

The background of the book cover is a composite image. On the left side, there are several tall, fluted classical columns made of light-colored stone or marble, with a decorative capital at the top. On the right side, there is a modern glass skyscraper with a grid of windows, reflecting the sky. The two images are overlaid on each other, with the classical columns in the foreground and the modern building in the background.

11th Edition

The Legal Environment of Business

Meiners | Ringleb | Edwards

THE LEGAL ENVIRONMENT OF BUSINESS

ELEVENTH EDITION

ROGER E. MEINERS

University of Texas at Arlington

AI H. RINGLEB

Consortium International MBA

FRANCES L. EDWARDS

Clemson University

 **SOUTH-WESTERN**
CENGAGE Learning

Australia • Brazil • Japan • Korea • Mexico • Singapore • Spain • United Kingdom • United States

This is an electronic version of the print textbook. Due to electronic rights restrictions, some third party content may be suppressed. Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. The publisher reserves the right to remove content from this title at any time if subsequent rights restrictions require it. For valuable information on pricing, previous editions, changes to current editions, and alternate formats, please visit www.cengage.com/highered to search by ISBN#, author, title, or keyword for materials in your areas of interest.



**The Legal Environment of Business,
Eleventh Edition**

**Roger E. Meiners, Al H. Ringleb, Frances
L. Edwards**

Vice President of Editorial, Business:
Jack W. Calhoun

Vice President/Editor-in-Chief: Karen
Schmohe

Executive Marketing Director: Lisa Lysne

Publisher: Rob Dewey

Senior Acquisitions Editor: Vicky
True-Baker

Senior Developmental Editor: Jan Lamar

Marketing Manager: Laura Aurora Stopa

Marketing Coordinator: Nicole Parsons

Content Project Management:

PreMediaGlobal

Production Technology Analyst: Emily
Gross

Senior Media Editor: Kristen Meere

Media Editor: Kristin Meere

Manufacturing Coordinator: Kevin Kluck

Production Service: PreMediaGlobal

Copyeditor: James Reidell

Senior Art Director: Michelle Kunkler

Cover Designer: Rose Alcorn

Cover Images:

Main image: © blackred/iStockphoto

Secondary Image: Marje Cannon/
iStockphoto

© 2012, 2009 South-Western, Cengage Learning

ALL RIGHTS RESERVED. No part of this work covered by the copyright herein may be reproduced, transmitted, stored or used in any form or by any means graphic, electronic, or mechanical, including but not limited to photocopying, recording, scanning, digitizing, taping, Web distribution, information networks, or information storage and retrieval systems, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without the prior written permission of the publisher.

For product information and technology assistance, contact us at
Cengage Learning Customer & Sales Support, 1-800-354-9706

For permission to use material from this text or product,
submit all requests online at www.cengage.com/permissions

Further permissions questions can be emailed to
permissionrequest@cengage.com

ExamView® is a registered trademark of eInstruction Corp. Windows is a registered trademark of the Microsoft Corporation used herein under license. Macintosh and Power Macintosh are registered trademarks of Apple Computer, Inc. used herein under license.

© 2008 Cengage Learning. All Rights Reserved.

Library of Congress Control Number: 2010941875

Student Edition ISBN-13: 978-0-538-47399-6

Student Edition ISBN-10: 0-538-47399-1

South-Western Cengage Learning

5191 Natorp Boulevard

Mason, OH 45040

USA

Cengage Learning products are represented in Canada by
Nelson Education, Ltd.

For your course and learning solutions, visit www.cengage.com/school

Visit our company website at www.cengage.com

To Dan,

*Who as an entrepreneur in education has built much
from little, and to Jane, who is the kind of teacher many
would like to be, but few can be.*

Roger



Brief Contents

Preface xv

PART I	Elements of Law and the Judicial Process	1
	1. Today's Business Environment: Law and Ethics	2
	2. The Court Systems	26
	3. Trials and Resolving Disputes	54
	4. The Constitution: Focus on Application to Business	86
	5. Criminal Law and Business	117
	<i>Pulling It Together</i>	147
PART II	Elements of Traditional Business Law	149
	6. Elements of Torts	150
	7. Business Torts and Product Liability	178
	8. Real and Personal Property	208
	9. Intellectual Property	237
	10. Contracts	262
	11. Domestic and International Sales	297
	12. Negotiable Instruments, Credit, and Bankruptcy	331
	13. Business Organizations	366
	14. Agency and the Employment Relationship	400
	<i>Pulling It Together</i>	430
PART III	The Regulatory Environment of Business	433
	15. The Regulatory Process	434
	16. Employment and Labor Regulations	457
	17. Employment Discrimination	497
	18. Environmental Law	530
	19. Consumer Protection	563
	20. Antitrust Law	599
	21. Securities Regulation	630
	22. The International Legal Environment of Business	660
	<i>Pulling It Together</i>	689
	Appendices	
	A Legal Research and the Internet	690
	B Case Analysis and Legal Sources	693
	C The Constitution of the United States of America	700
	D The Uniform Commercial Code (Excerpts)	715
	E National Labor Relations Act (Excerpts)	736
	F Title VII of Civil Rights Act of 1964 (Excerpts)	741

G	Americans with Disabilities Act (Excerpts)	744
H	The Antitrust Statutes (Excerpts)	747
I	Securities Statutes (Excerpts)	752

Glossary 757

Index 789



Contents

Preface xv

PART I

Elements of Law and the Judicial Process 1

CHAPTER 1 Today's Business Environment: Law and Ethics 2

Law and the Key Functions of the Legal System 3

International Perspective: Emerging Nations and the Law 5

Sources of Law in the United States 6

Lighter Side of the Law: Creative Common Law 9

International Perspective: Civil Law Systems 12

Classifications of Law 13

Business Ethics and Social Responsibility 16

Test Yourself 16

Issue Spotter: OK to Grease Palms? 17

Lighter Side of the Law: Our Values 18

Cyber Law: Online Ethics and Legal Compliance 19

International Perspective: Does Regulation Improve Business Ethics? 19

Issue Spotter: Putting Ethics into Practice 20

Test Yourself 22

CHAPTER 2 The Court Systems 26

The Court Systems 27

The Federal Courts 30

The State Courts 33

International Perspective: The French Court System 34

Lighter Side of the Law: In-the-Courtroom Training 35

Test Yourself 36

Jurisdiction 36

Lighter Side of the Law: Being a Judge Makes Me Sick? 37

International Perspective: London's Commercial Court 38

Cyber Law: The Long Arm of the Internet 40

Issue Spotter: Can Your Firm Be Reached? 42

Relations between the Court Systems 42

Venue 48

Lighter Side of the Law: Super Judicial Powers 48

Test Yourself 49

CHAPTER 3 Trials and Resolving Disputes 54

Basic Trial Procedures 55

Lighter Side of the Law: Is There Something Unclear About the Rule, Counselor? 60

International Perspective: British Courtroom Procedure 63

Test Yourself 64

Lighter Side of the Law: The Dog Ate My Summons 65

Lighter Side of the Law: You Got Me There, Counselor! 67

Lighter Side of the Law: The Legal Magic of Spell Check 74

International Perspective: German Trial Procedure 74

Test Yourself 75

Alternate Dispute Resolution 75

Issue Spotter: Are There Limits on the Terms of Arbitration? 77

Cyber Law: International Arbitration and Mediation of Domain Name Disputes 79

International Perspective: Global Acceptance of Arbitration 80

Test Yourself 81

CHAPTER 4 The Constitution: Focus on Application to Business 86

The Commerce Clause 87

Lighter Side of the Law: Great Constitutional Moments 91

The Taxing Power 93

Issue Spotter: Unconstitutional Business Activity? 95

Test Yourself 96

Business and Free Speech 96

International Perspective: Freedom of Speech 97

Lighter Side of the Law: Cookies Crushed by First Amendment 97

Cyber Law: Freedom of Speech on the Net 98

Lighter Side of the Law: Freedom of Bark but Not Burn in Ohio 102

Test Yourself 102

International Perspective: The (Partially) Unwritten Constitution of the United Kingdom 103

Other Key Parts of the Bill of Rights 103

Cyber Law: No Right of Privacy in Chat Rooms 108
Fourteenth Amendment 109

Lighter Side of the Law: Drop That Fry! Hands over Your Head! 111

Test Yourself 113

CHAPTER 5 Criminal Law and Business 117

Crime 118

Crime Categories 118

Lighter Side of the Law: How Not to Respond to Minor Problems 120

Crimes and Elements of Crime 120

Defenses 122

Prosecution Process 124

Test Yourself 127

White-Collar Crime 127

Lighter Side of the Law: How Not to Impress the Police 129

Lighter Side of the Law: Successful Sting Operation Nabs Criminal 130

International Perspective: Multinational Employers and Criminal Charges Abroad 132

Issue Spotter: Internal Fraud 133

Cyber Law: Your Laptop Is an Open Book 135

International Perspective: White-Collar Crime in France 138

Sentencing Guidelines and Compliance 140

Test Yourself 142

Pulling It Together 147

PART II

Elements of Traditional Business Law

149

CHAPTER 6 Elements of Torts 150

Torts and the Legal System 151

Negligence-Based Torts 152

International Perspective: No Litigation Jackpots in New Zealand 152

Lighter Side of the Law: Extending the Concept of Negligence 155

Issue Spotter: Effective Liability Releases 158

Test Yourself 160

Intentional Torts against Persons 161

Issue Spotter: Dealing with Drunks 162

Lighter Side of the Law: This Is a Real Arrest! 165

Test Yourself 167

Issue Spotter: Dealing with the Elderly and Their Heirs 167

Lighter Side of the Law: How Not to Teach Torts in Law School 170

Issue Spotter: Say Good Things about a Good Employee? 170

Cyber Law: Tort Liability for Internet Servers 171

International Perspective: Libel in Foreign Courts 171

Test Yourself 174

CHAPTER 7 Business Torts and Product Liability 178

Tort Law and Business 179

Test Yourself 186

Product Liability 186

Issue Spotter: Hiring Employees from Competitors 187

International Perspective: Is Japan Really Different? 189

Lighter Side of the Law: You Can't Be Too Careful: Winning Warning Labels 189

Issue Spotter: Understanding Product Problems 190

Lighter Side of the Law: I'm from the FBI; I Know the Law 193

Lighter Side of the Law: Reason #4 Why West Virginia Is Considered a Litigation Hellhole? 197

Issue Spotter: A Way to Reduce the Damage? 199

Lighter Side of the Law: Busted! 200

International Perspective: Asbestos Litigation in the United States and United Kingdom 201

Test Yourself 204

CHAPTER 8 Real and Personal Property 208

Real Property 209

Lighter Side of the Law: Is It Real Property or Personal Property? 211

International Perspective: Insecure Property Rights	213	Lighter Side of the Law: Listener Beware	266
Lighter Side of the Law: The Tenants Who Would Not Go Away	218	Lighter Side of the Law: Dancing Fool	271
International Perspective: Americans Crossing into Mexico for Land	219	Test Yourself	274
Issue Spotter: Would Tighter Leases Help?	220	International Perspective: Problems Enforcing Contracts	275
Test Yourself	221	Cyber Law: Digital Signatures and Contracts	279
Public Control of Real Property	222	Test Yourself	281
Torts against Property	224	Issue Spotter: Liars' Contest?	282
Issue Spotter: Protecting Company Property	228	Performance, Discharge, and Breach of Contracts	282
Lighter Side of the Law: My Personal Property Is Really Valuable	229	Issue Spotter: Do You Have to Eat the Loss?	285
Torts against Property Owners	229	Remedies	286
Issue Spotter: Duties to Elderly Customers	231	International Perspective: Contracting with the Japanese	289
Lighter Side of the Law: Pesky Surveillance Cameras	231	Lighter Side of the Law: Me, Read the Rules?	289
Issue Spotter: Protecting Customers' Kids	232	Test Yourself	292
Test Yourself	233		
CHAPTER 9 Intellectual Property	237	CHAPTER 11 Domestic and International Sales	297
Trademarks	238	Introduction to the UCC	298
Issue Spotter: Establishing Your Name	238	Forming a Sales Contract	301
Lighter Side of the Law: Do You Know Who We Are, You Rubes?	239	Cyber Law: Shrinkwrap Your Contract	305
International Perspective: Costs of Counterfeiting	240	Issue Spotter: Gouge the Wholesaler	308
Cyber Law: Who Owns and Controls Domain Names?	241	Performance and Obligations	308
Issue Spotter: Knock Off the Knock-Offs?	245	International Perspective: How to Assure Foreign Buyers of Product Quality	309
Lighter Side of the Law: No! We're Most Miserable!	247	Test Yourself	311
Test Yourself	248	Sales Warranties	311
Copyright	248	Issue Spotter: How Much Advice Should Retailers Give?	313
Patents	251	Lighter Side of the Law: Does It Come with a Warranty?	315
Issue Spotter: Fair Sharing of Educational Information?	252	Remedies and Damages	315
Lighter Side of the Law: Why Many Patents are Overturned When Challenged	252	International Sales	320
Trade Secrets	254	International Perspective: Contracts in China	321
International Perspective: Patent Differences	254	Issue Spotter: What Law Applies, and Where, to Your Contract?	322
Issue Spotter: Protecting Valuable Information	256	Test Yourself	326
Test Yourself	258		
CHAPTER 10 Contracts	262	CHAPTER 12 Negotiable Instruments, Credit, and Bankruptcy	331
Contract Law	263	Negotiable Instruments	332
Elements of a Contract	264	International Perspective: Mixing Religion and Finance	334

Lighter Side of the Law: Bounce My Check, Will You? 339
 Credit 339
Test Yourself 340
 Credit with Security 342
Issue Spotter: Helping a Dream? 343
Lighter Side of the Law: So, Do We Write This Off as a Bad Loan? 344
Issue Spotter: Lean on a Lien? 351
Test Yourself 352
 Bankruptcy 353
Issue Spotter: Credit for the Bankrupt? 356
International Perspective: International Bankruptcy Complexities 357
Lighter Side of the Law: Home Sweet Home 359
Test Yourself 361

CHAPTER 13 Business Organizations 366

Sole Proprietorships 367
 Partnerships 367
International Perspective: Small Is Not So Beautiful in Japan 370
 Limited Partnership 371
Issue Spotter: Brotherly Love? 372
 Corporations 373
Lighter Side of the Law: Your Honor, I'll Turn Rocks into Gold 376
Test Yourself 380
 Limited Liability Companies 380
Lighter Side of the Law: Mad at Each Other? Sue the Insurance Company 381
International Perspective: Offshore Businesses 382
 Key Organizational Features 383
Issue Spotter: Keeping Things in Order 388
Lighter Side of the Law: I'm the Real Owner! 389
 Franchises 389
Issue Spotter: The Road to Riches? 391
Cyber Law: Offering Franchises on the Internet 395
Test Yourself 395

CHAPTER 14 Agency and the Employment Relationship 400

Agency Relationships 401
Lighter Side of the Law: Is Slavery an Employment Relationship? 404
Cyber Law: Computer Abuse by Employees 410
 The Essential Employment Relationship 411
Test Yourself 412
International Perspective: Applying EU Law to Employment Contracts 416
Lighter Side of the Law: Can You Assess the Risk of Stupidity? 419
 Tort Liability for Employers and Principals 421
International Perspective: Workplace Data Privacy in the EU 422
Issue Spotter: Can You Be Too Encouraging to Employees? 423
Issue Spotter: Use of Company Cars 423
Test Yourself 425
Lighter Side of the Law: Who, Him? Must Be an Independent Contractor 426
Pulling It Together 430

PART III The Regulatory Environment of Business 433

CHAPTER 15 The Regulatory Process 434

Administrative Agencies 435
Lighter Side of the Law: Give Us All Your Imported Goods So We Can "Protect" Consumers 436
 Administrative Law 436
 Enforcing Rules 440
Cyber Law: Do Old Regulations Apply to New Forms of Competition? 441
Issue Spotter: Contest a Regulatory Order? 444
Test Yourself 445
 Judicial Review 445
International Perspective: Administrative Agencies in Japan 447
Lighter Side of the Law: Regulators Protecting Consumers? 448

Controls on Agencies 451
Lighter Side of the Law: Really Important Regulations and Reports 452
Test Yourself 453

CHAPTER 16 Employment and Labor Regulations 457

Public Policy Limits to At-Will Employment 458
Lighter Side of the Law: Grounds for Termination? 460
 Substance Abuse 462
Issue Spotter: What Attitude toward Drinking and the Office? 463
Issue Spotter: How Does an Employer Handle an Employee Who Flunks a Drug Test? 464
Test Yourself 465
 Worker Health and Safety 465
Lighter Side of the Law: Miracle Healing 468
 Workers' Compensation 469
Lighter Side of the Law: Donuts Are Not Healthy 472
Issue Spotter: Reducing Risks and Improving Looks 473
 Family and Medical Leave 473
 General Regulation of Labor Markets 475
Issue Spotter: How Do You Count Hours for Telecommuters? 476
International Perspective: Flexibility in Labor Markets 477
Issue Spotter: Moves to Help Keep Unions Out 480
Test Yourself 480
 Major Labor Relations Acts 481
Lighter Side of the Law: Do What We Say, Not What We Do 482
 The National Labor Relations Board 483
 Unionization 485
International Perspective: Labor Law in China 486
Issue Spotter: Hiring Documentation and Discrimination 487
 Collective Bargaining 488
Cyber Law: Employee Blogs 491
Test Yourself 492

CHAPTER 17 Employment Discrimination 497

Origins of Discrimination Law 498

Title VII of the 1964 Civil Rights Act 499
International Perspective: EEOC Impact on Global Operations 501
Lighter Side of the Law: A New Protected Class? 502
Cyber Law: Your E-mail Is Your Boss's E-mail 503
Test Yourself 506
 Bringing a Charge of Discrimination 506
Lighter Side of the Law: Modify Your Body in Private 509
Issue Spotter: Effective Sexual Harassment Policy 513
Issue Spotter: Dealing with Discrimination Complaints 515
Test Yourself 517
 Affirmative Action 518
 Disability Discrimination 519
International Perspective: Employment Discrimination in Europe and Japan 519
Lighter Side of the Law: Gaia Is My God 520
Issue Spotter: Accommodating Disabilities 524
Test Yourself 525
Lighter Side of the Law: Get the Women Out of My Classes 526

CHAPTER 18 Environmental Law 530

Environmental Regulation 531
 Pollution and the Common Law 532
 Clean Air Act 534
 Clean Water Act 539
International Perspective: Industrialization Brings Environmental Problems to China 539
Issue Spotter: Does Obeying EPA Regulations Eliminate Litigation? 543
Test Yourself 546
 Land Pollution 546
Lighter Side of the Law: Environmental Harmony 549
 Species Protection 552
Lighter Side of the Law: Protect Truly Rare Species 552
Issue Spotter: Picking a Sweet Spot 555
 Global Environmental Issues 555
Lighter Side of the Law: Let the Sun Shine! 556
International Perspective: CITES: Global Species Concerns May Conflict with Local Interests 557
Test Yourself 559

CHAPTER 19 Consumer Protection 563

- The FDA: Food and Drug Regulation 564
- Lighter Side of the Law: One Slice or Two? 566
- International Perspective: Drug Controls and Uncontrols 567
- Issue Spotter: How Much Can You Hype Health Supplements? 571
- Test Yourself 571
- The FTC and Consumer Protection 572
- Lighter Side of the Law: Protect Me from Myself! 572
- International Perspective: Foreign Advertising Regulation 579
- Issue Spotter: How Aggressive Can You Be in Advertising? 579
- Cyber Law: Regulating Cyberspace Advertising 580
- Lighter Side of the Law: Make Granny Pay More 581
- Consumer Credit Protection 582
- Test Yourself 583
- International Perspective: Credit around the World 588
- Issue Spotter: Dealing with Customer Records 590
- Lighter Side of the Law: Watch Who You Nickle and Dime 591
- Issue Spotter: How Should You Handle Unpaid Accounts? 592
- Test Yourself 595

CHAPTER 20 Antitrust Law 599

- Antitrust Statutes 600
- Monopolization 603
- Lighter Side of the Law: Didn't We Just Sue Them a Century Ago? 607
- Horizontal Restraints of Trade 608
- International Perspective: The European Union and Antitrust Law 609
- Lighter Side of the Law: We're Lawyers, and We're Here to Help You 613
- Issue Spotter: Share and Share Alike 614
- Test Yourself 615
- Vertical Restraint of Trade 615
- International Perspective: China's Anti-Monopoly Law 621
- Lighter Side of the Law: Give Us What We Want, or We Will Throw a Tantrum 622
- The Robinson-Patman Act 622

- Issue Spotter: Who Do You Sell What to, and for How Much? 624
- Test Yourself 625

CHAPTER 21 Securities Regulation 630

- The Elements of Securities 631
- What Is a Security? 632
- Cyber Law: Securities Offerings on the Web 634
- Offering Securities to Investors 634
- Issue Spotter: What Are You Selling? 635
- Issue Spotter: Can New Start-Up Firms Issue Securities? 637
- Regulation of Securities Trading 638
- Test Yourself 639
- Lighter Side of the Law: If It Seems too Good to Be True... 640
- Securities Fraud 640
- Lighter Side of the Law: The Pay Is Okay, but the Food Is Terrible 644
- Insider Trading 644
- International Perspective: London, New York, and the Sarbanes-Oxley Act 645
- The Investment Company Act 648
- International Perspective: European Approaches to Insider Trading 648
- Issue Spotter: Can You Exploit the Gossip? 649
- The Investment Advisers Act 650
- Lighter Side of the Law: The Fall of a Blood Brother 650
- Stock Market Regulation 651
- Test Yourself 655

CHAPTER 22 The International Legal Environment of Business 660

- International Law and Business 661
- U.S. Import Policy 664
- Lighter Side of the Law: Fair Trade! 666
- Issue Spotter: Starting an Import Business 667
- Issue Spotter: Making the Deal Stick 668
- Lighter Side of the Law: I Make Sure *Other* People Obey the Law 669
- Business Structures in Foreign Markets 670
- International Perspective: Controlling International Pirates 671

Test Yourself 672
Foreign Corrupt Practices Act 672
Lighter Side of the Law: All Corruption Is Not Created Equal 674
International Contracts 676
Issue Spotter: Where to Produce? 682
International Dispute Resolution 682
International Perspective: Migrating to Australia 684
Test Yourself 685
Pulling It Together 689

Appendices

A. Legal Research and the Internet 690
B. Case Analysis and Legal Sources 693

C. The Constitution of the United States of America 700
D. The Uniform Commercial Code (Excerpts) 715
E. National Labor Relations Act (Excerpts) 736
F. Title VII of Civil Rights Act of 1964 (Excerpts) 741
G. Americans with Disabilities Act (Excerpts) 744
H. The Antitrust Statutes (Excerpts) 747
I. Securities Statutes (Excerpts) 752

Glossary 757

Index 789

Table of Cases



The principal cases are in bold type. Cases cited or discussed in the text are roman type. References are to pages. Cases cited in principal cases and within other quoted materials are not included

A

American Trucking Association v. Environmental Protection Agency	537
Armstrong v. Food Lion	424
ASC Construction Equipment USA v. City Commercial Real Estate	183
Atkinson v. City of Pierre	226
Audi AG v. D'Amato	243
Axelson v. McEvoy-Willis	304

B

Ballalatak v. All Iowa Agriculture Association	459
Bearden v. Wardley	408
Blimka v. My Web Wholesalers, LLC	41
Bridge v. Phoenix Bond & Indemnity Co.	133
Brown v. Swett and Crawford of Texas	367
Burlington Industries v. Ellerth	511

C

Caley v. Gulfstream Aerospace Corp	270
Callison v. City of Philadelphia	474
Campisi v. Acme Markets, Inc.	230
Center for Biological Diversity v. Marina Point Development Associates	554
Central Hudson Gas and Electric Corporation v. Public Service Commission of New York	100
Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.	439
Chuway v. National Action Financial Service	592
Commonwealth v. Angelo Todesca Corporation	121
Consolidated Edison Company v. Public Service Commission of New York	98
Cooper Tire & Rubber v. Mendez	61
Crest Ridge Construction v. Newcourt	302

D

Dallas Parks v. George Steinbrenner and New York Yankees, Inc.	694
Davis v. Baugh Industrial Contractors, Inc.	11
Davis v. West	29
DCS Sanitation Management v. Castillo	277
DeRosier v. Utility Systems of America, Inc.	288
Deschamps v. Treasure State Trailer Court, Ltd.	280
Dunkin' Donuts Franchised Restaurants LLC v. Sandip, Inc.	392

E

Equal Employment Opportunity Comm. v. Dial Corporation	514
Erichsen v. No-Frills Supermarkets of Omaha	231
Erie Railroad Co. v. Tompkins	45

F

Federal Trade Commission v. Accusearch, Inc.	574
Fordyce Bank and Trust v. Bean Timberland	348
Forgie-Buccioni v. Hannaford Brothers	165
France v. Southern Equipment Co.	414
Freeman v. San Diego Association of Realtors	610
Fuerschbach v. Southwest Airlines	163

G

General Electric Business Financial Services v. Silverman	344
Georgia State Licensing Board for Residential and General Contractors v. Allen	71
Greenman v. Yuba Power Products	191
Gretillat v. Care Initiatives	521
Griffith v. Clear Lakes Trout	306
Guz v. Bechtel National	417

H

Harris v. Forklift Systems	504
Hicklin Engineering v. R.J. Bartell	255
Hinson v. N&W Construction Company	272
Hughes v. Oklahoma	92

I

In re 1545 Ocean Avenue, LLC	383
In re Darby	355
In the Matter of Kmart Corporation	359
Invention Submission v. Rogan	442
Ironite Products Co. v. Samuels	374

J

James v. Bob Ross Buick	168
Juarez v. CC Services	471

K

K.C. Roofing Center v. On Top Roofing, Inc.	385
Katzenbach v. McClung	89
Kelo v. City of New London, Connecticut	106
Kramer v. ATW Axtell Tech Wholesale, Inc.	318

L

Lamson v. Crater Lake Motors	21
Latta v. Rainey	653
Lee v. R & K Marine	314
Leegin Creative Leather Products v. PSKS	618
Lewis v. Heartland Inns of America, L.L.C.	509
Lightle v. Real Estate Commission	182
Lor-Mar/Toto v. Constitution Bank	336

M

MacPherson v. Buick Motor Company 188
Massachusetts v. Environmental Protection Agency 557
Maverick Recording Co. v. Harper 250
McCune v. Myrtle Beach Indoor Shooting Range 159
MDM Group Associates v. CX Reinsurance Company 185
Moran v. Sims 215

N

Naples v. Keystone Building and Development Corp. 69
Nielsen v. Gold’s Gym 220
Noel v. River Hills Wilsons, Inc. 172
Nystrom v. Trex Company 253

P

Palsgraf v. Long Island Railroad Company 155
Parish v. ICON 195
Parker v. Glosson 268
Peconic Baykeeper, Inc. v. Suffolk County 542
Powell v. Washburn 216
Pro’s Sports Bar & Grill v. City of Country Club Hills 110
Pulling It Together 147
Pulling It Together 430
Pulling It Together 689

R

R. Williams Construction v. Occupational Safety and Health Review Commission 466
Reget v. City of La Crosse 112
Responsible Economic Development v. S.C. Department of Health and Environmental Control 544
Reynolds v. Ethicon Endo-Surgery 168

S

Saadala v. East Brunswick Zoning Board of Adjustment 223
Scheerer v. Fisher 291
Schuchmann v. Air Services Heating and Air Conditioning 582
Slayton v. American Express Company 642

Smith v. Kulig 225
Spanish Broadcasting System of Florida v. Clear Channel Communications 604
Squish La Fish v. Thomco Specialty Products 153
Storetrax.com v. Gurland 377
Summers v. Earth Island Institute 449

T

Teamsters Local Union No. 523 v. National Labor Relations Board 490
Telebrands Corp. v. Federal Trade Commission 577
Timpte Industries, Inc. v. Gish 198
Todd v. Exxon Corporation 612
Town Center Shopping Center v. Premier Mortgage Funding 405
Treibacher Industrie, A.G. v. Allegheny Technologies 324

U

U.S. Securities and Exchange Commission v. Ginsburg 646
United States v. King 675
United States v. LaGrou Distribution Systems 565
United States v. Mead Corporation 665
United States v. Yang 257
United States v. Young 123
United States v. Young 141

W

Weyerhaeuser v. Ross-Simmons Hardwood Lumber 623
Whalen v. Union Bag and Paper 533
Williamson Pounder Architects PC v. Tunica County, Mississippi 47
Wyeth v. Levine 569

Y

Yim v. J’s Fashion Accessories, Inc. 410

Z

Zambelli Fireworks Manufacturing Co. v. Wood 461



Knowledge of the legal and regulatory environment of business provides practical background for students preparing for a variety of careers. There are legal, social, political, and ethical issues in every profession. Most situations are simple and can be handled with common sense. However, many situations require an understanding of the principles of law to help resolve an issue or know when legal counsel is needed.

This textbook presents the legal environment from the perspective of the professional who is not a lawyer. Only a few students who take this course will become lawyers, although some students will take an additional class or two that cover specific legal areas. This course provides the opportunity for people with a range of interests to learn key points of the law from the standpoint of a working professional.

We have received excellent feedback from professors and students who have used the ten previous editions of this book and have pointed out both shortcomings and strong points. We have taken these comments into account in preparing this edition to make the book even more helpful and practical as we study the complex legal environment that businesses face in an increasingly international setting.

Basic Organization

A one-semester course in the legal environment of business faces the problem of determining what to cover in such a short time. It is like a physician giving a one-semester course to teach students what they need to know about medicine—so many topics, so little time. There is agreement that the key elements of the legal system must be covered. This is done in Part One of the book, *Elements of Law and the Judicial Process*. Part Two, *Elements of Traditional Business Law*, reviews the major areas of the common law that apply to business. Part Three, *The Regulatory Environment of Business*, covers the major regulatory laws that managers are likely to face and reviews major points of international business law.

Key Features

Edited Cases

A primary way to learn law is to read real cases that the courts had to resolve. Each major case presented in the text has the background facts and legal proceedings summarized by the authors under the label **Case Background**. Then the court's holding, legal reasoning, and explanation of the law as it applies to the facts at hand are presented from the published opinion in the words of the judge in the **Case Decision**. Since most decisions are long, we present only the key portions of the holding. When there is a long deletion of material from a holding, you see asterisks (***) When there is a deletion of a smaller part of a decision there are periods (...). Finally, **Questions for Analysis** are offered for the reader to consider or for class discussion (answers are provided in the *Instructor's Resource Guide*).

Test Yourself

This new learning and review tool appears at least twice in each chapter. It provides the student a quick self-test of material just covered. There are multiple choice, true–false, and fill-in-the-blank questions. These are intended to hit major points in the chapter, not picky details, so if you miss questions, you need to return and reread the material.

International Perspectives

These features discuss how issues similar to those being reviewed in the text are handled in other countries. As globalization reaches more businesses, managers must know how to deal with different legal systems and cultures. This feature makes clear that the legal constraints are different in other nations and that managers must be prepared to resolve problems in different ways in different locales in today's complex legal environment.

Issue Spotters

About sixty Issue Spotters are scattered throughout the text. Each briefly presents a business situation that requires application of legal elements just covered in the text. These challenges are a way for students to self-test their retention and ability to reason as they apply newly learned principles to practice. They also remind readers that the material learned in this course is practical to everyday issues in business (discussion points are provided in the *Instructor's Resource Guide*).

Cyberlaw

This feature presents short discussions of application of the law to developments arising from the information age. E-commerce and e-mail mean legal issues for the courts to resolve as they apply legal principles to never-before-heard-of ways of doing business, transmitting information, and communicating with friends and strangers.

Lighter Side of the Law

These add a light touch to the topic at hand by discussing an actual case or unusual legal situation. While law and business are serious, odd things happen that remind us that trouble can come from unexpected places, that the results of the legal process can be surprising, that scoundrels are among us, and that truth can be stranger than fiction.

Summary

The text of each chapter is summarized in bullet format that provides a quick review of the major points of law and the major rules covered and serves as a self-test of points that will be covered in examinations.

Terms to Know

After the Summary, there is a list of key terms from the chapter. You should know what they mean as they are an important part of the vocabulary and

substance of the concepts covered in the chapter. Besides being in the chapter, and explained when it appears, each term is defined in the Glossary in the back.

Discussion Question

Every chapter has a question for general discussion that picks up on major ideas from the chapter. The purpose is to make sure you understand the concepts of the chapter well enough to be able to discuss a topic that was covered and should be expanded upon.

Case Questions

Most problems are solved, but some end up in court where judges decide the resolution based on legal principles. Real case problems are summarized in each case question. Using the knowledge from the chapter, and maybe some instinct about how a court is likely to resolve a dispute, try to decide which party to a dispute is likely to prevail and why. Some of the questions are answered online at www.cengagebrain.com. At the CengageBrain.com home page, search for the ISBN of your title (from the back cover of your book) using the search box at the top of the page. This will take you to the product page where free companion resources can be found.

Ethics Question

Each chapter has an ethics question that poses a problem related to the legal area covered in the chapter. Remember that ethical issues are different than legal issues, so we go beyond legal reasoning in considering the problem.

Internet Assignment

As discussed in Appendix A, *Legal Research on the Internet*, there most legal materials are available online. As students today are savvy Internet searchers, the Internet Assignments are only there to point out some major sites related to the material in the chapter. Appendix A, which contains a detailed discussion of Internet-based legal research, was prepared by Andrew Dorchak, Head of Reference and Foreign/International Law Specialist at Case Western Reserve University Law Library, Case Western Reserve University School of Law.

Pulling It Together

At the end of the three major sections of the text, several case questions are posed that bring together more than one legal issue covered in more than one chapter. Many situations involve more than one legal issue, so the cases here serve as a refresher to go back to earlier chapters and pull in concepts covered there along with legal principles covered in another chapter.

Glossary

At the back of the book is a list of about a thousand key terms covered in the text. While they were covered in the text when they first appeared in substantive

use, the terms are defined here too to help give a clear understanding of a legal concept that has a specific application in law.

Appendices

Besides *Legal Research on the Internet*, Appendix A, already mentioned, Appendix B covers *Case Analysis and Legal Research*. It explains the structure of court opinions and how they are often briefed by law students and lawyers to give a short summary of a complex matter. The case reporter system and other major legal resources are also reviewed. Appendix C is the full text of the United States Constitution. Appendices that follow give key portions of major statutes, including the Uniform Commercial Code, the National Labor Relations Act, Title VII of the Civil Right Act of 1964, the Americans with Disabilities Act, Antitrust Statutes, and Securities Statutes.

New to This Edition

Our reviewers convinced us that the text needed to be focused on practical aspects of basic legal rules but also include some “classic” cases. We try to keep to a minimum the legal minutia, such as exceptions that are uncommon or occur in only a few states, and focus on primary rules and issues that arise most often. We use business situations and examples to highlight legal principles in practice. In selecting major cases, the focus is on practical situations in business that students can best relate to and which are realistic in a business career. The holdings are straightforward applications of the law to the facts. However, some major cases are included so students can get a sense of how courts announce major rules and the evolution of law can be discussed.

While the entire text is revised for updates and clarifications, significant changes include: in Chapter 1, rewritten discussion of ethics and corporate social responsibility; in Chapter 3, new discussion of injunctions and a simplified review of alternative dispute resolution processes; in Chapter 4, improved discussion of the constitutionality of multi-state impact of state taxes and review of the *Citizens United* case; in Chapter 5, a major expansion of criminal law discovery rules, expanded discussion of RICO with a long application in the area of money laundering to show the potential wide application and issues for financial institutions; in Chapter 6, enhanced discussion of the evolution of the law of negligence; in Chapter 7, improved explanation of fraud and intentional misrepresentation; in Chapter 8, with the assistance of Professor Andrew P. Morriss of the University of Alabama law school, who teaches property law, a careful revision of all areas and more discussion of practical issues and a new section on the use of trusts; in Chapter 12, a revision of the discussion of negotiable instruments; in Chapter 13, an expanded discussion of the business judgment rule; in Chapter 14, again with the assistance of Professor Morriss, who is also an expert on labor and employment law, an expanded discussion of employment handbook issues and a new section on the impact of social media on the workplace; in Chapter 16, a new discussion on the many issues involving the process of hiring employees legally, so as to be in compliance with ICE rules; in Chapter 17, an expanded discussion of retaliation as the basis for an EEOC suit, and a major revision of the ADA section; in Chapter 19, a discussion of the new Consumer Credit Card Act (effective in 2010), the Red Flag Rule (effective in 2011

concerning proper protection of private information by debt collectors), and the new Consumer Financial Protection Bureau that emerges from the Dodd-Frank Act; in Chapter 21, further discussion of the Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), and, in Chapter 22, an explanation of the WTO process for subsidies and countervailing measures as well as a discussion of issues arising from currency exchange controls and transfer pricing.

Ancillaries

Companion Website

To access additional course materials, including CourseMate, please visit www.cengagebrain.com. At the CengageBrain.com home page, search for the ISBN of your title (from the back cover of your text) using the search box at the top of the page. This will take you to the product page where many resources can be found. To access the free study tools for this text, click the green Access Now button. Since you might want to access this site again, it is suggested that you bookmark the page for the book companion website. The book companion web site offers answers to selected chapter-ending Case Questions, an Interactive Quiz with multiple choice questions for each chapter in the text, links to the URLs mentioned in the text, and Case Updates.

- *The Instructor's Resource CD-ROM: Includes the Test Bank, Instructor's Resource Guide, ExamView, and PowerPoint.*
- An electronic *Instructor's Resource Guide* (available on the IRCD and companion website (login.cengage.com)) has been revised. As before, it answers all questions in the book. It also provides a detailed outline of each chapter, summarizing the content of the text, including all cases. The instructor can refer quickly to this guide to remember the points that students have covered in the text. The guide also provides numerous additional summarized cases that the instructor can use to illustrate key points of law. Additional material, such as more discussion of certain points and examples of the law in practice, is provided as lecture and discussion enhancements.
- The updated electronic *Test Bank* (available on IRCD and companion website (login.cengage.com)) has more than 6,000 multiple choice questions. This is a doubling of the size of the existing test bank, with at least 300 multiple choice questions per chapter. There are also true-false questions in the *Test Bank* and it is available on ExamView, which is a computerized testing software program. Most questions are referenced to the main text page. More questions based on fact have been added to test critical thinking ability.
- A set of *PowerPoint*[®] slides keyed to the text are available on both the IRCD and companion website (login.cengage.com).

CourseMate

CourseMate for business law brings business law concepts to life with interactive learning, study, and exam preparation tools that support the printed textbook. Built-in engagement tracking tools allow you to assess the study activities of your

students. Additionally, business law CourseMate includes an interactive online textbook, which contains the complete content of the print textbook enhanced by the many advantages of a digital environment.

Business Law Digital Video Library

Featuring more than sixty segments on the most important topics in Business Law, the Business Law Digital Video Library helps students make the connection between their textbook and the business world. Five types of clips are represented: (1) Legal Conflicts in Business features modern business scenarios; (2) Ask the Instructor clips offer concept review; (3) Drama of the Law presents classic legal situations; (4) LawFlix features segments from well-known and recent motion pictures; and (5) Real World Legal explore conflicts that arise in a variety of business environments. Together these clips bring Business Law to life. Access to the Business Law Digital Video Library is free when bundled with a new text. Access to the Business Law Digital Video Library is available in an optional package with a new text at no additional cost. If Business Law Digital Video Library access did not come packaged with your textbook, it can be purchased online at www.cengagebrain.com. At the CengageBrain.com home page, search for the ISBN of your title (from the back cover of your book) using the search box at the top of the page. This will take you to the product page where free companion resources can be found.

Acknowledgments

The authors thank the adopters and reviewers from around the country who sent helpful comments and materials for the tenth edition. Much of the credit for the improvements belongs to them. The reviewers for this edition include:

Nathan T. Garrett
North Carolina Central University

Paula Hearn Moore
University of Tennessee at Martin

Jack E. Karns
East Carolina University

Richard P. Rosen
Pima Community College

John King
Concordia University-Texas

Robert Rowland
Harrisburg Area Community College

Michael M. McKinney
East Tennessee State University

Bradford Winkler
Aquinas College

The authors also extend thanks to the professionals in business, law, and government who assisted in making this textbook as up-to-date and accurate as possible.

Finally, we thank the editors and staff of South-Western/Cengage Learning. In particular, we thank the sales representatives who continually give us valuable information on the day-to-day perceptions of the textbook—information provided by the instructors and students who are using it. We thank Mary Stone, whose diligence and determination got us through the production process on schedule. Special thanks also go to our developmental editor, Jan Lamar, who tolerates us with good humor. The efforts of our publisher, Rob Dewey, editor, Vicky True-Baker, and marketing manager, Laura Aurora-Stopa who manage huge tasks, are much appreciated.

We welcome and encourage comments from the users of this textbook—both students and instructors. By incorporating your comments and suggestions, we can make this text an even better one in the future.

Roger E. Meiners
Al H. Ringleb
Frances L. Edwards

OVERVIEW

Part One reviews the major components of the legal system and provides the framework for understanding the material presented in the later two parts of the book. Just as people in business should understand the elements of accounting, economics, finance, management, and marketing, it is important that they also know how the legal environment plays a critical role in the way business and the economy function. Law changes as the structure of business changes, as social pressures produce changes in the way business operates, as the ethical expectations of business increase, as politics change, and as the economy becomes more interwoven in international operations.

The chapters in Part One review the major components of the legal system: the origins of law, constitutional law, the role of law in society and business, the structure and functioning of the court system, the use of alternative forms of dispute resolution, and the key elements of criminal law as it applies to business. These chapters serve as the structural background for the rest of the text, which reviews substantive laws that impact business.



Elements of Law and the Judicial Process

- **CHAPTER 1: Today's Business Environment: Law and Ethics** The social and ethical pressures that people in business face today in a complex, international political economy are discussed in the context of the origins of our legal system. Our focus is on the purposes, sources, and structure of law and the legal system in the context of the modern economy.
- **CHAPTER 2: The Court Systems** The structure and power of our federal and state court systems are reviewed, followed by a discussion of how a case gets to a court and what powers the courts have over the parties to a case and its resolution.
- **CHAPTER 3: Trials and Resolving Disputes** The steps in litigation— from the time a party files a complaint, through the stages of litigation, the forms of relief possible, and the appeals process—are discussed. Most business disputes are not taken to court but to alternate dispute resolution. The key aspects of arbitration and mediation are reviewed.
- **CHAPTER 4: The Constitution: Focus on Application to Business** The constitutional limits on government actions, especially with respect to business matters, are covered. Congress has nearly unlimited power to regulate and tax, but some protections are provided for civil liberties against an over-reaching state.
- **CHAPTER 5: Criminal Law and Business** Many statutes provide the possibility of criminal penalties being imposed for violations that may involve persons in business capacities. The processes are reviewed as are key statutes that specifically target certain actions in business.

Today's Business Environment: Law and Ethics

Difficult economic times mean that getting a job and building a career after college are major challenges. Afraid of being left jobless, people often take something less than their dream jobs, but these sometimes turn out better than expected. On the other hand, some people get a prestige job that eventually turns out to present less-than-ideal circumstances.

It is not uncommon for recruiters to puff up the qualities of a position. A job billed as “character-building” may be one of unending stress. One advertised as having a “team working environment” may in fact mean people jammed in cubicles. One person reports that while being recruited he was shown a nice office and introduced to his supervisor, whom he liked very much. But when he arrived for work, he was stuck in a back room, the likeable supervisor was gone, replaced by someone he could not stand, and the assignments given were not of the quality discussed.

Suppose that happens to you. Can you sue the recruiter who brought you to the employer? Can you sue the company that hired you? Do you have the right to demand a better office? What is your legal status in the situation? These are some of the legal issues in business that we will explore.

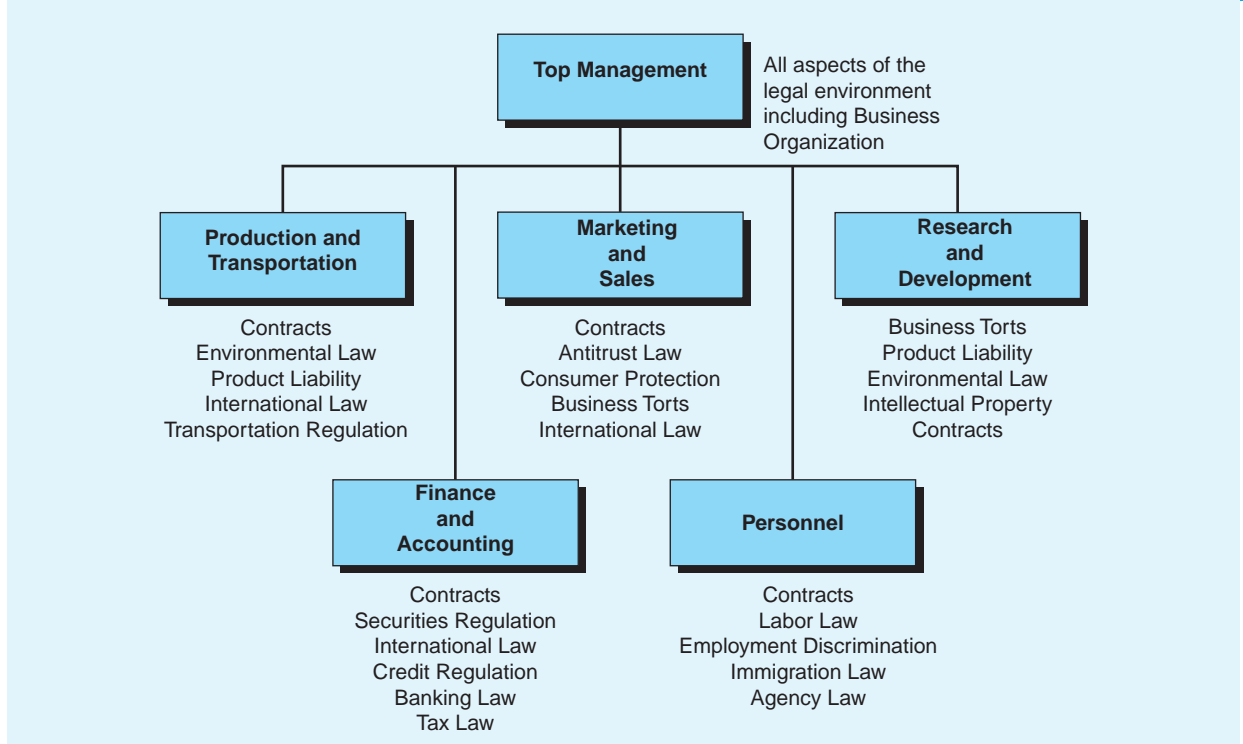
In the situation just posed, the new employee probably has little choice but to keep the job as is or leave. The employer is unlikely to have violated any legal obligation. What about the ethical obligation to be honest with current and potential employees? Is overstating the quality of a position unethical, even if it is not a violation of the law? This is another aspect of the modern business environment.

Business is complex. Ethical, legal, social, political, and international issues all impact company operations. As Exhibit 1.1 indicates, whether your field is human resources, banking, advertising, or software development, you must be familiar with a wide range of subjects to have the skills needed to be aware of possible problems and to recognize potential opportunities that someone with a limited view would be likely to miss. This book, which focuses on the legal environment of business, helps to fit one large piece into the complicated puzzle called the business world.

The study of the legal environment of business begins with an overview of the nature of law and the legal system. Composed of law from different sources, the legal environment is influenced by the needs and demands of the business community, consumers, and government. This chapter provides an understanding of the functions of law in society, the sources of U.S. law, and the classifications of law. It then considers some major ethical issues that play a role in the modern environment of business.

Exhibit 1.1

OVERVIEW OF A BUSINESS'S LEGAL ENVIRONMENT



Law and the Key Functions of the Legal System

There is no precise definition of **law**. In the legal environment of business, law refers to the rules, standards and principles that define the behavioral boundaries for business activities. In general, law is an abstract term but has long meant the same general thing. According to *Justinian's Institutes*, a summary of Roman law published in 533 in Constantinople, "The commandments of the law are these: live honorably; harm nobody; give everyone his due."

A bit more specific, a century ago Oliver Wendell Holmes, a legal scholar and Supreme Court justice, offered the following definition:

Law is a statement of the circumstances, in which the public force is brought to bear...through the courts.

In his 1934 book, *Growth of Law*, the famed jurist Benjamin N. Cardozo defined law as follows:

A principle or rule of conduct so established as to justify a prediction with reasonable certainty that it will be enforced by the courts if its authority is challenged.

Consider these modern definitions from *Black's Law Dictionary*, an authoritative legal dictionary:

1. Law, in its generic sense, is a body of rules of action or conduct prescribed by [the] controlling authority and having binding legal force.

2. That which must be obeyed and followed by [members of a society] subject to sanctions or legal consequences is a law.

Thus, law may be viewed as a collection of rules or principles intended to limit and direct human behavior. Enforcement of such rules or principles provide some predictability and uniformity to the boundaries of acceptable conduct in a society. Nations have both formal *rules*, that is, what are commonly called laws, and informal rules that come from a society's history, customs, commercial practices, and ethics.

Law and the legal system serve several key roles in society. The most important functions include: (1) influencing the behavior of the members of a society, (2) resolving disputes within society, (3) maintaining important social values, and 4) providing a method for assisting social change. The experience of Haiti and other nations, as discussed in the *International Perspective*, reminds us of how difficult it is to do business in a country without a workable legal system.

Improving Social Stability by Influencing Behavior

The legal system is a major institution that helps define acceptable social behavior. The law limits activities that are detrimental to the “public interest.” It restricts business practices that are viewed as outside the ethical and social norms of a society. At the same time, the law can encourage practices that further social and political goals.

The laws in different countries reflect social norms. The business of raising and selling marijuana in Amsterdam (Holland) is legal because the government decided that legalizing marijuana would reduce crime in the drug trade and make it less likely that people would use more harmful drugs such as heroin. In the United States, growing and selling marijuana is generally illegal and can be punished by long prison terms. On the other hand, the production and sale of alcoholic beverages to adults is legal in most of the country, although it was illegal nationwide from 1919 to 1933. In Saudi Arabia today, people are executed for being involved in the alcohol business, as alcohol violates Sharia law in that country. Other countries also make alcohol a criminal matter, while some countries have few restrictions on its sale. These examples illustrate that different societies use the law to enforce different social norms.

Conflict Resolution

A critical function of the law is dispute resolution. Disagreements are inevitable since societies are made up of people with differing desires and values. Karl N. Llewellyn, a famous legal theorist, stated:

What, then, is this law business about? It is about the fact that our society is honeycombed with disputes. Disputes actual and potential, disputes to be settled and disputes to be prevented; both appealing to law, both making up the business of law.... This doing of something about disputes, this doing of it reasonably, is the business of law.

A formal mechanism for the resolution of disputes is the court system, which is used for both private disputes between members of society and public

INTERNATIONAL PERSPECTIVE



Emerging Nations and the Law

When Haiti was devastated by an earthquake in 2010 that killed hundreds of thousands of people, many Americans were shocked to learn of such poverty so close to the United States. Haiti's poverty is all the more shocking because the country shares the island of Hispaniola with the Dominican Republic, where the average income is four times higher than in Haiti. What makes Haiti so poor?

The tragedy of the earthquake led many nations and organizations to pledge aid to help rebuild Haiti, sparking discussion about how to encourage economic development there, ensure the aid was used effectively, and prevent corruption. Haiti, like many poor countries, suffers under a notoriously corrupt government and a legal system that provides no meaningful law to protect people's lives and property. Interviewed after the earthquake, one businessman with operations in several Caribbean nations said that doing business in Haiti was nearly impossible because the demands for bribes are endless.

This comment is backed up by countrywide surveys of Haiti's residents. Transparency International, the Berlin-based organization that studies corruption, ranks Haiti the 168th most corrupt country in the world; only nine countries are worse. Haiti's more prosperous neighbor, the Dominican Republic, ranks 99th. The least corrupt countries—New Zealand and Denmark—are high-income countries. Many studies have found that there is a strong relationship between a lack of corruption, a well-functioning legal system, and the level of economic development.

There are no easy answers for creating a functioning legal system in a country without one and where government authorities make a living by being on the take. Finding the answer to that puzzle may be the most important step toward developing business opportunities that benefit ordinary citizens.

disputes between individuals and the government. Our court system is intended to provide a fair mechanism for resolving these disputes. As we will see in Chapter 3, businesses are increasingly turning to alternate dispute resolution outside of the courts, often because the courts are expensive and slow.

Social Stability and Change

Every society is shaped by its values and customs. It is not surprising, then, that law plays a role in maintaining the social environment. Honesty and integrity are reflected by the enforceability of contracts, respect for other people and their property is reflected in tort and property law, and some measures of acceptable behavior are reflected in criminal laws.

Consider gay relationships. Not many years ago, gay partners could be subject to criminal prosecution for the fact of a personal, voluntary relationship. Now the discussion has turned to whether such relationships should have the same status as traditional marriages. Some contend that legalizing same-sex marriages would be destructive to the structure of society; others argue that it would be stabilizing and should be a civil right.

The legal system provides a way to bring about changes in "acceptable" behavior. For example, in the past, some states required businesses to discriminate on the basis of race. Attitudes changed, and those laws gradually disappeared and grossly discriminatory behavior is no longer legally acceptable. Rather than requiring discrimination, laws now restrict race discrimination in

employment decisions. Major changes in the law usually happen slowly. Next we turn to the sources of law and how law is created.

Sources of Law in the United States

The U.S. and state constitutions created three branches of government—each of which has the ability to make law. Congress—the legislative branch of government—passes statutes. The executive branch—the President and administrative agencies—issues regulations under those statutes. The courts create legal precedents through their decisions.

Constitutions

A **constitution** is the fundamental law of a nation. It establishes and limits the powers of government. Other laws are created through a constitution. The U.S. Constitution (see Appendix C) allocates the powers of government between the states and the federal government. Powers not granted to the federal government are retained by states or are left to the people. Note that a constitution need not be a written document—the United Kingdom’s is not—but it usually is.

The U.S. Constitution

The U.S. Constitution is the oldest written constitution in force in the world. Although it contains some very clear rules, such as the President must be at least age 35, it is mostly made up of general principles. It sets forth the general organization, powers, and limits of the federal government. Specifically, the Constitution creates the legislative, executive, and judicial branches of the U.S. government.

This division of governmental power is referred to as the separation of powers. It arose out of the founders’ fear that too much power concentrated in one governmental branch would reproduce the tyranny they experienced under King George III. The separation of powers means that each branch of government has functions to perform that can be checked by the other branches. The government structure that has developed is illustrated in Exhibit 1.2.

As the highest legal authority, the U.S. Constitution overrides any state or federal laws that go beyond what the Constitution permits. According to Article VI:

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

State Constitutions

The powers and structures of all state governments are based on written constitutions. Like the federal government, state governments are divided into legislative, judicial, and executive branches. The constitutions specify how state officials are chosen and removed, how laws are passed, how the court systems run, and how finances and revenues are paid and collected. On matters of state law, each

state's constitution is the highest form of law for that state, although the federal Constitution can override the state constitutions. Some state constitutions, unlike the U.S. Constitution, are very long and filled with details, in part because amending state constitutions is often much easier than changing the U.S. Constitution.

Legislatures and Statutes

Congress and state legislatures are the sources of *statutory law*. Statutes, also known as legislation, make up much of the law that significantly affects business behavior. For example, in 1972, Congress enacted the Clean Water Act. It sets standards for water quality for the nation and grants the Environmental Protection Agency the authority to adopt regulations that help make the goals of the statute effective. Similarly at the state level, every state legislature has passed statutes to regulate the insurance industry, usually with the help of a state insurance commission.

Federal courts may review statutes passed by Congress to ensure that they do not violate the U.S. Constitution. State courts may review statutes passed by their legislatures to ensure that they do not violate the constitution of the state or of the United States. If a state legislature enacts a statute that violates the U.S. Constitution, and a state court does not strike down the statute, it may be stricken by a federal court.

United States Congress

Article I, Section 1, of the U.S. Constitution provides that all power to make laws for the federal government is given to Congress, a legislature consisting of the Senate and the House of Representatives. Of the thousands of pieces of legislation proposed in each session of Congress, only about 200 to 300 pass both the House and Senate and go to the President for his signature.

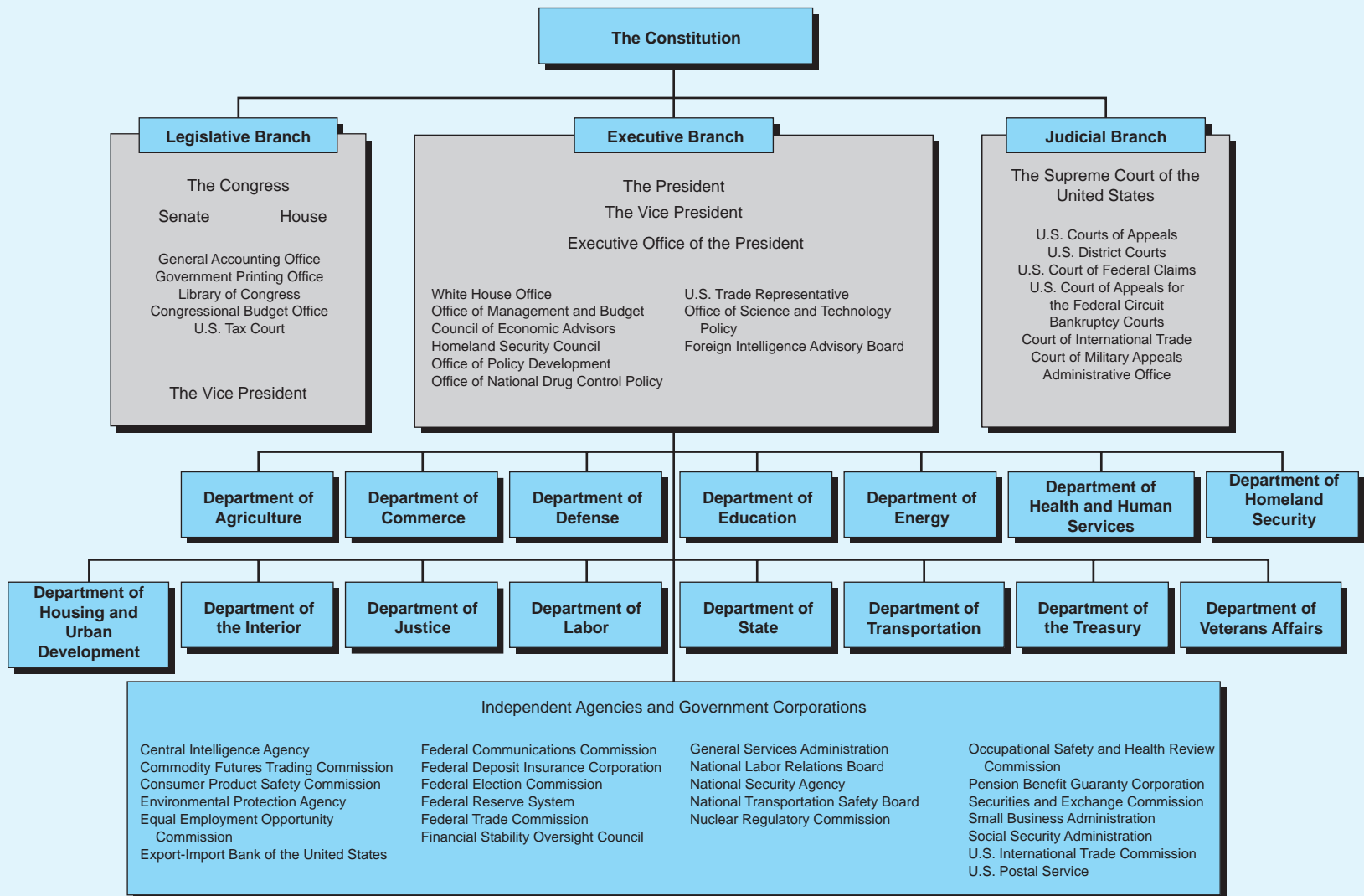
State Legislatures

Each state has lawmaking bodies similar to Congress in their functions and procedures. With the exception of Nebraska, all states have a two-part legislature containing a House of Representatives (sometimes called a House of Delegates or an Assembly) and a Senate. Dividing power between two houses is intended to serve as an added check on government power. The lawmaking process in state legislatures is similar to the procedure followed by the Congress. However, in some states voters may directly enact legislation through the voting process in referendums or initiatives.

The National Conference of Commissioners on Uniform State Laws works with lawyers, law professors, the business community, and judges. For over a century, it has drafted proposed laws for consideration by state legislatures. Some are ignored, but others have been widely adopted, such as the Uniform Commercial Code (UCC). The UCC, discussed in Chapters 11 and 12, is designed to ease the legal relationship among parties in commercial transactions by making laws uniform among the states. Another important uniform law adopted by most state legislatures is the Uniform Partnership Act, covered in Chapter 13.

Administrative Agencies and Regulations

An administrative agency is created by the delegation of legislative power to the executive branch. Congress or the state legislature enacts a law that directs the agency to issue regulations, bring lawsuits, and otherwise act to fulfill the law's



Note: This chart shows only the more important federal agencies that affect business agencies.

goals. For example, after President Nixon created the Environmental Protection Agency, Congress gave it authority to enact regulations to implement the goals of environmental statutes and to be the primary enforcer of those laws. Similarly, all states have created state environmental agencies to design and enforce state environmental regulation.

Within the boundaries set by the legislature, administrative agencies can exercise broad powers to enact regulations, supervise compliance with those regulations, and adjudicate violations of regulations. Regulations flowing from administrative agencies are among the important sources of law affecting the legal environment of business today. Agency procedures are discussed in Chapter 15.

The Judiciary and Common Law

The **common law**—law made and applied by judges as they resolve disputes among private parties—is an important component of the legal environment of business as it is the foundation of agency, contract, property, and tort law. In addition to applying the common law, the judiciary interprets and enforces laws enacted by legislatures. As we will see, some statutes, such as the antitrust laws, are written broadly and require significant court interpretation to be understood. The judiciary also reviews actions taken by the executive branch and administrative agencies to make sure they comply with the Constitution.

The oldest source of law in the United States, the common law dates to colonial times, when English common law governed most internal legal matters. To maintain social order and to encourage commerce, the colonists retained English common law when the United States became an independent nation.



Lighter Side of the LAW

Creative Common Law

An 18-year-old high school student in California “earned” over \$1 million in a stock scam. When the federal authorities busted his operation, charged him with securities fraud, and made him repay his earnings, he was also booted off his high school baseball team.

He then sued his high school for \$50 million. The basis of his suit was that he had planned to be a major league baseball player, but now that he could not play on his high school team, he could not perform in front of baseball scouts who would draft him into the pros. He lost.

Source: *True Stella Awards*

Getty Images

Case Law

Under the common law, a dispute comes to court in the form of a *case*. A case is a dispute between two or more parties that is resolved through the legal process. In common law cases, the judge follows earlier judicial decisions that resolved similar disputes. For hundreds of years now, the decisions written by judges to explain their rulings in important cases, and some not-so-important cases, have been published in books called **case reporters**. The reporters are the official publication of case decisions and are public information. To settle disputes that are similar to

past disputes, judges look for guidance by studying decisions from earlier recorded cases. This is referred to as **precedent** that is applied to the facts of the new cases under consideration and helps to guide the decision.

To settle unique or novel disputes, judges create new common law. Even in such cases, their rulings are based on the general principles suggested by many previously reported decisions. Since common law is state law, there are some differences across the states in the interpretation of common-law principles, but the judges in one state can look to cases from other states to help resolve disputes if there is no decision on point from their own state. Sometimes they will even look to decisions of courts in other common law countries.

Doctrine of Stare Decisis

The practice of deciding new cases by referencing previous decisions is the foundation of the Anglo-American judicial process used in Australia, Britain, Canada, New Zealand, India, South Africa, and other former British colonies, including the United States. The use of precedent in deciding present cases is a doctrine called **stare decisis**, meaning “to stand on decided cases.” Under this doctrine, judges are expected to stand by established rules of law. According to Judge Richard Posner:

Judge-made rules are the outcome of the practice of decision according to precedent (stare decisis). When a case is decided, the decision is thereafter a precedent, i.e., a reason for deciding a similar case the same way. While a single precedent is a fragile thing...an accumulation of precedents dealing with the same question will create a rule of law having virtually the force of an explicit statutory rule.

Value of Precedent

Stare decisis is useful for several reasons. First, consistency in the legal system improves the ability to plan business decisions. Second, as a rule is applied in many disputes involving similar facts, people become increasingly confident that the rule will be followed in the resolution of future disputes. Third, the doctrine creates a more just legal system by neutralizing the prejudices of individual judges. If judges use precedent as the basis for decisions, they are less likely to be influenced by their personal biases.

Changes in Law and Society

An advantage of dispute resolution through the common law is its ability to adapt. Although most cases are decided on the basis of precedent, judges are not prohibited from modifying legal principles if conditions warrant. As changes occur in technology or in social values, the common law evolves and provides new rules that better fit the new environment. A court may modify or reverse an existing legal principle. If that decision is appealed to a higher court for review, the higher court may accept the new rule as the one to be followed or retain the existing rule. In the case *Davis v. Baugh Industrial Contractors, Inc.* that follows, we see a state high court deciding it is time to change a common law rule.

Reporting Court Case

Like all cases presented in this book, the *Davis v. Baugh Industrial Contractors* case begins with its legal citation. There were several parties to the case on both

Davis v. Baugh Industrial Contractors, Inc.



Supreme Court of Washington
159 Wash.2d 413, 150 P.3d 545 (2007)

Case Background *Glacier Northwest hired Baugh Industrial Contractors to build a processing facility that included a system of underground pipes. Three years later, Glacier suspected a leak in a pipe. It assigned an employee, Alan Davis, to uncover the leak, which he did. While he was down in a hole dug to get to the pipes, a concrete wall collapsed, killing him. While the pipes were supposed to last 100 years, it is likely they had been damaged when installed, resulting in a leak. Tami Davis, Alan's daughter, sued Baugh and others, contending their negligent practices were the cause of Alan's death.*

The trial court, called the superior court, held for Baugh and dismissed the suit. Under the traditional common law rule, the contractor was not liable for such an accident, so the risk of liability was on the property owner, Glacier. This decision was appealed to the Washington state high court which then issued this decision.

Case Decision *Chambers, Justice*

* * *

Under the completion and acceptance doctrine, once an independent contractor finishes work on a project, and the work has been accepted by the owner, the contractor is no longer liable for injuries to third parties, even if the work was negligently performed. Historically, after completion and acceptance, the risk of liability for the project belonged solely to the property owner. This court has not addressed this doctrine in over 40 years and, in the meantime, 37 states have rejected it. Under the modern...approach, a builder or construction contractor is liable for injury or damage to a third person as a result of negligent work, even after completion and acceptance of that work, when it was reasonably foreseeable that a third person would be injured due to that negligence.

We join the vast majority of our sister states and abandon the ancient Completion and Acceptance Doctrine. We find it does not accord with currently accepted principles of liability...

The Completion and Acceptance Doctrine is also grounded in the assumption that if owners of land inspect and accept the work, the owner should be responsible for any defects in that accepted work. While this assumption may have been well founded in the mists of history, it can no longer be justified. Today, wood and metal have been replaced with laminates, composites, and aggregates. Glue has been replaced with molecularly altered adhesives. Wiring, plumbing, and other mechanical components are increasingly concealed in conduits or buried under the earth. In short, construction has become highly scientific and complex. Landowners increasingly hire contractors for their expertise and a nonexpert landowner is often incapable of recognizing substandard performance...

We conclude that the Doctrine of Completion and Acceptance is outmoded, incorrect, and harmful and join the modern majority of states that have abandoned it in favor of the [modern] approach [holding a builder or contractor liable for injury due to negligent work]. We reverse the superior court order...and remand for further proceedings in keeping with this holding.

Questions for Analysis

1. The court rejected the common law rule concerning completion and acceptance that had been in effect until this decision and ordered a new trial. What was the key reason for that decision? How does the new rule affect liability?
2. A judge on the court dissented from the decision. Explaining his opposition to the decision of the majority, he said this change in the law should have been done by the legislature in a statute, not the court. What are the practical problems with such a view?

sides, but the citation only refers to the lead plaintiff, who brought the suit, and the first defendant named in the suit. Then we see where the decision comes from and the reporter citation that tells us where it can be found. The decision was issued by the Washington state Supreme Court in 2007. It is published in volume 159 of the state of Washington official reporter, in its second series, beginning on page 413. It is also published in volume 150 of the *Pacific Reporter* (P), which is in

its third series, and the case begins on page 545. The *Pacific Reporter* is a multi-state reporter produced by Westlaw. We follow the citation with a description of the facts determined at trial (Case Background), which is a summary by the textbook authors. Then we move to the Case Decision, an explanation of the law, and legal reasoning. The judge who authored the decision for the court is named, and the material that follows is quoted from the decision itself. After the decision, we consider Questions for Analysis.

Reported cases are called “primary sources” because they *are* the law. But, when trying to understand an area of law, it is common to rely upon “secondary sources” that explain the law. When secondary sources are respected, they will be referred to by judges when giving decisions in cases. For example, the *Restatement of Torts* is an authoritative source on the law of torts. It is one of the many *Restatements of the Law* that are published on all major areas of common law by the American Law Institute (ALI; see www.ali.org). The ALI describes itself as “the leading independent organization in the United States producing scholarly work to clarify, modernize, and otherwise improve the law.” It appoints “reporters” to contribute to *Restatements* according to their area of expertise. The reporters are lawyers, judges, and law professors who contribute to an ongoing review of the law. Every several decades, there may have been

INTERNATIONAL PERSPECTIVE



Civil Law Systems

Much of the world has a *civil law* (sometimes called a *civilian system*). Civil law systems are dominant in most countries in Europe and Central and South America, as well as in parts of Asia and Africa. While each civil law system has unique features, there are three major characteristics that differentiate a civil law system from common law:

- Civil law systems are inquisitorial rather than adversarial.
- Civil law is code-based rather than case-based.
- Civil law is influenced more by academic experts than by practicing lawyers.

Civil law has its roots in the Roman Empire. A body of legal experts gradually became prominent in Rome and their writings on law came to be seen as authoritative. As the Empire grew, Roman law adapted to the needs of commerce across an ever-larger territory and developed sophisticated concepts of contract and property law. The Emperor Justinian (ruled 518–565 C.E.) ordered the compilation of the law (*The Digest of Justinian*) and an introductory text (*The Institutes of Justinian*). These works survived the collapse of the Roman Empire and became the basis for modern European legal systems when copies were rediscovered in libraries in the sixteenth century.

The French Emperor Napoleon initiated the next step in the civil law’s development. He ordered French legal experts to create a comprehensive code of laws for the French empire. After its adoption in 1804, Napoleon implemented the code in the countries he conquered; it proved so useful that many retained their Napoleonic Codes even after French rule. Continental European powers transmitted the civil law to their colonies in the Americas, Asia, and Africa. Other nations, including China and Japan, adopted civil law systems after studying European laws.

There are three key things about the civil law for businesses. First, because the structures of civil law systems are so different from common law ones, doing business in civil law countries requires careful legal review of contracts and other documents. Words that mean one thing in the common law may take on a quite different meaning in a civil law system. Second, because civil law systems are inquisitorial, judges have much greater power to direct the course of legal proceedings. Instead of only ruling on matters lawyers bring to them, civil law judges can initiate proceedings on their own. Third, even where the rules are similar, civil law system procedures differ, making it important to have local attorneys who can explain and handle proceedings.

enough change in an area of law for reporters to believe that a new *Restatement* should be published. For instance, the *Restatement (Third) of Torts* is now published in what is called “tentative draft form” alongside the older *Restatement (Second) of Torts*. This does not mean that the older *Restatement* is not a good source on the law—indeed it still dominates. However, courts are beginning to refer to the *Restatement (Third) of Torts*, as we will see in future chapters.

The Executive

In addition to being the one who signs (or vetoes) bills passed by the legislature, the president or governor is another source of law. He or she creates law by issuing **executive orders**, requiring agencies to do certain things within the executive's scope of authority, such as an order to give preference to buying recycled products or to restrict financial transactions by suspected terrorist organizations.

The chief executive can also influence how administrative agencies undertake their duties and responsibilities. One administration may not pursue environmental, antitrust, or international trade regulation as strongly as another administration. Thus, some industries or companies may face a more hostile legal environment under one administration than under another.

International Sources of Law

A firm doing business in another country is subject to its laws. Sources of international law affecting business include the laws of individual countries; the laws defined by treaties, which are international agreements, including trade agreements among countries; and the rules enacted by multinational regional or global entities, such as the World Trade Organization, and decisions of international tribunals, such as those created by the North American Free Trade Agreement (NAFTA).

Article II, Section 2 of the U.S. Constitution requires approval by two thirds of the Senate before a treaty agreed to by the president becomes binding on the U.S. Treaties of significance to business include the United Nations Convention on Contracts for the International Sale of Goods, which can govern the sale of goods between parties from different countries (discussed in Chapter 11), and the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which assists in the enforcement of arbitration clauses in international business contracts. Treaties and laws particular to the international legal environment are discussed in Chapter 22 and at various points in other chapters.

Classifications of Law

The organization of law can be thought of in several ways, such as whether it originated from a constitution, a legislative body, or the judiciary. It is common to classify law on the basis of whether it is: 1) public or private, 2) civil or criminal, or 3) procedural or substantive. Laws usually fall into more than one classification. For example, the sale of car insurance is affected by private law (a contract between the company and the buyer) and public law (state regulation of insurance). A violation of law could result in civil law penalties or criminal law penalties for an insurance seller. A violation of a contract could result in a civil suit by the wronged party.

Public and Private Law

Some examples of public and private law are provided in Exhibit 1.3. **Public law** concerns the legal relationship between members of society—businesses and individuals—and the government. Public law includes statutes enacted by Congress and state legislatures and regulations issued by administrative agencies.

Private law sets forth rules governing the legal relationships among members of society. It helps to resolve disputes and to provide a way for the values and customs of society to influence law. Private law is primarily common law and is enforced mostly through the state court systems. Unlike public law, which at times makes major changes in legal rules, private law tends to be quite stable and changes slowly.

Exhibit 1.3

EXAMPLES OF PUBLIC AND PRIVATE LAW

Public Law	Private Law
Administrative Law	Agency Law
Antitrust Law	Contract Law
Bankruptcy Law	Corporation Law
Constitutional Law	Partnership Law
Criminal Law	Personal Property Law
Environmental Law	Real Property Law
Labor Law	Tort Law
Securities Regulation	Trusts and Estate Law

Civil and Criminal Law

When a legislative body enacts a statute, it decides whether the law is to be civil, criminal, or both. Unless a statute is designated as criminal, it is considered to be civil law. Examples of civil and criminal law are provided in Exhibit 1.4.

Exhibit 1.4

EXAMPLES OF CIVIL AND CRIMINAL LAW

Civil Law	Criminal Law
Contract Law:	Misdemeanor Offenses:
Auto Repairs	Simple Assault
Buying Airline Tickets	Disturbing the Peace
Forming a Business	Larceny (Petit)
Sale of Clothing	Public Intoxication
House Insurance	Trespass
Tort Law:	Felony Offenses:
Battery	Burglary
Defamation	Homicide
Invasion of Privacy	Larceny (Grand)
Medical Malpractice	Manslaughter
Trespass	Robbery

Criminal law concerns legal wrongs or crimes committed against the state. As determined by federal or state statute, a crime is classified as a **felony** or a **misdemeanor**. A person found guilty of a criminal offense may be fined, imprisoned, or both. To find a person guilty of a crime, the trial court must find that the evidence presented showed beyond a **reasonable doubt** that the person committed the crime. The severity of punishment depends in part on whether the offense was a felony or a misdemeanor. Generally, offenses punishable by imprisonment for more than a year are classified as felonies. Misdemeanors are generally less serious crimes, punishable by a fine and/or imprisonment for less than a year. We discuss criminal law with respect to business in Chapter 5.

Civil law is concerned with the rights and responsibilities that exist among members of society or between individuals and the government in noncriminal matters. A person or business found liable for a *civil wrong* may be required to pay money damages to the injured party, to do or refrain from doing a specific act, or both. In finding the wrongdoer liable, the jury (or the judge in a nonjury trial) must find that the **preponderance of the evidence** favored the injured party, a lower standard of proof than is required in criminal cases.

Substantive and Procedural Law

Substantive law includes common law and statutory law that define and establish legal rights and regulate behavior. **Procedural law** determines how substantive law is enforced through the courts by determining how a lawsuit begins, what documents need to be filed, which court can hear the case, how the trial proceeds, and so on.

A criminal trial, for example, follows criminal procedural law which sets deadlines, determines how evidence is introduced, and so forth. The appropriate appellate procedure must be followed when a lower-court decision is appealed to a higher court for review. Similarly, agencies enforcing administrative laws and regulations must follow appropriate procedures. While most of our focus will be on substantive law, it is important to keep in mind that proper procedure must be followed by all participants in the formal legal system. Examples of categories of substantive and procedural law are provided in Exhibit 1.5.

Exhibit 1.5

EXAMPLES OF SUBSTANTIVE AND PROCEDURAL LAW

Substantive Law	Procedural Law
Antitrust Law	Administrative Procedure
Contract Law	Appellate Procedure
Criminal Law	Civil Procedure
Environmental Law	Criminal Procedure
Labor Law	Discovery Rules
Securities Law	Evidence Rules



TEST YOURSELF

1. State constitutions must be approved by Congress: T–F.
2. When a court decides a common law case it usually relies on _____ from earlier decisions under the doctrine of _____.
3. When the president and Congress agree to bind the United States to an international agreement, the agreement is called:
 - a. An executive order
 - b. A treaty
 - c. A constitutional amendment
 - d. A uniform act
4. In the case *Davis v. Baugh Industrial Contractors*, the Washington state high court held that it would abandon an old rule concerning employer liability for worksite injury: T–F.

Answers: f.; precedent and stare decisis; b.; T.

Business Ethics and Social Responsibility

Public confidence in many major institutions is low. Surveys indicate that the least trusted institutions are law firms, Wall Street, Congress, big companies, labor unions, and the media. Most trusted are the military and small businesses. This must be taken with a grain of salt. Despite not trusting Congress, most people like their members of Congress; reelection rates are high. Despite not trusting big companies or Wall Street in general, most people buy products and services from big companies and keep their money in Wall Street firms. Nevertheless, when a firm suffers a scandal, the loss of reputation means lost sales and a decline in the value of the company. Trust is critical in business relationships, so building and maintaining a reputation for ethical standards is valuable.

Ethics, Integrity, Morality, and the Law

The concepts of ethics, integrity, morality, and the law are related but are not the same. **Ethics**, in the context of business practitioners, has to do with rules or standards governing the conduct of members of a profession and how standards are put into action within an organization. **Integrity** means living by a moral code and standards of ethics. **Morality** concerns conformity to rules of correct conduct within the context of a society, religion, or other institution.

The law is often distinct from those concepts because ethics, integrity, and morality concern voluntarily adopted standards of conduct. The law contains rules that are not moral or ethical but are imposed upon people. Slavery was legal until the 1860s and, even after it was abolished, there were laws for another century that mandated race discrimination. During that time, subverting the law may have been unlawful, but few would assert such actions were immoral or unethical. Indeed, people who engaged in acts that intentionally defied the law, such as Martin Luther King, Jr., are regarded as having great integrity.

Business Ethics

Peter Drucker, one of the most noted management consultants of all time, said that one should not make a distinction between business ethics and personal ethics. We should put into practice what we believe and not compromise based on moral relativism or business necessity of the time or place.

Consider this situation: The company Lockheed was in a struggle for survival in the 1970s because its commercial aircraft were not selling well. To obtain a large order from All Nippon Airways in Japan, the company had to bribe members of the Japanese government. Paying the bribes, and getting the order for new aircraft, did not put money in the pockets of the Lockheed executives, but it did save thousands of jobs at Lockheed. When the bribes became known, the top executives at Lockheed were ousted. Forgetting the fact that the bribes were illegal under U.S. law, was the bribe ethical because it saved many jobs?

Drucker said no, a bribe is a bribe. If business is not worth doing on a competitive basis, it should be abandoned. Lockheed should have gotten out of the commercial aircraft business (which it soon did) and looked for something more profitable to pursue, not rely on bribes to stay in a market. A firm that must do that to survive is not one that can survive on its merits. Once business leaders go down the path of justifying this act and that act, even if not for personal profit, ethics are lost.

Political Reality

Such situations are not confined to other countries. In the United States, for example, many “pay to play” cases have come to light. That is, in some cases firms must pay bribes, directly or indirectly, to city, state, or federal government officials to have a chance to receive lucrative contracts. If uncovered, there may be criminal charges involved; but even when certain the payments would go undiscovered, you must ask yourself if the business is worth getting in any case?

Campaign contributions by businesses and business leaders are a part of the political economy in which we operate. Most contributions are legal, but the suspicion of influence peddling is always present. If you do not contribute, maybe your firm will get passed by in consideration for contracts that are awarded each year under the direction of political leaders. To get along, you have to go along, so most companies do, but the practice is regarded with great suspicion by the public.



ISSUE Spotter

OK to Grease Palms?

You are hired as a construction supervisor by a firm specializing in multi-story offices. Such construction requires visits by city building inspectors, who must sign off on certain work completed before a permit is issued to begin the next stage. Other supervisors let you know that the inspectors are used to being slipped \$100 to \$500, depending on the level of permit being issued. You get repaid by a petty cash fund that is largely for this purpose. What are your options?

Bribes are illegal and unethical. The hard ethical questions arise when something is not illegal but ethics are in question. In many jurisdictions, discrimination against people on the basis of sexual preference is not illegal. Assuming it is not, is it ethical to allow such discrimination within a business? These are profoundly difficult questions that are more properly addressed in a class on business ethics. Here we are only touching on the interface between law and ethics.

Perceptions of Ethics and Responses

In response to public image and real internal problems, most corporations have written codes of ethics. Making these more than window dressing can be difficult. In one study, Professor William Frederick found that corporations with codes of ethics were cited for legal infractions by federal regulatory agencies more frequently than corporations without codes. Similarly, corporations that made a special effort to improve corporate ethics by placing more people purported to have a socially conscious perspective on their boards of directors witnessed little change in the corporate culture. That is, building ethical standards into business operations—such that it is more than just slogans—is a complex task.



Lighter Side of the LAW

Our Values

Respect: We treat others as we would like to be treated ourselves. We do not tolerate abusive or disrespectful treatment. Ruthlessness, callousness, and arrogance don't belong here.

Integrity: We work with customers and prospects openly, honestly, and sincerely. When we say we will do something, we will do it; when we say we cannot or will not do something, then we won't do it.

Source: *Enron 1998 Annual Report*

Getty Images

Ethics Codes and Compliance Programs

Ethics codes matter little unless there is a serious effort to ensure compliance within an organization. Ethics and legal requirements may be blended in compliance codes. To be effective, such codes require diligent enforcement by management. According to the Department of Justice (DOJ), the existence of an effective corporate **compliance program** is a key factor in the agency's decision whether to prosecute an organization or to recommend leniency to a court when a legal problem arises. This will be discussed more in Chapter 5.

The U.S. Sentencing Guidelines, which list punishment recommendations for various crimes, state that a company found guilty of violating a law could have its fines reduced by as much as 95 percent if it is found to have a strong compliance program in place. A good ethics/compliance program can also result in a civil proceeding rather than a criminal prosecution of legal violations.



CYBER LAW

Online Ethics and Legal Compliance

The evolution of the Internet has meant changes in the law, as we will see at various points in the text. It also means new ethical challenges—but also some opportunities.

Software allows employers to monitor every keyboard click an employee makes. This is criticized as an invasion of privacy. Is it wrong for an employee to send personal e-mails from work? Is that really any different from chatting about a basketball game for a few minutes with a co-worker? However, since employers can be sued for sexual harassment if obscene e-mails are passed around or if pornographic websites are accessed from company computers, managers have good reason to monitor

employees' website visits and to keep copies of all e-mail transmissions. They can also watch for breaches in security to be sure that proprietary company information is not being released.

Many companies have employees take legal and ethics training online. It is a cost-effective way to make sure employees are informed about employment discrimination, payoffs, conflicts of interest, and other matters that can spell big trouble for businesses. Employees may also be tested online regarding their knowledge of law and ethics. Many employers find online training more effective than gathering people in auditoriums for instruction, where they may tune out the information presented.

Getty Images

Prevention is less costly than a cure. A survey of 3,000 workers found that 69 percent had received ethics training at work. Such training has been rising steadily over time, which is likely evidence of intent to instill good practices. But remember that compliance programs are internal management tools for helping to avoid legal problems; ethical standards beyond compliance required by law, or so as to reduce possible punishment, are management decisions about law, not ethics.

INTERNATIONAL PERSPECTIVE



Does Regulation Improve Business Ethics?

The financial scandals have been a reason for expanded securities regulation. The drug trade has resulted in increased control of money transfers. When problems arise, there is usually a call for increased government regulation to prevent future problems.

All nations have regulations and bureaucracy. But the wrong kind of regulation, especially when coupled with a corrupt bureaucracy, stifles business and reduces economic opportunities for ordinary people. The World Bank report, *Doing Business*, notes that the more regulation a country has, the more corruption it is likely to have and the lower its standard of living.

The World Bank gives some examples. To start a small business in Indonesia, an entrepreneur must wait an average of six months for permits. In the United Arab Emirates, trying to collect payment from a customer

who will not pay requires 27 procedures taking almost two years. In India, bankruptcy procedures take an average of ten years. Countries that regulate business the most include Bolivia, Congo, Guatemala, Haiti, Mali, Mozambique, Paraguay, the Philippines, and Venezuela. The countries that regulate the least include Australia, Canada, Denmark, Hong Kong, the Netherlands, New Zealand, Norway, Singapore, and the United Kingdom.

Good regulation requires ethics in government. In many countries, regulation simply provides a legal excuse to collect bribes. The regulations stay as they are because there are political interests that want to keep the system in place, including established business interests that want to be protected against new competitors.

Getty Images



ISSUE Spotter

Putting Ethics into Practice

A large chain of stores gives all employees a brief pamphlet called *Business Conduct Guide*. It states that everyone in the company should be “guided by the highest ethical and legal standards.” It then gives brief guidance on a number of legal issues. For example:

Antitrust: We must compete vigorously and fairly in the marketplace using our independent judgment to make the best decisions for the Company.

Credit: We must provide accurate disclosure of credit terms and meet all requirements relating to fair credit reporting and equal credit opportunity.

Employees are told to report violations either to their supervisor or to the Chief Financial Officer of the company. Is this likely to be part of an effective ethics/compliance program? Can sales clerks relate to these issues?

Getty Images

Ethics and Corporate Social Responsibility

Peter Drucker, the “Father of Modern Management,” discussed “the ethics of social responsibility.” Sometimes this is called **corporate social responsibility**. Drucker asserted that this ethic applied to those in leadership positions. The first responsibility of a business leader is to ensure that the corporate mission is fulfilled. That is why a person is put in a position of leadership—to help make effective use of resources entrusted to a company by investors. To earn a profit is an ethical social responsibility. Part of that responsibility is minimizing errors that impose damage. That conforms to the old norm, “first, do no harm.”

That is closely related to Google’s “Don’t be evil” rule. The Google Code of Conduct spells this out in detail as it applies to many areas of operation, including serving customers, personnel policy, and privacy issues. The company said it took the Code seriously when it decided to close operations in China, where it had more than a third of the Internet search market and was growing rapidly. The government of China stated that Google was breaking Chinese law by refusing to submit to censorship. Google agreed and withdrew rather than submit to the law.

Many companies have staffs dedicated to considering a wide range of impacts from company operations. This can help firms discover issues that may not have been considered when only focusing on, say, the costs of alternative site locations for a facility. Evaluation of a wide range of social impacts on a community and in a market can reveal issues that have an effect on the long-term costs of operations. There is a wide range of opinions about how much social responsibility, beyond the immediate impact on operations, a company has as part of being a good citizen.

A commitment to a code of ethics, which takes a firm beyond its legal obligations, is generally not binding on a company. Violations that are ignored may cause bad press for a company and bad morale for employees, however, as the *Lamson v. Crater Lake Motors* case makes clear, codes of ethics and the law are distinct matters.

Lamson v. Crater Lake Motors



Court of Appeals of Oregon
216 Or.App. 355, 173 P.3d 1242 (2007)

Case Background For 15 years, Kevin Lamson was a sales manager for a car dealership. He was a good employee who valued his job and liked the company's philosophy that "customers come first." He believed the dealership was held in respect for not having aggressive sales tactics. Lamson had a reputation among his employees "for adhering to a high standard of ethics and integrity."

When sales were lagging, the company hired an outside sales firm, Real Performance Marketing (RPM) to run a five-day sales promotion. During the promotion, Lamson observed "a number of activities he considered to be unethical or unlawful or both." RPM produced a video that said that "all vehicles" would be cut in price. In fact, only the vehicles pictured in the video were on sale. RPM also tried to "pack the payments" by providing customers such things as life insurance and service contracts in purchase agreements without the customers' knowledge. When Lamson complained to the general manager (GM), he was told to go home.

After the sale, relations worsened. The GM told Lamson that another sales manager was making an extra \$600 profit per sale. Lamson checked the records and found it was \$100 per sale. The GM hired RPM to run another sale. He and Lamson argued. Lamson said it sounded as if the GM wanted him out and the GM said, "You're right." He told Lamson to cooperate with RPM. Lamson gave the company owner a letter complaining of RPM's tactics, noting that it violated company rules regarding sales ethics and that he did not want to see "the values, ethics, morals, and honorable dealings" of the company lost. He asked him to rethink the "profit at any cost mentality."

The owner said that the company would still be "treating customers with the highest ethical standards" and that RPM promised "no misrepresentations or illegal statements." When Lamson did not cooperate with RPM during the next sale, he was fired. He sued for wrongful discharge, contending that he was fired for complaining about sales tactics that may have been illegal and that violated the company's code of ethics. The jury held for Lamson. The company appealed, contending that Lamson had no cause of action.

Case Decision Edmonds, Presiding Judge.

Nor can we conclude...that plaintiff's internal complaints of unlawful sales practices are of the same public importance as the reports of health and safety violations in our earlier case law. Here, plaintiff did not report or threaten to report RPM's activities to anyone *outside of defendant*, and there is no evidence that defendant intended to "silence" him in a manner that would conceal illegal activities. On these facts, we cannot conclude that plaintiff's internal complaints about defendant's use of a sales firm serves a societal duty.... Thus, we conclude that plaintiff's internal complaints, standing alone, did not serve an important societal obligation for purposes of a common-law wrongful discharge claim.

* * *

In sum, the evidence, viewed in the light most favorable to plaintiff, does not establish a legally cognizable basis for a claim for wrongful discharge. The employment relationship between plaintiff and defendant was an at-will employment relationship, which meant that plaintiff could be discharged for any reason, unless the discharge was for exercising a job-related right reflecting an important public policy or for fulfilling an important public duty. Here, the evidence is undisputed that plaintiff was not explicitly or impliedly directed to participate in any unlawful activity.... Even if defendant's actions, viewed together as plaintiff posits, were pretextual because defendant no longer desired to employ plaintiff and expected that he would not attend the March 2004 sale, plaintiff was not discharged for fulfilling what the law would recognize as an important *public duty*. In other words, defendant took no action concerning plaintiff that amounted to a tort under the applicable law regarding at-will employment relationships. Regardless of whether plaintiff's refusal to work on the ground that his presence would "condone" RPM's sales tactics was laudable, his actions do not fall within the narrowly defined exceptions created by the law of wrongful discharge, and defendant's conduct is not actionable in a court of law.

For all of the reasons stated above, the trial court should have granted defendant's motion for a directed verdict. Reversed.

* * *

Questions for Analysis

1. Suppose some of the sale tactics used by RPM violated Oregon law. What could Lamson do about it? Unless he suffered the effects of an illegal practice by making a purchase based on such practice, he had no complaint at law. Who would know more about such practices: those involved in putting them in place or a customer? Do you think any other car dealer would want to hire Lamson if he went public about his complaints?
2. Why do you think the courts are shy to get involved in such incidents? Should the courts be enforcers of company's ethical practices and codes of ethics?



TEST YOURSELF

1. Which of the following is not held by the public in low esteem:
 - a. Congress
 - b. Small business
 - c. Law firms
 - d. Big business
2. A person with a strong set of _____ is more likely to be a person of high _____.
3. To reduce the severity of penalty in case of prosecution by the government, many companies have adopted: _____.
4. Peter Drucker, like others, argued that it is not unethical for a firm to pay bribes in another country, if that is the norm, and if it protects jobs in the United States: T-F.

Answers: b; ethics or morals; integrity; codes of compliance; F.

SUMMARY

- The modern environment of business means that managers in all firms face a variety of ethical, legal, social, political, and international issues that make business increasingly complex.
- Law is a collection of principles and rules that establish, guide, and alter the behavior of members of society. Rules include both the formal rules (law) of society and the informal rules as dictated by customs, traditions, and social ethics.
- Law and the legal system serve important functions in an orderly society. Law helps to define acceptable behavior. To ensure order, the legal system provides a formal means through which disputes can be resolved. The law maintains the important values of a society. Finally, the legal system provides a way to encourage changes in social consciousness.
- Sources of law include the U.S. and state constitutions, Congress and the state legislatures, the judiciary branch, the executive branch (the president at the federal level and the governors at the state level), state and federal administrative agencies, and multiple sources that form the international legal environment of business.
- Judge-made or common law is the original source of law in this country. This system encourages judges to use prior decisions, or precedents, for guidance in deciding new disputes. The doctrine of stare decisis, standing on precedent, helps give consistency to case law.

- Law can be classified on the basis of whether it is public or private, civil or criminal, or substantive or procedural.
- The public image of big business and of other major institutions is low. Dishonesty is believed to be common. To overcome problems, many companies use codes of ethics, and firms are enforcing compliance programs to help reduce severity of punishment by regulators in case of law violations.
- Business ethics involve standards and obligations that persons and firms may uphold in business that go beyond the requirements of the law. Some firms have active corporate social responsibility programs that engage the company in activities not required by law.

TERMS TO KNOW

You should be able to define the following terms:

law, 3	private law, 14	substantive law, 15
constitution, 6	criminal law, 15	procedural law, 15
common law, 9	felony, 15	ethics, 16
case reporters, 9	misdemeanor, 15	integrity, 16
precedent, 10	reasonable doubt, 15	morality, 16
stare decisis, 10	civil law, 15	compliance program, 18
executive orders, 13	preponderance of the	corporate social
public law, 14	evidence, 15	responsibility, 20

DISCUSSION QUESTION

Should the common-law maxim “Ignorance of the law is no excuse” apply to an immigrant who speaks little English and was not educated in the United

States? How about for a tourist who does not speak English?

CASE QUESTIONS

1. Consider the following factual situation taken from an English judge’s decision in 1884: “The crew of an English yacht...were cast away in a storm on the high seas...and were compelled to put into an open boat belonging to the said yacht. That in this boat they had no supply of water and no supply of food.... That on the eighteenth day...they... suggested that one should be sacrificed to save the rest.... That next day...they...went to the boy...put a knife into his throat and killed him then and there; that the three men fed upon the body...of the boy for four days; that on the fourth day after the act had been committed the boat was picked up by a passing vessel, and [they] were rescued, still alive.... That they were carried to the port of Falmouth, and committed for trial...That if the men had not fed upon the body of the boy they would probably not have survived to be so picked up and rescued, but would within the four days have died of famine. That the boy, being in a much weaker condition, was likely to have died before them.... The real question in this case [is] whether killing under the conditions set forth...be or be not murder.” [*Regina v. Dudley and Stephens*, 14 Queens Bench Division 273 (1884)] Do you consider the acts to be murder? Was the action immoral?
2. We know that smoking is a serious health hazard. Should cigarette manufacturers be liable for the serious illnesses and untimely deaths caused by their products, even though they post a warning on the package and consumers voluntarily assume the health risks by smoking? [*Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 112 S. Ct. 2608 (1992)]

✓ Check your answer at <http://www.cengagebrain.com>. Please see page xvii in the Preface for directions.

3. Two eight-year-old boys were seriously injured when riding Honda mini trail bikes provided by their parents. The boys were riding on public streets and ran a stop sign when they were hit by a truck. One boy was not wearing a helmet. The bikes had clear warning labels on the front stating that they were only for offroad use. The owner's manual was clear that the bikes were not to be used on public streets and that riders should wear helmets. The parents sued Honda. The supreme court of Washington said that there was one basic issue. "Is a manufacturer liable when children are injured while riding one of its mini trail bikes on a public road in violation of manufacturer and parental warnings?" Is it unethical to make products like mini trail bikes that will be used by children, when we know some accidents like this will happen? [*Baughn v. Honda Motor Co.*, 727 P.2d 655 Sup. Ct., Wash., (1986)]
4. Johnson Controls adopted a "fetal protection policy" that women of childbearing age could not work in the battery-making division of the company. Exposure to lead in the battery operation could cause harm to unborn babies.

The company was concerned about possible legal liability for injury suffered by babies of mothers who had worked in the battery division. The Supreme Court held that the company policy was illegal. It was an "excuse for denying women equal employment opportunities." Is the Court forcing the company to be unethical by allowing pregnant women who ignore the warnings to expose their babies to the lead? [*United Auto Workers v. Johnson Controls*, 499 U. S. 187 (1991)]

✓ Check your answer at <http://www.cengagebrain.com>. Please see page xvii in the Preface for directions.

5. Noonan worked for Staples, the office supply store company. It has a Code of Ethics for employees. One provision states: "We expect you to keep accurate records and reports.... We do not permit...false or misleading entries in the company's books or records for any reason." Noonan was fired for padding expense accounts. The company had the right to fire him, but it also denied him any severance benefits that he would otherwise have received. Is it proper for a company to deny such a benefit for an employee for a violation of its Code of Ethics? [*Noonan v. Staples, Inc.*, 556 F.3d 20 (2009)].

ETHICS QUESTIONS

1. The federal tax code is riddled with special-interest loopholes. Most of these exist because firms and trade associations lobby Congress and provide campaign support to members of Congress to gain special favors to individual firms or industries. Is it ethical for firms to seek special privilege?
2. "Fair trade" goods have become popular as some people are willing to pay more to know that the goods come from workers paid a decent price for their efforts. However, some retailers who sell fair trade goods mark them up substantially more than non-fair trade goods. One study showed that coffee growers got an average of 44 cents a pound more for fair trade coffee, but the coffee at retail was marked up an additional \$3.46 per pound. At one super-market chain, fair trade bananas that cost an

extra 3.6 cents per pound were marked up four times the price of non-fair trade bananas. Fair trade goods are claimed to be a form of social responsibility. Is that true if it just means higher profit margins?

3. Union Carbide (now a subsidiary of Dow Chemical) decided to locate a new plant in a depressed area with high unemployment and chose a small town in West Virginia. It built a state-of-the-art plant that had the latest pollution control technology. It created 2,500 jobs. Later, the company was attacked for polluting a previously "pristine" area. Had the plant been built in an industrial area, such as the coast near Houston, no one would have been likely to complain. Was the company socially irresponsible for building the plant in such an area?

INTERNET ASSIGNMENT

Look at these major websites for the U.S. Code and federal court system as well as key legal materials of the federal government:

Office of Law Revision Counsel, U.S. Code:

<http://uscode.house.gov/>

Cornell University Law School, U.S. Code:

www4.law.cornell.edu/uscode/

United States Courts:

www.uscourts.gov/

United States Supreme Court:

www.uscourts.gov/

The Court Systems

Billy Bones Longboards of Oregon advertises and sells its products in western states. Its boards and other goods are mostly made in Oregon. If a customer in Arizona buys a Billy Bones' board after seeing it on the Bones' website, and is then injured using it, can that injured customer bring the lawsuit in the Arizona state court? Must the dispute be decided in an Oregon state court because the business is located in that state? Or would such a dispute be decided in the federal court system? Which substantive law concerning product liability applies? Which court procedure governs the matter? In any dispute, parties must understand and resolve these questions before they can effectively use our court system.

This chapter provides an overview of the American court system and discusses how a party who has suffered a legal wrong can seek relief in the courts. In their operations, businesses may face disputes with competitors, suppliers, customers, shareholders, and government agencies. Many problems are resolved by the parties with no serious disruption in business relationships or activities. A significant number, however, require resolution in our court system through civil litigation.

A business that has a civil dispute going to litigation must first determine, with the help of an attorney, which court has the power and the authority to decide the case. That is, which court has the jurisdiction to take the case for resolution? Today, many businesses operate in multiple states and often in several countries. As a consequence, the choice of the appropriate court may not be clear, or the parties may be in a position to choose between more than one court.

The Court Systems

The federal court system was created in response to the following provision of the U.S. Constitution:

The judicial Power of the United States shall be vested in one supreme Court and in such inferior Courts [courts subordinate to the Supreme Court] as the Congress may from time to time ordain and establish.

Over many years, the federal court system developed into a three-level system. It consists of the U.S. district courts, the U.S. courts of appeals, and the U.S. Supreme Court. In addition, there are specialized courts, such as the bankruptcy courts. Each court has its own role within the federal court system. Since the thirteen original states had courts before the federal system was created, they have the oldest court systems. The two systems have evolved to have many similarities but there are still important differences.

Federal Judges

Federal judges are nominated by the president and confirmed by a majority vote in the U.S. Senate. Since the Constitution guarantees federal judges the right to serve “during good behavior,” they enjoy a lifetime appointment. Judges below the Supreme Court level retire at age 70, but may remain on “senior status,” still hear cases, and are paid. There are about 1,200 federal judges. According to the Constitution, federal judges may be removed from office only if the Congress impeaches them for treason, bribery, or other high crimes and misdemeanors. The impeachment process includes the actual impeachment (indictment) by the House of Representatives, followed by a trial before the Senate. If at least two thirds of the senators vote for removal, the judge is removed from office. This happens rarely; only a handful of federal judges in history have been removed.

While Congress may change the structure of the federal court system, it may not reduce a judge’s salary or term of office once an appointment has been made. The writers of the Constitution gave federal judges job security because they wanted to guarantee that judges would be independent and free from the pressure of politics.

State Judges

State judges are chosen by a variety of methods, as Exhibit 2.1 shows. They are elected, appointed, or chosen by a method that mixes the election and appointment processes. In several states with the mixed system, the state bar association has a committee to recommend candidates for the bench. The governor then appoints a judge from its list. The judge selected then serves until the next election, at which time the public is asked to vote for or against him. This system for selecting judges is referred to as the Missouri System.

In contrast to the position enjoyed by federal judges, most state judges serve for a fixed term, whether they are appointed or elected. Terms range from one year for judges in some Midwestern states to a fourteen year term for judges in New York. Massachusetts and New Hampshire appoint judges to serve until they reach age 70; only Rhode Island provides a lifetime term of office.

Some observers claim that appointed judges are of higher average quality than elected judges. Others claim that elected judges work harder than

Exhibit 2.1 SELECTION METHODS FOR APPEALS COURT AND TRIAL COURT JUDGES				
Merit Selection by Nominating Commission and Governor	Governor (G) or Legislature (L) Appointment	Elections by Party	Non-Partisan Elections	Combined Merit Selection and Other Methods
Alaska	California (G)	Alabama	Arkansas	Arizona
Colorado	Maine (G)	Illinois	Georgia	Florida
Connecticut	New Jersey (G)	Louisiana	Idaho	Indiana
Delaware	New Hampshire (G)	Michigan	Kentucky	Kansas
Hawaii	South Carolina (L)	Ohio	Minnesota	Missouri
Iowa	Virginia (L)	Pennsylvania	Mississippi	New York
Maryland		Texas	Montana	Oklahoma
Massachusetts		West	Nevada	South Dakota
Nebraska		Virginia	North Carolina	Tennessee
New Mexico			North Dakota	
Rhode Island			Oregon	
Utah			Washington	
Vermont			Wisconsin	
Wyoming				

Source: American Judicature Society

appointed judges. There is statistical evidence that in states with elected judges, the average awards in tort cases are larger and out-of-state companies are treated worse than in states with appointed judges. However, many elected judges are initially appointed to fill vacancies created by retirements. The evidence is that elected and appointed judges are similar in characteristics.

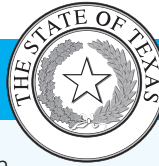
Judicial Immunity

Under the **doctrine of judicial immunity**, a judge is absolutely immune from suit for damages for judicial acts. This immunity applies even when the judge acts maliciously. Without this rule, judges could fear being sued by parties unhappy with their judicial decisions. As a result, judges would lose their ability to be independent decision makers. By protecting judges from such suits, judicial immunity aims to keep judges unconcerned about the relative power of parties who appear in court. Judicial immunity extends to parties who perform services that are related to the performance of judicial functions as we see in the *Davis* case. It also applies to certain quasi-judicial functions, such as officials who perform regulatory duties.

Organization of the Court Systems

Both state and federal court systems have lower courts of **original jurisdiction**, where disputes are first brought and tried, and courts of **appellate jurisdiction**, where the decisions of a lower court can be taken for review. In both systems, the courts of original jurisdiction are trial courts. One judge presides. The court’s principal function is to determine the facts in the dispute and to apply the appropriate law to those facts in making a decision or judgment. As we

Davis v. West



Court of Appeals of Texas, Houston
317 S.W.3d 301 (2009)

Case Background *Houston Reporting Service (HRS) provided court reporting services for attorney Davis. HRS billed Davis for its services, but was never paid. HRS sued Davis for \$1,083.98 for the deposition reported, plus attorney's fees, interest, and costs. As Davis did not defend herself against the suit, a default judgment was entered by the Justice Court in Harris County. HRS then began collection efforts. The court appointed Radoff as receiver in the case and issued an order commanding that Radoff take possession of "all...monies in deposit [by Davis] in financial institutions" pursuant to the court's order.*

Radoff sent Davis a letter informing her that he was the receiver and asked her for payment to satisfy the judgment. He sent a letter to Davis's bank demanding that the bank turn over \$4,144.91 to Radoff, which the bank did. That satisfied the judgment. HRS was paid and the receivership was closed. Davis then sued Radoff for abuse of process. The trial court granted summary judgment in Radoff's favor on the grounds that he was entitled to derived judicial immunity. Davis appealed.

Case Decision George C. Hanks, Jr., Justice

* * *

A person entitled to derived judicial immunity receives the same absolute immunity from liability for acts performed within the scope of his jurisdiction as a judge. Judicial immunity can attach to certain non-judges because the policy reasons for judicial immunity—protection of individual judges and of the public's interest in an independent judiciary—are also implicated when judges delegate their authority, appoint another to perform services for the court, or allow another to otherwise serve as an officer of the court. In those circumstances, the immunity attaching to the judge follows the delegation, appointment, or court employment. The person acting in such a capacity thus also enjoys absolute immunity, which is known as derived judicial immunity.

Texas uses a "functional approach" to determine whether someone is entitled to derived judicial immunity. The "functional approach looks to whether the person seeking immunity is intimately associated with the judicial process" and whether "that person exercises discretionary judgment comparable to that of the judge." The functional approach focuses on the nature of the function performed, not the identity of the actor, and considers whether the court officer's conduct is like that of the delegating or appointing judge.

Radoff contends that, as a court-appointed receiver acting within the scope of his authority, he is entitled to derived judicial immunity. We agree. "Like a court-appointed bankruptcy trustee acting within his authority as trustee, a court-appointed receiver acts as an arm of the court and is immune from liability for actions grounded in his conduct as receiver."

"Once an individual is cloaked with derived judicial immunity because of a particular function being performed for a court, every action taken with regard to that function—whether good or bad, honest or dishonest, well-intentioned or not—is immune from suit. Once applied to the function, the cloak of immunity covers all acts, both good and bad."

* * *

We conclude that the trial court properly granted summary judgment on Radoff's motion for summary judgment as a matter of law on his defense of derived judicial immunity....

Affirmed.

Questions for Analysis

1. Why did Radoff ask for, and get, \$4,144.91 when the amount owed was \$1,083.98?
2. Do you think Davis could have a cause of action against her bank for giving her money to Radoff without her permission?

discuss in the next chapter, the jury is responsible for deciding the facts in a case; if there is no jury in a case, the judge decides the facts.

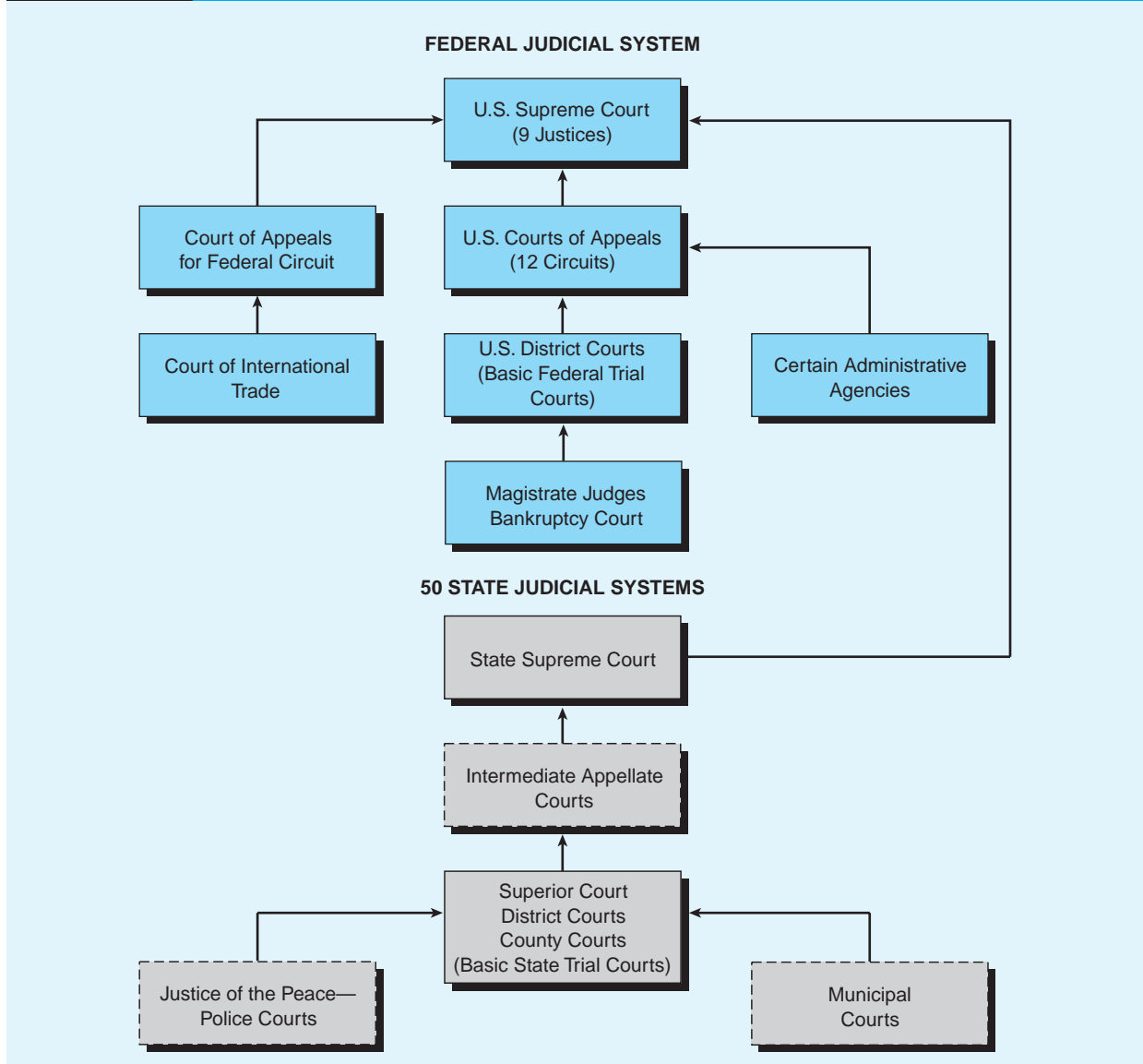
Appellate courts are concerned with correcting errors in the application of the law and making sure proper procedure was followed in the trial court

proceeding. Normally three judges review decisions at the intermediate appeals court level. Five or more judges are used in the highest appellate state courts, the state supreme courts. The basic structure of the American court system is illustrated in Exhibit 2.2. While we focus more on federal courts here, the majority of litigation occurs in state courts.

The Federal Courts

The Constitution intends for the judiciary in the United States to have significant independence from the other branches of government as part of the system of

Exhibit 2.2 THE COURT SYSTEMS



checks and balances. This is quite unlike most countries, where judges are civil servants who tend to have less independence than judges in the United States enjoy. While some state judges are in political positions, as we will discuss, federal judges, once on the bench, are quite independent. With the exception of bankruptcy judges, federal judges are appointed by the president and confirmed by the Senate. Some appointments are controversial and are rejected by the Senate.

Federal District Courts

As the trial courts of the federal system, U.S. district courts are the courts of original jurisdiction in the federal system. The district courts are the only courts in the system that use juries. Most cases involving questions of federal law originate in these courts. The geographical boundary of a district court's jurisdiction does not cross state lines. There are a total of 94 federal districts in the court system. Thus, each state has at least one federal district court; the more populated states are divided into two, three, or—as in California, New York, and Texas—four districts. In addition, there are federal district courts in the District of Columbia, Puerto Rico, Guam, and the Virgin Islands. There are 670 federal district judges, so many districts have multiple judges.

In addition to district judges, federal trial courts also use judicial officers called “magistrates.” In each district in which the Judicial Conference of the United States has authorized them to do so, the federal judges may jointly appoint one or more magistrates for eight-year terms. The judges can then send particular matters to the magistrate to be heard, such as discovery disputes, habeas corpus petitions, or civil rights claims filed by prisoners, with the magistrate making a recommendation to the district judge. Cases may even be tried before a magistrate instead of a judge, if both parties agree. This typically happens where courts have a backlog and the parties want a quicker trial than is available before the district judge. Since magistrates are not appointed under Article III of the Constitution, however, they cannot try cases in the place of a district judge without the parties' consent.

Federal Appellate Courts

U.S. courts of appeals may review federal district court decisions. Established in 1891, the U.S. courts of appeals are the intermediate-level appellate courts in the federal system. There are 12 geographically based courts of appeals, one for each of the 11 circuits into which the United States is divided and one for the District of Columbia, which hears many cases involving federal regulations. The division of the states into circuits and the location of the U.S. courts of appeals are presented in Exhibit 2.3.

The U.S. courts of appeals exercise only appellate jurisdiction. If either party to the litigation is not satisfied with a federal district court's decision, it has the right to appeal to the court of appeals for the circuit in which that district court is located. The Fourth Circuit U.S. Court of Appeals in Richmond, Virginia, for example, will hear appeals only from the federal district courts in the states of Maryland, North Carolina, South Carolina, Virginia, and West Virginia. The one exception is the U.S. government, which does not have the right to appeal a verdict in a criminal case.

Although they have many judges, the U.S. courts of appeals assign three-judge panels to review most district courts decisions appealed within their

Exhibit 2.3 THE FEDERAL JUDICIAL CIRCUITS



circuits. Occasionally, all the active judges in a circuit will hear a case in what is known as an **en banc proceeding**. As a practical matter, because it is so difficult to obtain review by the U.S. Supreme Court, the courts of appeals make the final decision in most cases.

Specialized Federal Courts

Although the U.S. Supreme Court, courts of appeals, and district courts are the most visible federal courts, there are also courts with limited or special jurisdiction within the federal court system. These courts differ from other federal courts in that their jurisdictions are defined in terms of subject matter. U.S. Bankruptcy Courts exist alongside the District Courts. Some districts have multiple bankruptcy judges because there are about 350 such judges. They handle, of course, cases under federal bankruptcy law. They are appointed by the judges of the courts of appeals and serve 14-year terms. The U.S. Court of Federal Claims, which is located in Washington, D.C., has 16 judges who serve 15-year terms. They hear cases involving monetary claims against the federal government. The U.S. Court of International Trade, which sits in New York City, has nine judges. They hear cases involving international customs matters, such as tariff classifications, and trade dispute issues. The U.S. Tax Court consists of 19 judges appointed for 15-year terms. The court primarily hears tax disputes involving the Internal Revenue Service. The court

is not a part of the federal judiciary; it is a part of the legislative branch of government.

The Court of Appeals for the Federal Circuit was created in 1982 and has 12 judges who sit in Washington, D.C. Although its jurisdiction is nationwide, its subject-matter jurisdiction is limited to appeals from the district courts in patent, trademark, and copyright cases; in cases where the United States is a defendant; appeals from the Court of Federal Claims and from the Court of International Trade; and the review of administrative rulings of the U.S. Patent and Trademark Office. Because these matters are technical, Congress established the Federal Circuit so that appeals could be heard by judges who gained expertise in these areas.

U.S. Supreme Court

The U.S. Supreme Court is the highest court in the country, as we see in Exhibit 2.2. Created by the U.S. Constitution, the Supreme Court is primarily an appellate review court. Cases reaching the Court are usually heard by nine justices, one of whom is the Chief Justice. The term of the Court begins, by law, on the first Monday in October and continues as long as the business of the Court requires. The Court sits in Washington, D.C.

As an appellate court, the Supreme Court may review appeals from the U.S. district courts, the U.S. courts of appeals, and the highest courts of the states when federal and constitutional issues are at stake. In rare instances, such as in a dispute between two state governments, the U.S. Supreme Court has original and exclusive jurisdiction. Although Congress may change the Court's appellate jurisdiction, it cannot change the Court's original jurisdiction conferred upon it by the Constitution.

Appellate review is normally obtained by petitioning the court for a writ of certiorari. Appeals to the Supreme Court are heard only at the Court's discretion. The members of the Court determine which cases they wish to review; at least four justices must agree to review a case. If that does not happen, the decision of the lower court becomes final. Although it receives thousands of such petitions each term, the Court accepts few. The Court issues about 70 to 80 opinions per term, down from more than 200 opinions in earlier decades. In contrast, most state high courts issue more opinions, such as the Montana Supreme Court, which issues more than 350 per year. Most petitions granted by the U.S. Supreme Court involve an issue of constitutional importance or a conflict between the decisions of two or more U.S. courts of appeals.

Despite differences in substantive law, foreign courts are often similar in basic structure, but not in procedure, to those in the United States. The *International Perspective* feature looks at the court system in France to contrast it to the system in the United States.

The State Courts

Although the names and organization differ somewhat from state to state, the state court systems are similar in general framework and jurisdictional authorities. Many are three-level systems and many states have local courts of special or limited jurisdiction.