

TENTH EDITION

# ESSENTIALS OF **BUSINESS LAW**



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ANTHONY L. **LIUZZO**  
RUTH C. **HUGHES**



# ESSENTIALS OF **BUSINESS LAW**

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**Tenth Edition**

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## ESSENTIALS OF BUSINESS LAW, TENTH EDITION

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# Dedication

To our faculty colleagues at Wilkes University  
who, for so many years, have  
provided us with support,  
encouragement and friendship

“A quality education has the power to transform  
societies in a single generation: provide children  
with the protection they need from the hazards  
of poverty, labor exploitation and disease;  
and give them the knowledge, skills,  
and confidence to reach their full potential.”

Audrey Hepburn,  
actress and humanitarian

# ABOUT OUR AUTHORS



Courtesy of Anthony L. Liuzzo.  
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University

**Anthony L. Liuzzo, J.D., MBA, Ph.D.** Dr. Anthony L. Liuzzo is Professor Emeritus at Wilkes University where, until recently, he served as Professor of Business and Economics and Chairperson of the Business Programs of Arizona.

Dr. Liuzzo is a licensed attorney and economist. He earned his Ph.D. in business administration, Master of Philosophy in economics, and MBA in management and organizational behavior from New York University; his law degree from St. John's University; and his bachelor's degree in marketing from Fordham University in New York City.

Specializing in public policy issues, employment law, and holiday retail sales forecasting, he has been cited on numerous occasions in hundreds of publications—including CNN, Fox News, *Forbes*, *The New York Times*, *USA Today*, the *Arizona Republic*, the *New York Daily News*, the *Philadelphia Daily News*, the *Chicago Tribune*, the *Washington Times*, the *Cincinnati Enquirer*, the *Pittsburgh Post-Gazette*, the *Detroit News*, the *Christian Science Monitor*, and the *San Francisco Examiner*—for his views on legal and business issues.

Dr. Liuzzo has been the author of several editions of the popular textbook, *Essentials of Business Law*, and its accompanying assessment materials, mobile applications, and instructor's manual, published by McGraw-Hill.

Dr. Liuzzo is also the author of several books and numerous articles that have appeared in scholarly and professional journals. He has served as editor of a scholarly journal and has been instrumental in creating several successful small businesses.

Dr. Liuzzo is an active member of many professional and community organizations and currently serves as a member and officer of several boards of directors.



©David B. Moore Photography

**Ruth Calhoun Hughes, J.D.** Ruth Hughes serves as Assistant Professor of Business Law at Wilkes University in Wilkes-Barre, Pennsylvania.

Hughes is a licensed attorney and received her JD from Washington and Lee University in Lexington, Virginia, and her BA in economics from Tulane University in New Orleans, Louisiana.

She began her career as an attorney specializing in corporate transactions in New York City and Wilkes-Barre, Pennsylvania. She was director of the Small Business Development Center in Wilkes-Barre for many years before joining the faculty of the Sidhu School of Business and Leadership at Wilkes University in 2013.

Her research interests, publications, and presentations include the areas of environmental sustainability in business, equity crowdfunding, and emerging trends in securities laws. She serves as a reviewer for several academic publications.

Hughes is an active member of many university, professional and community organizations. She is married to Richard Hughes and the proud mother of three children, Callie, Ellen, and Richard.



Courtesy of Ruth Hughes

# Preface

## WELCOME TO *ESSENTIALS OF BUSINESS LAW*

The new, tenth edition of the *Essentials of Business Law* program is a practical, concise, and broad-based introduction to the vibrant field of business law. While continuing to offer all of the features that have made the nine prior editions successful, this new edition includes a new chapter on the areas of law affected by social media, updated content, and enhanced support materials. Both the traditional areas of law, such as contracts and property, and the emerging areas of law, such as e-commerce and environmental, are covered in short, informative chapters written to capture the essence of each topic. The objective of the text throughout its coverage is ease—ease of use, ease of teaching, ease of assessment, and ease of understanding. It has been developed for those seeking a more fundamental overview of the concepts and principles that are vital to the understanding of business law.

## NOTE TO STUDENTS

The tenth edition of *Essentials of Business Law* covers the latest developments in the legal field. This text will help you discover a wealth of information and learning opportunities that will give you a clear understanding of business law topics. The text will also help you identify, explain, and apply the principles of business law in your daily life and in the larger world in which you live. The world of business is continually changing, especially with the advent and evolution of the global marketplace. The concepts and principles presented in the text will assist you in understanding those changes as they relate to business law.

The chapters in *Essentials of Business Law* are organized in a concise and easy-to-read way. Numerous examples applying the law to real-world situations will assist you in understanding important concepts, whereas key term definitions are provided throughout the text for your reference. The end-of-chapter assessments will help you apply your knowledge and gauge your understanding of the material as you progress, and the extra resources accompanying the text will provide useful and easy-to-use tools to supplement your appreciation of the material.

## NOTE TO INSTRUCTORS

What sets *Essentials of Business Law* apart from other programs available is its concise organizational nature and supplementary materials. Chapters are succinct, making it simple for you to plan presentations and teach the course. Each chapter offers an abundance of assessment tools that will help you evaluate your students' progress. The new edition offers expanded coverage of current or emerging areas in the business law field, including legal ethics and laws applying to social media, e-commerce and health care law. In addition, the number of key terms has been increased to include both legal and nonlegal definitions. As a result, *Essentials of Business Law* offers you and your students the coverage of essential topics that many larger, more expensive book programs miss entirely. The tenth edition has been expanded and updated to include a variety of teaching tools that make it simple for you to organize your classroom discussions, effectively communicate the important business law concepts in each

chapter, and assess your students' grasp of the material. The book is accompanied by an Instructor Resource Center, complete with an Instructor's Manual, a Test Bank, and PowerPoint slides for each chapter. Each tool makes planning and teaching the course easier than ever.

### Changes for this edition include:



#### ROGER CPA REVIEW

McGraw-Hill Education has partnered with Roger CPA Review, a global leader in CPA Exam preparation, to provide students a smooth transition from the accounting classroom to successful completion of the CPA Exam. While many aspiring accountants wait until they have completed their academic studies to begin preparing for the CPA Exam, research shows that those who become familiar with exam content earlier in the process have a stronger chance of successfully passing the CPA Exam. Accordingly, students using these McGraw-Hill materials will have access to sample CPA Exam Multiple-Choice questions and Task-based Simulations from Roger CPA Review, with expert-written explanations and solutions. All questions are either directly from the AICPA or are modeled on AICPA questions that appear in the exam. Instructors may assign the auto-gradable Roger CPA Review Multiple-choice Questions in Connect, and Task-based Simulations are delivered via the Roger CPA Review platform, which mirrors the look, feel and functionality of the actual exam. McGraw-Hill Education and Roger CPA Review are dedicated to supporting every accounting student along their journey, ultimately helping them achieve career success in the accounting profession. For more information about the full Roger CPA Review program, exam requirements and exam content, visit [www.rogercpareview.com](http://www.rogercpareview.com).

#### PRESENTATION AND DESIGN

The design has been updated, and every page of *Essentials of Business Law* is printed in color, making for a textbook that is modern and visually stimulating, as well as fun and easy to read. Each chapter opens with a photograph that illustrates the chapter topic, and a quote about the topic from a famous individual. Chapter-by-chapter changes include:

#### CHAPTER 2

Ethics and the Law has been substantially revised and reorganized.

*New to this chapter:*

- Examples 2.1 and 2.2 with updated examples of situations involving ethics.
- Deleted *culture* and *subculture* as defined terms.
- New Example 2.3 to demonstrate the relationship between ethical lapse and legal response with Enron and Sarbanes-Oxley.
- Added Approaches to Ethical Reasoning, with two new defined terms: *duty-based reasoning* and *outcome-based reasoning*.
- Changed Matching Legal Terms and True/False questions to be consistent with text changes.
- Replaced question 31 to assess avoiding regulation.

#### CHAPTER 3

Criminal Law has been revised to provide a clarification in Example 3.2 that the citation issued is a misdemeanor—that is, a crime; in Example 3.8, that the conduct described was under false pretenses.

*New to this chapter:*

- A new, topical question 42 has replaced an outdated one.

---

#### CHAPTER 4

Tort Law has been revised to update the names used in Example 4.16.

---

#### CHAPTER 5

Constitutional Law has been revised to delete Figure 5.2 and add a fifth bullet point to the paragraph immediately following the figure.

*New to this chapter:*

- A modern Example 5.3, relating to social media and freedom of speech, has been added.

---

#### CHAPTER 7

Introduction to Contracts has been revised to clarify, and to add to, the Learning Outcomes and Chapter Summary; to update Uniform Commercial Code citations; and to update Examples 7.9 and 7.11.

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#### CHAPTER 10

Consideration has been revised to update Uniform Commercial Code citations.

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#### CHAPTER 15

Discharge of Contracts has been revised to update Uniform Commercial Code citations.

---

#### CHAPTER 16

Transfer of Title has some minor revisions in the text to clarify the relationship with Chapter 17 and the role of the bill of sale.

*New to this chapter:*

- Revised question 46 in the Assessments.

---

#### CHAPTER 17

Sales has a minor revision to clarify the coverage of UCC Article 2.

*New to this chapter:*

- Revised question 36 in the Assessments.

---

#### CHAPTER 18

Warranties has been revised to update examples.

*New to this chapter:*

- Revised Example 18.2.
- Revised Example 18.6.
- Revised question 43 in the Assessments.

---

#### CHAPTER 20

Business Organizations, Section 20.4, Corporations, has been revised to clarify role of shareholders in corporate governance, shareholder limited liability, and fiduciary duty of directors.

---

#### CHAPTER 21

Bankruptcy has been revised only with minor clerical clarifications.

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## CHAPTER 24

Real and Personal Property has been revised to clarify fixtures to real property and subterranean rights.

*New to this chapter:*

- New Example 24.9 to explain subterranean rights.
- Updated state response to the *Kelo* case.
- Revised question 45 in the Assessments.

---

## CHAPTER 27

Wills, Intestacy, and Trusts has been revised to reflect updated attention to use of electronic signatures for wills.

*New to this chapter:*

- New question 35 assesses critical thinking about electronic signatures.

---

## CHAPTER 28

Intellectual Property has been updated to include the Defend Our Trade Secrets Act of 2016 and to clarify the relationship with the Economic Espionage Act of 1996.

*New to this chapter:*

- Revised question 32 in the Assessments.

---

## CHAPTER 29

Computer Privacy and Speech has removed Social Media as a subsection and included that material, now expanded, as a new Chapter 30. Advertising on the Web was moved from Conducting Business in Cyberspace to this chapter on Computer Privacy and Speech because it involved commercial speech.

*New to this chapter:*

- Eliminated Section 29.5, Social Media, and added Section 29.5, Advertising on the Web.
- Revised questions 14, 15, and 32 to assess understanding of advertising on the web.

---

## CHAPTER 30

Social Media Law is new to the text and provides information, cases, and examples on important issues in social media as it relates to business. Chapter 30 was formerly Conducting Business in Cyberspace, which is now Chapter 31. This new chapter outlines the legal issues in business with social media, including privacy in employment, criminal activity, and other emerging issues. Note that all subsequent chapters have been renumbered as a result of this addition.

*New to this chapter:*

- Overview of social media and how it interacts with business.
- Explanation of impact of social media on expectation of privacy in employment.
- Description of how social media may be used as evidence in civil trials.
- Description of crimes affecting business that may be committed using social media.
- Description of social media's impact on speech, including defamation, intellectual property infringement, and deceptive advertising.
- Overview of emerging issues including use of social media to determine creditworthiness and securities law disclosure on social media.

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## CHAPTER 31

Conducting Business in Cyberspace has been revised to eliminate Advertising on the Web, which was moved to Chapter 29, Computer Privacy and Speech. The chapter now also includes information on the JOBS Act of 2012 and equity crowdfunding as well as personal jurisdiction issue when conducting business in cyberspace. The revision also condensed the information about the Dodd Frank Act to indicate the evolving nature of this regulation.

*New to this chapter:*

- New Example 31.5 to explain equity crowdfunding.
- New Example 31.7 to explain personal jurisdiction.
- New questions 8, 9, 10, 23, 28, 33 and 36 to reflect on the updated material in the chapter.

---

## CHAPTER 32

The Employer–Employee Relationship has been revised to include a new quote at the beginning of the chapter and contains a clarification about minimum wage.

---

## CHAPTER 33

Employment Law has been revised to include the conflicting case law on whether the Civil Rights Act gives protection based on sexual orientation or gender identity.

*New to this chapter:*

- Added *labor union* as a glossary term.
- New question 33 to assess critical thinking regarding gender discrimination.

---

## CHAPTER 35

Professionals' Liability has been revised to clarify the different types of liabilities that professionals face, as well as the source of the professionals' duty of care.

*New to this chapter:*

- New question 36 regarding liability of accountants.

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## CHAPTER 36

International Business Law has been revised to update the list of European Union country members and official candidates for membership.

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## CHAPTER 38

Health Care Law Section 38.5 has been changed substantially to reflect the evolving character of federal regulation of access to health insurance.

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## OTHER SIGNIFICANT CHANGES

- The numbering of Chapter Summaries has been revised so as to tie each point with the appropriate Learning Outcome and with the major section within the chapter itself. This allows the student to more easily discern the organization of the chapter.

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## SUPPLEMENTARY MATERIALS

The Constitution of the United States can be found in the Appendix.

# A GUIDED TOUR

The tenth edition of *Essentials of Business Law* is designed to ensure that students will not only learn fundamental applications of business law, but also will be able to put those basics into practice after reading a multitude of real-world examples and performing several skill assessment activities.

“A concise, well written, introduction into Business Law that focuses on essential knowledge regarding the various topics. An excellent textbook for college students embarking into the subject of Business Law.”

—*Fran Tannenbaum, Northern Virginia  
Community College: Woodbridge Campus*

## CHAPTER OPENING QUOTE

Each chapter opens with a lighthearted but thoughtful quote. The quotes come from a variety of sources, including famous judges, lawyers, entertainers, and businesspeople.

## OUR SYSTEM OF LAW

“As long as I have any choice,  
I will stay only in a country where  
political liberty, toleration, and  
equality of all citizens before the  
law are the rule.”

*Albert Einstein, noted scientist*

## LEARNING OUTCOMES

*After studying this chapter and completing the assessment, you will be able to*

- 1.1 Discuss the application of law in today's world.
- 1.2 Provide examples of how the application of law affects (a) one's personal or social life, (b) business or business operations, and (c) governments.
- 1.3 Identify the principal sources of law in the United States.
- 1.4 Explain the reasons for the preparation of the Uniform Commercial Code.
- 1.5 Cite and describe the major classifications of law.
- 1.6 Distinguish moral law from legal obligations.
- 1.7 Describe the structure of our federal and state court systems.

## LEARNING OUTCOMES

Learning Outcomes outline the focus of the chapter and provide a roadmap for the material ahead. Each is tied directly to a main heading in the chapter, as well as a corresponding Chapter Summary point, to help reiterate important topics throughout.

## LEGAL TERMS

Legal Terms are identified at the beginning of each chapter, as well as in the margins where they first appear in the text. They offer expanded coverage to ensure students are comfortable with the language after completing the course.

### terms

#### LEGAL

plaintiff  
defendant  
*stare decisis*  
common law  
precedent  
case law  
statutory law

ordinance  
administrative law  
Uniform Commercial Code (UCC)  
moral law  
jurisdiction

### EXAMPLE 2.1

BP Oil operated a drilling facility in the Gulf of Mexico that exploded, killing 11 workers and creating a devastating oil spill that had an enormous negative impact on the ecosystem of the Gulf. BP Oil was accused of using shortcuts in its well capping system and also appears to have had an inadequate response system in place for the spill.

“I particularly like these examples because they are real-life cases that explain the material that the student just read. My students have said the examples help them to understand the Principles of Law.”

—Kristin Mueller,  
Ivy Tech Community College

## EXAMPLES

Examples throughout the chapter help students understand concepts in a real-world context. Each creates a scenario that ties directly to a key topic, ensuring students will be able to recognize and apply what they have learned in their careers.

## CHAPTER SUMMARIES

Chapter Summaries correspond to particular performance objectives and chapter headings, making quick reference and retention of key concepts easy.

## CHAPTER SUMMARY

- 2.1** Examples of how ethics in our world have negatively affected business practices include investors acting on insider information, accounting scandals, investment fraud, businesses polluting our natural habitat, and individuals acting unethically in the development of medical and electronic technology. The expansion of global markets also raises some ethical predicaments for business professionals.
- 2.2** Morals are concerned with an individual person's beliefs as to right and wrong. Ethics is about the standards and principles for the behavior of individuals within a society. Values are beliefs or standards considered worthwhile.
- 2.3** Legal mandates are imposed on individuals or groups by authorities or governments. In contrast, ethical considerations generally spring from within individuals or organizations.

However, ethical beliefs are the foundation of many of our laws.

- 2.4** Business firms respond to ethical concerns by acts of corporate responsibility and the formulation of codes of ethics, or credos. Educational institutions offer courses and workshops and expand their existing programs. Governments enact legislation and create programs to protect consumers and the environment and to ensure ethical behavior of business firms and the government itself. Trade and professional associations develop guidelines for business and professional members.
- 2.5** Some ways business can ensure ethical practices include integrating corporate codes of ethics and relying on whistleblowers. Corporate codes of ethics vary from one firm or industry to another. Whistleblowing is the exposing of an unethical situation to an authority or the media.

# A GUIDED TOUR

## CHAPTER ONE ASSESSMENT

### MATCHING LEGAL TERMS

Match each of the numbered definitions with the correct term in the following list.

- |                       |                          |                            |
|-----------------------|--------------------------|----------------------------|
| a. administrative law | g. executive order       | m. <i>stare decisis</i>    |
| b. appellate court    | h. moral law             | n. trial court             |
| c. civil law          | i. original jurisdiction | o. Uniform Commercial Code |
| d. common law         | j. plaintiffs            |                            |
| e. criminal law       | k. precedents            |                            |
| f. defendants         | l. statutory law         |                            |

1. A legally binding directive issued by the president.
2. The portion of the law based on the decisions of the old English courts.
3. A judicial body that has original jurisdiction in cases involving state law.
4. Court decisions that later courts tend to follow.
5. Those who bring suit against others.
6. A judicial body empowered by law to review the findings of a lower judicial body.

## CHAPTER ASSESSMENTS

Chapter Assessments sharpen students' critical thinking, decision making, teamwork, technology, and communication skills and aid in student retention. Assessments include:

- Matching Key Terms
- True/False Quiz
- Discussion Questions
- Thinking Critically about the Law
- Case Questions
- Case Analysis
- Legal Research

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### 38 Part 1 Introduction to Law

**white-collar crime**  
A term used to describe various crimes that typically do not involve force or violence committed by and against businesses.

#### WHITE-COLLAR CRIME

White-collar crime is the term used to describe various crimes that typically involve force or violence committed by and against businesses. Originally white-collar crime related only to nonviolent crimes against businesses, usually committed by employees. The most common white-collar crime was the theft of an employee's access to such funds (embezzlement). In recent years, however, the official category of illegal activity has been applied to nonviolent crimes committed by business firms as well as against business firms. In this newer, broader application, white-collar crime covers a wide range of crimes, including stock swindles, frauds against companies, credit card fraud, income tax evasion, cyberspace fraud and theft programs, agreements with competitors to fix prices, and others. Depending on the jurisdiction, a white-collar crime can be either a felony or a misdemeanor and can be prosecuted under federal or state law.

**RICO**  
One of the most successful

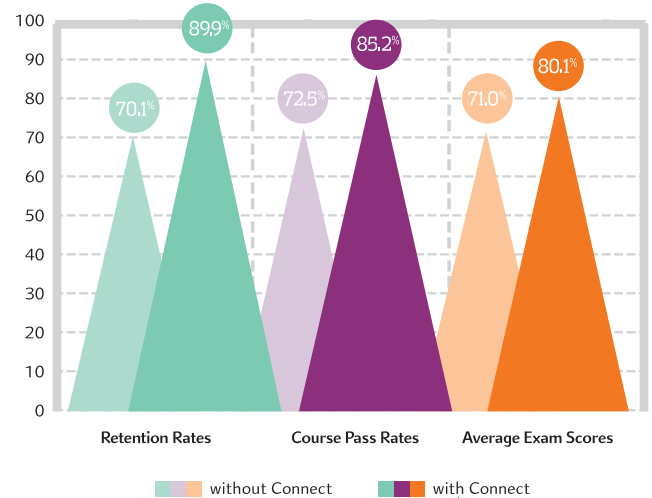
The Racketeer Influenced and Corrupt Organizations Act of 1970, RICO, is one of the most successful laws used to combat white-collar crime.

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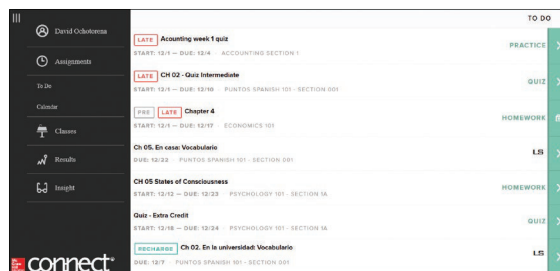


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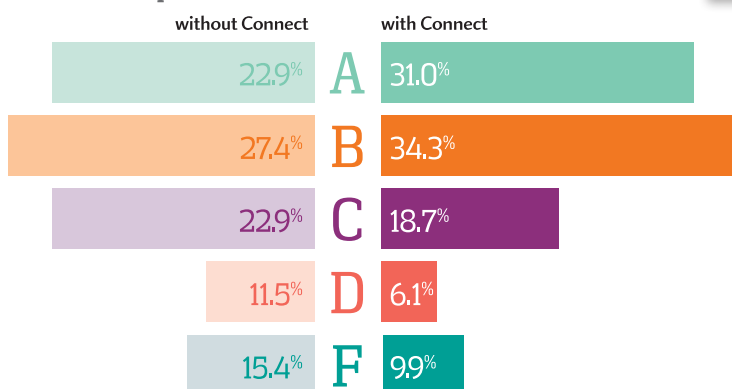
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# Introduction to Law

**1.** Our System of Law

**2.** Ethics and the Law

**3.** Criminal Law

**4.** Tort Law

**5.** Constitutional Law

**6.** Administrative Law



# chapter 1

## Our System of Law

### LEARNING OUTCOMES

*After studying this chapter and completing the assessment, you will be able to*

- 1.1 Discuss the application of law in today's world.
- 1.2 Provide examples of how the application of law affects (a) one's personal or social life, (b) business or business operations, and (c) governments.
- 1.3 Identify the principal sources of law in the United States.
- 1.4 Explain the reasons for the preparation of the Uniform Commercial Code.
- 1.5 Cite and describe the major classifications of law.
- 1.6 Distinguish moral law from legal obligations.
- 1.7 Describe the structure of our federal and state court systems.

### terms

#### LEGAL

plaintiff  
defendant  
*stare decisis*  
common law  
precedent  
case law  
statutory law

ordinance  
administrative law  
Uniform Commercial Code (UCC)  
moral law  
jurisdiction

A woman with short brown hair, wearing a dark blue blazer over a light blue and white striped shirt, stands in a courtroom. She is holding a large blue folder and a pen. The background features wooden paneling and a portion of an American flag.

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## OUR SYSTEM OF LAW

“As long as I have any choice, I will stay only in a country where political liberty, toleration, and equality of all citizens before the law are the rule.”

*Albert Einstein, noted scientist*



The US Supreme Court Building.  
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# 1.1

## THE LAW IN OUR WORLD

When students in their 20s were asked to say the first thing that came to mind when they heard the word *law*, responses included “cops and robbers,” “courtroom,” “narcs,” “drug raid,” “legislators,” “speed limit,” and “traffic violation.” Without doubt, the impressions that most people have of the law are influenced not so much by actual experience, but by the way the law is portrayed on television and in movies. Sometimes the picture is distorted. Justice always seems to triumph, the “good guys” usually win, and the “bad guys” ultimately are caught and punished—a view that society wishes were true.

Unfortunately, movies and television shows provide the only picture many people get of the law. What people do not see are the many day-in, day-out applications of the law that deal with such ordinary matters as an automobile driver charged with having caused injury to another driver or one corporation suing another corporation over responsibility for defective merchandise. In real life, the administration of justice can be much less exciting than is often portrayed. There are areas of the law that do not hinge on clear-cut “right” or “wrong” but on an ill-defined middle ground. Still, justice and law are hallmarks of a free society in today’s world.

The fact of the matter is that our system of law functions largely outside the spotlight of public attention. Every business day, in every city, town, and village in this country, courts are in session, juries are being selected, and attorneys are busy seeking favorable decisions for their clients, who might be either a **plaintiff**, the person who brings a lawsuit against another, or a **defendant**, the person against whom a lawsuit is brought or who is charged with a violation of the law.

Although the ordinary applications of law are not quite as exciting as a television drama, it is important to understand certain essential legal principles because they affect both your business and your personal life. Accountants, for example, need to know that if they do their work carelessly and cause someone to sustain a loss, they could be sued. Just as important, a person who is planning to rent an apartment or buy a home needs to know his or her legal rights as they relate to property.

No one person can possibly know the entire body of law. Even learned judges and lawyers tend to specialize in certain fields of law. The average person should, however, strive to understand some of the general principles of law, how to avoid common problems and pitfalls, and when to seek professional help.

The law presented in this text deals primarily with the general principles of law and their applications to business. Some chapters focus on personal applications of the law, however, and others treat ethical aspects of personal and business behavior.

### **plaintiff**

The party who begins a lawsuit by filing a complaint in the appropriate court.

### **defendant**

The party against whom a lawsuit is brought and from whom recovery is sought.

# 1.2

## APPLICATIONS OF LAW

The effects of law are felt throughout society. Indeed, some aspects of the law apply to all persons, institutions, and organizations.

### **PERSONAL APPLICATIONS OF LAW**

Imagine, for a moment, how the law affects just one day in your life. The alarm clock that awakens you in the morning is set to a time that is regulated by a law establishing standard

time zones. Various federal and state laws regulate the purity and wholesomeness of your breakfast foods. The clothing you wear is labeled in compliance with governmental regulations. Your right to drive a car is regulated by state laws, and speed limits and other traffic laws are often the responsibility of state or local officials. You know that no one else may occupy your home while you are away at school or work because the law protects your property rights. The safety and freedom you enjoy are possible because you live in a nation of order—and that order is a result of laws passed for the benefit of the people and the protection of their rights.

---

### **BUSINESS APPLICATIONS OF LAW**

If your personal life is influenced by law, think of how much more businesses, and those who work for businesses, are affected by law. Every business must comply with many federal, state, and local laws that are primarily aimed at regulating business activity. A firm that wishes to set up business in a particular community may find that there are laws that prohibit such activities. For example, local zoning ordinances might prohibit the operation of a noisy factory in a residential area. State and federal laws prohibit or regulate the operation of certain businesses that might pollute the environment. Still other laws require that businesses provide safe working conditions for employees or demand that only qualified persons perform certain jobs. State laws, for instance, require that barbers and pharmacists pass examinations to be licensed.

---

### **GOVERNMENT APPLICATIONS OF LAW**

Legislatures at all levels of government pass many laws that apply only to businesses and individuals, but some laws apply specifically to governments. For example, the federal government may pass a law that provides funding for building highways or for low-income housing. The same law may require that states, counties, or municipalities maintain them.

## **1.3 SOURCES OF LAW**

The ever-changing body of law that affects everyone in our country has arisen from a number of sources. As a result, laws sometimes conflict with one another. The way these conflicts are resolved will be discussed in this chapter.

---

### **CONSTITUTIONAL LAW**

In our country, the principles and ideals that protect individual liberty and freedom are incorporated in the Constitution of the United States (the federal Constitution). This historic document gives the federal government certain reasonable powers and, at the same time, clearly limits the use of those powers. In addition, each state has a constitution of its own that gives certain powers to the various levels of government within that state. Like the federal Constitution, state constitutions provide safeguards for the rights of individuals within that particular state. You will learn more about the Constitution of the United States and the important foundation it provides to our legal system in Chapter 5 (see Appendix).



The United States Constitution.  
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### **stare decisis**

The practice of relying on previous decisions in which similar disputes arose.

### **common law**

The body of recorded decisions that courts refer to and rely upon when making later legal decisions.

### **precedent**

A model case that a court can follow when facing a similar situation.

## **EXECUTIVE ORDERS**

An executive order is a legally binding directive issued by the president with the intent to change the manner in which federal agencies and officials operate so as to improve the practices of the federal government. Perhaps the most historically significant example of an executive order was President Lincoln's *Emancipation Proclamation*, an order issued on January 1, 1863, proclaiming all those enslaved to be forever free, and ordering all segments of the executive branch to treat these persons as free.

## **TREATIES**

A treaty is a written agreement between two or more countries that serves to establish terms of an international relationship. Treaties become legally binding when they are approved by two-thirds of the Senate (see Chapter 36).

## **COMMON LAW**

After the Revolutionary War, one of the most difficult tasks faced by our newly independent nation was to establish a system of law. Because the original states were formerly English colonies, it is not surprising that the new states adopted the system of laws that had been used in England for hundreds of years—that is, relying on previous legal decisions when similar disputes

arose. This practice of relying on previous decisions is known as **stare decisis**, which means “to stand on decided cases.” The English system is known as the **common law** and still influences legal decisions in the United States today.

## **PRECEDENT**

A **precedent** is a court decision on which later courts rely in similar cases. In some instances, a court may be influenced by precedent; in other cases it may not. Whether a court follows a precedent, or decides to overrule it, depends on the court that has ruled on the case and whether the previous case was decided by the highest court in the same state. Decisions made by the U.S. Supreme Court, for example, must be followed by other courts.

Court decisions are recorded in writing so that lawyers and judges can refer to them in preparing or hearing a case. These decisions are published in books called reporters, and many of these decisions are available online. Each case decision is identified by a citation, which includes the names of the parties involved followed by the volume number, the name of the reporter, and the beginning page number of the case. For example, the case of *Milkovich v. News-Herald*, 473 N.E.2d 1191, is reported in volume 473 of the *Northeastern Reporter, Second Series*, beginning on page 1191.

## **CASE LAW**

Sometimes a statute or a common law precedent may be difficult to apply to certain cases or, with the passing of time, may take on different meaning. An existing statute or an accepted precedent may be based on outmoded standards of justice. In such cases, a court may disregard earlier interpretations of a statute or a principle of common law, or it may



Court decisions are published in books called reporters.  
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interpret them differently. The court's decisions in these cases influence later cases because they too become precedents that may be followed in similar cases. The effects of these decisions have been called **case law**.

### STATUTORY LAW

Both federal and state constitutions are general statements of the powers of governments and the rights of individuals. The specific applications of powers and rights are provided for in laws enacted by federal, state, and local governments. Each state constitution provides for a legislature that represents the people. These legislatures have the power to enact laws so long as they do not conflict with either the federal or the state constitution. The laws passed by Congress and by state legislatures are called statutes, and the field of the law that deals with these statutes is known as **statutory law**. A law that is passed by a local government, such as a city council, is often called an **ordinance**.

Not only do statutes provide the specific applications of the powers and rights in the constitutions, they also allow governments to respond to particular circumstances. For example, when the federal and state constitutions were written, cellular telephones and automobiles were not even imagined, much less matters to be regulated. Yet after these were developed, various legislatures passed statutes that restricted the use of cellular telephones while driving.

### ADMINISTRATIVE LAW

Protection of the rights and freedom of individuals and organizations is well established by the federal and state constitutions, by statutory law, and by common law. Still, today's complex society and system of justice present special needs that require certain laws that include their own administrative machinery. Sometimes when a federal, state, or local legislative body enacts a law, it also sets up an organization to establish rules and enforce them. **Administrative law** is the body of rules, regulations, and decisions created by administrative agencies.

#### **case law**

The effects of court decisions that involve the same or similar facts.

#### **statutory law**

The field of law involving statutes, which are laws passed by Congress or by state legislatures.

#### **ordinance**

A law that is passed by a local government, such as a city council.

#### **administrative law**

The body of rules, regulations, and decisions created by administrative agencies.

The practice of establishing specialized administrative agencies has several advantages. For example, it relieves the police and the courts from having to establish and enforce regulations that are often highly technical. Administrative agencies include federal agencies such as the National Labor Relations Board, state agencies such as public service commissions, and local agencies such as boards of health. These agencies have in common the authority to establish rules that have the force of law, to maintain “courts” that are often called appeal boards, and to conduct “trials” that are often called hearings. Because administrative law has become such an important part of our legal system, an entire chapter will be devoted to it.

## 1.4 UNIFORM COMMERCIAL CODE

When the United States was primarily a farming nation and there was relatively little commerce between states, it did not matter that the state constitutions and statutes differed from state to state. As trade between the states increased, however, so did the problems caused by the conflict in business laws among the different states. For example, a businessperson knowing the laws of his or her state had little difficulty so long as customers were all from the same state. But when business was conducted with customers in many states, he or she had to know the law in all of them.

### Uniform Commercial Code (UCC)

A set of laws that govern various commercial transactions and that are designed to bring uniformity to the laws of the states.

To solve this problem, the **Uniform Commercial Code (UCC)** was prepared in 1952 by the National Conference of Commissioners on Uniform State Laws. The UCC is a set of laws that govern various commercial transactions and are designed to bring uniformity to the laws of the states. Over a period of 15 years, 49 states adopted the UCC as part of their state law. Not every state has adopted the entire UCC, and often state courts have differing interpretations of their UCC sections. For example, Louisiana, having been a French territory and therefore greatly influenced by French civil law, has adopted only parts of the Code. Because the UCC is so widely accepted, this book is based on it.

## 1.5 CLASSIFICATION OF LAWS

The various laws, regardless of origin, can be grouped into several broad classifications, each of which represents a legal specialty. Frequently a lawyer will specialize in one of these areas.

- ▶ *Constitutional law* is the study of the federal Constitution, its interpretation by the federal courts, and its relationship to existing laws.
- ▶ *Civil law* is the study of the rights and obligations of individuals and includes the law of property, the law of contracts, and the law of torts.
- ▶ *Criminal law* is concerned with acts against society (criminal acts) and the regulation of criminal activity.
- ▶ *Administrative law* is concerned with the conduct of governmental administrative agencies and their regulations. Examples are tax laws and laws dealing with transportation and trade.
- ▶ *International law* is concerned with the conduct of nations in their relations with other nations.



Moral law refers to the unenforceable obligations that people have to one another.

Source: MC3 Dylan McCord/US Navy

## 1.6 MORAL LAW

Since earliest times, people have recognized that they are to a certain extent responsible for one another and have obligations to one another beyond those required by the law. For example, a person who sees someone drowning has a moral obligation to try to save him or her, and a person who hears someone screaming for help in the night has a moral duty to at least call the police. Such obligations are based on **moral law**—that is, the “law” concerned with the unenforceable obligations that people have to one another. Many legal obligations are based on moral obligations, but not all moral obligations are legally enforceable; a person’s conscience is often the only means of enforcement.

### **moral law**

The “law” concerned with the unenforceable obligations that people have to one another.

## 1.7 A SYSTEM OF COURTS

Some of our laws came from sources that were not originally concerned with human freedom. However, most legal scholars agree that today’s laws provide adequate protection of the rights of the individual. But the mere existence of laws is not enough.

There must be a means of administering the law to protect the rights of individuals and businesses and to curtail the activities of wrongdoers. In this country, courts and governmental agencies have been established to administer the law. The federal and state constitutions and the entire body of written law would be of little value to individuals and businesses if there were no provision for enforcing the law. Police alone cannot fulfill this function. The federal and state constitutions provide for the establishment of a system of courts that ensure citizens’ rights and enforce federal and state statutes.

**jurisdiction**

The authority of a court, as granted by a constitution or legislative act, to hear and decide cases.

**COURT JURISDICTION**

The authority or power of a court to hear cases, as granted by a constitution or legislative act, is known as the court's **jurisdiction**. A court may be limited in its powers to certain kinds of cases or to certain geographical areas. A court has original jurisdiction if it is authorized to hear and decide a case when it is first presented. If a court has the power to review the decisions of another court, it has appellate jurisdiction (the authority to hear appeals).

Courts that are given the power to hear only certain kinds of cases have special jurisdiction. Examples are family courts, traffic courts, and tax courts.

**FEDERAL COURTS**

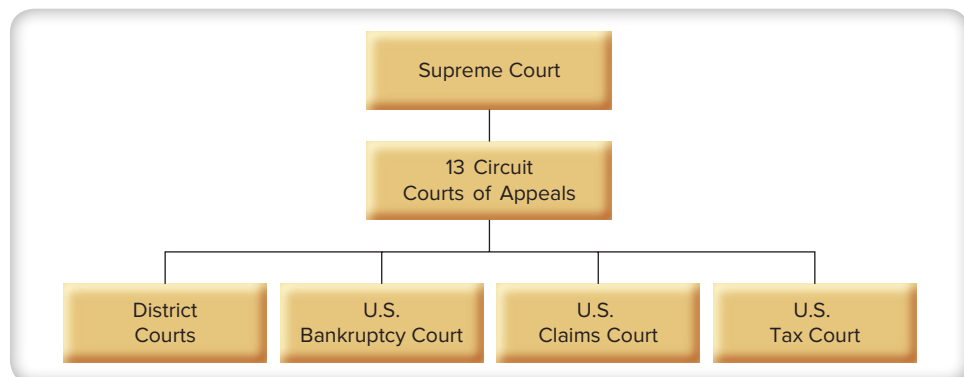
The U.S. Constitution provides for a federal court system: "The judicial power of the United States, shall be vested in one Supreme Court, and in such inferior courts as the Congress may from time to time ordain and establish."

The court system that has developed has various levels. The Supreme Court of the United States is the highest court in the federal system. It serves as the court of original jurisdiction for certain kinds of cases, such as those in which a state is one of the parties. The Supreme Court rules on the constitutionality of laws by hearing selected cases that test those laws. The Supreme Court also hears appeals from the highest state courts. However, the Court actually hears only a small percentage of appeals because it has no legal obligation to review decisions of lower courts, except in very limited cases.

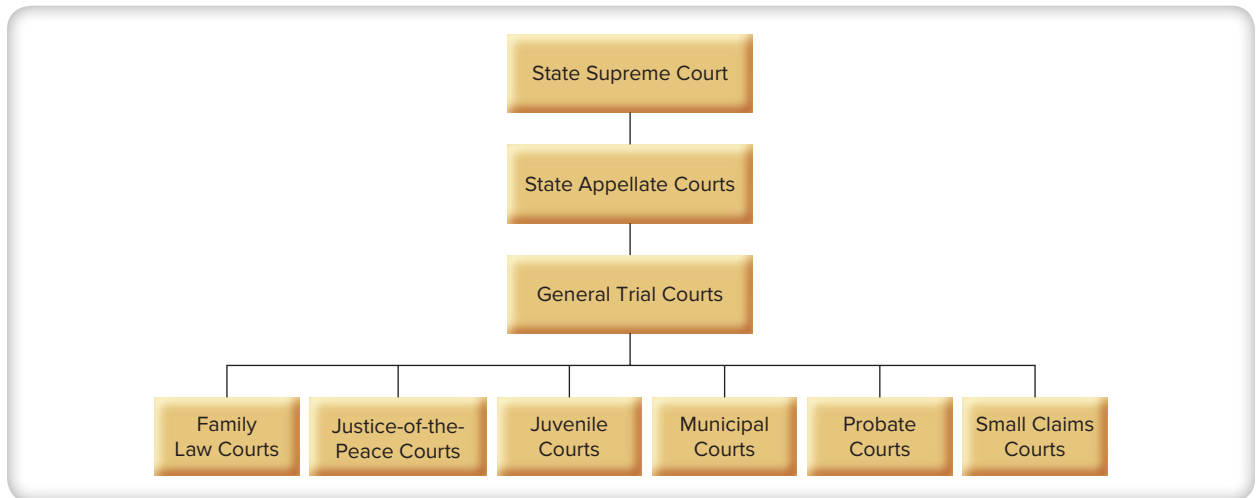
The federal district courts have original jurisdiction in cases involving federal statutes and in cases when the parties are citizens of different states and the amount involved is greater than \$75,000. There are a total of 94 federal district courts—each state having at least one.

Most appeals from the district courts go to one of the 13 circuit courts of appeals. The decisions of the circuit courts are usually final, although further appeal to the U.S. Supreme Court is possible. Appeals of the decisions of federal administrative agencies, such as the Federal Trade Commission (FTC), are also made to the U.S. Circuit Courts of Appeals.

The federal court system also includes specialized courts that hear only certain kinds of cases. Three of these specialized courts are the U.S. Tax Court, the U.S. Bankruptcy Court, and the U.S. Claims Court. Figure 1.1 gives an overview of the federal court system. For a complete listing, maps, and information regarding the court system, visit: [http://www.uscourts.gov/court\\_locator.aspx](http://www.uscourts.gov/court_locator.aspx).



**FIGURE 1.1** The Federal Court System



**FIGURE 1.2** The State Court System

### STATE COURTS

State court systems vary, but there are certain basic similarities in all state court systems. All states have general trial courts, which are courts of original jurisdiction, authorized to hear cases not otherwise restricted to specialized courts. General trial courts handle nearly all important disputes involving contracts, criminal law, and corporations. Trial courts in a state may be large municipal courts, with such specialized areas of jurisdiction as traffic violations, juvenile conduct, and domestic relations, or they may be small justice-of-the-peace courts called magistrate courts, established to hear certain minor violations of law.

If one of the parties in a case feels that he or she did not have a fair trial in the court of original jurisdiction, he or she can, with the aid of an attorney, seek an appeal in a state appellate court, which hears appeals from the trial courts. The names of appellate courts vary in different states. Beyond the courts of appeals are higher-level courts, often called supreme courts, which make final determinations on matters of law. In some less populous states that have no intermediate court of appeals, the state supreme court also serves as a court of appeals. Figure 1.2 gives an overview of the state court system.

Many communities have special courts to handle cases involving small amounts of money. Where these courts exist, there is usually a limit, ranging from \$1,000 to \$15,000, on the amount of the claim. Because there is a limit on the amount of money that can be involved, these courts are often called small claims courts. The proceedings usually are quite informal, and the parties involved typically are required or encouraged to appear without lawyers to represent them.

## CHAPTER SUMMARY

**1.1** It is important to understand certain essential legal principles because they affect both one's business and personal life. Accountants, for example, need to know that if they do their work

carelessly and cause someone to sustain a loss, they could be sued. A person who is planning to rent an apartment or buy a home needs to know his or her legal rights as they relate to property.

- 1.2** Examples of how the application of law affects a person's personal and social life can be seen everywhere from the foods eaten, the medicines used, the goods purchased, to the clothing worn. Examples of how the law affects business can be seen in zoning ordinances, regulation of environmental pollution, and licensing laws. Examples of how the law affects the federal government include laws providing for funding for building highways or for low-income housing, or requiring that states, counties, or municipalities maintain them.
- 1.3** The sources of law in the United States are the Constitution, executive orders, treaties, common law, precedent, case law, statutory law, and administrative law.
- 1.4** To address conflicts in business law between states, the UCC was prepared in 1952. The UCC is a set of laws that govern various commercial transactions and are designed to bring uniformity to the laws of the states.
- 1.5** Law in the United States is typically classified as constitutional law, civil law, criminal law, administrative law, and international law.
- 1.6** Moral law is concerned with the unenforceable obligations that people have to one another; legal obligations are those required by enacted statutes and other laws.
- 1.7** The structure of the federal and state court systems includes courts of original jurisdiction (federal district courts and state courts) and appeals courts (federal circuit courts of appeals, the U.S. Supreme Court, and state appellate courts).

## CHAPTER ONE

# ASSESSMENT

### MATCHING LEGAL TERMS

Match each of the numbered definitions with the correct term in the following list.

- |                              |                                 |                                   |
|------------------------------|---------------------------------|-----------------------------------|
| <b>a.</b> administrative law | <b>g.</b> executive order       | <b>m.</b> <i>stare decisis</i>    |
| <b>b.</b> appellate court    | <b>h.</b> moral law             | <b>n.</b> trial court             |
| <b>c.</b> civil law          | <b>i.</b> original jurisdiction | <b>o.</b> Uniform Commercial Code |
| <b>d.</b> common law         | <b>j.</b> plaintiffs            |                                   |
| <b>e.</b> criminal law       | <b>k.</b> precedents            |                                   |
| <b>f.</b> defendants         | <b>l.</b> statutory law         |                                   |

1. A legally binding directive issued by the president.
2. The portion of the law based on the decisions of the old English courts.
3. A judicial body that has original jurisdiction in cases involving state law.
4. Court decisions that later courts tend to follow.
5. Those who bring suit against others.
6. A judicial body empowered by law to review the findings of a lower judicial body.
7. The practice of a court to follow previous decisions.
8. The category of law concerned with acts against society.

9. The authorization of a judicial body to hear certain types of cases when they are first brought to court.
10. The legal specialty concerned with the rights and obligations of individuals.
11. A group of laws dealing with business transactions in a consistent manner that have been adopted by most of the states.
12. The legal specialty concerned with the relationship between businesses or individuals and government agencies.
13. The branch of the law concerned with the laws passed by Congress and by state legislatures.
14. The law concerned with the unenforceable obligations that people have to one another.
15. Those against whom a suit is brought or who are charged with a violation of the law.

#### TRUE/FALSE QUIZ

Indicate whether each of the following statements is true or false.

16. In our country, the principles and ideals guarding our individual liberty and freedom are presented in the common law.
17. Amendments to the federal Constitution require approval, or ratification, by a majority vote by Congress.
18. The power of a court to determine whether laws enacted by legislatures or decisions made by lower courts violate the Constitution is judicial review.
19. Statutes are laws passed by state and federal legislatures.
20. Laws enacted by local governments such as a city council are often called ordinances.
21. The kind of law that results when a court disregards an existing statute, an accepted precedent, or a principle of common law, or interprets them differently, with the result that a new precedent is established, is known as precedent law.
22. The purpose of the Uniform Commercial Code is to provide uniform laws for all states to regulate business transactions in the states.
23. Unenforceable obligations that people have to one another are considered to be an aspect of moral law.
24. The authority of a court, as granted by a constitution or legislative act, is known as the court's jurisdiction.
25. If a court has the power to review the decisions of another court, it has original jurisdiction.

26. Juvenile courts, the U.S. Tax Court, and domestic relations courts are known as courts of original jurisdiction.
27. A court that has original jurisdiction in cases involving federal statutes, and in cases when the parties are citizens of different states, is known as a federal district court.
28. Normally appeals from federal district courts are initially heard by state supreme courts.
29. Special courts set up to handle small or minor cases, often with a limit on the amount of the claim, are known as circuit courts.
30. State courts that have original jurisdiction for cases not otherwise directed to a specialized court are trial courts.

### DISCUSSION QUESTIONS

Answer the following questions and discuss them in class.

31. Describe what contemporary society would be like without the system of laws that currently exists.  

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32. Explain how law affects (a) your personal or social life and (b) business or business operations.  

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33. Identify the principal origins of law in the United States.  

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34. Cite and describe the major classifications of law.  

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35. Distinguish moral law from legal obligations.  

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36. Can common law and statutory law operate side by side? What are the advantages of each?  

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**THINKING CRITICALLY ABOUT THE LAW**

Answer the following questions, which require you to think critically about the legal principles that you learned in this chapter.

- 37. Personal Applications of Law** Many applications of law primarily affect individuals, such as buying or selling personal property. Critique the amount and kinds of protection provided to individuals and whether you think that the law provides too much protection, limiting individual freedom, or too little protection against harm. What are some examples?

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- 38. Business Applications of Law** Consider the numerous laws that affect businesses and evaluate the regulatory climate in which they operate. Does it seem that there are too many regulations or too few? Explain your answer.

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- 39. Government Regulation of Governments** Various levels of government enact laws that affect other levels of government. Explain the reason for such seemingly inefficient interrelationships and offer an opinion of whether there might be other ways to achieve the same objectives.

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- 40. Stare Decisis** The legal concept of *stare decisis*, which means “to stand on decided cases,” is an important factor in our system of law. Is it possible that previous cases, or precedents, do not always embody the exact same issues, concepts, and present-day circumstances as the current case to which the earlier one is applied and by which the current one is judged? What would you suggest as an alternative to the use of precedents?

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- 41. A Question of Ethics** Normally there are no prosecutions for “padding” an expense account, yet it is considered unethical. Should such activity be prosecuted more forcefully?

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**CASE QUESTIONS**

Study each of the following cases. Answer the questions that follow with Yes or No.

- 42. Precedent** Ferguson was arrested for possession of marijuana in a state where it was illegal. He argued at his trial that the highest court in a neighboring state had ruled a similar law invalid, which would be a binding precedent.
- a. Is Ferguson correct in his belief?
  - b. Can a state's highest court rule that the law of another state is not binding in its own state?
  - c. Does a precedent in one state affect the law in another?
- 43. Jurisdiction** A television station aired a broadcast containing insulting remarks about a local official. The official had the broadcaster charged under a state statute that prohibited making defamatory remarks on public airwaves. The broadcaster argued that the statute was in conflict with the U.S. Constitution's guaranty of free speech. The public official countered that the statute was legal and enforceable.
- a. Can states enact laws that limit free speech?
  - b. Can defamatory remarks be made illegal?
  - c. Can a state statute be in conflict with the U.S. Constitution?
- 44. Civil Law** Phipps became involved in a case of mistaken identity. A local merchant falsely accused him, in front of people who knew him, of shoplifting. Phipps was charged but not convicted. Angry and embarrassed, yet not wanting to spend money for an attorney, he acted as his own attorney and sued the merchant for false arrest in small claims court.
- a. Can Phipps act as his own attorney?
  - b. Does small claims court have jurisdiction in this case?
  - c. Is there a dollar limit on the kind of case that can be brought to small claims court?

**CASE ANALYSIS**

Study each of the following cases carefully. Briefly state the principle of law and your decision.

- 45. Interpretation of Statute** Muscarello illegally sold marijuana, which he transported in a small truck. Police discovered a handgun in the locked glove compartment of the truck. A provision in the firearms chapter of the federal law demands a five-year required prison term for persons who use or carry a firearm during or related to trafficking in drugs. Muscarello claimed that because the gun was in the locked glove compartment of the truck, it did not fall within the description of the word "carry" as used in the statute and that he was not subject to the required five-year prison term. *Did Muscarello violate the firearms chapter of the criminal code?* [Muscarello v. United States, 118 S. Ct. 1911 (1998)]

**Principle of Law:**

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**Decision:**

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- 46. Contract Essentials** Without first obtaining the required marriage license, Evelyn and Joseph Carabetta were married in a religious ceremony. Thereafter, they lived together as husband and wife. They raised four children, all of whose birth certificates listed Joseph Carabetta as their father. At no time did either party ever deny that they were married. In an action to dissolve the marriage, Evelyn Carabetta claimed that the lack of a marriage license made the marriage void. *Does the lack of a marriage license make the marriage void?* [*Carabetta v. Carabetta*, 438 A.2d 109 (Connecticut)]

**Principle of Law:**

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**Decision:**

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**LEGAL RESEARCH**

Complete the following activities. Share your findings with the class.

- 47. Working in Teams** In teams of three or four, interview the owners or managers of small businesses to determine the levels of laws—federal, state, or local—to which the firm is subject. Further, ask the interviewee to provide examples.

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- 48. Using Technology** Using the Internet and search engines, investigate the operation of small claims courts in your community or one nearby. Determine the kinds of cases typically heard and the limit in dollars involved in cases that these courts are authorized to hear.

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# chapter 2

## Ethics and the Law

### LEARNING OUTCOMES

*After studying this chapter and completing the assessment, you will be able to*

- 2.1** Cite some examples of how unethical behavior in our world has negatively affected business practices.
- 2.2** Distinguish among ethics, morals, and values. Cite influences on group and individual values.
- 2.3** Discuss the relationship between law and ethics.
- 2.4** Discuss the different types of ethical reasoning and provide examples of responses to ethical issues by business firms, educational institutions, governments, and trade and professional associations.
- 2.5** Discuss some ways businesses can ensure ethical practices.

### terms

#### LEGAL

morals  
ethics  
values  
Sarbanes–Oxley

code of ethics  
stakeholders  
whistleblower



## ETHICS AND THE LAW

“There may be times when we are powerless to prevent injustice, but there must never be a time when we fail to protest.”

*Elie Wiesel, writer, Nobel laureate,  
and Holocaust survivor*

## 2.1 UNETHICAL BEHAVIOR IN OUR WORLD

The news abounds with examples of unethical behavior in business, including poor treatment of employees, using insider information for personal gain, violation of consumer interests, and environmental damage from operations.

### EXAMPLE 2.1

BP Oil operated a drilling facility in the Gulf of Mexico that exploded, killing 11 workers and creating a devastating oil spill that had an enormous negative impact on the ecosystem of the Gulf. BP Oil was accused of using shortcuts in its well capping system and also appears to have had an inadequate response system in place for the spill.

Examples of unethical behavior in professions or government may also affect business. Technology and expansion of global markets have presented businesses with a new array of ethical questions and corresponding unethical behavior. For example, advances in genetics, cloning technology, and the use of stem cells in medical science have all raised ethical issues that were unknown even a decade earlier. Internet, computer technology and social media have all prompted discussions of ethical issues surrounding privacy and free speech (See Chapters 29 and 30). The expansion of global markets has created new ethical issues as well. Is it ethical for an American company to do business with a company in an undemocratic country or one that engages in systemic racial segregation?

### EXAMPLE 2.2

The Rev. Leon Sullivan was a director of the General Motors Corporation who proposed that American companies should ensure that equal employment would be available regardless of race in its South Africa operations, even though South Africa had laws in place at that time requiring racial segregation. These principles were eventually adopted by several hundred other companies doing business in South Africa.

## 2.2 MORALS, ETHICS, AND VALUES

While morals, ethics and values may seem synonymous, the three terms have different meanings.

#### morals

Beliefs about behavior as judged by society.

#### ethics

The philosophical study of what is right and wrong, good and bad.

#### values

Beliefs or standards considered worthwhile, and from which a society derives its moral rules.

**Morals** are individual and societal beliefs as to what is right and wrong. **Ethics** consist of the standards and principles that govern the behavior of individuals within a society. Both ethics and morals derive from **values**—that is, the beliefs or standards that underlie an individual and society's beliefs.

Individual and group values are influenced by religion, traditions, and customs. Values may be influenced by a variety of factors from one's culture—those of a nation or an ethnic group. The American culture, for example, holds that such characteristics as freedom, individualism, family life, fair play, hard work, and honesty are important. On the other hand, the values held by a subculture—for example, employees of a corporation or a department within a company—may differ from those of the larger culture.