy.

Professor Stemler is also a faculty associate at the Berkman Klein Center for Internet & Society at Harvard University, practicing attorney, entrepreneur, and consultant for governments and multinational organizations such as the World Bank Group.

# Preface

This is the 18th Edition (and the 24th overall edition) of a business law text that first appeared in 1935. Throughout its more than 80 years of existence, this book has been a leader and an innovator in the fields of business law and the legal environment of business. One reason for the book's success is its clear and comprehensive treatment of the standard topics that form the traditional business law curriculum. Another reason is its responsiveness to changes in these traditional subjects and to new views about that curriculum. In 1976, this textbook was the first to inject regulatory materials into a business law textbook, defining the "legal environment" approach to business law. Over the years, this textbook has also pioneered by introducing materials on business ethics, corporate social responsibility, global legal issues, and the law of an increasingly digital world. The 18th Edition continues to emphasize change by integrating these four areas into its pedagogy.

## Appendix B: The Uniform Commercial Code

The Uniform Commercial Code, or UCC, was developed by the American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL) as a body of rules intended to make the application of law to commercial transactions consistent across fifty states. The UCC has been adopted in whole by all but one state legislature, Louisiana, which adopted only certain sections. Such widespread use of the UCC, even with the minor deviations some jurisdictions make from the official code, makes possible more efficient and more confident transactions across state lines. The UCC can be accessed here: [www.law.cornell.edu/ucc](http://www.law.cornell.edu/ucc).

## Continuing Strengths

The 18th Edition continues the basic features that have made its predecessors successful. They include:

- *Comprehensive coverage.* We believe that the text continues to excel in both the number of topics it addresses and the depth of coverage within each topic. This is true not only of the basic business law subjects that form the core of the book, but also of the regulatory and other subjects that are said to constitute the "legal environment" curriculum.
- *Style and presentation.* This text is written in a style that is direct, lucid, and organized, yet also relatively relaxed and conversational. For this reason, the text lends itself to the flipped classroom, allowing coverage of certain topics by assigning them as reading without lecturing on them. As always, key points and terms are emphasized; examples, charts, figures, and concept summaries are used liberally; and elements of a claim and lists of defenses are stated in numbered paragraphs.
- *Case selection.* We try very hard to find cases that clearly illustrate important points made in the text, that should interest

students, and that are fun to teach. Except when older decisions are landmarks or continue to provide the best illustrations of particular concepts, we also try to select recent cases. Our collective in-class teaching experience with recent editions has helped us determine which of those cases best meet these criteria.

## Important Changes in This Edition

For this edition, we welcome Todd Haugh and Abbey Stemler, our Indiana University colleagues, to the author team. They bring new teaching, research, and legal practice experiences to our team that have helped shape our approach to the 18th Edition and will allow us to continue to deliver excellent coverage of the ever-changing legal environment of business.

Our longtime co-author Arlen Langvardt decided to retire from authoring the textbook along with retiring from his faculty position at Indiana University. The author team wishes to express our gratitude for his leadership on the textbook for the past couple of editions and to thank him for the profound impact he has made on this text. In his place, Jamie Prenkert has moved into the lead author role. Co-author Jim Barnes remains our connection to the long and vital history of this textbook. With this edition, Jim will have been a co-author of this text for more than 50 years!

In this edition, the combination of new and longstanding authors has led to a number of innovations, while maintaining the thorough yet accessible approach for which the book is well known. Along with a more explicit focus on compliance in addition to ethics (see Ethics and Compliance in Action features), the 18th Edition includes new cases, tracks recent developments in various substantive areas of law, and offers revisions to various textual material in our ongoing commitment to clarity and completeness. The book continues to include both hypothetical examples and real-life cases so that instructors can elucidate important concepts for students while also maintaining student interest and engagement. Key additions and revisions for the 18th Edition include the following:

### Chapter 1

- New problem case dealing with a spectator injured by a foul ball at a professional baseball game. The problem case can be used to enrich class discussion around case law reasoning, as illustrated in the *Coomer* case in the main text.
- Introduction of the new Ethics and Compliance in Action feature, which is present throughout the book.

### Chapter 2

- New discussion of the Forced Arbitration Injustice Repeal Act (Fair Act).

### Chapter 3

- Incorporation in the text of several recent Supreme Court cases, including *Trump v. Vance* (separation of powers and

Supremacy Clause), *Burwell v. Hobby Lobby Stores and Masterpiece Cakeshop, Ltd. v. Colorado Civil Rights Commission* (First Amendment religion clause, as well as the federal Religious Freedom Restoration Act).

- Reorganization of the Commerce Clause discussion and the addition of 2018 Supreme Court decision *South Dakota v. Wayfair, Inc.*, which illustrates the standard for excessive burden on interstate commerce.
- New figure describing the Food and Drug Administration's tobacco regulations pursuant to the Family Smoking Prevention and Tobacco Control Act and related court challenges, with specific focus on First Amendment speech issues.
- New discussion of the claims against Harvard College and the University of North Carolina related to their admissions practices.

#### Chapter 4

- New discussion of the Business Roundtable's 2019 statement regarding stakeholder theory.

#### Chapter 5

- New discussion of Fourth Amendment searches and the third-party doctrine.
- New case note that highlights the importance of *New York Central & Hudson River Railroad v. United States*, which established the concept of corporate criminal liability.
- Revision of discussion of criminal racketeering offenses.
- New problem regarding whether a health care company and its senior executives had standing to challenge a warrant in a tax fraud case based on Fourth Amendment grounds.
- New problem case on the Sixth Amendment's reach in the context of corporate criminal fines based on the *Apprendi* line of Supreme Court cases.

#### Chapter 7

- New case that provides a clear illustration of negligence elements in the context of an easily understood fact pattern.

#### Chapter 8

- New case, *ZUP, LLC v. Nash Manufacturing, Inc.*, which provides a relatable example of the patent requirement of nonobviousness.

#### Chapter 9

- New case, *Grimes v. Young Life, Inc.*, which deals with a hybrid contract and the application of the predominant factor test.
- New case, *PWS Environmental, Inc. v. All Clear Restoration and Remediation, LLC*, which provides a straightforward application of quasi-contract.

#### Chapter 10

- New Cyberlaw in Action feature dealing with Twitter and offer terms.
- Replacement of the term "insanity" with the more modern concept of "mental incapacity."

#### Chapter 11

- General update of examples to ensure that concepts and technology references remain relevant.

#### Chapter 12

- New case, *Mid-American Salt, LLC v. Morris County Cooperative Pricing Council*, which illustrates that requirements contracts, though recognized under the UCC, must create some obligation in order to avoid being illusory.
- Revision of the discussion of forbearance as a form of consideration for added clarity.

#### Chapter 16

- Discussion of the 21st Century Integrated Digital Experience Act (IDEA).

#### Chapter 17

- New Ethics and Compliance in Action feature, which explores the ethics of obligating a donee beneficiary to an arbitration clause.

#### Chapter 18

- New case, *Macomb Mechanical, Inc. v. Lasalle Group Inc.*, which illustrates the operation of a "pay if paid" clause as a condition precedent.

#### Chapter 19

- New case, *National Music Museum: America's Shrine to Music v. Johnson*, which deals with a contract for the sale of a guitar once owned by Elvis Presley and illustrates the rules concerning the passage of title.

#### Chapter 20

- New introduction problem, which explores products liability and ethical issues involving JUUL e-cigarettes.
- New Cyberlaw in Action feature that explores the question of whether Amazon, when it sells a defective product via a third-party seller, can be held liable. The box references and discusses recent litigation including *Allstate New Jersey Insurance Co. v. Amazon.com*; *Eberhart v. Amazon.com*; *Oberdorf v. Amazon.com, Inc.*; and *Papataros v. Amazon.com*.
- Revision of discussion of punitive damages to include recent verdicts against Johnson & Johnson and Monsanto.

#### Chapter 21

- New case, *Hillerich & Bradsby v. Charles Products*, which addresses whether a buyer timely notified the seller that products delivered to the buyer for sale to children in buyer's Louisville Slugger Museum Store were defective (i.e., contained lead content in excess of limits prescribed under the Consumer Products Safety Improvement Act of 2008).

#### Chapter 22

- New case, *Beau Townsend Ford Lincoln v. Don Hinds Ford*, which illustrates the principle that a buyer is liable for the purchase price of goods that have been received and accepted and that the buyer is not relieved of that obligation when deceived into making payment to someone other than the seller to whom the buyer is contractually obligated to pay.

#### Chapter 23

- New problem case.

**Chapter 24**

- Revision to *Francini v. Goodspeed Airport, LLC* to note that the Connecticut Supreme Court upheld the Connecticut Appellate Court's decision (included in the text) in 2018.

**Chapter 25**

- Revisions to text to clarify state and local variations in the law that have developed in recent years.
- Revision and update to the discussion of a landlord's duty to mitigate damages.

**Chapter 26**

- Revision to the explanation of the formalities of a will for greater clarity.

**Chapter 27**

- New Cyberlaw in Action feature discussing the burgeoning cyber insurance market.
- Updates to the status of health care insurance under the Affordable Care Act.

**Chapter 28**

- New case, *Trump Endeavor 12 LLC v. Fernich, Inc. d/b/a The Paint Spot*, involving a contractor who sued to enforce a lien on property on which it had provided materials but had not been paid by the owner of the property.

**Chapter 29**

- New case, *Hyman v. Capital One Auto Finance*, where the court held that a debtor had stated a case for conversion and breach of the peace in the course of an attempted repossession of her automobile where the "repo man" involved the state police without judicial authorization.

**Chapter 30**

- Revision of discussion of preferential liens.
- New case, *Rosenberg v. N.Y. State Higher Education Services Corp.*, in which a bankruptcy court granted a discharge of student loans on the grounds their repayment would constitute an undue hardship. The court criticized previous bankruptcy court decisions that produced harsh results for students on the grounds that the courts did not properly apply prior case authority.
- New text concerning the Small Business Organization Act of 2019 that provides a modified procedure to facilitate reorganization under Chapter 11 of small businesses in financial difficulty.

**Chapter 32**

- New case, *Triffin v. Sinha*, which illustrates the operation of the shelter rule: The assignee of a check was held to be entitled to holder-in-due-course status because the entity that assigned the check to him was a holder in due course.

**Chapter 33**

- Revision of the text for clarity and to reflect recent changes in the law.

**Chapter 34**

- New case, *Grodner & Associates v. Regions Bank*, which involves a bookkeeper who defrauded the law firm for which she worked over a period of 15 months by writing checks utilizing

facsimile signatures and initiating ACH transactions, which she was not authorized to perform. The bank refused to recredit the account on the grounds the law firm had not notified the bank of the fraud within a year after receiving a statement containing an unauthorized payment and the law firm was unable to show any deviation from the bank's own procedures or local banking standards or from the terms of the parties' deposit agreement.

- Revision of discussion of Check 21, the electronic processing of checks, and Federal Reserve Board Regulations concerning wire transfers.

**Chapter 35**

- New case, *Krakauer v. Dish Network LLC*, which illustrates the objective standard of manifested assent for agency formation.
- New Cyberlaw in Action feature, which discusses California's judicial and legislative responses to misclassification of gig workers as nonemployee agents in a variety of industries, specifically focusing on sharing-economy platform businesses like Uber and Lyft.

**Chapter 36**

- New case, *Synergies3 Tec Services, LLC v. Corvo*, in which the court analyzes whether employees' intentional tort was committed in the scope of their employment.

**Chapter 37**

- Introduction of one of the newest business forms: the benefit corporation.

**Chapter 38**

- New problem case, which deals with the possible creation of a partnership amid a pandemic.

**Chapter 39**

- New case, *Gelman v. Buehler*, which demonstrates to students the importance of partnership agreements.

**Chapter 40**

- New introduction problem, which examines the appropriateness for and tax implications of forming a limited liability company.
- New in-depth discussion of the tax advantages of limited liability companies.
- Removal of discussion of the now-outdated business form: the limited liability limited partnership.

**Chapter 41**

- New text, which discusses benefit corporations and their growing importance, including a new chart comparing benefit corporations and certified "B corps."
- New case about scholarly critique of benefit corporations suggesting they may actually hurt socially conscious companies that are more traditionally organized.

**Chapter 42**

- Revision of Ethics and Compliance in Action feature concerning offshore tax havens used by major U.S. companies.



- New problem cases about the policy arguments for holding promoters liable for preincorporation contracts and the equity stakes taken in entrepreneurial ventures on the popular show *Shark Tank*.

#### Chapter 43

- New text related to CEO compensation, including that of Tesla's Elon Musk and Disney's Bob Iger.
- New text that highlights the duty-of-care obligations related to the oversight of legal compliance.
- New case, *In re Caremark Int'l Inc. Derivative Litig.*, which established the fiduciary obligation of board oversight of compliance and effectively created modern corporate compliance regimes.
- Revised discussion of the foundations of corporate criminal liability and the costs of white-collar crime.
- New problem case about a shareholder suit against Allergan, the company that makes Botox, and the theory of legal liability underlying fiduciary duty claims.

#### Chapter 44

- New Ethics and Compliance in Action feature about the ethicality of share dissolution at Facebook.
- New problem case regarding dividend distribution under the Model Business Corporation Act.

#### Chapter 45

- New discussion of the Security and Exchange Commission's powers, including implications of recent Supreme Court opinions *Lucia v. SEC* and *Kokesh v. SEC*.
- New and revised text about Section 5 of the Securities Act of 1933, including Rules 163A, 135, 169, and the Jumpstart Our Business Startups (JOBS) Act.
- Revision of the Concept Review concerning the communications issuers may provide to the public.
- New text on "gun jumping" violations levied against Google and Salesforce.
- Revisions to text on offering exemptions, including new text concerning Regulation A, Regulation Crowdfunding, and Rule 506, and deletion of text referring to the withdrawn Rule 595.
- Revision of Ethics and Compliance in Action feature related to the trade-offs and criticisms of the JOBS Act.
- Revision of the Concept Review regarding issuers' exemptions from registration requirements.
- New discussion of scienter and the Private Litigation Securities Reform Act.
- Revision of text concerning insider trading, including a new discussion of classical and misappropriation theories, as well as tippee liability under *Dirks v. SEC*.
- New case, *SEC v. Dorozhko*, which considered computer hacking as insider trading under the misappropriation theory.
- New case note comparing *United States v. Newman* and *United States v. Salman*, which address the personal benefit test of tippee liability.
- New problem case on whether Elon Musk violated securities laws based on his tweets.

- New problem case about insider trading prosecution of Mathew Martoma and SAC Capital Advisors.

#### Chapter 46

- New discussion of Regulation Best Interest, including a summary chart of obligations of broker-dealers.
- New case, *United States v. Goyal*, which concerned the evidence used to convict a former CFO for securities fraud violations under Section 10(b) of the 1934 Act.
- New problem case about whether the suit against a seller of high-performance liquid chromatography systems met the pleading standards for scienter and materiality under the securities laws.

#### Chapter 47

- Revision to discussion of Federal Communications Commission action about network neutrality regulation.

#### Chapter 48

- Revision to discussion of the recent actions taken by the FTC to regulate deceptive practices.
- Revision to discussion of the Truth in Lending Act.
- New discussion of the Economic Growth, Regulatory Relief, and Consumer Protection Act (Economic Growth Act) and its impact on the Fair Credit Reporting Act.

#### Chapter 49

- New case box about *United States v. Apple, Inc.*, in which Apple was held responsible for violating the Sherman Act when it conspired among major book publishers to raise the retail prices of ebooks.
- New Ethics and Compliance in Action feature that discusses how antitrust laws may hinder socially responsible business practices.

#### Chapter 50

- New Ethics and Compliance in Action feature about consolidation among big tech firms such as Facebook and Instagram.

#### Chapter 51

- New case concerning workers' compensation, *American Greetings Corp. v. Bunch*, in which an employee is injured during a work-related event but not while performing day-to-day work responsibilities.
- Added discussion of emergency medical and family leave provisions of the Families First Coronavirus Response Act.
- Revised discussion of collective bargaining and unionization to reflect recent Supreme Court cases, including *Janus v. AF-SCME* and *Epic Systems Corp. v. Lewis*.
- New discussion of the Equal Pay Act that includes consideration of the U.S. Women's National Soccer Team's pay discrimination claim against U.S. Soccer.
- New case, *Bostock v. Clayton County*, in which the U.S. Supreme Court held that Title VII of the 1964 Civil Rights Act prohibition against discrimination in employment because of sex includes discrimination on the basis of sexual orientation and gender identity.

**Chapter 52**

- Revision of text to incorporate retrenchment by Trump administration of Environmental Protection Agency regulations to control greenhouse gasses associated with global climate change, including the Clean Power Plan and the automobile fuel economy standards adopted during the Obama administration.

**Acknowledgments**

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# A Guided Tour

## A New Kind of Business Law

The 18th Edition of *Business Law* continues to focus on global, ethical, and digital issues affecting legal aspects of business. The new edition contains a number of new features as well as a revised supplements package. Please take a few moments to page through some of the highlights of this new edition.

### OPENING VIGNETTES

Each chapter begins with an opening vignette that presents students with a mix of real-life and hypothetical situations and discussion questions. These stories provide a preview of issues addressed in the chapter and help to stimulate students' interest in the chapter content.

CHAPTER 2

### The Resolution of Private Disputes

Allnews Publishing Inc., a firm whose principal offices are located in Orlando, Florida, owns and publishes 33 newspapers. These newspapers are published in 21 different states of the United States. Among the Allnews newspapers is the *Snakebite Rattler*, the lone newspaper in the city of Snakebite, New Mexico. The *Rattler* is sold in print form only in New Mexico. However, many of the articles in the newspaper can be viewed by anyone with Internet access, regardless of his or her geographic location, by going to the Allnews website.

In a recent *Rattler* edition, an article appeared beneath this headline: "Local Business Executive Sued for Sexual Harassment." The accompanying article, written by a *Rattler* reporter (an Allnews employee), stated that a person named Phil Anderson was the defendant in the sexual harassment case. Besides being married, Anderson was a well-known businessperson in the Snakebite area. He was active in his church and in community affairs in both Snakebite (his city of primary home) and Petoskey, Michigan (where he and his wife have a summer home). A stock photo of Anderson, which had been used in connection with previous *Rattler* stories mentioning him, appeared alongside the story about the sexual harassment case. Anderson, however, was not the defendant in that case. He was named in the *Rattler* story because of an error by the *Rattler* reporter. The actual defendant in the sexual harassment case was a local business executive with a similar name: Phil Anderer.

Anderson plans to file a defamation lawsuit against Allnews because of the above-described falsehood in the *Rattler* story. He expects to seek \$500,000 in damages for harm to his reputation and for other related harms. In Chapter 6, you will learn about the substantive legal issues that will arise in Anderson's defamation case. For now, however, the focus is on important legal matters of a procedural nature.

Consider the following questions regarding Anderson's case as you read this chapter:

- Where, in a geographic sense, may Anderson properly file and pursue his lawsuit against Allnews?
- Must Anderson pursue his case in a state court, or does he have the option of litigating it in federal court?
- Assuming that Anderson files his case in a state court, what strategic option may Allnews exercise if it acts promptly?
- In the run-up to a possible trial in the case, what legal mechanisms may Anderson utilize in order to find out, on a pretrial basis, what the *Rattler* reporter and other Allnews employees would say in possible testimony at trial? Is Allnews entitled to do the same with regard to Anderson?
- If Anderson's case goes to trial, what types of trials are possible?
- Through what legal mechanisms might a court decide the case without a trial?
- Today, many legal disputes are decided through arbitration rather than through proceedings in court. Given the prevalence of arbitration these days, why isn't Anderson's case a candidate for arbitration?

#### LO LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- |  |   |
|--|---|
| <b>2-1</b> Describe the basic structures of state court systems and the federal court system.  | <b>2-5</b> Identify the major steps in a civil lawsuit's progression from beginning to end. |
| <b>2-2</b> Explain the difference between subject-matter jurisdiction and in personam jurisdiction.  | <b>2-6</b> Describe the different forms of discovery available to parties in civil cases.   |
| <b>2-3</b> Identify the major legal issues courts must resolve when deciding whether in personam jurisdiction exists with regard to a defendant in a civil case. | <b>2-7</b> Explain the differences among the major forms of alternative dispute resolution. |
| <b>2-4</b> Explain what is necessary in order for a federal court to have subject-matter jurisdiction over a civil case.   |   |

### LEARNING OBJECTIVES

Active **Learning Objectives** open each chapter. LOs inform you of specific outcomes you should have after finishing the chapter. Icons reference each LO's reference within the chapter.

## CYBERLAW IN ACTION



In recent years, the widespread uses of e-mail and information presented and stored in electronic form have raised questions about whether, in civil litigation, an opposing party's e-mails and electronic information are discoverable to the same extent as conventional written or printed documents. With the Federal Rules of Civil Procedure and comparable discovery rules applicable in state courts having been devised prior to the explosion in e-mail use and online activities, the rules' references to "documents" contemplated traditional on-paper items. Courts, however, frequently interpreted "documents" broadly, so as to include e-mails and certain electronic communications within the scope of discoverable items.

Even so, greater clarity regarding discoverability seemed warranted—especially as to electronic material that might be less readily classifiable than e-mails as "documents." Various states responded by updating their discovery rules to include electronic communications within the list of discoverable items. So did the Federal Judicial Conference. In Federal Rules of Civil Procedure amendments proposed by the Judicial Conference and ratified by Congress in 2006, "electronically stored information" became a separate category of discoverable material. The *electronically stored information (ESI)* category is broad enough to include e-mails and similar communications as well as electronic business records, web pages, dynamic databases, and a host of other material existing in electronic form. So-called e-discovery has become a

objection is valid in light of the particular facts and circumstances. For instance, if requested e-mails appear only on backup tapes and searching those tapes would require the expenditures of significant time, money, and effort, are the requested e-mails "not reasonably accessible because of undue burden or costs"? Perhaps, but perhaps not. The court will rule, based on the relevant situation. The court may deny the discovery request, uphold it, or condition the upholding of it on the requesting party's covering part or all of the costs incurred by the other party in retrieving the ESI and making it available. When a party fails or refuses to comply with a legitimate discovery request and the party seeking discovery of ESI has to secure a court order compelling the release of it, the court may order the noncompliant party to pay the attorney fees incurred by the requesting party in seeking the court order. If a recalcitrant party disregards a court order compelling discovery, the court may assess attorney fees against that party and/or impose evidentiary or procedural sanctions such as barring that party from using certain evidence or from raising certain claims or defenses at trial.

The discussion suggests that discovery requests regarding ESI may be extensive and broad-ranging, with logistical issues often attending those requests. In recognition of these realities, the Federal Rules seek to head off disputes by requiring the parties to civil litigation to meet, at least through their attorneys, soon after the case is filed. The meeting's goal is development of a discovery plan that outlines the parties' intentions regarding ESI discovery and sets forth an agreement on such matters as the form in which the

## CYBERLAW IN ACTION BOXES

In keeping with today's technological world, these boxes describe and discuss actual instances of how the Internet is affecting business law today.

## ETHICS AND COMPLIANCE IN ACTION BOXES

These boxes appear throughout the chapters and offer critical thinking questions and situations that relate to ethical/public policy concerns.



## Ethics and Compliance in Action

The broad scope of discovery rights in a civil case will often entitle a party to seek and obtain copies of e-mails, records, memos, and other documents and electronically stored information from the opposing party's files. In many cases, some of the most favorable evidence for the plaintiff will have come from the defendant's files, and vice versa. If your firm is, or is likely to be, a party to civil litigation and you know that the firm's files contain materials that may be damaging to the firm in the litigation, you may be faced with the temptation to alter or destroy the potentially damaging items. This temptation poses serious ethical dilemmas. Is it morally defensible to change the content of records or documents on an after-the-fact basis, in order to lessen the adverse effect on your firm in pending or probable litigation? Is document destruction or e-mail deletion ethically justifiable when you seek to protect your firm's interests in a lawsuit?

If the ethical concerns are not sufficient by themselves to make you leery of involvement in document alteration or destruction, consider the potential legal consequences for yourself and your firm. The much-publicized collapse of the Enron Corporation in 2001 led to considerable scrutiny of the actions of the Arthur Andersen firm, which had provided auditing and consulting services to Enron. An Andersen partner, David Duncan, pleaded guilty to a criminal obstruction of justice charge that accused him of having destroyed, or having instructed Andersen employees to destroy, certain Enron-related records in order to thwart a Securities and Exchange Commission (SEC) investigation of Andersen. The U.S. Justice Department also launched an obstruction of justice prosecution against Andersen on the theory that the firm altered or destroyed records pertaining to Enron in order to impede the SEC investigation. A jury found Andersen guilty of obstruction of justice. Although the Andersen conviction was later overturned by the

to impose appropriate sanctions on the document-destroying party. These sanctions may include such remedies as court orders prohibiting the document-destroyer from raising certain claims or defenses in the lawsuit, instructions to the jury regarding the wrongful destruction of the documents, and court orders that the document-destroyer pay certain attorney fees to the opposing party.

What about the temptation to refuse to cooperate regarding an opposing party's lawful request for discovery regarding material in one's possession? Although a refusal to cooperate seems less blameworthy than destruction or alteration of documents, extreme instances of recalcitrance during the discovery process may cause a party to experience adverse consequences similar to those imposed on parties who destroy or alter documents. Litigation involving Ronald Perelman and the Morgan Stanley firm provides an illustration. Perelman had sued Morgan Stanley on the theory that the investment bank participated with Sunbeam Corp. in a fraudulent scheme that supposedly induced him to sell Sunbeam his stake in another firm in return for Sunbeam shares whose value plummeted when Sunbeam collapsed. During the discovery phase of the case, Perelman had sought certain potentially relevant e-mails from Morgan Stanley's files. Morgan Stanley repeatedly failed and refused to provide this discoverable material and, in the process, ignored court orders to provide the e-mails.

Eventually, a fed-up trial judge decided to impose sanctions for Morgan Stanley's wrongful conduct during the discovery process. The judge ordered that Perelman's contentions would be presumed to be correct and that the burden of proof would be shifted to Morgan Stanley so that Morgan Stanley would have to disprove Perelman's allegations. In addition, the trial judge prohibited Morgan Stanley from



## The Global Business Environment

Just as statutes may require judicial interpretation when a dispute arises, so may treaties. The techniques that courts use in interpreting treaties correspond closely to the statutory interpretation techniques discussed in this chapter. *Olympic Airways v. Husain*, 540 U.S. 644 (2004), furnishes a useful example.

In *Olympic Airways*, the U.S. Supreme Court was faced with an interpretation question regarding a treaty, the Warsaw Convention, which deals with airlines' liability for passenger deaths or injuries on international flights. Numerous nations (including the United States) subscribe to the Warsaw Convention, a key provision of which provides that in regard to international flights, the airline "shall be liable for damages sustained in the event of the death or wounding of a passenger or any other bodily injury suffered by a passenger, if the accident which caused the damage so sustained took place on board the aircraft or in the course of any of the operations of embarking or disembarking." A separate provision imposes limits on the amount of money damages to which a liable airline may be subjected.

The *Olympic Airways* case centered around the death of Dr. Abid Hanson, a severe asthmatic, on an international flight operated by Olympic. Smoking was permitted on the flight. Hanson was given a seat in the nonsmoking section,

whereupon his wife and a doctor who was on board gave him shots of epinephrine from an emergency kit that Hanson carried. Although the doctor administered CPR and oxygen when Hanson collapsed, Hanson died. Husain, acting as personal representative of her late husband's estate, sued Olympic in federal court on the theory that the Warsaw Convention made Olympic liable for Hanson's death. The federal district court and the court of appeals ruled in favor of Husain.

In considering Olympic's appeal, the U.S. Supreme Court noted that the key issue was one of treaty interpretation: whether the flight attendant's refusals to reseat Hanson constituted an "accident which caused" the death of Hanson. Noting that the Warsaw Convention itself did not define "accident" and that different dictionary definitions of "accident" exist, the Court looked to a precedent case, *Air France v. Saks*, 470 U.S. 392 (1985), for guidance. In the *Air France* case, the Court held that the term "accident" in the Warsaw Convention means "an unexpected or unusual event or happening that is external to the passenger." Applying that definition to the facts at hand, the Court concluded in *Olympic Airways* that the repeated refusals to reseat Hanson despite his health concerns amounted to unexpected and unusual behavior for a flight attendant. Although the refusals were not the sole rea-

## THE GLOBAL BUSINESS ENVIRONMENT BOXES

Because global issues affect people in many different aspects of business, this material appears throughout the text instead of in a separate chapter on international issues. This feature brings to life global issues that are affecting business law.

## LOG ON BOXES

These appear throughout the chapters and direct students, where appropriate, to relevant websites that will give them more information about each featured topic. Many of these are key legal sites that may be used repeatedly by business law students and business professionals alike.



**LOG ON**

For a great deal of information about the U.S. Supreme Court and access to the Court's opinions in recent cases, see the Court's website at <http://www.supremecourtus.gov>.

CONCEPT REVIEW		
The First Amendment		
Type of Speech	Level of First Amendment Protection	Consequences When Government Regulates Content of Speech
Noncommercial	Full	Government action is constitutional only if action is necessary to fulfillment of compelling government purpose. Otherwise, government action violates First Amendment.
Commercial ( <i>nonmisleading and about lawful activity</i> )	Intermediate	Government action is constitutional if government has substantial underlying interest, action directly advances that interest, and action is no more extensive than necessary to fulfillment of that interest (i.e., action is narrowly tailored).

## CONCEPT REVIEWS

These boxes visually represent important concepts presented in the text to help summarize key ideas at a glance and simplify students' conceptualization of complicated issues.

## FIGURES

The figures appear occasionally in certain chapters. These features typically furnish further detail on special issues introduced more generally elsewhere in the text.

Figure 2.1 The Thirteen Federal Judicial Circuits			
<b>First Circuit</b> ( <i>Boston, Mass.</i> ) Maine, Massachusetts, New Hampshire, Puerto Rico, Rhode Island	<b>Second Circuit</b> ( <i>New York, N.Y.</i> ) Connecticut, New York, Vermont	<b>Third Circuit</b> ( <i>Philadelphia, Pa.</i> ) Delaware, New Jersey, Pennsylvania, Virgin Islands	<b>Fourth Circuit</b> ( <i>Richmond, Va.</i> ) Maryland, North Carolina, South Carolina, Virginia, West Virginia
<b>Fifth Circuit</b> ( <i>New Orleans, La.</i> ) Louisiana, Mississippi, Texas	<b>Sixth Circuit</b> ( <i>Cincinnati, Ohio</i> ) Kentucky, Michigan, Ohio, Tennessee	<b>Seventh Circuit</b> ( <i>Chicago, Ill.</i> ) Illinois, Indiana, Wisconsin	<b>Eighth Circuit</b> ( <i>St. Louis, Mo.</i> ) Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota, South Dakota

Abdouch v. Lopez	829 N.W.2d 662 (Neb. 2013)
<p><i>Helen Abdouch, an Omaha, Nebraska, resident, served as executive secretary of the Nebraska presidential campaign of John F. Kennedy in 1960. Ken Lopez, a Massachusetts resident, and his Massachusetts-based company, Ken Lopez Bookseller (KLB), are engaged in the rare book business. In 1963, Abdouch received a copy of a book titled Revolutionary Road. Its author, Richard Yates, inscribed the copy with a note to Abdouch. The inscribed copy was later stolen from Abdouch. In 2009, Lopez and KLB bought the inscribed copy from a seller in Georgia. They sold it that same year to a customer from a state other than Nebraska. In 2011, Abdouch learned that Lopez had used the inscription and references to her in an advertisement on KLB's website. The advertisement, which appeared on the website for more than three years after Lopez and KLB sold the inscribed copy, contained a picture of the inscription, the word "SOLD," and this statement:</i></p> <p><i>This copy is inscribed by Yates: For Helen Abdouch—with admiration and best wishes. Dick Yates. 8/19/63. Yates had worked as a speech writer for Robert Kennedy when Kennedy served as Attorney General. Abdouch was the executive secretary of the Nebraska (John F.) Kennedy organization when Robert Kennedy was campaign manager. . . . A scarce book, and it is extremely uncommon to find this advance issue of it signed. Given the date of the inscription—that is, during JFK's Presidency—and the connection between writer and recipient, it's reasonable to suppose this was an author's copy, presented to Abdouch by Yates.</i></p> <p><i>Because Lopez and KLB did not obtain her permission before mentioning her and using the inscription in the advertisement, Abdouch filed an invasion-of-privacy lawsuit against Lopez and KLB in a Nebraska state district court. Contending that the Nebraska court lacked in personam jurisdiction, Lopez and KLB filed a motion to dismiss the case. The state district court granted the motion. Abdouch then appealed to the Supreme Court of Nebraska. (Further facts bearing upon the in personam jurisdiction issue appear in the following edited version of the Supreme Court's opinion.)</i></p>	

## CASES

The cases in each chapter help to provide concrete examples of the rules stated in the text. A list of cases appears at the front of the text.

## PROBLEMS AND PROBLEM CASES

Problem cases appear at the end of each chapter for student review and discussion.

### Problems and Problem Cases

1. Victoria Wilson, a resident of Illinois, wishes to bring an invasion of privacy lawsuit against XYZ Co. because XYZ used a photograph of her, without her consent, in an advertisement for one of the company's products. Wilson will seek money damages of \$150,000 from XYZ, whose principal offices are located in New Jersey. A New Jersey newspaper was the only print media outlet in which the advertisement was published. However, XYZ also placed the advertisement on the firm's website. This website may be viewed by anyone with Internet access, regardless of the viewer's geographic location. Where, in a geographic sense, may Wilson properly file and pursue her lawsuit against XYZ? Must Wilson pursue her case in a state court, or does she have the option of litigating in federal court? Assuming that Wilson files her case in state court, what strategic option may XYZ exercise if it acts promptly?
2. Alex Ferrer, a former judge who appeared as "Judge Alex" on a television program, entered into a contract with Arnold Preston, a California attorney who rendered services to persons in the entertainment industry. Seeking fees allegedly due under the contract, Preston invoked the clause setting forth the parties' agreement to arbitrate "any dispute . . . relating to the terms of [the contract] or the breach, validity, or legality thereof . . . in accordance with the rules [of the American Arbitration Association]." Ferrer countered Preston's demand for arbitration by filing, with the California Labor Commissioner, a petition in which he contended that the contract was unenforceable under

residents Anne and Jim Cornelsen. When Anne Cornelsen telephoned the Bomblisses and said she was ready to sell two litters of Tibetan mastiff puppies, Ron Bombliss expressed interest in purchasing two females of breeding quality. The Cornelsens had a website that allowed communications regarding dogs available for purchase but did not permit actual sales via the website. The Bomblisses traveled to Oklahoma to see the Cornelsens' puppies and ended up purchasing two of them. The Cornelsens provided a guarantee that the puppies were suitable for breeding purposes. Following the sale, the Cornelsens mailed, to the Bomblisses' home in Illinois, American Kennel Club registration papers for the puppies. Around this same time, Anne Cornelsen posted comments in an Internet chat room frequented by persons interested in Tibetan mastiffs. These comments suggested that the mother of certain Tibetan mastiff puppies (including one the Bomblisses had purchased) may have had a genetic disorder. The comments were made in the context of an apparent dispute between the Cornelsens and Richard Eichhorn, who owned the mother mastiff and had made it available to the Cornelsens for breeding purposes. The Bomblisses believed that the comments would have been seen by other persons in Illinois and elsewhere and would have impaired the Bomblisses' ability to sell their puppies even though, when tested, their puppies were healthy. The Bomblisses therefore sued the Cornelsens in an Illinois court on various legal theories. The Cornelsens asked the Illinois court to dismiss the case on the ground that the court lacked in personam jurisdiction over them. Did the Illinois court lack in personam jurisdiction?

## KEY TERMS

Key terms are in color and bolded throughout the text and defined in the Glossary at the end of the text for better comprehension of important terminology.

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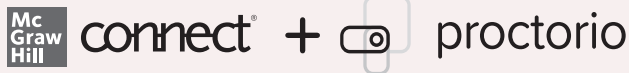
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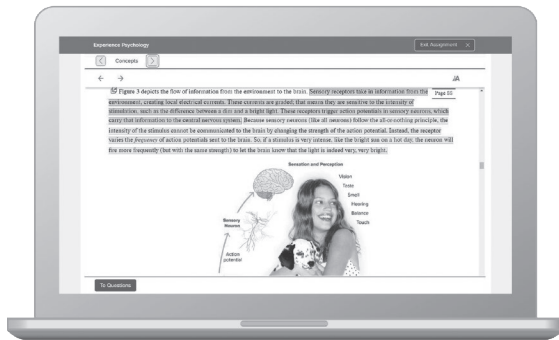


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